FIRST UNITED CORP/MD/
Form 10-K
March 09, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

**FORM 10-K**

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

**For the fiscal year ended December 31, 2014**

Commission file number 0-14237

**FIRST UNITED CORPORATION**

*(Exact name of registrant as specified in its charter)*

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

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 þ

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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. þ

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 ¨ Non-accelerated filer ¨ Smaller reporting company þ

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

The aggregate market value of the registrant's outstanding voting and non-voting common equity held by non-affiliates as of June 30, 2014: **$48,306,011.**

The number of shares of the registrant's common stock outstanding as of February 27, 2015: **6,238,598.**

**Documents Incorporated by Reference**

Portions of the registrant's definitive proxy statement for the 2014 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 on Form 10-K of First United Corporation (the "Corporation" and "we", "our" or "us" on a consolidated basis) contains forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Such statements include projections, predictions, expectations or statements as to beliefs or future events or results or refer to other matters that are not historical facts. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking statements contained in this annual report are based on various factors and were derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like "may", "will", "should", "expect", "plan", "anticipate", "intend", "believe", "estimate", "predict", "po "continue" or the negative of those words and other comparable words. You should be aware that those statements reflect only our predictions. If known or unknown risks or uncertainties should materialize, or if underlying assumptions should prove inaccurate, actual results could differ materially from past results and those anticipated, estimated or projected. You should bear this in mind when reading this annual report and not place undue reliance on these forward-looking statements. Factors that might cause such differences include, but are not limited to:

- the risk that the weak national and local economies and depressed real estate and credit markets caused by the recent global recession will continue to adversely impact the demand for loan, deposit and other financial services and/or increase loan delinquencies and defaults;
- changes in market rates and prices may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet;
- our liquidity requirements could be adversely affected by changes in our assets and liabilities;
- the effect of legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;
- competitive factors among financial services organizations, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;
- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board (the "FASB"), the Securities and Exchange Commission (the "SEC"), the Public Company Accounting Oversight Board and other regulatory agencies; and
- the effect of fiscal and governmental policies of the United States federal government.

You should also consider carefully the risk factors discussed in Item 1A of Part I of this annual report, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. The risks discussed in this annual report are factors that, individually or in the aggregate, management believes could cause our actual results to differ materially from expected and historical results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider such disclosures to be a complete discussion of all potential risks or uncertainties.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

ITEM 1. BUSINESS

**General**

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered with the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). Between July 1, 1985 and September 2014, the Corporation was registered with the Federal Reserve as a financial holding company under the federal Gramm-Leach-Bliley Act (the “GLB Act”). The Corporation terminated its election to operate as a financial holding company because it is not engaged, and does not anticipate engaging in the foreseeable future, in any activity that requires that election. The termination is not expected to have any material impact on our future financial condition or results of operations. The Corporation’s primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company (the “Bank”), First United Statutory Trust I (“Trust I”) and First United Statutory Trust II (“Trust II”), both Connecticut statutory business trusts, and First United Statutory Trust III, a Delaware statutory business trust (“Trust III” and together with Trust I and Trust II, the “Trusts”). The Trusts were formed for the purpose of selling trust preferred securities that qualified as Tier 1 capital. The Corporation is also the parent company of First United Insurance Group, LLC, an inactive Maryland limited liability company that, until January 1, 2012, operated as a general insurance agency. The Bank has three wholly-owned subsidiaries: OakFirst Loan Center, Inc., a West Virginia finance company; OakFirst Loan Center, LLC, a Maryland finance company (collectively, the “OakFirst Loan Centers”), and First OREO Trust, a Maryland statutory trust formed for the purposes of servicing and disposing of the real estate that the Bank acquires through foreclosure or by deed in lieu of foreclosure. The Bank also owns 99.9% of the limited partnership interests in Liberty Mews Limited Partnership, a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing units in Garrett County, Maryland. Until March 27, 2013, the Bank also owned a majority interest in Cumberland Liquidation Trust, a Maryland statutory trust formed for the purposes of servicing and disposing of real estate that secured a loan made by another bank and in which the Bank held a participation interest, but this entity was dissolved on such date.

At December 31, 2014, we had total assets of $1.3 billion, net loans of $827.9 million, and deposits of $981.3 million. Shareholders' equity at December 31, 2014 was $109.0 million.

The Corporation maintains an Internet website at www.mybank4.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 SEC.

**Banking Products and Services**

The Bank operates 25 banking offices, one call center and 28 Automated Teller Machines ("ATMs") in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Mineral County, Berkeley 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, money market deposit accounts, and certificates of deposit, business loans, personal loans, mortgage loans, lines of credit, and consumer-oriented retirement accounts including individual retirement accounts ("IRAs") and employee benefit accounts. In addition, the Bank provides full brokerage services through a networking arrangement with Cetera Investment Services, LLC., a full service broker-dealer. The Bank also provides safe deposit and night depository facilities, insurance products and trust services. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC").

***Lending Activities***— Our lending activities are conducted through the Bank. Since 2010, the Bank has not originated any new loans through the OakFirst Loan Centers and their sole activity is servicing existing loans.

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 business operations 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 throughout the duration of the loan 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 ("CRE") 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 CRE construction lending is controlled through conservative underwriting procedures such as loan to value ratios of 80% or less, obtaining additional collateral when prudent, analysis of cash flows, 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 federal Community Reinvestment Act (the "CRA") or to complement our asset liability mix. 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, is 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.

***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 Certificate of Deposit Account Registry Service®, or CDARS®, program to municipalities, businesses, and consumers through which the Bank provides access to multi-million-dollar certificates of deposit that are FDIC-insured. The Bank also offers Insured Cash Sweep, or ICS, program to municipalities, businesses, and consumers through which the Bank provides access to multi-million-dollar savings and demand deposits that are FDIC-insured. In addition, we offer our commercial customers packages which include Treasury Management, Cash Sweep and various checking opportunities.

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.

***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.

At December 31, 2014 and 2013, the total market value of assets under the supervision of the Bank's Trust Department was approximately $702 million and $675 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.

**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, 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 and on the internet.

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 customers, and specialized services tailored to meet 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, 2014, the most recent date for which comparative information is available.

| | Offices (in Market) | Deposits (in thousands) | Market Share |
|---|---|---|---|
| Allegany County, Maryland: | | | |
| Susquehanna Bank | 4 | $ 289,261 | 43.78 % |
| Manufacturers & Traders Trust Company | 6 | 163,739 | 24.78 % |
| First United Bank & Trust | 3 | 110,595 | 16.75 % |
| PNC Bank NA | 2 | 49,979 | 7.56 % |
| Standard Bank | 2 | 47,088 | 7.13 % |

*Source: FDIC Deposit Market Share Report*

| | | | |
|---|---|---|---|
| Frederick County, Maryland: | | | |
| PNC Bank NA | 19 | $1,148,600 | 28.71% |
| Branch Banking & Trust Co. | 12 | 673,783 | 16.84% |
| Bank Of America NA | 5 | 323,255 | 8.08 % |
| Frederick County Bank | 5 | 275,975 | 6.90 % |
| Manufacturers & Traders Trust Company | 6 | 263,675 | 6.59 % |
| Capital One NA | 6 | 242,423 | 6.06 % |
| Woodsboro Bank | 7 | 206,765 | 5.17 % |
| Wells Fargo Bank NA | 2 | 149,813 | 3.74 % |
| Middletown Valley Bank | 4 | 134,713 | 3.37 % |
| First United Bank & Trust | 4 | 130,987 | 3.27 % |
| SunTrust Bank | 3 | 126,346 | 3.16 % |
| BlueRidge Bank | 1 | 125,998 | 3.15 % |
| Sandy Spring Bank | 4 | 99,185 | 2.48 % |
| Santander Bank, N.A. | 1 | 35,480 | 0.89 % |
| The Columbia Bank | 2 | 28,614 | 0.72 % |
| Damascus Community Bank | 1 | 18,799 | 0.47 % |
| SONABANK | 1 | 15,654 | 0.39 % |
| Woodforest National Bank | 1 | 509 | 0.01 % |

*Source: FDIC Deposit Market Share Report*

| | | | |
|---|---|---|---|
| Garrett County, Maryland: | | | |
| First United Bank & Trust | 6 | $327,922 | 57.43% |
| Susquehanna Bank | 2 | 109,605 | 19.19% |
| Manufacturers & Traders Trust Company | 3 | 92,279 | 16.16% |
| Clear Mountain Bank | 1 | 34,765 | 6.09 % |
| Miners & Merchants Bank | 1 | 6,441 | 1.13 % |

*Source: FDIC Deposit Market Share Report*

| Washington County, Maryland: | | | |
|---|---|---|---|
| Susquehanna Bank | 9 | $679,314 | 33.13% |
| The Columbia Bank | 9 | 444,537 | 21.66% |
| Manufacturers & Traders Trust Company | 11 | 389,161 | 18.98% |
| PNC Bank NA | 5 | 171,034 | 8.34 % |
| United Bank | 2 | 85,432 | 4.17 % |

[6]

| | | | |
|---|---|---|---|
| First United Bank & Trust | 3 | 74,838 | 3.65% |
| Santander Bank, N.A. | 3 | 73,822 | 3.60% |
| Capital One NA | 2 | 46,310 | 2.26% |
| CNB Bank, Inc. | 1 | 35,251 | 1.72% |
| Orrstown Bank | 1 | 23,748 | 1.16% |
| Middletown Valley Bank | 1 | 15,360 | 0.75% |
| Jefferson Security Bank | 1 | 7,773 | 0.38% |
| Bank of Charles Town | 1 | 4,033 | 0.20% |

*Source: FDIC Deposit Market Share Report*

| Berkeley County, West Virginia: | | | |
|---|---|---|---|
| Branch Banking & Trust Company | 5 | $334,451 | 29.21% |
| United Bank | 4 | 171,838 | 15.01% |
| First United Bank & Trust | 4 | 125,695 | 10.98% |
| City National Bank of West Virginia | 4 | 123,676 | 10.80% |
| Susquehanna Bank | 3 | 107,597 | 9.40 % |
| MVB Bank Inc. | 2 | 105,382 | 9.20 % |
| Jefferson Security Bank | 2 | 70,904 | 6.19 % |
| Bank of Charles Town | 2 | 49,178 | 4.29 % |
| CNB Bank, Inc. | 3 | 43,395 | 3.79 % |
| Summit Community Bank | 1 | 12,185 | 1.06 % |
| Woodforest National Bank | 1 | 846 | 0.07 % |

*Source: FDIC Deposit Market Share Report*

| Mineral County, West Virginia: | | | |
|---|---|---|---|
| First United Bank & Trust | 2 | $85,044 | 36.92% |
| Branch Banking & Trust Company | 2 | 71,240 | 30.92% |
| Manufacturers & Traders Trust Company | 2 | 45,831 | 19.89% |
| Grant County Bank | 1 | 28,276 | 12.27% |

*Source: FDIC Deposit Market Share Report*

| Monongalia County, West Virginia: | | | |
|---|---|---|---|
| United Bank | 7 | $678,417 | 32.04% |
| Branch Banking & Trust Company | 6 | 431,829 | 20.39% |
| Huntington National Bank | 6 | 370,407 | 17.49% |
| Clear Mountain Bank | 6 | 193,622 | 9.14 % |
| Wesbanco Bank, Inc. | 5 | 132,817 | 6.27 % |
| First United Bank & Trust | 3 | 126,327 | 5.97 % |
| MVB Bank, Inc. | 2 | 102,875 | 4.86 % |

| | | | |
|---|---|---|---|
| PNC Bank NA | 2 | 33,454 | 1.58 % |
| First Exchange Bank | 1 | 26,787 | 1.26 % |
| Citizens Bank of Morgantown, Inc. | 1 | 21,146 | 1.00 % |

*Source: FDIC Deposit Market Share Report*

[7]

For further information about competition in our market areas, see the Risk Factor entitled "**We operate in a competitive environment, and our inability to effectively compete could adversely and materially impact our financial condition and results of operations**" 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 registered with the Board of Governors of the Federal Reserve System (the "Federal Reserve") as a bank holding company 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 Federal Reserve. As a publicly-traded company whose common stock is registered 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 also subject to regulation and supervision by the SEC and The NASDAQ Stock Market, LLC ("NASDAQ").

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 (the "Maryland Commissioner"), who is required by statute to make at least one examination in each calendar year (or at 18-month intervals if the Maryland 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 Federal Reserve, and, as affiliates of the Bank, are subject to examination by the FDIC and the Maryland Commissioner. In addition, OakFirst Loan Center, Inc. is subject to licensing and regulation by the West Virginia Division of Banking, and OakFirst Loan Center, LLC is subject to licensing and regulation by the Maryland Commissioner.

**Regulatory Reforms**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which was enacted in July 2010, significantly restructures the financial regulatory regime in the United States. Although the Dodd-Frank Act’s provisions that have received the most public attention generally have been those applying to or more likely to affect larger institutions such as banks and bank holding companies with total consolidated assets of $50 billion or more, it contains numerous other provisions that affect all financial institutions, including the Corporation and the Bank. The Dodd-Frank Act contains a wide variety of provisions (many of which are not yet effective) affecting the regulation of bank holding companies and depository institutions, including restrictions related to mortgage originations, risk retention requirements as to securitized loans, and the establishment of a new financial consumer protection agency, known as the Consumer Financial Protection Bureau (the “CFPB”), that is empowered to promulgate and enforce new consumer protection regulations and revise and enforce existing regulations in many areas of consumer compliance.

Moreover, not only are the states’ attorneys general entitled to enforce consumer protection rules issued by the CFPB, but states are permitted to adopt their own consumer protection laws that are more strict than those created under the Dodd-Frank Act. Recently, U.S. financial regulatory agencies have increasingly used general consumer protection statutes to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. Prior to the Dodd-Frank Act, there was little formal guidance as to the parameters for compliance with the federal “unfair or deceptive acts or practices” (“UDAP”) laws. However, the UDAP provisions have been expanded under the Dodd-Frank Act to apply to “unfair, deceptive or abusive acts or practices”, which has been delegated to the CFPB for supervision.

Many of the Dodd-Frank Act’s provisions are subject to final rulemaking by the U.S. financial regulatory agencies, and the Dodd-Frank Act’s impact on our business will depend to a large extent on how and when such rules are adopted and implemented by the primary U.S. financial regulatory agencies. We continue to analyze the impact of rules adopted under the Dodd-Frank Act on our business, but the full impact will not be known until the rules and related regulatory initiatives are finalized and their combined impact can be understood. We do anticipate that the Dodd-Frank Act will increase our regulatory compliance burdens and costs and may restrict the financial products and services that we offer to our customers in the future. In particular, the Dodd-Frank Act will require us to invest significant management attention and resources so that we can evaluate the impact of and ensure compliance with this law and its rules.

**Regulation of Bank Holding Companies**

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 Federal Reserve policy, the Corporation is expected to act as a source of strength to the Bank, and the Federal Reserve may charge the Corporation with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. This support may be required at times when the bank holding company may not have the resources to provide the support. Under the prompt corrective action provisions, if a controlled bank is undercapitalized, then the regulators could require the bank holding company to guarantee the bank's capital restoration plan. In addition, if the Federal Reserve believes that a bank holding company's activities, assets or affiliates represent a significant risk to the financial safety, soundness or stability of a controlled bank, then the Federal Reserve could require the bank holding company to terminate the activities, liquidate the assets or divest the affiliates. The regulators may require these and other actions in support of controlled banks even if such actions are not in the best interests of the bank holding company or its stockholders. Because the Corporation is a bank holding company, it is viewed as a source of financial and managerial strength for any controlled depository institutions, like the Bank.

During 2013, significant media attention was given to the Dodd-Frank Act's amendment of the BHC Act to require the U.S. financial regulatory agencies to adopt rules that prohibit banking institutions and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the "Volcker Rule". The U.S. financial regulatory agencies adopted final rules implementing the Volcker Rule on December 10, 2013. The Volcker Rule became effective on July 21, 2012 and the final rules had an effective date of April 1, 2014, but the U.S. financial regulatory agencies issued an order in December 2014 extending the period during which institutions have to conform their activities and investments to the requirements of the Volcker Rule to July 21, 2015. We do not anticipate that the Volcker Rule or the final rules adopted thereunder will have a material effect on our operations, as we believe that we do not engage in the businesses prohibited by the Volcker Rule. (But see the risk factor entitled, "**The Volcker Rule may require us to dispose of certain investments by July 21, 2015, which could result in a significant charge to earnings.**" contained in Item 1A of this Part I of this annual report.) We may incur costs related to the adoption of additional policies and systems to ensure compliance with the Volcker Rule, but we do not expect that such costs would be material.

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 Federal Reserve 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 those available to persons who are not related to 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 capital standards on insured depository institutions.

The Community Reinvestment Act 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 had a CRA rating of “Satisfactory”.

The Bank is also subject to a variety of other laws and regulations with respect to the operation of its business, including, but not limited to, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, Expedited Funds Availability (Regulation CC), Reserve Requirements (Regulation D), Privacy of Consumer Information (Regulation P), Margin Stock Loans (Regulation U), the Right To Financial Privacy Act, the Flood Disaster Protection Act, the Homeowners Protection Act, the Servicemembers Civil Relief Act, the Real Estate Settlement Procedures Act, the Telephone Consumer Protection Act, the CAN-SPAM Act, the Children’s Online Privacy Protection Act, and the John Warner National Defense Authorization Act.

**Capital Requirements**

The Corporation and the Bank are subject to the regulatory capital requirements administered by the Federal Reserve and the FDIC, respectively. Until January 1, 2015, the federal regulatory authorities’ risk-based capital guidelines were based upon the 1988 capital accord (“Basel I”) of the Basel Committee on Banking Supervision (the “Basel Committee”). The Basel Committee is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines for use by each country’s supervisors in determining the supervisory policies they apply. Capital guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the requirements, banking organizations are required to maintain minimum ratios for Tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization’s assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. A depository institution’s or holding company’s capital, in turn, is classified in one of two tiers, depending on type:

- Core Capital (Tier 1). Tier 1 capital includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in equity accounts of consolidated subsidiaries (and, under existing standards, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level), less goodwill, most intangible assets and certain other assets.
- Supplementary Capital (Tier 2). Tier 2 capital includes, among other things, perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for loan and lease losses, subject to limitations.

The Corporation, like other bank holding companies, currently is required to maintain Tier 1 capital and “total capital” (the sum of Tier 1 and Tier 2 capital) equal to at least 4.0% and 8.0%, respectively, of its total risk-weighted assets (including various off-balance-sheet items, such as letters of credit). The Bank, like other depository institutions, is required to maintain similar capital levels under capital adequacy guidelines. In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its Tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively.

Bank holding companies and banks are also currently required to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization’s Tier 1 capital to its total adjusted quarterly average assets (as defined for regulatory purposes). The requirements necessitate a minimum leverage ratio of 3.0% for bank holding companies and member banks that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority’s risk-adjusted measure for market risk. All other bank holding companies and member banks are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In addition, for a depository institution to be considered “well capitalized” under the regulatory framework for prompt corrective action, its leverage ratio must be at least 5.0%.

On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to First United Corporation. The FDIC subsequently approved the same rules. The final rules implement the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act and are effective January 1, 2015.

The Basel III capital rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and which refine the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation under the final rules will be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a “capital conservation buffer” above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (a) a common equity Tier 1 capital ratio of 7.0%; (b) a Tier 1 capital ratio of 8.5%; and (c) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The Basel III capital rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. Under the final rules, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations like the Corporation and the Bank that are not considered "advanced approaches" banking organizations may make a one-time permanent election to continue to exclude these items. The Corporation and the Bank expect to make this election in their first quarter 2015 regulatory filings in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Corporation's available-for-sale securities portfolio. Additionally, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The final rules set forth certain changes for the calculation of risk-weighted assets. The number of credit risk exposure categories and risk weights has increased, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; and (d) revised capital treatment for derivatives and repo-style transactions.

We believe that we are in compliance with the applicable requirements of the final rules.

Additional information about our capital ratios and requirements is contained in Item 7 of Part II of this annual report under the heading "Capital Resources".

**Prompt Corrective Action**

The Federal Deposit Insurance ("FDI") Act requires, among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDI Act includes the following five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total capital ratio, the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure,

(ii) “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater and is not “well capitalized”, (iii) “undercapitalized” if the institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0%, (iv) “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%, and (v) “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects for other purposes.

Effective January 1, 2015, the Basel III capital rules revise the prompt corrective action requirements by (i) introducing the CET1 ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category (other than critically undercapitalized), with the minimum Tier 1 capital ratio for well-capitalized status being 8%; and (iii) eliminating the provision that permitted a bank with a composite supervisory rating of 1 but a leverage ratio of at least 3% to be deemed adequately capitalized. The Basel III Capital Rules do not change the total risk-based capital requirement for any prompt corrective action category.

The FDI Act generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.” Significantly undercapitalized” depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well capitalized insured depository institution as adequately capitalized. The FDI Act provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

The Corporation believes that, as of December 31, 2014, the Bank was “well capitalized” based on the aforementioned ratios.

**Liquidity Requirements**

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio (“LCR”), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity’s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (“NSFR”), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. In October 2013, the federal banking agencies proposed rules implementing the LCR for advanced approaches banking organizations and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to the Corporation or the Bank. The federal banking agencies have not yet proposed rules to implement the NSFR.

**Deposit Insurance**

The Bank is a member of the FDIC and pays an insurance premium to the FDIC based upon its assessable deposits on a quarterly basis. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the United States Government.

Under the Dodd-Frank Act, a permanent increase in deposit insurance was authorized to $250,000. The coverage limit is per depositor, per insured depository institution for each account ownership category.

The Dodd-Frank Act also set a new minimum DIF reserve ratio at 1.35% of estimated insured deposits. The FDIC is required to attain this ratio by September 30, 2020. The Dodd-Frank Act required the FDIC to redefine the deposit insurance assessment base for an insured depository institution. Prior to the Dodd-Frank Act, an institution's assessment base has historically been its domestic deposits, with some adjustments. As redefined pursuant to the Dodd-Frank Act, an institution's assessment base is now an amount equal to the institution's average consolidated total assets during the assessment period minus average tangible equity. Institutions with $1.0 billion or more in assets at the end of a fiscal quarter, like the Bank, must report their average consolidated total assets on a daily basis and report their average tangible equity on an end-of-month balance basis.

The Federal Deposit Insurance Reform Act of 2005, which created the DIF, gave the FDIC greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments. The FDIC has the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment, if certain conditions are met.

DIF-insured institutions pay a Financing Corporation ("FICO") assessment in order to fund the interest on bonds issued in the 1980s in connection with the failures in the thrift industry. These assessments will continue until the bonds mature in 2019.

The FDIC is authorized to conduct examinations of and require reporting by FDIC-insured institutions. It is also authorized to terminate a depository bank's deposit insurance upon a finding by the FDIC that the bank's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the bank's regulatory agency. The termination of deposit insurance for our national bank subsidiary would have a material adverse effect on our earnings, operations and financial condition.

**Bank Secrecy Act/Anti-Money Laundering**

The Bank Secrecy Act ("BSA"), which is intended to require financial institutions to develop policies, procedures, and practices to prevent and deter money laundering, mandates that every national bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA.

The program must, at a minimum: (i) provide for a system of internal controls to assure ongoing compliance; (ii) provide for independent testing for compliance; (iii) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (iv) provide training for appropriate personnel. In addition, state-chartered banks are required to adopt a customer identification program as part of its BSA compliance program. State-chartered banks are also required to file Suspicious Activity Reports when they detect certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity or a violation of the BSA.

In addition to complying with the BSA, the Bank is subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act"). The USA Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the United States' financial system and has significant implications for depository institutions, brokers, dealers, and other businesses involved in the transfer of money. The USA Patriot Act mandates that financial service companies implement additional policies and procedures and take heightened measures designed to address any or all of the following matters: customer identification programs, money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, currency crimes, and cooperation between financial institutions and law enforcement authorities.

**Mortgage Lending and Servicing**

In January 2013, the CFPB issued eight final regulations governing mainly consumer mortgage lending. These regulations became effective in January 2014.

One of these rules, effective on January 10, 2014, requires mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. This rule also defines "qualified mortgages." In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or a term exceeding 30 years, where the lender determines that the borrower has the ability to repay, and where the borrower's points and fees do not exceed 3% of the total loan amount. Qualified mortgages that that are not "higher-priced" are afforded a safe harbor presumption of compliance with the ability to repay rules. Qualified mortgages that are "higher-priced" garner a rebuttable presumption of compliance with the ability to repay rules.

The CFPB regulations also: (i) require that "higher-priced" mortgages must have escrow accounts for taxes and insurance and similar recurring expenses; (ii) expand the scope of the high-rate, high-cost mortgage provisions by, among other provisions, lowering the rates and fees that lead to coverage and including home equity lines of credit; (iii) revise rules for mortgage loan originator compensation; (iv) add prohibitions against mandatory arbitration provisions and financing single premium credit insurances; and (v) impose a broader requirement for providing borrowers with copies of all appraisals on first-lien dwelling secured loans.

Effective January 10, 2014, the CFPB's final Truth-in-Lending Act rules relating to mortgage servicing impose new obligations to credit payments and provide payoff statements within certain time periods and provide new notices prior to interest rate and payment adjustments. Effective on that same date, the CFPB's final Real Estate Settlement Procedures Act rules add new obligations on the servicer when a mortgage loan is default.

On November 20, 2013, the CFPB issued a final rule on integrated mortgage disclosures under the Truth-in-Lending Act and the Real Estate Settlement Procedures Act, for which compliance is required by August 1, 2015. We are evaluating these integrated mortgage disclosure rules for compliance by that deadline.

**Federal Securities Laws and NASDAQ Rules**

The shares of the Corporation's common stock are registered with the SEC under Section 12(b) of the Exchange 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, and rules adopted by NASDAQ. 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, the Corporation must comply with certain enhanced corporate governance requirements, and various issuances of securities by the Corporation require shareholder approval.

**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 Federal Reserve. An important function of the Federal Reserve 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 Federal Reserve 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 Federal Reserve 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 Federal Reserve, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or their effect on our businesses and earnings.

**SEASONALITY**

Management does not believe that our business activities are seasonal in nature. Deposit and loan 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, 2014, we employed 372 individuals, of whom 303 were full-time employees.

**ITEM 1A. RISK FACTORS**

The significant risks and uncertainties related to us, our business and our securities of which we are aware are discussed below. You should carefully consider these risks and uncertainties before making investment decisions in respect of our securities. Any of these factors could materially and adversely affect our business, financial condition, operating results and prospects and could negatively impact the market price of our securities. If any of these risks materialize, you could lose all or part of your investment in the Corporation. Additional risks and uncertainties that we do not yet know of, or that we currently think are immaterial, may also impair our business operations. You should also consider the other information contained in this annual report, including our financial statements and the related notes, before making investment decisions in respect of our securities.

***Risks Relating to First United Corporation and its Affiliates***

**First United Corporation's future success 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 our 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 of Atlanta (the "FHLB"). Interest rate risk arises from mismatches (*i.e.*, the interest sensitivity gap) between the dollar amount of repricing or maturing assets and liabilities. If more assets reprice or mature than liabilities during a falling interest rate environment, then our earnings could be negatively impacted. Conversely, if more liabilities reprice or mature than assets during a rising interest rate environment, then our earnings could be negatively impacted. 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, much of which involves real estate lending, so a decline in the real estate and credit markets could materially and adversely impact our financial condition and results of operations.**

Most of the Bank's loans are made to borrowers located in Western Maryland and Northeastern West Virginia, and many of these loans, including construction and land development loans, are secured by real estate. Approximately 12%, or $99 million, of total loans are real estate acquisition construction and development projects that are secured by real estate. Accordingly, a decline in local economic conditions would likely have an adverse impact on our financial condition and results of operations, and the impact on us would likely be greater than the impact felt by larger financial institutions whose loan portfolios are geographically diverse. We cannot guarantee that any risk management practices we implement to address our geographic and loan concentrations will be effective to prevent losses relating to our loan portfolio.

The national and local economies were significantly and adversely impacted by the banking crisis and resulting economic recession that began around 2008, and these conditions have caused, and continue to cause, a host of challenges for financial institutions, including the Bank. For example, these conditions have made it more difficult for real estate owners and owners of loans secured by real estate to sell their assets at desirable times and prices. Not only has this impacted the demand for credit to finance the acquisition and development of real estate, but it has also impaired the ability of banks, including the Bank, to sell real estate acquired through foreclosure. In the case of real estate acquisition, construction and development projects that we have financed, these challenging economic conditions have caused some of our borrowers to default on their loans. Because of the deterioration in the market values of real estate collateral caused by the recession, banks, including the Bank, have been unable to recover the full amount due under their loans when forced to foreclose on and sell real estate collateral. As a result, we have realized significant impairments and losses in our loan portfolio, which have materially and adversely impacted our financial condition and results of operations. These conditions and their consequences are likely to continue until the nation fully recovers from the recent economic recession. Management cannot predict the extent to which these conditions will cause future impairments or losses, nor can it provide any assurances as to when, or if, economic conditions will improve.

**The Bank's concentrations of commercial real estate loans could subject it to increased regulatory scrutiny and directives, which could force us to preserve or raise capital and/or limit future commercial lending activities.**

The Federal Reserve, the FDIC, and the other federal banking regulators issued guidance in December 2006 entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" directed at institutions who have particularly high concentrations of CRE loans within their lending portfolios. This guidance suggests that these institutions face a heightened risk of financial difficulties in the event of adverse changes in the economy and CRE markets. Accordingly, the guidance suggests that institutions whose concentrations exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk. The guidance provides that banking regulators may require such institutions to reduce their concentrations and/or maintain higher capital ratios than institutions with lower concentrations in CRE.

**The Bank may experience loan losses in excess of its allowance, which would reduce our earnings.**

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, 2014, we had classified a cost basis of $231.7 million and a market value of $221.1 million of our investment securities as available-for-sale pursuant to FASB Accounting Standards Codification ("ASC") Topic 320, *Investments – Debt and Equity Securities*, relating to accounting for investments. Topic 320 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 loss. 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.

Management believes that several factors could affect the market value 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.

**The Volcker Rule may require the Bank to dispose of certain investments by July 21, 2015, which could result in a significant charge to earnings.**

On December 10, 2013, the SEC, the Federal Reserve, the FDIC and other financial regulatory agencies issued final regulations to implement the Volcker Rule. Among other things, these regulations prohibit banking entities from acquiring or retaining an "ownership interest" in a "covered fund", as such terms are defined in the regulations. A banking entity that owns such an interest must dispose of it no later than July 21, 2015. Although the agencies stated in their final rule release that debt securities evidencing typical extensions of credit (i.e., those that provide for payment of stated principal and interest calculated at a fixed rate or at a floating rate based on an index or interbank rate) do not generally meet the definition of an "ownership interest", the agencies' release contains a statement to the effect that all collateralized debt obligations ("CDOs") backed by trust preferred securities are prohibited investments under the Volcker Rule. Subsequently, on January 14, 2014, the agencies issued an interim final rule that exempts a CDO if (i) the issuer was established, and the CDO was originally issued, before May 19, 2010, (ii) the banking entity investor reasonably believes that the offering proceeds received by the issuer were invested primarily in trust preferred securities or subordinated debt instruments issued prior to May 19, 2010 by a depository institution holding company that satisfied certain criteria at the time of issuance, and (iii) the banking entity investor acquired the CDO on or before December 10, 2013. The agencies' rule releases create significant uncertainty with respect to whether the Volcker Rule will be applied to CDOs that are backed by non-bank trust preferred securities but that take the form of debt securities evidencing typical extensions of credit, because the agencies did not, in making the statement that CDOs backed by trust preferred securities are generally prohibited investments, acknowledge or otherwise address the fact that an investment must, as a threshold matter, meet the definition of "ownership interest" before it can be characterized as a prohibited investment.

At December 31, 2014, the Bank owns $37.1 million in aggregate principal amount of promissory notes that are collateralized primarily by trust preferred securities and/or subordinated debt instruments issued by insurance entities and that provide for the payment of stated principal and interest at rates tied to LIBOR. These promissory notes are held in the Bank's investment portfolio and, as of December 31, 2014, are classified as available-for-sale. The Bank has analyzed these promissory notes under the final Volcker Rule regulations and has concluded that they are not prohibited investments because they do not exhibit, on a current, future, or contingent basis, any of the characteristics of an equity, partnership or other similar interest in the issuers identified in the Volcker Rule's definition of "ownership interest". If the FDIC were to disagree with the Bank's conclusion and determine that these promissory notes constitute prohibited "ownership interests", then the Bank would be required to dispose of them on or before January 21, 2015, likely at a considerable loss due to their current market values.

**Impairment of investment securities, goodwill, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.**

In assessing whether the impairment of investment securities is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. See the discussion under the heading "Estimates and Critical Accounting Policies – Other-Than-Temporary Impairment of Investment Securities" in Item 7 of Part II of this annual report for further information.

Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. A decline in the price of the Corporation's common stock or occurrence of a triggering event following any of our quarterly earnings releases and prior to the filing of the periodic report for that period could, under certain circumstances, cause us to perform a goodwill impairment test and result in an impairment charge being recorded for that period which was not reflected in such earnings release. In the event that we conclude that all or a portion of our goodwill may be impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital. At December 31, 2014, we had recorded goodwill of $11.0 million, representing approximately 10% of shareholders' equity. See the discussion under the heading "Estimates and Critical Accounting Policies – Goodwill" in Item 7 of Part II of this annual report for further information.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Assessing the need for, or the sufficiency of, a valuation allowance requires management to evaluate all available evidence, both negative and positive, including the recent trend of quarterly earnings. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carryback and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (*e.g.*, cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At December 31, 2014, our net deferred tax assets were $23.3 million.

The impact of each of these impairment matters could have a material adverse effect on our business, results of operations, and financial condition.

**We operate in a competitive environment, and our inability to effectively compete could adversely and materially impact our financial condition and results of operations.**

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 securities products, comes from other banks, securities and brokerage companies, 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, changes to the banking laws over the last several years have facilitated interstate branching, merger and expanded activities by banks and holding companies. For example, 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 and other non-banking activities of any company that controls an FDIC insured financial institution. As a result, the ability of financial institutions to branch across state lines and the ability of these institutions to engage in previously-prohibited activities are now accepted elements of competition in the banking industry. These changes may bring us into competition with more and a wider array of institutions, which may reduce our ability to attract or retain customers. Management cannot predict the extent to which we will face such additional competition or 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 Federal Reserve. 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.

**The full impact of the Dodd-Frank Act is unknown because significant rule making efforts are still required to fully implement all of its requirements, but it will likely materially increase our regulatory expenses.**

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States and affects the lending, investment, trading and operating activities of all financial institutions. Significantly, the Dodd-Frank Act includes the following provisions that affect the Bank:

- It established the CFPB, which has rulemaking authority over many of the statutes governing products and services offered to Bank customers. The creation of the CFPB will directly impact the scope and cost of products and services offered to consumers by the Bank and may have a significant effect on its financial performance.
- It revised the FDIC's insurance assessment methodology so that premiums are assessed based upon the average consolidated total assets of the Bank less tangible equity capital.
- It permanently increased deposit insurance coverage to $250,000.
- It authorized the Federal Reserve to set debit interchange fees in an amount that is "reasonable and proportional" to the costs incurred by processors and card issuers. Under the final rule issued by the Federal Reserve, there is a cap of $0.21 per transaction (with a maximum of $.24 per transaction permitted if certain requirements are met). Implementation of these caps went into effect on October 1, 2011.

- It imposes proprietary trading restrictions on insured depository institutions and their holding companies that prohibit them from engaging in proprietary trading except in limited circumstances, and prevents them from owning equity interests in excess of three percent (3%) of a bank’s Tier 1 capital in private equity and hedge funds.

Based on the text of the Dodd-Frank Act and the implementing regulations (both effective and yet-to-be-published), it is anticipated that the costs to banks may increase or fee income may decrease significantly, which could adversely affect our results of operations, financial condition and/or liquidity.

**The Consumer Financial Protection Bureau may reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices. Compliance with any such change may impact our business operations.**

The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers. The CFPB has also been directed to adopt rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The concept of what may be considered to be an “abusive” practice is new under the law. The full scope of the impact of this authority has not yet been determined as the CFPB has not yet released significant supervisory guidance.

As discussed above, the CFPB issued several rules in 2013 relating to mortgage operations and servicing, including a rule requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms, or to originate “qualified mortgages” that meet specific requirements with respect to terms, pricing and fees. These new rules will likely require the Bank to dedicate significant personnel resources and could have a material adverse effect on our operations.

**Bank regulators and other regulations, including the Basel III Capital Rules, may require higher capital levels, impacting our ability to pay dividends or repurchase our stock.**

The capital standards to which we are subject, including the standards created by the Basel III Capital Rules, may materially limit our ability to use our capital resources and/or could require us to raise additional capital by issuing common stock. The issuance of additional shares of common stock could dilute existing stockholders.

**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 certain bank holding companies to become financial holding companies. Financial holding companies are permitted to engage in a host of financial activities, and activities that are incidental to financial activities, that are not permitted for bank holding companies who have not elected to become financial holding companies, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities. The Corporation terminated its financial holding company election in September 2014, and this election and the GLB Act may increase the competition that we face from other entities that provide financial products and services. It is not possible to predict the full effect that the GLB Act will have on us.

The federal Sarbanes-Oxley Act of 2002 requires management of every publicly traded company to perform an annual assessment of the company's internal control over financial reporting and to report on whether the system is effective as of the end of the company's fiscal year. If our management were to discover and report significant deficiencies or material weaknesses in our internal control over financial reporting, then the market value of our securities and shareholder value could decline.

The 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.

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

With 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.

**The Bank's funding sources may prove insufficient to replace deposits and support our future growth.**

The Bank relies on customer deposits, advances from the FHLB, lines of credit at other financial institutions and brokered funds to fund our operations. Although the Bank has historically been able to replace maturing deposits and advances if desired, no assurance can be given that the Bank 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.

**Recent rulemaking efforts by the Federal Reserve may negatively impact our non-interest income.**

On November 12, 2009, the Federal Reserve announced the final rules amending Regulation E that prohibit financial institutions from charging fees to consumers for paying overdrafts on automated teller machine and one-time debit card transactions, unless a consumer consents, or opts-in, to the overdraft service for those types of transactions. Compliance with this regulation is effective July 1, 2010 for new consumer accounts and August 15, 2010 for existing consumer accounts. These new rules negatively impacted the Banks' non-interest income in 2013 and 2014 may continue to do so in future periods.

In addition, the Federal Reserve has issued rules pursuant to the Dodd-Frank Act governing debit card interchange fees that apply to institutions with greater than $10 billion in assets. Although we are not subject to these rules, market forces may effectively require the Bank to adopt a debit card interchange fee structure that complies with these rules, in which case our non-interest income for future periods could be materially and 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 and the market areas we serve. 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.

**The Bank's lending activities subject the Bank to the risk of environmental liabilities.**

A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank 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, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's 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 the Bank's exposure to environmental liability. Although the Bank has 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 subject to claims and the costs of defensive actions, and such claims and costs could materially and adversely impact our financial condition and results of operations.**

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 will result in legal expenses and could subject us to 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.

**Safeguarding our business and customer information increases our cost of operations. To the extent that we, or our third party vendors, are unable to prevent the theft of or unauthorized access to this information, our operations may become disrupted, we may be subject to claims, and our net income may be adversely affected.**

Our business depends heavily on the use of computer systems, the Internet and other means of electronic communication and recordkeeping. Accordingly, we must protect our computer systems and network from break-ins, security breaches, and other risks that could disrupt our operations or jeopardize the security of our business and customer information. Moreover, we use third party vendors to provide products and services necessary to conduct our day-to-day operations, which exposes us to risk that these vendors will not perform in accordance with the service arrangements, including by failing to protect the confidential information we entrust to them. Any security measures that we or our vendors implement, including encryption and authentication technology that we use to effect secure transmissions of confidential information, may not be effective to prevent the loss or theft of our information or to prevent risks associated with the Internet, such as cyber-fraud. Advances in computer capabilities, new discoveries in the field of cryptography, or other developments could permit unauthorized persons to gain access to our confidential information in spite of the use of security measures that we believe are adequate. Any compromise of our security measures or of the security measures employed by our vendors of our third party could disrupt our business and/or could subject us to claims from our customers, either of which could have a material adverse effect on our business, financial condition and results of operations.

***Risks Relating to First United Corporation's Securities***

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

The shares of the Corporation's common stock, the shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock"), and its outstanding warrant to purchase 326,323 shares of common stock (the "Warrant") are not deposits and are not insured against loss by the FDIC or any other governmental or private agency.

**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. The 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.

**Because of the Corporation's participation in the Troubled Asset Relief Program, the Corporation 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 shares.**

On January 30, 2009, the Corporation participated in the Troubled Asset Relief Program Capital Purchase Program (the "TARP CPP") of the U.S. Department of the Treasury (the "Treasury") by issuing 30,000 shares of Series A Preferred Stock and the Warrant to the Treasury in exchange for $30,000,000. These securities were issued pursuant to a Securities Purchase Agreement – Standard Terms, or Purchase Agreement, the terms of which limit the Corporation's ability to declare or pay dividends on shares of its capital stock. Specifically, the terms of the Series A Preferred Stock prohibit the Corporation from declaring or paying any dividends or making other distributions on the outstanding shares of its common stock, and from repurchasing, redeeming or otherwise acquiring shares of its common stock, if the Corporation is in arrears on any quarterly cash dividend due on the Series A Preferred Stock. In 2010, at the request of the Federal Reserve Bank of Richmond (the "Reserve Bank"), the Corporation elected to defer regularly scheduled quarterly dividends on the Series A Preferred Stock. In April 2014, the Corporation received approval from the Reserve Bank to terminate that deferral by making the quarterly dividend payments due in May 2014, and it thereafter received approvals to pay the quarter dividends due in August 2014, November 2014 and February 2015. For the foreseeable future, the Corporation's ability to make each future quarterly dividend payment due under the Series A Preferred Stock will depend on its receipt of an approval from the Reserve Bank. In addition, it should be noted that the Corporation's ability to make future quarterly dividend payments will depend in large part on its receipt of dividends from the Bank, and the Bank may pay dividends only with the prior approval of the FDIC and the Maryland Commissioner. As a result of these limitations, no assurance can be given that the Corporation will make the quarterly dividend payments due under the Series A Preferred Stock in any future quarter. If the Corporation and/or the Bank do not receive the approvals necessary for the Corporation to make a future quarterly dividend payment, then Corporation would be prohibited from paying cash dividends on or making other distributions with respect to the shares of its common stock.

**The Corporation and the Bank have entered into informal agreements with their regulators that limit their ability to pay dividends and make other distributions on outstanding securities.**

The Corporation has entered into an informal agreement with the Reserve Bank pursuant to which it agreed to obtain the Reserve Bank's approval before paying dividends on outstanding shares of its common stock or on outstanding shares of its Series A Preferred Stock, making interest payments under the Corporation's junior subordinated debentures ("TPS Debentures") underlying the trust preferred securities issued by the Trusts, or taking any other action that would reduce regulatory capital. The Bank has entered into a similar agreement with the FDIC and the Maryland Commissioner. These agreements give our regulators the ability to prohibit a proposed dividend payment, or any other distribution with respect to outstanding securities, including the repurchase of stock, at a time or times when applicable banking and corporate laws would otherwise permit such a dividend or distribution. There is no requirement that our regulators take consistent approaches when exercising their powers under these agreements. For example, even though the Reserve Bank might approve the payment of a particular dividend, that dividend could be effectively prohibited by the FDIC and/or the Maryland Commissioner if the Corporation intended to fund that dividend through a dividend by the Bank and the FDIC and/or the Maryland Commissioner were to deny the Bank's dividend request. Similarly, even though the FDIC and the Maryland Commissioner might approve a dividend by the Bank to the Corporation, the Reserve Bank could prevent the Corporation from using that dividend to make a distribution to the holders of its outstanding common stock, Series A Preferred Stock, or outstanding TPS Debentures. These agreements increase the likelihood that we will realize the other risks discussed below related to our ability to pay dividends and make other distributions.

**The Corporation's ability to pay dividends on its capital securities is also subject to the terms of the outstanding TPS Debentures, which prohibit the Corporation from paying dividends during an interest deferral period.**

In March 2004, the Corporation issued approximately $30.9 million of TPS Debentures to Trust I and Trust II in connection with the sales by those Trusts of $30.0 in mandatorily redeemable preferred capital securities to third party investors. Between December 2009 and January 2010, the Corporation issued approximately $10.8 million of TPS Debentures to Trust III in connection with the sale by Trust III of approximately $10.5 million in mandatorily redeemable preferred capital securities to third party investors. The terms of the TPS Debentures require the Corporation to make quarterly payments of interest to the Trusts, as the holders of the TPS Debentures, although the Corporation has the right to defer payments of interest for up to 20 consecutive quarterly periods. An election to defer interest payments does not constitute an event of default under the terms of the TPS Debentures. The terms of the TPS Debentures prohibit the Corporation from declaring or paying any dividends or making other distributions on, or from repurchasing, redeeming or otherwise acquiring, any shares of its common stock or shares of its Series A Preferred Stock if the Corporation elects to defer quarterly interest payments under the TPS Debentures. In addition, a deferral election will require the Trusts to likewise defer the payment of quarterly dividends on their related trust preferred securities.

In 2010, at the request of the Reserve Bank, the Corporation elected to defer regularly scheduled quarterly interest payments under the TPS Debentures, and this deferral required the Trusts to defer regular quarterly dividend payments

on their trust preferred securities. In February 2014, the Corporation received approval from the Reserve Bank to terminate that deferral by making the quarterly interest payments due to the Trusts in March 2014, and the Corporation thereafter received approvals to make the quarterly interest payments due in June 2014, September 2014, December 2014 and March 2015. For the foreseeable future, the Corporation's ability to make each future quarterly interest payment will depend on its receipt of an approval from the Reserve Bank. In addition, it should be noted that the Corporation's ability to make future quarterly interest payments under the TPS Debentures will depend in large part on its receipt of dividends from the Bank, and the Bank may pay dividends only with the prior approval of the FDIC and the Maryland Commissioner. As a result of these limitations, no assurance can be given that the Corporation will make the quarterly interest payments due under the TPS Debentures in any future quarter. If the Corporation and/or the Bank do not receive the approvals necessary for the Corporation to make any future quarterly interest payment, then the Corporation would be prohibited from paying cash dividends on or making other distributions with respect to the shares of its common stock or the shares of its Series A Preferred Stock.

**If the Corporation fails to make six quarterly dividend payments on the Series A Preferred Stock, then the holders thereof would have the right to elect up to two additional directors to the Corporation's Board of Directors.**

The terms of the Series A Preferred Stock permit the Corporation to defer the payment of quarterly dividends, but, in that case, undeclared dividends will continue to accrue and must be paid in full at the time the Corporation terminates the dividend deferral. The terms further provide that whenever, at any time or times, dividends payable on the outstanding shares of the Series A Preferred Stock have not been paid for an aggregate of six quarterly dividend periods or more, whether or not consecutive, the authorized number of directors then constituting the Corporation's Board of Directors will automatically be increased by two. Thereafter, holders of the Series A Preferred Stock, together with holders of any outstanding stock having voting rights similar to the Series A Preferred Stock, voting as a single class, will be entitled to fill the vacancies created by the automatic increase by electing up to two additional directors (the "Preferred Stock Directors") at the next annual meeting (or at a special meeting called for the purpose of electing the Preferred Stock Directors prior to the next annual meeting) and at each subsequent annual meeting until all accrued and unpaid dividends for all past dividend periods have been paid in full. The Corporation currently does not have any outstanding stock with voting rights on par with the Series A Preferred Stock.

**Applicable banking and Maryland laws impose additional restrictions on the ability of the Corporation and the Bank to pay dividends and make other distributions on their capital securities, and, in any event, the payment of dividends is at the discretion of the boards of directors of the Corporation and the Bank.**

In the past, the Corporation's ability to pay dividends to shareholders has been largely dependent upon the receipt of dividends from the Bank. Since December 2009, the Corporation had used its cash to pay dividends. In December 2010, however, the Corporation contributed substantially all of its excess cash to the Bank to strengthen the Bank's capital levels. Accordingly, in the event that the Corporation desires to pay cash dividends on the common stock and/or the Series A Preferred Stock in the future, and assuming such dividends are then permitted under the terms of the Series A Preferred Stock and the TPS Debentures, the Corporation will likely need to rely on dividends from the Bank to pay such dividends, and there can be no guarantee that the Bank will be able to pay such dividends. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. Under Maryland law, a state-chartered commercial bank may pay dividends only out of undivided profits or, with the prior approval of the Maryland 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 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. Banks that are considered "troubled institution" are prohibited by federal law from paying dividends altogether. Notwithstanding the foregoing, shareholders must understand that the declaration and payment of dividends and the amounts thereof are at the discretion of the Corporation's Board of Directors. Thus, even at times when the Corporation is not prohibited from paying cash dividends on its capital securities, neither the payment of such dividends nor the amounts thereof can be guaranteed.

**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 (the "Charter") and its Amended and Restated Bylaws, as amended (the "Bylaws") 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. The Maryland 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. The Maryland 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 prices of the Corporation's securities.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

This Item 1B is not applicable because the Corporation is a "smaller reporting company".

**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 20 of its banking offices and leases five. The Bank also leases one office that is used for disaster recovery purposes and one specialty office. Total rent expense on the leased offices and properties was $.5 million in 2014.

**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. MINE SAFETY DISCLOSURES**

Not applicable.

**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 27, 2015, the Corporation had 1,639 shareholders of record. The high and low sales prices for the shares of the Corporation's common stock for each quarterly period of 2014 and 2013 are set forth below. On March 6, 2015, the closing sales price of the common stock as reported on the NASDAQ Global Select Market was $9.18 per share. During 2014 and 2013, the Corporation did not declare any dividends on its common stock.

| | High | Low |
|---|---|---|
| 2014 | | |
| 1st Quarter | $9.00 | $7.35 |
| 2nd Quarter | 9.04 | 7.54 |
| 3rd Quarter | 8.95 | 7.92 |
| 4th Quarter | 8.75 | 7.93 |
| | | |
| 2013 | | |
| 1st Quarter | $9.00 | $6.68 |
| 2nd Quarter | 8.95 | 7.15 |
| 3rd Quarter | 9.35 | 7.05 |
| 4th Quarter | 8.92 | 7.31 |

The ability of the Corporation to declare dividends is limited by federal and state banking laws and state corporate laws. Subject to these and the terms of its other securities, including the Series A Preferred Stock and the TPS

Debentures, the payment of dividends on the shares of common stock and the amounts thereof are at the discretion of the Corporation's Board of Directors. Prior to November 2010, cash dividends were typically declared on a quarterly basis. Historically, dividends to shareholders were generally dependent on the ability of the Corporation's subsidiaries, especially the Bank, to declare dividends to the Corporation. Like the Corporation, the Bank's ability to declare and pay dividends is subject to limitations imposed by federal and state banking and corporate laws. A complete discussion of these and other dividend restrictions is contained in Item 1A of Part I of this annual report under the heading "***Risks Relating to First United Corporation's Securities***" and in Note 21 to the Consolidated Financial Statements, both of which are incorporated herein by reference. Accordingly, there can be no assurance that dividends will be declared on the shares of common stock in any future fiscal quarter.

The Corporation intends to periodically evaluate its dividend policy both internally and with the Federal Reserve, but it has no present intention of resuming dividend payments on its common stock in the foreseeable future.

**Issuer Repurchases**

Neither the Corporation nor any of its affiliates (as defined by Exchange Act Rule 10b-18) repurchased any shares of the Corporation's common stock during 2014.

**Equity Compensation Plan Information**

Pursuant to the SEC's Regulation S-K Compliance and Disclosure Interpretation 106.01, the information regarding the Corporation's equity compensation plans required by this Item pursuant to Item 201(d) of Regulation S-K is located in Item 12 of Part III of this annual report and is incorporated herein by reference.

**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth certain selected financial data for each of the five calendar years in the period ended December 31, 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.

| (Dollars in thousands, except for share data) | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Balance Sheet Data | | | | | |
| Total Assets | $1,332,296 | $1,334,046 | $1,321,296 | $1,391,350 | $1,696,903 |
| Net Loans | 827,926 | 796,646 | 858,782 | 919,214 | 987,615 |
| Investment Securities | 330,566 | 340,489 | 227,313 | 245,023 | 229,687 |
| Deposits | 981,323 | 977,403 | 976,884 | 1,027,784 | 1,301,646 |
| Long-term Borrowings | 182,606 | 182,672 | 182,735 | 207,044 | 243,100 |
| Shareholders' Equity | 108,999 | 101,883 | 99,418 | 97,141 | 96,098 |
| Operating Data | | | | | |
| Interest Income | $46,386 | $49,914 | $53,111 | $59,496 | $70,747 |
| Interest Expense | 10,870 | 11,732 | 13,965 | 21,206 | 29,164 |
| Net Interest Income | 35,516 | 38,182 | 39,146 | 38,290 | 41,583 |
| Provision for Loan Losses | 2,513 | 380 | 9,390 | 9,157 | 15,726 |
| Other Operating Income | 13,066 | 13,137 | 13,658 | 14,993 | 15,382 |
| Net Securities Impairment Losses | 0 | 0 | 0 | (19) | (8,364) |
| Net Gains/(Losses) – Other | 1,053 | 229 | 1,708 | 2,302 | (6,014) |
| Other Operating Expense | 40,254 | 42,471 | 39,518 | 43,410 | 45,049 |
| Income/(Loss) Before Taxes | 6,868 | 8,697 | 5,604 | 3,018 | (18,188) |
| Income Tax expense/(benefit) | 1,271 | 2,222 | 913 | (635) | (8,017) |
| Net Income/(Loss) | $5,597 | $6,475 | $4,691 | $3,653 | $(10,171) |
| Accumulated preferred stock dividend and discount accretion | (2,601) | (1,778) | (1,691) | (1,609) | (1,559) |
| Net income available to/(loss) attributable to common shareholders | $2,996 | $4,697 | $3,000 | $2,044 | $(11,730) |
| Per Share Data | | | | | |
| Basic and diluted net Income/(Loss) per common share | $0.48 | $0.76 | $0.48 | $0.33 | $(1.91) |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Dividends Paid | 0 | | 0 | | 0 | | 0 | | 0.13 | |
| Book Value | 13.30 | | 11.49 | | 11.14 | | 10.80 | | 10.68 | |
| | | | | | | | | | | |
| Significant Ratios | | | | | | | | | | |
| Return on Average Assets | 0.42 | % | 0.49 | % | 0.34 | % | 0.24 | % | (0.58 | )% |
| Return on Average Equity | 5.07 | % | 6.48 | % | 4.79 | % | 3.71 | % | (10.10 | )% |
| Dividend Payout Ratio | 0.00 | % | 0.00 | % | 0.00 | % | 0.00 | % | (7.85 | )% |
| Average Equity to Average Assets | 8.26 | % | 7.52 | % | 7.19 | % | 6.55 | % | 5.73 | % |
| Total Risk-based Capital Ratio | 15.40 | % | 15.33 | % | 14.13 | % | 13.05 | % | 11.57 | % |
| Tier I Capital to Risk Weighted Assets | 14.23 | % | 13.71 | % | 12.54 | % | 11.30 | % | 9.74 | % |
| Tier I Capital to Average Assets | 11.29 | % | 11.02 | % | 10.32 | % | 9.10 | % | 7.34 | % |

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## 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 Consolidated Financial Statements and notes thereto for the year ended December 31, 2014, which are included in Item 8 of Part II of this annual report.

### Overview

First United Corporation is a bank holding company that, 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 two Northeastern West Virginia counties. Its principal operating subsidiary is the Bank, which consists of a community banking network of 25 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 available to common shareholders was $3.0 million for the year ended December 31, 2014, compared to $4.7 million for 2013. Basic and diluted net income per common share for the year ended December 31, 2014 was $.48, compared to basic and diluted net income per common share of $.76 for 2013. The decrease in earnings for 2014 was due to a decrease of $3.5 million in interest income, primarily interest on loans, and an increase in provision expense of $2.1 million, offset by an increase of $.8 million in other operating income, a decrease of $.9 million in interest expense, and a $2.2 million decrease in other operating expenses. The increase in other operating income was attributable to an increase of $.8 million in gains on sales of securities, a $.3 million increase in Trust department income, and a $.4 million increase in Bank Owned Life Insurance ("BOLI") income. These increases were offset by a $.5 million decrease in service charges, primarily NSF fees, and a $.2 million decrease in other income. The decrease in other operating expenses was due to a decrease of $.4 million in salaries and benefits, a decrease of $.6 million in Other Real Estate Owned ("OREO") expenses and a decrease of $.7 million in other miscellaneous expenses. The increase of $.8 million on the Series A Preferred Stock dividends in 2014 also contributed to the decrease in net income available to common shareholders due to an increase in the contractual rate paid in 2014. The net interest margin for the year ended December 31, 2014, on a fully tax equivalent ("FTE") basis, decreased to 3.00% from 3.25% for the year ended December 31, 2013.

The provision for loan losses increased to $2.5 million for the year ended December 31, 2014 compared to $.4 million for the year ended December 31, 2013. The increase was driven by rolling historical loss rates, management's consideration of the qualitative factors that are likely to cause losses, and an $.8 million recovery on a large commercial real estate credit during the third quarter of 2013. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the allowance for loan losses (the "ALL") have been adjusted based on the current economic environment and the characteristics of the loan portfolio.

Interest expense on our interest-bearing liabilities decreased $.9 million for the year ended December 31, 2014 when compared to 2013 due to a decrease of $25.2 million in average interest-bearing deposits and a decrease of 21 basis points on the average rate paid on long-term borrowings. During 2014, we continued to focus on shifting our deposit mix away from higher cost certificates of deposit and toward lower cost money market and transaction accounts.

Other operating income increased $.8 million for the year ended December 31, 2014 when compared to 2013. This increase was primarily attributable to $1.1 million in gains on the sale of securities for the year ended December 31, 2014 compared to $.2 million for the year ended December 31, 2013, a $.3 million increase in Trust department income, and a $.4 million increase in BOLI income. The increase in BOLI income was attributable to a one-time death benefit of $.4 million received in December 2014.

Operating expenses decreased $2.2 million for the year ended December 31, 2014 when compared to the same period of 2013. This decrease was due to decreases of $.4 million in salaries and benefits, $.6 million in OREO expenses and $.7 million in other expenses. Declines in other expenses were due primarily to reduced personnel related expenses such as in house training, a decline in telephone expenses, and reduced fraud expenses related to debit cards.

Comparing December 31, 2014 to December 31, 2013, outstanding loans increased $29.8 million (3.7%). CRE loans decreased $11.9 million as a result of the payoff of two large loans of approximately $15 million during the third quarter of 2014. Acquisition and development (“A&D”) loans decreased $7.9 million due to regularly scheduled principal payments and payoffs. Commercial and industrial (“C&I”) loans increased $33.5 million due to new loan relationships, primarily one large relationship in the first quarter of 2014. Residential mortgage loans increased $16.7 million due to increased production of loans primarily in our 10/1 and 7/1 adjustable rate mortgage program. The Bank continues to use Fannie Mae for the majority of new, longer-term, fixed-rate residential loan originations. The consumer loan portfolio decreased slightly by $.6 million due to repayment activity in the indirect auto portfolio offsetting new production. At December 31, 2014, approximately 44% of the commercial loan portfolio was collateralized by real estate, compared to approximately 57% at December 31, 2013.

Interest income on loans decreased by $4.7 million (on a FTE basis) in 2014 when compared to 2013 due to the continued low rate environment. Interest income on our investment securities increased by $1.2 million (on a FTE basis) in 2014 when compared to 2013 due to purchases during 2014. (Additional information on the composition of interest income is available in Table 1 that appears on page 31).

Total deposits at December 31, 2014 increased $3.9 million when compared to December 31, 2013. We recorded increases in core deposits and reductions in certificates of deposit due to our continued focus on shifting the mix of our deposit portfolio from higher cost certificates of deposit to lower cost money market and transaction accounts. Non-interest bearing deposits increased $25.3 million. Traditional savings accounts increased $13.0 million due to continued growth in our Prime Saver product. Total demand deposits decreased $8.4 million and total money market accounts increased $8.9 million. Time deposits less than $100,000 declined $22.4 million and time deposits greater than $100,000 decreased $12.5 million.

Interest expense decreased $.9 million in 2014 when compared to 2013. The decline was primarily due to our continued focus on shifting our deposit mix from higher cost certificates of deposit to core deposits.

***Other Operating Income/Other Operating Expense***

Other operating income, exclusive of gains, decreased $.1 million for the year ended December 31, 2014 when compared to 2013. Service charge income decreased $.5 million for the year ended December 31, 2014 when compared to 2013 due to reduced insufficient funds fees (“NSF fees”). The reduction in NSF fees was due to the increased regulations on fees. Other income declined by $.3 million due to a decline in fair values on deferred compensation plans. These decreases were offset by an increase of $.3 million in Trust department income and $.4 million in BOLI income.

Net gains of $1.1 million were reported through other income for the year ended December 31, 2014, compared to net gains of $.2 million for 2013. The increase in net gains for 2014 over 2013 was due to a net gain of $1.1 million realized on sales of investment securities.

Operating expenses decreased $2.2 million for the year ended December 31, 2014 when compared to the same period of 2013. This decrease was due to decreases of $.4 million in salaries and benefits, $.6 million in OREO expenses and $.7 million in other expenses. Declines in other expenses were due primarily to reduced personnel related expenses such as in house training, a decline in telephone expenses, and reduced fraud expenses related to debit cards.

***Dividends –*** The Corporation's Board of Directors suspended the payment of dividends on outstanding shares of common stock in December 2010 when it approved the deferral cash of dividends on the Series A Preferred Stock, and this suspension remains in effect.

***Looking Forward –*** We will continue to face risks and challenges in the future, including, without limitation, 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 laws and regulations that apply to 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.

**Estimates and Critical Accounting Policies**

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 of America. 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 to the Consolidated Financial Statements.) On an on-going basis, management evaluates estimates and bases those 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, or ALL*

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 ALL, the valuation of underlying collateral, the timing of loan charge-offs and the placement of loans on non-accrual status. The ALL 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 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 ALL relies on management's estimates and judgments relating to inherently uncertain events, actual results may differ from management's estimates.

The ALL is also discussed below in Item 7 under the heading "Allowance for Loan Losses" and in Note 7 to the Consolidated Financial Statements.

*Goodwill*

ASC Topic 350, *Intangibles – Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. At December 31, 2014, we had $11.0 million in recorded goodwill that is related to the 2003 acquisition of Huntington National Bank and is not subject to periodic amortization.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Corporation's reporting units be compared to the carrying amount of its net assets, including goodwill. If the estimated current fair value of the reporting unit exceeds its carrying value, no additional testing is required and an impairment loss is not recorded. Otherwise, additional testing is performed, and to the extent such additional testing results in a conclusion that the carrying value of goodwill exceeds its implied fair value, an impairment loss is recognized.

Our goodwill relates to the value inherent in the banking business, and that 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. ASC Topic 350 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments and estimates.

During 2014, shares of the Corporation's common stock traded at prices that were below the common stock's book value and, at December 31, 2014, the sales price was below the common stock's tangible book value. Management believed that these circumstances could indicate the possibility of impairment. Accordingly, management consulted a third party valuation specialist to assist it with the determination of the fair value of the Corporation, considering both the market approach (guideline public company method) and the income approach (discounted future benefits method). Due to the illiquidity in the common stock and the adverse conditions surrounding the banking industry, reliance was placed on the income approach in determining the fair value of the Corporation. The income approach is a discounted cash flow analysis that is determined by adding (i) the present value, which is a representation of the current value of a sum that is to be received some time in the future, of the estimated net income, net of dividends paid out, that the Corporation could generate over the next five years and (ii) the present value of a terminal value, which is a representation of the current value of an entity at a specified time in the future. The terminal value was calculated

using both a price to tangible book multiple method and a capitalization method and the more conservative of the two was utilized in the fair value calculation.

Significant assumptions used in the above methods include:

- Net income from our forward five-year operating budget, incorporating conservative growth and mix assumptions;
- A discount rate of 14.15% based on an internally derived cost of equity capital determined using the "build-up" method;
- A price to tangible book multiple of 1.18x, which was the median multiple of non-assisted transactions for non-assisted commercial bank acquisitions during the twelve months ended September 30, 2014 for selling companies headquartered in the Eastern regional area as compiled by Boenning & Scattergood, Inc.; and
- A capitalization rate of 8.15% (discount rate of 14.15% adjusted for a conservative growth rate of 6.0%).

The resulting fair value of the income approach resulted in the fair value of the Corporation exceeding the carrying value by 52%. Management stressed the assumptions used in the analysis to provide additional support for the derived value. This stress testing showed that (i) the discount rate could increase to 27% before the excess would be eliminated in the tangible multiple method, and (ii) the assumption of the tangible book multiple could decline to 0.59x and still result in a fair value in excess of book value. Based on the results of the evaluation, management concluded that the recorded value of goodwill at December 31, 2014 was not impaired. However, future changes in strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded asset balances. Management will continue to evaluate goodwill for impairment on an annual basis and as events occur or circumstances change.

*Accounting for Income Taxes*

We account for income taxes in accordance with ASC Topic 740, "*Income Taxes*". Under this guidance, deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates that will apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

We regularly review the carrying amount of our net deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of our net deferred tax assets will not be realized in future periods, then a deferred tax valuation allowance must be established. Consideration is given to various positive and negative factors that could affect the realization of the deferred tax assets. In evaluating this available evidence, management considers, among other things, historical performance, expectations of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with utilization of operating loss and tax credit carry forwards not expiring, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. Our evaluation is based on current tax laws as well as management's expectations of future performance.

Management expects that the Corporation's adherence to the required accounting guidance may result in increased volatility in quarterly and annual effective income tax rates because of changes in judgment or measurement including changes in actual and forecasted income before taxes, tax laws and regulations, and tax planning strategies.

*Other-Than-Temporary Impairment of Investment Securities*

Management systematically evaluates the securities in our investment portfolio for impairment on a quarterly basis. Based upon the application of accounting guidance for subsequent measurement in ASC Topic 320 (Section 320-10-35), management assesses whether (i) we have the intent to sell a security being evaluated and (ii) it is more likely than not that we will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other-than-temporary impairment ("OTTI") losses, management considers (a) the length of time and the extent to which the fair value has been less than cost, (b) adverse conditions specifically related to the security, an industry, or a geographic area, (c) the historic and implied volatility of the fair value of the security, (d) changes in the rating of the security by a rating agency, (e) recoveries or additional declines in fair value subsequent to the balance sheet date, (f) failure of the issuer of the security to make scheduled interest or principal payments, and (g) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). This process is described more fully in the section of the Consolidated Balance Sheet Review entitled "Investment Securities".

*Fair Value of Investments*

We have determined the fair value of our investment securities in accordance with the requirements of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. We measure the fair market values of our investments based on the fair value hierarchy established in Topic 820. The determination of fair value of investments and other assets is discussed further in Note 24 to the Consolidated Financial Statements.

*Pension Plan Assumptions*

Our pension plan costs are calculated using actuarial concepts, as discussed within the requirements of ASC Topic 715, *Compensation – Retirement Benefits.* 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 18 to the Consolidated Financial Statements.

Other than as discussed above, management does not believe that any material changes in our critical accounting policies have occurred since December 31, 2014.

*Adoption of New Accounting Standards and Effects of New Accounting Pronouncements*

Note 1 to the Consolidated Financial Statements discusses new accounting pronouncements that, when adopted, could affect our future 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 that we earn on our interest-earning assets and the interest expense we incur on our interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to an FTE 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 an FTE basis) for 2014 and 2013.

| (Dollars in thousands) | 2014 | 2013 |
|---|---|---|
| Interest income | $47,350 | $50,893 |
| Interest expense | 10,870 | 11,732 |
| Net interest income | $36,480 | $39,161 |
| | | |
| Net interest margin % | 3.00 % | 3.25 % |

Net interest income on an FTE basis decreased $2.7 million (6.8%) for the year ended December 31, 2014 when compared to 2013 due to a $3.5 million (7.0%) decrease in interest income, which was partially offset by a $.8 million (7.3%) decrease in interest expense. The decrease in interest income was primarily due to the $23.9 million (2.8%) reduction in the average balance of loans and a decrease of 43 basis points on yields when comparing the years ended December 31, 2014 and December 31, 2013. The reduction in loan yields was attributable to loans repricing at lower rates and new loans booked at lower rates. The decline in interest income was partially offset by a decline in interest expense due to the reduction in the average balances of interest-bearing deposits and a decrease of 21 basis points on long-term borrowings. We saw a decrease in the net interest margin for the year ended December 31, 2014 to 3.00% when compared to 3.25% for the year ended December 31, 2013 and 3.30% for the year ended December 31, 2012.

When comparing the year ended December 31, 2014 to the year ended December 31, 2013, there was an overall $9.6 million increase in average interest-earning assets, driven by an increase of $57.1 million in investment securities, offset by a $23.9 million reduction in loans and a $23.6 million decrease in other interest-earning assets, primarily cash.

Interest expense decreased for the year ended December 31, 2014 when compared to the year ended December 31, 2013 due primarily to an overall decrease of $27.1 million on our average interest-bearing liabilities. The overall effect was a 6 basis point decrease in the average rate paid from 1.13% for 2013 to 1.07% for 2014. This decrease was due to a reduction of $47.2 million in certificates of deposit and a decrease of $1.9 million in borrowings, offset by an increase of $22.0 million in demand deposits, savings and money market accounts.

As shown below, the composition of total interest income between 2014 and 2013 remained relatively stable between interest and fees on loans and investment securities with a slight decline in interest and fees on loans offset by an increase in interest on investment securities.

| | % of Total Interest Income | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| Interest and fees on loans | 81 | % | 85 | % |
| Interest on investment securities | 18 | % | 14 | % |
| Other | 1 | % | 1 | % |

[29]

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 2014, 2013 and 2012. 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 2014, 2013 and 2012. 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**

**Table 1**

| | For the Years Ended December 31 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | | 2012 | | |
| (Dollars in thousands) | Average Balance | Interest | Average Yield/Rate | Average Balance | Interest | Average Yield/Rate | Average Balance | Interest | Average Yield/Rate |
| Assets | | | | | | | | | |
| Loans | $820,076 | $37,525 | 4.58% | $843,996 | $42,292 | 5.01% | $908,213 | $46,742 | 5.15% |
| Investment Securities: | | | | | | | | | |
| Taxable | 288,022 | 6,981 | 2.42 | 236,762 | 5,557 | 2.35 | 172,765 | 4,077 | 2.36 |
| Non taxable | 52,408 | 2,467 | 4.71 | 46,584 | 2,701 | 5.80 | 59,779 | 3,128 | 5.23 |
| Total | 340,430 | 9,448 | 2.78 | 283,346 | 8,258 | 2.91 | 232,544 | 7,205 | 3.10 |
| Federal funds sold | 37,069 | 84 | 0.23 | 56,363 | 141 | 0.25 | 58,645 | 138 | 0.24 |
| Interest-bearing deposits with other banks | 7,931 | 2 | 0.03 | 11,845 | 3 | 0.03 | 11,113 | 4 | 0.04 |
| Other interest earning assets | 7,599 | 291 | 3.83 | 7,995 | 199 | 2.49 | 9,762 | 167 | 1.71 |
| Total earning assets | 1,213,105 | 47,350 | 3.90% | 1,203,545 | 50,893 | 4.23% | 1,220,277 | 54,256 | 4.45% |
| Allowance for loan losses | (12,558) | | | (15,862) | | | (17,379) | | |
| Non-earning assets | 140,666 | | | 148,025 | | | 158,488 | | |
| Total Assets | $1,341,213 | | | $1,335,708 | | | $1,361,386 | | |
| | | | | | | | | | |
| Liabilities and Shareholders' Equity | | | | | | | | | |
| Interest-bearing demand deposits | $139,875 | $127 | 0.09% | $137,348 | $159 | 0.12% | $120,616 | $180 | 0.15% |
| Interest-bearing money markets | 214,268 | 501 | 0.23 | 205,608 | 464 | 0.23 | 203,497 | 424 | 0.21 |
| Savings deposits | 123,756 | 234 | 0.19 | 112,999 | 215 | 0.19 | 107,964 | 205 | 0.19 |
| Time deposits: | | | | | | | | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Less than $100k | 163,100 | 1,769 | 1.08 | 195,084 | 2,070 | 1.06 | 214,613 | 2,696 | 1.26 |
| $100k or more | 145,024 | 1,972 | 1.36 | 160,203 | 2,168 | 1.35 | 198,051 | 3,054 | 1.54 |
| Short-term borrowings | 45,997 | 63 | 0.14 | 47,829 | 62 | 0.13 | 38,875 | 133 | 0.34 |
| Long-term borrowings | 182,637 | 6,204 | 3.40 | 182,702 | 6,594 | 3.61 | 198,541 | 7,273 | 3.66 |
| Total interest-bearing liabilities | 1,014,657 | 10,870 | 1.07% | 1,041,773 | 11,732 | 1.13% | 1,082,157 | 13,965 | 1.29% |
| Non-interest-bearing deposits | 196,468 | | | 164,299 | | | 160,145 | | |
| Other liabilities | 19,254 | | | 29,141 | | | 21,258 | | |
| Shareholders' Equity | 110,834 | | | 100,495 | | | 97,826 | | |
| Total Liabilities and Shareholders' Equity | $1,341,213 | | | $1,335,708 | | | $1,361,386 | | |
| Net interest income and spread | | $36,480 | 2.83% | | $39,161 | 3.09% | | $40,291 | 3.16% |
| Net interest margin | | | 3.00% | | | 3.25% | | | 3.30% |

**Notes:**

(1) The above table reflects the average rates earned or paid stated on a FTE basis assuming a tax rate of 35% for 2014, 2013 and 2012. The FTE adjustments for the years ended December 31, 2014, 2013 and 2012 were $964, $979 and $1,145, respectively.

(2) The average balances of non-accrual loans for the years ended December 31, 2014, 2013 and 2012, which were reported in the average loan balances for these years, were $15,093, $18,343 and $29,208, respectively.

(3) Net interest margin is calculated as net interest income divided by average earning assets.

(4) The average yields on investments are based on amortized cost.

**Interest Variance Analysis (1)**

**Table 2**

| | 2014 Compared to 2013 | | | 2013 Compared to 2012 | | |
|---|---|---|---|---|---|---|
| (In thousands and tax equivalent basis) | Volume | Rate | Net | Volume | Rate | Net |
| Interest Income: | | | | | | |
| Loans | $(1,095) | $(3,672) | $(4,767) | $(3,218) | $(1,232) | $(4,450) |
| Taxable Investments | 1,242 | 182 | 1,424 | 1,502 | (22) | 1,480 |
| Non-taxable Investments | 274 | (508) | (234) | (765) | 338 | (427) |
| Federal funds sold | (44) | (13) | (57) | (6) | 9 | 3 |
| Other interest earning assets | (166) | 257 | 91 | (26) | 57 | 31 |
| Total interest income | 211 | (3,754) | (3,543) | (2,513) | (850) | (3,363) |
| Interest Expense: | | | | | | |
| Interest-bearing demand deposits | 15 | (47) | (32) | 4 | (25) | (21) |
| Interest-bearing money markets | 20 | 17 | 37 | 5 | 35 | 40 |
| Savings deposits | 20 | (1) | 19 | 10 | 0 | 10 |
| Time deposits less than $100 | (347) | 46 | (301) | (207) | (419) | (626) |
| Time deposits $100 or more | (206) | 10 | (196) | (512) | (374) | (886) |
| Short-term borrowings | (3) | 4 | 1 | 12 | (83) | (71) |
| Long-term borrowings | (2) | (388) | (390) | (572) | (107) | (679) |
| Total interest expense | (503) | (359) | (862) | (1,260) | (973) | (2,233) |
| Net interest income | $714 | $(3,395) | $(2,681) | $(1,253) | $123 | $(1,130) |

**Note:**

(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 $2.5 million for the year ended December 31, 2014 compared to $.4 million for the year ended December 31, 2013. During 2014, we continued to experience reductions in our total rolling historical loss rates and impact of the qualitative factors utilized in the determination of the ALL, as well as continued reduction in the level of classified and impaired assets (discussed below in the section entitled “FINANCIAL CONDITION” under the heading “Allowance and Provision for Loan Losses”). The higher provision expense was primarily due to higher net charge-offs of $4.0 million in 2014, compared to net charge-offs of $2.8 million in 2013, as well as the impact of higher loan balances in 2014. Management strives to ensure that the ALL reflects a level commensurate with the risk inherent in our loan portfolio.

**Other Operating Income**

The following table shows the major components of other operating income for the past two years, exclusive of net gains/(losses), and the percentage changes during these years:

| (Dollars in thousands) | 2014 | 2013 | % Change |
|---|---|---|---|
| Service charges on deposit accounts | $2,243 | $2,615 | -14.23 % |
| Other service charge income | 690 | 854 | -19.20 % |
| Debit card income | 2,034 | 1,954 | 4.09 % |
| Trust department income | 5,343 | 5,020 | 6.43 % |
| Bank owned life insurance (BOLI) income | 1,392 | 1,035 | 34.49 % |
| Brokerage commissions | 800 | 806 | -0.74 % |
| Other income | 564 | 853 | -33.88 % |
| Total other operating income | $13,066 | $13,137 | -0.54 % |

Other operating income, exclusive of gains, increased slightly by approximately $71,000 during 2014 when compared to 2013. The increase was attributable to the increase in BOLI income from a one-time death benefit of $.4 million received in December 2014. Trust department income increased $.3 million and debit card income increased $.1 million when comparing 2014 to 2013. These increases were offset by decreases in service charges on deposit accounts of $.4 million and other service charges of $.2 million and a decrease in other income of $.3 million. Trust assets under management were $702 million at December 31, 2014 and $675 million at December 31, 2013.

Net gains of $1.0 million were reported through other income during 2014, compared to net gains of $.2 million during 2013. The increase was due to increased gains on sales of investment securities when comparing 2014 to 2013.

**Other Operating Expense**

The following table compares the major components of other operating expense for 2014 and 2013:

| (Dollars in thousands) | 2014 | 2013 | % Change | |
|---|---|---|---|---|
| Salaries and employee benefits | $19,518 | $19,946 | -2.15 | % |
| Other expenses | 5,790 | 6,687 | -13.40 | % |
| FDIC premiums | 1,842 | 1,875 | -1.76 | % |
| Equipment | 2,508 | 2,595 | -3.35 | % |
| Occupancy | 2,468 | 2,628 | -6.09 | % |
| Data processing | 3,198 | 3,069 | 4.20 | % |
| Professional services | 1,287 | 1,495 | -13.91 | % |
| Other real estate owned expense | 2,318 | 2,909 | -20.32 | % |
| Contract labor | 669 | 615 | 8.80 | % |
| Line rentals | 656 | 652 | 0.61 | % |
| Total other operating expense | $40,254 | $42,471 | -5.22 | % |

Operating expenses decreased $2.2 million for the year ended December 31, 2014 when compared to the same period of 2013. This decrease was due to decreases of $.4 million in salaries and benefits, $.6 million in OREO expenses and $.7 million in other expenses. Declines in other expenses were due primarily to reduced personnel related expenses such as in house training, a decline in telephone expenses, and reduced fraud expenses related to debit cards.

**Applicable Income Taxes**

Due to decreased operating results in 2014, we recognized a tax expense of $1.3 million in 2014, compared to a net tax expense of $2.2 million in 2013. See the discussion under "Income Taxes" in Note 17 to the Consolidated Financial Statements presented elsewhere in this annual report for a detailed analysis of our deferred tax assets and liabilities. A valuation allowance has been provided for the $1.7 million in state tax loss carry forwards included in deferred tax assets, which will expire commencing in 2030.

At December 31, 2014, we had federal net operating losses ("NOLs") of approximately $12.0 million and West Virginia NOLs of approximately $5.3 million for which deferred tax assets of $4.2 million and $0.2 million, respectively, have

been recorded at December 31, 2014. The federal and West Virginia NOLs were created in 2010, 2012 and 2014 and will begin expiring in 2030. Management has determined that a deferred tax valuation allowance for these NOLs is not required for 2014 because we believe it is more likely than not that these deferred tax assets can be realized prior to expiration of their carry-forward periods.

At December 31, 2014, the Corporation had Maryland NOLs of $34.0 million for which a deferred tax asset of $1.7 million has been recorded. There has been and continues to be a full valuation allowance on these NOLs based on the fact that it is more likely than not that this deferred tax asset will not be realized because the Corporation files a separate Maryland income tax return, has recurring tax losses and will not generate sufficient taxable income in the future to utilize them before they expire beginning in 2019. The valuation allowance of $1.7 million at December 31, 2014 reflects an increase of $.1 million from the level at December 31, 2013.

In addition, we have concluded that no valuation allowance is deemed necessary for our remaining federal and state deferred tax assets at December 31, 2014, as it is more likely than not (defined a level of likelihood that is more than 50%) that they will be realized based on the expected reversal of deferred tax liabilities, the generation of future income sufficient to realize the deferred tax assets as they reverse, and the ability to implement tax planning strategies to prevent the expiration of any carry-forward periods. In making this determination, management considered the following:

- the expected reversal of $1.0 million of the total $3.8 million of deferred tax liabilities at December 31, 2014 in such a manner so as to substantially utilize the dollar for dollar impact against the deferred tax assets at December 31, 2014;
- for the remaining excess deferred tax assets that will not be utilized by the reversal of deferred tax liabilities, our expected future income will be sufficient to utilize the deferred tax assets as they reverse or before any net operating loss, if created, would expire; and
- tax planning strategies that can provide both one-time increases to taxable income of up to approximately $13.1 million and recurring annual decreases in unfavorable permanent items.

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We will need to generate future taxable income of approximately $49 million to fully utilize the Maryland net deferred tax assets in the years in which they are expected to reverse. Management estimates that we can fully utilize the deferred tax assets in approximately seven years based on the historical pre-tax income and forecasts of estimated future pre-tax income as adjusted for permanent book to tax differences.

## CONSOLIDATED BALANCE SHEET REVIEW

### Overview

Total assets remained stable at $1.3 billion at December 31, 2014 and December 31, 2013. When comparing 2014 to 2013, cash and interest-bearing deposits in other banks decreased $7.6 million, the investment portfolio decreased $9.9 million, and gross loans increased $29.8 million. We sold investments during 2014 in order to reduce interest rate volatility and to provide funding for higher yielding loans. OREO balances decreased $4.1 million due to sales of properties. Total liabilities decreased by $9.8 million for the year ended December 31, 2014 when compared to 2013 due primarily to a decrease of $9.8 million in accrued interest payable and other liabilities. Other liabilities decreased as a result of cash payments of accrued interest on the Trust Preferred Debentures and accrued cash dividends on the outstanding shares of Series A Preferred Stock dividend. Comparing December 31, 2014 to December 31, 2013, shareholders' equity increased $7.1 million as a result of a decrease of $4.0 million in accumulated other comprehensive loss.

The total interest-earning asset mix remained relatively stable at December 31, 2014 and December 31, 2013. The mix for each year is illustrated below:

| | Year End Percentage of Total Assets | |
|---|---|---|
| | 2014 | 2013 |
| Cash and cash equivalents | 3 % | 3 % |
| Net loans | 62 % | 60 % |
| Investments | 25 % | 26 % |

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

Year End Percentage of Total Liabilities

| | 2014 | | 2013 | |
|---|---|---|---|---|
| Total deposits | 80 | % | 79 | % |
| Total borrowings | 18 | % | 18 | % |

**Loan Portfolio**

The Bank is actively engaged in originating loans to customers primarily in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Berkeley 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. Generally, a 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 heading “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 any of the years presented.

**Summary of Loan Portfolio**

**Table 3**

The following table presents the composition of our loan portfolio for the past five years:

| (In millions) | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Commercial real estate | $256.1 | $268.0 | $298.8 | $336.2 | $348.6 |
| Acquisition and development | 99.3 | 107.2 | 128.4 | 142.9 | 156.9 |
| Commercial and industrial | 93.3 | 59.8 | 69.0 | 78.7 | 70.0 |
| Residential mortgage | 367.6 | 350.9 | 346.9 | 347.2 | 356.7 |
| Consumer | 23.7 | 24.3 | 31.7 | 33.7 | 77.6 |
| Total Loans | $840.0 | $810.2 | $874.8 | $938.7 | $1,009.8 |

Comparing December 31, 2014 to December 31, 2013, outstanding loans increased $29.8 million (3.7%). CRE loans decreased $11.9 million as a result of the payoffs of two large loans of approximately $15 million during the third quarter of 2014. A&D loans decreased $7.9 million due to regularly scheduled principal payments and payoffs. C&I loans increased $33.5 million due to new loan relationships, primarily one large relationship in the first quarter of 2014. Residential mortgage loans increased $16.7 million due to increased production of loans primarily in our 10/1 and 7/1 adjustable rate mortgage program. The Bank continues to use Fannie Mae for the majority of new, longer-term, fixed-rate residential loan originations. The consumer loan portfolio decreased slightly by $.6 million due to repayment activity in the indirect auto portfolio offsetting new production.

At December 31, 2014, approximately 44% of the commercial loan portfolio was collateralized by real estate, compared to approximately 57% at December 31, 2013.

Adjustable interest rate loans made up 64% of total loans at December 31, 2014 and 2013, with the balance being fixed–interest rate loans.

Comparing December 31, 2013 to December 31, 2012, outstanding loans decreased $64.6 million (7.4%). CRE loans decreased $30.8 million as a result of the payoff of several large loans and ongoing scheduled principal payments. A&D loans decreased $21.2 million due primarily to $5.0 million of principal amortization and $28.7 million of payoffs, offset by $17.9 million of new loans. C&I loans decreased $9.2 million due primarily to $8.7 million of payoffs and scheduled principal payments. Residential mortgage loans increased $4.0 million due to increased production of loans primarily in our 10/1 adjustable rate mortgage program, although production of new loans through Fannie Mae slowed during the third and fourth quarters of 2013. The consumer loan portfolio decreased $7.4 million due primarily to repayment activity in the indirect auto portfolio offsetting new production.

The following table sets forth the maturities, based upon contractual dates, for selected loan categories as of December 31, 2014:

**Maturities of Loan Portfolio at December 31, 2014**

**Table 4**

| (In thousands) | Maturing Within One Year | Maturing After One Year But Within Five Years | Maturing After Five Years | Total |
|---|---|---|---|---|
| Commercial Real Estate | $ 19,389 | $ 100,196 | $ 136,479 | $256,064 |
| Acquisition and Development | 32,139 | 19,777 | 47,385 | 99,301 |
| Commercial and Industrial | 23,130 | 44,641 | 25,484 | 93,255 |
| Residential Mortgage | 8,179 | 6,750 | 352,712 | 367,641 |
| Consumer | 4,155 | 16,189 | 3,386 | 23,730 |
| Total Loans | $ 86,992 | $ 187,553 | $ 565,446 | $839,991 |
| | | | | |
| Classified by Sensitivity to Change in Interest Rates | | | | |
| Fixed-Interest Rate Loans | 34,934 | 125,123 | 142,282 | 302,339 |
| Adjustable-Interest Rate Loans | 52,058 | 62,430 | 423,164 | 537,652 |
| Total Loans | $ 86,992 | $ 187,553 | $ 565,446 | $839,991 |

Management monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment has not been received for 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Our policy for recognizing interest income on impaired loans does not differ from our overall policy for interest recognition.

Table 5 sets forth the amounts of non-accrual, past-due and restructured loans for the past five years:

**Risk Elements of Loan Portfolio**

**Table 5**

| | At December 31, | | | | |
|---|---|---|---|---|---|
| (In thousands) | 2014 | 2013 | 2012 | 2011 | 2010 |
| Non-accrual loans: | | | | | |
| Commercial real estate | $5,762 | $7,433 | $6,194 | $10,069 | $11,893 |
| Acquisition and development | 3,609 | 5,632 | 10,778 | 14,938 | 16,269 |
| Commercial and industrial | 171 | 191 | 176 | 9,364 | 1,355 |
| Residential mortgage | 2,009 | 4,126 | 2,731 | 3,796 | 5,236 |
| Consumer | 0 | 14 | 36 | 21 | 152 |
| Total non-accrual loans | $11,551 | $17,396 | $19,915 | $38,188 | $34,905 |
| | | | | | |
| Accruing Loans Past Due 90 days or more: | | | | | |
| Commercial real estate | $0 | $65 | $0 | $0 | $0 |
| Acquisition and development | 1 | 282 | 200 | 128 | 128 |
| Commercial and industrial | 4 | 133 | 0 | 0 | 44 |
| Residential mortgage | 485 | 730 | 1,888 | 1,509 | 2,437 |
| Consumer | 39 | 24 | 58 | 142 | 183 |
| Total accruing loans past due 90 days or more | $529 | $1,234 | $2,146 | $1,779 | $2,792 |
| | | | | | |
| Total non-accrual and past due 90 days or more | $12,080 | $18,630 | $22,061 | $39,967 | $37,697 |
| | | | | | |
| Restructured Loans (TDRs): | | | | | |
| Performing | $7,621 | $10,567 | $12,134 | $10,657 | $5,506 |
| Non-accrual (included above) | 6,063 | 7,380 | 5,540 | 7,385 | 9,593 |
| Total TDRs | $13,684 | $17,947 | $17,674 | $18,042 | $15,099 |
| | | | | | |
| Other Real Estate Owned | $12,932 | $17,031 | $17,513 | $16,676 | $18,072 |
| | | | | | |
| Impaired loans without a valuation allowance | $19,937 | $24,296 | $39,361 | $41,778 | $42,890 |
| Impaired loans with a valuation allowance | 4,844 | 9,013 | 8,481 | 20,048 | 19,713 |
| Total impaired loans | $24,781 | $33,309 | $47,842 | $61,826 | $62,603 |
| Valuation allowance related to impaired loans | $1,236 | $2,283 | $1,632 | $3,951 | $4,366 |

Non-Accrual Loans as a % of Applicable Portfolio

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Commercial real estate | 2.3 % | 2.8 % | 2.1 % | 3.0 % | 3.4 % |

| | | | | | |
|---|---|---|---|---|---|
| Acquisition and development | 3.6 % | 5.3 % | 8.4 % | 10.5% | 10.4% |
| Commercial and industrial | 0.2 % | 0.3 % | 0.3 % | 11.9% | 1.9 % |
| Residential mortgage | 0.5 % | 1.2 % | 0.8 % | 1.1 % | 1.5 % |
| Consumer | 0.0 % | 0.1 % | 0.1 % | 0.1 % | 0.2 % |

Interest income not recognized as a result of placing loans on non-accrual status was $.8 million for the year ended December 31, 2014, and there was $.1 million of interest income recognized on a cash basis during 2014.

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Performing loans considered to be impaired (including performing troubled debt restructurings, or TDRs), as defined and identified by management, amounted to $13.2 million at December 31, 2014 and $15.9 million at December 31, 2013. Loans are identified as impaired when, based on current information and events, management determines that we will be unable to collect all amounts due according to contractual terms. These loans consist primarily of A&D loans and CRE 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 to repay the loan balance if liquidated and there is no secondary source of repayment available.

The level of performing impaired loans (other than performing TDRs) increased $.3 million during the year ended December 31, 2014, due to payoffs and principal reductions of $1.7 million, as well as the reclassification of seven loans totaling $1.3 million out of impaired status due to improved performance, offset by the addition of a $3.1 million non-owner occupied real estate loan, as well as two mortgage loans totaling $.2 million that were formerly reported as TDRs. Management will continue to monitor all loans that have been removed from an impaired status and take appropriate steps to ensure that satisfactory performance is sustained.

The following table presents the details of TDRs by loan class at December 31, 2014 and December 31, 2013:

| (Dollars in thousands) | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Number of Contracts | Recorded Investment | Number of Contracts | Recorded Investment |
| Performing | | | | |
| Commercial real estate | | | | |
| Non owner-occupied | 2 | $ 270 | 2 | $ 257 |
| All other CRE | 1 | 2,843 | 2 | 3,313 |
| Acquisition and development | | | | |
| 1-4 family residential construction | 1 | 790 | 1 | 1,547 |
| All other A&D | 4 | 2,154 | 7 | 3,867 |
| Commercial and industrial | 1 | 404 | 2 | 614 |
| Residential mortgage | | | | |
| Residential mortgage – term | 7 | 1,160 | 6 | 969 |
| Residential mortgage – home equity | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 |
| Total performing | 16 | $ 7,621 | 20 | $ 10,567 |
| | | | | |
| Non-accrual | | | | |
| Commercial real estate | | | | |
| Non owner-occupied | 1 | $ 458 | 1 | $ 448 |
| All other CRE | 4 | 2,073 | 3 | 2,217 |
| Acquisition and development 1-4 family residential construction | 0 | 0 | 0 | 0 |
| All other A&D | 4 | 3,139 | 4 | 4,075 |

| | | | | |
|---|---|---|---|---|
| Commercial and industrial | 1 | 171 | 0 | 0 |
| Residential mortgage | | | | |
| Residential mortgage – term | 1 | 222 | 3 | 640 |
| Residential mortgage – home equity | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 |
| Total non-accrual | 11 | 6,063 | 11 | 7,380 |
| Total TDRs | 27 | $ 13,684 | 31 | $ 17,947 |

The level of TDRs decreased $4.3 million during the year ended December 31, 2014. Two loans totaling $.2 million were added to performing TDRs, one loan totaling $.4 million was added to non-performing TDRs, and eight loans already in performing TDRs were re-modified. Two loans totaling $.2 million that had been modified prior to December 31, 2014 are no longer reported as performing TDRs because the borrowers had made at least six consecutive payments and were current at the time of reclassification. During the year ended December 31, 2014 there were charge-offs totaling $1.2 million to five non-performing loans and three loans totaling $1.6 million were transferred to OREO. Net principal payments and payoffs totaling $1.9 million were received during the same time period.

At December 31, 2014, additional funds of up to $10,400 were committed to be advanced in connection with TDRs. Interest income not recognized due to rate modifications of TDRs was $.1 million, and interest income recognized on all TDRs was $.4 million in 2014.

**Allowance for Loan Losses**

The ALL is maintained to absorb losses from the loan portfolio. The ALL 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.

The ALL is also 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 ALL. The methodology used to determine the adequacy of the ALL 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 ALL decreased to $12.1 million at December 31, 2014, compared to $13.6 million at December 31, 2013. The provision for loan losses for the year ended December 31, 2014 increased to $2.5 million from $.4 million for the year ended December 31, 2013. The higher provision expense was primarily due to higher net charge-offs of $4.0 million in 2014, compared to net charge-offs of $2.8 million in 2013, as well as the impact of higher loan balances in 2014. The ratio of the ALL to loans outstanding as of December 31, 2014 was 1.44%, which was lower than the 1.68% at December 31, 2013 due to the charge-off or removal of specific allocations as a result of changing circumstances, as well as the overall higher quality of the loan portfolio in 2014.

The ratio of net charge-offs to average loans for the year ended December 31, 2014 was .49%, compared to .34% for the year ended December 31, 2013. Relative to December 31, 2013, two segments of loans, C&I and consumer, showed improvement. The CRE portfolio had an annualized net charge-off rate of .18% as of December 31, 2014, compared to an annualized net recovery rate of .27% as of December 31, 2013, which was driven by an $.8 million partial recovery on a non-owner occupied CRE loan that was repaid during 2013. The annualized net charge-off rate for A&D loans as of December 31, 2014 was 2.46% compared to an annualized net charge-off rate of 1.78% as of December 31, 2013, due to partial charge-offs on several projects and individual loans due to declining appraisal values. The ratios for C&I loans were .31% and 1.53% for December 31, 2014 and December 31, 2013, respectively. The residential mortgage loan ratios were .17% and .08% for December 31, 2014 and December 31, 2013, respectively, and the consumer loan ratios were .71% and .83% for December 31, 2014 and December 31, 2013, respectively.

Accruing loans past due 30 days or more declined to 1.62% of the loan portfolio at December 31, 2014, compared to 2.10% at December 31, 2013. The decrease for 2014 was primarily due to a decrease in past-due accruing residential mortgage term and all other A&D loans. Other improvements in the levels of past-due loans were attributable to a combination of a slowly improving economy and vigorous collection efforts by the Bank.

Non-accrual loans totaled $11.6 million at December 31, 2014, compared to $17.4 million at December 31, 2013. Non-accrual loans which have been subject to a partial charge-off totaled $4.6 million at December 31, 2014, compared to $1.9 million at December 31, 2013.

Management believes that the ALL at December 31, 2014 is adequate to provide for probable losses inherent in our loan portfolio. Amounts that will be recorded for the provision for loan losses in future periods will depend upon trends in the loan balances, including the composition of the loan portfolio, changes in loan quality and loss experience trends, potential recoveries on previously charged-off loans and changes in other qualitative factors. Management also applies interest rate risk, collateral value and debt service sensitivity analyses to the CRE loan portfolio and obtains new appraisals on specific loans under defined parameters to assist in the determination of the periodic provision for loan losses.

Comparing 2013 to 2012, the ALL decreased to $13.6 million at December 31, 2013, compared to $16.0 million at December 31, 2012. The provision for loan losses for the year ended December 31, 2013 decreased to $.4 million from $9.4 million for the year ended December 31, 2012. Net charge-offs decreased to $2.8 million for the year ended December 31, 2013, compared to $12.8 million for the year ended December 31, 2012. Included in the net charge-offs for the year ended December 31, 2013 were a $1.8 million partial charge-off on an A&D loan and an $.8 million charge-off of a C&I loan, which were partially offset by an $.8 million partial recovery on a non owner-occupied CRE loan that was repaid during the year. The lower provision expense was primarily due to the lower net charge-offs and the impact of lower loan balances. The ratio of the ALL to loans outstanding as of December 31, 2013 was 1.68%, which was lower than the 1.83% at December 31, 2012 due to the charge-off or removal of specific allocations as a result of changing circumstances.

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**

**Table 6**

| | For the Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| (In thousands) | 2014 | 2013 | 2012 | 2011 | 2010 |
| Balance, January 1 | $13,594 | $16,047 | $19,480 | $22,138 | $20,090 |
| Charge-offs: | | | | | |
| Commercial real estate | (485) | (233) | (2,289) | (6,886) | (543) |
| Acquisition and development | (2,673) | (2,200) | (809) | (3,055) | (9,770) |
| Commercial and industrial | (266) | (1,066) | (9,402) | (840) | (2,225) |
| Residential mortgage | (847) | (485) | (1,314) | (1,664) | (2,008) |
| Consumer | (512) | (590) | (650) | (893) | (1,791) |
| Total charge-offs | (4,783) | (4,574) | (14,464) | (13,338) | (16,337) |
| Recoveries: | | | | | |
| Commercial real estate | 11 | 1,004 | 156 | 95 | 94 |
| Acquisition and development | 133 | 100 | 420 | 322 | 1,097 |
| Commercial and industrial | 26 | 79 | 464 | 57 | 538 |
| Residential mortgage | 229 | 199 | 177 | 550 | 391 |
| Consumer | 342 | 359 | 424 | 499 | 539 |
| Total recoveries | 741 | 1,741 | 1,641 | 1,523 | 2,659 |
| Net credit losses | (4,042) | (2,833) | (12,823) | (11,815) | (13,678) |
| Provision for loan losses | 2,513 | 380 | 9,390 | 9,157 | 15,726 |
| Balance at end of period | $12,065 | $13,594 | $16,047 | $19,480 | $22,138 |
| | | | | | |
| Allowance for loan losses to loans outstanding (as %) | 1.44 % | 1.68 % | 1.83 % | 2.08 % | 2.19 % |
| Net charge-offs to average loans outstanding during the period (as %) | 0.49 % | 0.34 % | 1.41 % | 1.24 % | 1.28 % |

Table 7 presents management's allocation of the ALL by major loan category in comparison to that loan category's percentage of total loans. Changes in the allocation over time reflect changes in the composition of the loan portfolio risk profile and refinements to the methodology of determining the ALL. Specific allocations in any particular category may be reallocated in the future as needed to reflect current conditions. Accordingly, the entire ALL is considered available to absorb losses in any category.

**Allocation of the Allowance for Loan Losses**

**Table 7**

| | For the Years Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (In thousands) | 2014 | % of Total Loans | 2013 | % of Total Loans | 2012 | % of Total Loans | 2011 | % of Total Loans | 2010 | % of Total Loans |
| Commercial real estate | $2,424 | 30 % | $4,052 | 33 % | $5,206 | 34 % | $6,218 | 36 % | $8,658 | 35 % |
| Acquisition and development | 3,912 | 12 % | 4,172 | 13 % | 5,029 | 15 % | 7,190 | 15 % | 6,345 | 16 % |
| Commercial and industrial | 1,680 | 11 % | 766 | 8 % | 906 | 8 % | 2,190 | 8 % | 1,345 | 7 % |
| Residential mortgage | 3,862 | 44 % | 4,320 | 43 % | 4,507 | 39 % | 3,430 | 37 % | 4,211 | 35 % |
| Consumer | 187 | 3 % | 284 | 3 % | 399 | 4 % | 452 | 4 % | 1,579 | 7 % |
| Total | $12,065 | 100% | $13,594 | 100 % | $16,047 | 100 % | $19,480 | 100 % | $22,138 | 100 % |

[39]

**Investment Securities**

The following table sets forth the composition of our securities portfolio by major category as of the indicated dates:

**Table 8**

| (In thousands) | At December 31, 2014 | | | **2013** | | | **2012** | | |
|---|---|---|---|---|---|---|---|---|---|
| | Amortized Cost | Fair Value (FV) | FV As % of Total | Amortized Cost | Fair Value (FV) | FV As % of Total | Amortized Cost | Fair Value (FV) | FV AS % of Total |
| Securities Available-for-Sale: | | | | | | | | | |
| U.S. treasuries | $29,607 | $29,596 | 13 % | $0 | $0 | 0 % | $0 | $0 | 0 % |
| U.S. government agencies | 39,077 | 38,941 | 18 % | 97,242 | 92,035 | 27 % | 40,334 | 40,320 | 18 % |
| Residential mortgage-backed agencies | 45,175 | 45,273 | 21 % | 116,933 | 112,444 | 33 % | 43,596 | 44,108 | 20 % |
| Commercial mortgage-backed agencies | 26,007 | 25,957 | 12 % | 31,025 | 29,905 | 9 % | 37,330 | 37,618 | 17 % |
| Collateralized mortgage obligations | 8,611 | 8,707 | 4 % | 30,468 | 29,390 | 9 % | 31,836 | 31,731 | 14 % |
| Obligations of states and political subdivisions | 46,151 | 47,304 | 21 % | 55,505 | 55,277 | 17 % | 55,212 | 58,054 | 26 % |
| Collateralized debt obligations | 37,117 | 25,339 | 11 % | 37,146 | 17,538 | 5 % | 36,798 | 11,442 | 5 % |
| Total available for sale | $231,745 | $221,117 | 100 % | $368,319 | $336,589 | 100 % | $245,106 | $223,273 | 100 % |
| Securities Held to Maturity: | | | | | | | | | |
| U.S. government agencies | $24,520 | $25,034 | 23 % | $0 | $0 | 0 % | $0 | $0 | 0 % |
| Residential mortgage-backed agencies | 58,400 | 59,008 | 53 % | 0 | 0 | 0 % | 0 | 0 | 0 % |
| Commercial mortgage-backed agencies | 16,425 | 16,737 | 15 % | 0 | 0 | 0 % | 0 | 0 | 0 % |

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Collateralized mortgage obligations | 7,379 | 7,384 | 7 | % | 0 | 0 | 0 | % | 0 | 0 | 0 | % |
| Obligations of states and political subdivisions | 2,725 | 2,608 | 2 | % | 3,900 | 3,590 | 100 | % | 4,040 | 4,347 | 100 | % |
| Total held to maturity | $109,449 | $110,771 | 100 | % | $3,900 | $3,590 | 100 | % | $4,040 | $4,347 | 100 | % |

Total fair value of investment securities at December 31, 2014 decreased $8.3 million when compared to the balance at December 31, 2013. At December 31, 2014, the securities classified as available-for-sale included a net unrealized loss of $10.6 million, which represents the difference between the fair value and amortized cost of securities in the portfolio and is primarily attributable to our CDOs. On June 1, 2014, management reclassified an amortized cost basis of $107.6 million of available-for-sale securities to held to maturity. The unrealized loss of approximately $4.0 million, at the date of transfer, will continue to be reported in a separate component of shareholders' equity as accumulated other comprehensive income and will be amortized over the remaining life of the securities as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

As discussed in Note 24 to the Consolidated Financial Statements, we measure fair market values based on the fair value hierarchy established in ASC Topic 820, *Fair Value Measurements and Disclosures*. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Level 3 prices or valuation techniques require inputs that are both significant to the valuation assumptions and are not readily observable in the market (i.e. supported with little or no market activity). These Level 3 instruments are valued based on both observable and unobservable inputs derived from the best available data, some of which is internally developed, and considers risk premiums that a market participant would require.

Approximately $195.8 million of the available-for-sale portfolio was valued using Level 2 pricing and had net unrealized gains of $1.2 million at December 31, 2014. The remaining $25.3 million of the securities available-for-sale represents the entire CDO portfolio, which was valued using significant unobservable inputs, or Level 3 pricing. The $11.8 million in net unrealized losses associated with the CDO portfolio relates to 17 pooled trust preferred securities. Unrealized losses of $6.2 million represent non-credit related OTTI charges on 12 of the securities, while $5.6 million of unrealized losses relates to five securities which have no credit related OTTI. The unrealized losses on these securities are primarily attributable to continued depression in the marketability and liquidity associated with CDOs.

The following table provides a summary of the trust preferred securities in the CDO portfolio and the credit status of the securities as of December 31, 2014.

**Level 3 Investment Securities Available for Sale**

**(Dollars in Thousands)**

| Investment Description | | First United Level 3 Investments | | | | Security Credit Status | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Deal | Class | Amortized Cost | Fair Market Value | Unrealized Gain/(Loss) | Lowest Credit Rating | Original Collateral | Deferrals/ Defaults as % of Original Collateral | Performing Collateral | Collateral Support | Collateral Support as % of Performing Collateral | Number of Performing Issuers/Total Issuers |
| Preferred Term Security XI* | B-1 | 1,339 | 735 | (604 ) | C | 635,775 | 16.12 % | 385,575 | (48,350 ) | -12.54 % | 43/56 |
| Preferred Term Security XVI* | C | 479 | 1,397 | 918 | C | 606,040 | 33.25 % | 331,800 | (101,885) | -30.71 % | 36/54 |
| Preferred Term Security XVIII* | C | 3,059 | 1,596 | (1,463 ) | C | 676,565 | 22.51 % | 420,014 | (39,127 ) | -9.32 % | 50 / 70 |
| Preferred Term Security XVIII | C | 2,185 | 1,064 | (1,121 ) | C | 676,565 | 22.51 % | 420,014 | (39,127 ) | -9.32 % | 50/70 |
| Preferred Term Security XIX* | C | 3,104 | 1,873 | (1,231 ) | C | 700,535 | 10.66 % | 485,061 | (40,196 ) | -8.29 % | 50/62 |
| Preferred Term Security XIX* | C | 1,343 | 803 | (540 ) | C | 700,535 | 10.66 % | 485,061 | (40,196 ) | -8.29 % | 50/62 |
| Preferred Term Security XIX* | C | 1,345 | 803 | (542 ) | C | 700,535 | 10.66 % | 485,061 | (40,196 ) | -8.29 % | 50/62 |
| | C | 2,254 | 1,338 | (916 ) | C | 700,535 | 10.66 % | 485,061 | (40,196 ) | -8.29 % | 50/62 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Preferred Term Security XIX* | | | | | | | | | | | |
| Preferred Term Security XXII* | C-1 | 3,998 | 2,936 | (1,062) | C | 1,386,600 | 19.76% | 947,100 | (37,187) | -3.93% | 65/86 |
| Preferred Term Security XXII* | C-1 | 1,599 | 1,174 | (425) | C | 1,386,600 | 19.76% | 947,100 | (37,187) | -3.93% | 65/86 |
| Preferred Term Security XXIII | C-1 | 1,953 | 932 | (1,021) | C | 1,467,000 | 20.31% | 892,169 | (29,520) | -3.31% | 87/108 |
| Preferred Term Security XXIII* | D-1 | 2,561 | 2,739 | 178 | C | 1,467,000 | 20.31% | 892,169 | (147,116) | -16.49% | 87/108 |
| Preferred Term Security XXIII* | D-1 | 854 | 913 | 59 | C | 1,467,000 | 20.31% | 892,169 | (147,116) | -16.49% | 87/108 |
| Preferred Term Security XXIV* | C-1 | 1,044 | 529 | (515) | C | 1,050,600 | 32.39% | 627,334 | (177,995) | -28.37% | 56/84 |
| Preferred Term Security I-P-I | B-2 | 2,000 | 1,504 | (496) | CCC- | 351,000 | 9.26% | 155,800 | 14,635 | 9.39% | 14/16 |
| Preferred Term Security I-P-IV | B-1 | 3,000 | 1,876 | (1,124) | CCC- | 325,000 | 0.00% | 157,500 | 35,168 | 22.33% | 17/17 |
| Preferred Term Security I-P-IV | B-1 | 5,000 | 3,127 | (1,873) | CCC- | 325,000 | 0.00% | 157,500 | 35,168 | 22.33% | 17/17 |
| Total Level 3 Securities Available for Sale | | 37,117 | 25,339 | (11,778) | | | | | | | |

* Security has been deemed other-than-temporarily impaired and loss has been recognized in accordance with ASC Section 320-10-35.

The terms of the debentures underlying trust preferred securities allow the issuer of the debentures to defer interest payments for up to 20 quarters, and, in such case, the terms of the related trust preferred securities require their issuers to contemporaneously defer dividend payments. The issuers of the trust preferred securities in our investment portfolio have defaulted and/or deferred payments, ranging from 0.00% to 33.25% of the total collateral balances underlying the securities. The securities were designed to include structural features that provide investors with credit enhancement or support to provide default protection by subordinated tranches. These features include over-collateralization of the notes or subordination, excess interest or spread which will redirect funds in situations where collateral is insufficient, and a specified order of principal payments. There are securities in our portfolio that are under-collateralized, which does represent additional stress on our tranche. However, in these cases, the terms of the securities require excess interest to be redirected from subordinate tranches as credit support, which provides additional support to our investment.

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of ASC Topic 320 (Section 320-10-35), management must assess whether (i) we have the intent to sell the security and (ii) it is more likely than not that we will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair value of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses. The other losses are recognized in other comprehensive income. In estimating OTTI charges, management considers (a) the length of time and the extent to which the fair value has been less than cost, (b) adverse conditions specifically related to the security, an industry, or a geographic area, (c) the historic and implied volatility of the security, (d) changes in the rating of a security by a rating agency, (e) recoveries or additional declines in fair value subsequent to the balance sheet date, (f) failure of the issuer of the security to make scheduled interest payments, and (g) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Due to the duration and the significant market value decline in the pooled trust preferred securities held in our portfolio, we performed more extensive testing on these securities for purposes of evaluating whether or not an OTTI has occurred.

The market for these securities as of December 31, 2014 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as no new CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities, or any securities other than those issued or guaranteed by the Treasury, are very depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (i) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at December 31, 2014, (ii an income valuation approach technique (i.e. present value) that maximizes the use of relevant unobservable inputs and minimizes the use of observable inputs will be equally or more representative of fair value than a market approach, and (iii) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management utilizes an independent third party to prepare both the evaluations of OTTI and the fair value determinations for the CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between December 31, 2013 and December 31, 2014.

The approach used by the third party to determine fair value involved several steps, including detailed credit and structural evaluation of each piece of collateral in each bond, default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that no securities had credit-related OTTI during 2014.

On December 10, 2013, to implement Section 619 of the Dodd-Frank Act, the four federal banking regulatory agencies and the SEC adopted the Volcker Rule. The Volcker Rule prohibits a banking institution from acquiring or retaining an “ownership interest” in a “covered fund”. A “covered fund” is (i) an entity that would be an investment company under the Investment Company Act of 1940, as amended, but for the exemptions contained in Section 3(c)(1) or Section 3(c)(7) of that Act, (ii) a commodity pool with certain characteristics, and/or (iii) a non-US entity with certain characteristics that is sponsored or owned by a banking entity located or organized in the US. The term “ownership interest” is defined as “any equity, partnership, or other similar interest.”

On January 14, 2014, the federal banking agencies adopted a final interim rule that exempts CDOs from the scope of the Volcker Rule if they were issued in offerings in which, among other things, the proceeds were used primarily to purchase securities issued by depository institutions and their affiliates. In connection with that final interim rule, the agencies published a non-exclusive list of exempt offerings. Of the 18 CDOs held by the Bank, 15 were issued in exempt offerings. The three remaining CDOs are collateralized primarily by securities issued by insurance companies and are not included in the agencies’ list of exempt offerings, which fact required management to make a determination as to whether the CDOs constituted an “ownership interest” in a “covered fund”, such that the Bank would be required to dispose of them pursuant to the Volcker Rule. To make this determination, management conducted a thorough review of the Indentures that govern the CDOs and the other offering materials used by the issuers to offer and sell the CDOs.

The Volcker Rule defines an “ownership interest” as an equity, partnership or other similar interest. The CDOs are debt securities (promissory notes) issued by corporations that call for regularly-scheduled payments of principal and interest, with interest calculated either at a fixed-rate or at a rate that is tied to LIBOR. Accordingly, none of the CDOs represent an equity or partnership interest in the issuers. In their adopting rule release, the agencies stated that debt

securities evidencing “typical extensions of credit” – those that “provide for payment of stated principal and interest calculated at a fixed rate or at a floating rate based on an index or interbank rate” – do not generally meet the definition of “other similar interest”. To be considered an “other similar interest”, a debt security must exhibit one or more of seven specified characteristics identified in the Volcker Rule on a current, future, or contingent basis:

Based on its review, management concluded that the three CDOs evidence “typical extensions of credit” and do not exhibit any of these seven characteristics. Accordingly, management concluded that none of these CDOs constitutes an “ownership interest” as defined by the Volcker Rule and that, therefore, as of December 31, 2014, the Corporation has the current intent and ability to hold these CDOs until maturity.

During the first quarter of 2014 and following the promulgation of the Volcker Rule, the fair value of the CDO portfolio improved significantly. The improvement was due to several factors including improved financial condition of the issuers, improved cash flows and a lower discount rate. As the issuers resumed payments of previously deferred interest during the quarter, cash flow projections for the securities increased. In addition, the discount rate utilized in the cash flow models was reduced as the base line current market yield for comparable corporate and structured products improved and the projected credit performance of the CDOs improved with favorable market conditions. The resulting increase in cash flow projections over the remaining life of the securities yielded a higher fair market value.

The risk-based capital ratios require that banks set aside additional capital for securities that are rated below investment grade. Securities rated one level below investment grade require a 200% risk weighting. As of December 31, 2014, we did not hold any investments that require the 200% risk weighting. Additional methods are applicable to securities rated more than one level below investment grade. As of December 31, 2014, there were 4 CDOs in the portfolio that exceeded a gross up value of 12.5% utilizing the direct reduction method.

Table 9 sets forth the contractual or estimated maturities of the components of our securities portfolio as of December 31, 2014 and the weighted average yields on a tax-equivalent basis.

**Investment Security Maturities, Yields, and Fair Values at December 31, 2014**

**Table 9**

| (In thousands) | Within 1 Year | 1 Year To 5 Years | 5 Years To 10 Years | Over 10 Years | Total Fair Value |
|---|---|---|---|---|---|
| Securities Available-for-Sale: | | | | | |
| U.S. treasuries | $ 19,524 | $ 10,072 | $ 0 | $ 0 | $ 29,596 |
| U.S. government agencies | 0 | 30,007 | 8,934 | 0 | 38,941 |
| Residential mortgage-backed agencies | 0 | 15,531 | 20,993 | 8,749 | 45,273 |
| Commercial mortgage-backed agencies | 0 | 16,505 | 9,452 | 0 | 25,957 |
| Collateralized mortgage obligations | 731 | 3,366 | 0 | 4,610 | 8,707 |
| Obligations of states and political subdivisions | 0 | 4,687 | 20,874 | 21,743 | 47,304 |
| Collateralized debt obligations | 0 | 0 | 0 | 25,339 | 25,339 |
| Total available for sale | $ 20,255 | $ 80,168 | $ 60,253 | $ 60,441 | $ 221,117 |
| | | | | | |
| Percentage of total | 9.16 % | 36.26 % | 27.25 % | 27.33 % | 100.00 % |
| Weighted average yield | 0.16 % | 2.34 % | 4.43 % | 3.67 % | 3.07 % |
| | | | | | |
| Held to Maturity: | | | | | |
| U.S. government agencies | $ 0 | $ 0 | $ 15,775 | $ 9,259 | $ 25,034 |
| Residential mortgage-backed agencies | 0 | 0 | 40,743 | 18,265 | 59,008 |
| Commercial mortgage-backed agencies | 0 | 0 | 16,737 | 0 | 16,737 |
| Collateralized mortgage obligations | 0 | 0 | 7,384 | 0 | 7,384 |
| Obligations of states and political subdivisions | 0 | 0 | 0 | 2,608 | 2,608 |
| Total held to maturity | $ 0 | $ 0 | $ 80,639 | $ 30,132 | $ 110,771 |
| | | | | | |
| Percentage of total | 0.00 % | 0.00 % | 72.80 % | 27.20 % | 100.00 % |
| Weighted average yield | 0.00 % | 0.00 % | 2.91 % | 3.17 % | 2.98 % |

The weighted average yield was calculated using historical cost balances and does not give effect to changes in fair value. At December 31, 2014, we did not hold any securities in the name of any one issuer exceeding 10% of shareholders' equity.

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**Deposits**

Table 10 sets forth the actual and average deposit balances by major category for 2014, 2013 and 2012:

**Deposit Balances**

**Table 10**

| (In thousands) | 2014 Actual Balance | 2014 Average Balance | 2014 Average Yield | 2013 Actual Balance | 2013 Average Balance | 2013 Average Yield | 2012 Actual Balance | 2012 Average Balance | 2012 Average Yield |
|---|---|---|---|---|---|---|---|---|---|
| Non-interest-bearing demand deposits | $201,188 | $196,468 | 0.00 % | $175,863 | $164,299 | 0.00 % | $161,500 | $160,145 | 0.00 % |
| Interest-bearing deposits: | | | | | | | | | |
| Demand | 134,302 | 139,875 | 0.09 % | 142,711 | 137,348 | 0.13 % | 119,306 | 120,616 | 0.15 % |
| Money Market: | | | | | | | | | |
| Retail | 224,699 | 214,268 | 0.23 % | 215,842 | 205,608 | 0.23 % | 202,678 | 203,497 | 0.21 % |
| Brokered | 0 | 0 | 0.00 % | 0 | 0 | 0.00 % | 0 | 0 | 0.00 % |
| Savings deposits | 129,392 | 123,756 | 0.19 % | 116,345 | 112,999 | 0.19 % | 109,740 | 107,964 | 0.19 % |
| Time deposits less than $100K | 146,764 | 163,100 | 1.08 % | 169,136 | 195,084 | 1.06 % | 188,341 | 214,613 | 1.26 % |
| Time deposits $100K or more: | | | | | | | | | |
| Retail | 141,455 | 140,489 | 1.36 % | 151,928 | 149,285 | 1.35 % | 164,085 | 158,298 | 1.72 % |
| Brokered/CDARS | 3,523 | 4,535 | 0.11 % | 5,578 | 10,918 | 0.19 % | 31,234 | 39,753 | 0.84 % |
| Total Deposits | $981,323 | $982,491 | | $977,403 | $975,541 | | $976,884 | $1,004,886 | |

Total deposits increased $3.9 million at December 31, 2014 when compared to December 31, 2013. With our continued focus on changing the mix of our deposit portfolio away from higher cost certificates of deposit and toward lower cost money market and transaction accounts, we have seen increases in core deposits and reductions in certificates of deposit. Non-interest bearing deposits increased $25.3 million. Traditional savings accounts increased $13.0 million due to continued growth in our Prime Saver product. Total demand deposits decreased $8.4 million and total money market accounts increased $8.9 million. Time deposits less than $100,000 declined $22.4 million and time deposits greater than $100,000 decreased $12.5 million.

The following table sets forth the maturities of time deposits of $100,000 or more:

**Maturity of Time Deposits of $100,000 or More**

**Table 11**

| (In thousands) | December 31, 2014 |
|---|---|
| Maturities | |
| 3 Months or Less | $21,607 |
| 3-6 Months | 17,714 |
| 6-12 Months | 31,475 |
| Over 1 Year | 74,182 |
| Total | $144,978 |

**Borrowed Funds**

The following shows the composition of our borrowings at December 31:

| (In thousands) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Securities sold under agreements to repurchase | $39,801 | $43,676 | $39,257 |
| Total short-term borrowings | $39,801 | $43,676 | $39,257 |
| | | | |
| Long-term FHLB advances | $135,876 | $135,942 | $136,005 |
| Junior subordinated debentures | 46,730 | 46,730 | 46,730 |
| Total long-term borrowings | $182,606 | $182,672 | $182,735 |
| | | | |
| Total borrowings | $222,407 | $226,348 | $221,992 |
| | | | |
| Average balance (from Table 1) | $228,634 | $230,531 | $237,416 |

The following is a summary of short-term borrowings at December 31 with original maturities of less than one year:

| (Dollars in thousands) | 2014 | 2013 | 2012 |
|---|---|---|---|
| Securities sold under agreements to repurchase: | | | |
| Outstanding at end of year | $39,801 | $43,676 | $39,257 |
| Weighted average interest rate at year end | 0.15 % | 0.14 % | 0.34 % |
| Maximum amount outstanding as of any month end | $53,819 | $61,354 | $52,367 |
| Average amount outstanding | 45,702 | 48,299 | 38,812 |
| Approximate weighted average rate during the year | 0.13 % | 0.13 % | 0.34 % |

Total borrowings decreased by $3.9 million, or 1.7%, in 2014 when compared to 2013, while the average balance of borrowings decreased by $1.9 million during the same period. The decrease was due to a $3.9 million decrease in our Treasury Management product combined with a decrease of $66 thousand in long-term borrowings due to scheduled monthly amortization of long-term advances.

Total borrowings increased by $4.4 million, or 2.0%, in 2013 when compared to 2012, while the average balance of borrowings decreased by $6.9 million during the same period. The increase was due to a $4.4 million increase in our Treasury Management product which was offset slightly by a decrease of $63 thousand in long-term borrowings due to scheduled monthly amortization of long-term advances.

Management will continue to closely monitor interest rates within the context of its overall asset-liability management process. See the discussion under the heading "Interest Rate Sensitivity" in this Item 7 for further information on this topic.

As of December 31, 2014, we had additional borrowing capacity with the FHLB totaling $32.7 million, an additional $70 million of unused lines of credit with various financial institutions, $26.9 million of an unused secured line of credit with the Federal Reserve Bank and approximately $49 million available through wholesale money market funds. See Note 12 to the Consolidated Financial Statements presented elsewhere in this annual report for further details about our borrowings and additional borrowing capacity, which is incorporated herein by reference.

**Capital Resources**

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdraw demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not

adequate to fund our capital requirements, we can rely on the funding sources identified below under the heading "Liquidity Management". At December 31, 2014, the Bank had $70 million available through unsecured lines of credit with correspondent banks, $26.9 million available through a secured line of credit with the Fed Discount Window and approximately $32.7 million available through the FHLB**.** Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

In addition to operational requirements, the Bank and the Corporation are subject to risk-based capital regulations, which were adopted and are monitored by federal banking regulators. These regulations are used to evaluate capital adequacy and require an analysis of an institution's asset risk profile and off-balance sheet exposures, such as unused loan commitments and stand-by letters of credit. The regulations require that a portion of total capital be Tier 1 capital, consisting of common shareholders' equity, the qualifying portion of trust issued preferred securities, and perpetual preferred stock, less goodwill and certain other deductions. The remaining capital, or Tier 2 capital, consists of subordinated debt, mandatory convertible debt, the remaining portion of trust issued preferred securities, grandfathered senior debt and the ALL, subject to certain limitations.

Banking organizations are currently required to maintain a minimum 8% (10% for well capitalized banks) total risk-based capital ratio (total qualifying capital divided by risk-weighted assets), including a Tier 1 ratio of 4% (6% for well capitalized banks). The risk-based capital rules have been further supplemented by a leverage ratio, defined as Tier I capital divided by average assets, after certain adjustments. The minimum leverage ratio is 4% (5% for well capitalized banks) for banking organizations that do not anticipate significant growth and have well-diversified risk (including no undue interest rate risk exposure), excellent asset quality, high liquidity and good earnings. Other banking organizations not in this category are expected to have ratios of at least 4-5%, depending on their particular condition and growth plans. Regulators may require higher capital ratios when warranted by the particular circumstances or risk profile of a given banking organization. In the current regulatory environment, banking organizations must stay well capitalized in order to receive favorable regulatory treatment on acquisition and other expansion activities and favorable risk-based deposit insurance assessments. Our capital policy establishes guidelines meeting these regulatory requirements and takes into consideration current or anticipated risks as well as potential future growth opportunities.

At December 31, 2014, the Corporation's total risk-based capital ratio was 15.40% and the Bank's total risk-based capital ratio was 15.60%, both of which were well above the regulatory minimum of 8%. The total risk-based capital ratios of the Corporation and the Bank at December 31, 2013 were 15.33% and 16.22%, respectively. The increase for the Corporation in 2014 was due to a change in composition of risk based assets as well as the increase in net income.

At the Bank level, the ratios declined slightly from December 31, 2013 to December 31, 2014 primarily because of the Bank's payment in 2014 of approximately $11.0 million in cash dividends to the Corporation, which were used to pay all deferred interest and dividends and to make quarterly interest payments due under the TPS Debentures and quarterly dividends due on the outstanding shares of Series A Preferred Stock.

As of December 31, 2014, the most recent notification from the regulators categorizes the Corporation and the Bank as "well capitalized" under the regulatory framework for prompt corrective action. See Note 4 to the Consolidated Financial Statements presented elsewhere in this annual report for additional information regarding regulatory capital ratios.

The current capital regime will significantly change when the Basel III Capital Rules are phased in starting on January 1, 2015. These changes are discussed in Item 1 of Part I of this annual report under the heading, "**Capital Requirements**".

In January 2009, pursuant to the TARP CPP, the Corporation sold 30,000 shares of its Series A Preferred Stock and a Warrant to purchase 326,323 shares of its common stock, having an exercise price of $13.79 per share, to the Treasury for an aggregate purchase price of $30 million. The proceeds from this transaction count as Tier 1 capital and the Warrant qualifies as tangible common equity. Information about the terms of these securities is provided in Note 13 to the consolidated financial statements.

The terms of the Series A Preferred Stock call for the payment, if declared by the Corporation's Board of Directors, of cash dividends on February 15$^{th}$, May 15$^{th}$, August 15$^{th}$ and November 15$^{th}$ of each year. On November 15, 2010, at the request of the Reserve Bank, the Corporation's Board of Directors voted to suspend quarterly cash dividends on the Series A Preferred Stock beginning with the dividend payment due November 15, 2010. During the suspension, dividends of $.4 million per dividend period continued to accrue. In April 2014, the Corporation received approval from the Reserve Bank to terminate this deferral by making a $6.5 million payment to the Treasury, representing the quarterly dividend payment due in May 2014 and all unpaid dividends that accrued during the suspension period. In July 2014, November 2014 and January 2015, the Corporation received approvals to pay the $.7 million in quarterly dividends due in each of August 2014, November 2014 and February 2015, respectively.

At the request of the Reserve Bank in December 2010, the Corporation's Board of Directors elected to defer quarterly interest payments under the TPS Debentures beginning with the payments due in March 2011. The terms of the TPS Debentures permit the Corporation to elect to defer payments of interest for up to 20 consecutive quarterly periods, provided that no event of default exists under the TPS Debentures at the time of the election. An election to defer interest payments is not considered a default under the TPS Debentures. In February 2014, First United Corporation received approval from the Reserve Bank to terminate this deferral by making the quarterly interest payments due to the Trusts in March 2014 and paying all deferred interest for prior quarters. In connection with this deferral termination, deferred interest of approximately $1.024 million as well as $77,166 of current interest was paid to Trust I on March 17, 2014, deferred interest of approximately $2.048 million as well as $154,325 in current interest was paid to Trust II on March 17, 2014, and deferred interest of approximately $3.763 million as well as $266,650 in current interest was paid to Trust III on March 15, 2014. In April 2014, July 2014 and November 2014, the Corporation received approvals to pay the quarterly interest due to the Trusts in June 2014, September 2014 and December 2014, respectively. Details of these payments are provided in the table below. In January 2015, the Corporation received approval from the Reserve Bank to pay the quarterly interest due to the Trusts in March 2015.

| Payment Date | Trust I Accrued Interest | Quarterly Interest | Trust II Accrued Interest | Quarterly Interest | Trust III Accrued Interest | Quarterly Interest |
|---|---|---|---|---|---|---|
| March 2014 | $1.024 million | $ 77,166 | $2.048 million | $ 154,325 | $3.763 million | $ 266,650 |
| June 2014 | - | 78,604 | - | 157,202 | - | 266,650 |
| September 2014 | - | 78,572 | - | 157,136 | - | 266,650 |
| December 2014 | - | 77,783 | - | 155,558 | - | 266,650 |

Until further notice from the Reserve Bank, the Corporation is required to obtain the Reserve Bank's prior approval before paying any future quarterly cash dividend on the shares of Series A Preferred Stock or making any future payment of quarterly interest due under the TPS Debentures. In considering a request for approval, the Reserve Bank will consider, among other things, the Corporation's financial condition and its quarterly results of operations. In addition to this pre-approval requirement, the Corporation's ability to pay these dividends or make these interest payments will depend in large part on its receipt of dividends from the Bank, and the Bank may make dividend payments only with the prior approval of the FDIC and the Maryland Commissioner. As a result of these limitations, no assurance can be given that the Corporation will pay quarterly cash dividends on the shares of Series A Preferred Stock or make quarterly interest payments due under the TPS Debentures in any future quarter. In the event that the Corporation and/or the Bank do not receive the required approvals, the will have to again elect to defer payments.

The Corporation's Board of Directors suspended the payment of cash dividends on the common stock in December 2010 when it approved the above-mentioned deferral of cash dividends on the Series A Preferred Stock, and this suspension remains in effect

**Liquidity Management**

Liquidity is a financial institution's capability to meet customer demands for deposit withdrawals while funding all credit-worthy loans. The factors that determine the institution's liquidity are:

- Reliability and stability of core deposits;
- Cash flow structure and pledging status of investments; and
- Potential for unexpected loan demand.

We actively manage our liquidity position through weekly meetings of a sub-committee of executive management, known as the internal treasury team, which looks forward 12 months at 30-day intervals. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Monthly reviews by management and quarterly reviews by the Asset and Liability Committee under prescribed policies and procedures are designed to ensure that we will maintain adequate levels of available funds.

It is our policy to manage our affairs so that liquidity needs are fully satisfied through normal Bank operations. That is, the Bank will manage its liquidity to minimize the need to make unplanned sales of assets or to borrow funds under emergency conditions. The Bank will use funding sources where the interest cost is relatively insensitive to market changes in the short run (periods of one year or less) to satisfy operating cash needs. The remaining normal funding will come from interest-sensitive liabilities, either deposits or borrowed funds. When the marginal cost of needed wholesale funding is lower than the cost of raising this funding in the retail markets, the Corporation may supplement retail funding with external funding sources such as:

- Unsecured Fed Funds lines of credit with upstream correspondent banks (M&T Bank, Atlantic Community Banker's Bank, Community Banker's Bank, PNC Financial Services ("PNC"), SunTrust and Zions Bancorp.
- Secured advances with the FHLB of Atlanta, which are collateralized by eligible one to four family residential mortgage loans, home equity lines of credit, commercial real estate loans, and various securities. Cash may also be pledged as collateral.
- Secured line of credit with the Fed Discount Window for use in borrowing funds up to 90 days, using municipal securities as collateral.
- Brokered deposits, including CDs and money market funds, provide a method to generate deposits quickly. These deposits are strictly rate driven but often provide the most cost effective means of funding growth.

- One Way Buy CDARS funding – a form of brokered deposits that has become a viable supplement to brokered deposits obtained directly.

Management believes that we have adequate liquidity available to respond to current and anticipated liquidity demands and is not aware of any trends or demands, commitments, events or uncertainties that are likely to materially affect our ability to maintain liquidity at satisfactory levels.

Management believes that we have adequate liquidity available to respond to current and anticipated liquidity demands and is not aware of any trends or demands, commitments, events or uncertainties that are likely to materially affect our ability to maintain liquidity at satisfactory levels.

**Market Risk and Interest Sensitivity**

Our primary market risk is interest rate fluctuation. Interest rate risk results primarily from the traditional banking activities that we engage in, such as gathering deposits and extending loans. Many factors, including economic and financial conditions, movements in interest rates and consumer preferences affect the difference between the interest earned on our assets and the interest paid on our liabilities. Interest rate sensitivity refers to the degree that earnings will be impacted by changes in the prevailing level of interest rates. Interest rate risk arises from mismatches in the repricing or maturity characteristics between interest-bearing assets and liabilities. Management seeks to minimize fluctuating net interest margins, and to enhance consistent growth of net interest income through periods of changing interest rates. Management uses interest sensitivity gap analysis and simulation models to measure and manage these risks. The interest rate sensitivity gap analysis assigns each interest-earning asset and interest-bearing liability to a time frame reflecting its next repricing or maturity date. The differences between total interest-sensitive assets and liabilities at each time interval represent the interest sensitivity gap for that interval. A positive gap generally indicates that rising interest rates during a given interval will increase net interest income, as more assets than liabilities will reprice. A negative gap position would benefit us during a period of declining interest rates.

During 2014, we continued to shift our focus from a shorter duration balance sheet to a more neutral to slightly asset sensitive position as we anticipate a flat to rising rate environment in the future. As of December 31, 2014, we were asset sensitive.

Our interest rate risk management goals are:

- Ensure that the Board of Directors and senior management will provide effective oversight and ensure that risks are adequately identified, measured, monitored and controlled;
- Enable dynamic measurement and management of interest rate risk;
- Select strategies that optimize our ability to meet our long-range financial goals while maintaining interest rate risk within policy limits established by the Board of Directors;
- Use both income and market value oriented techniques to select strategies that optimize the relationship between risk and return; and
- Establish interest rate risk exposure limits for fluctuation in net interest income (“NII”), net income and economic value of equity.

In order to manage interest sensitivity risk, management formulates guidelines regarding asset generation and pricing, funding sources and pricing, and off-balance sheet commitments. These guidelines are based on management’s outlook regarding future interest rate movements, the state of the regional and national economy, and other financial and business risk factors. Management uses computer simulations to measure the effect on net interest income of various interest rate scenarios. Key assumptions used in the computer simulations include cash flows and maturities of interest rate sensitive assets and liabilities, changes in asset volumes and pricing, and management’s capital plans. This modeling reflects interest rate changes and the related impact on net interest income over specified periods.

We evaluate the effect of a change in interest rates of +/-100 basis points to +/-400 basis points on both NII and Net Portfolio Value (“NPV”) / Economic Value of Equity (“EVE”). We concentrate on NII rather than net income as long as NII remains the significant contributor to net income.

NII modeling allows management to view how changes in interest rates will affect the spread between the yield paid on assets and the cost of deposits and borrowed funds. Unlike traditional Gap modeling, NII modeling takes into account the different degree to which installments in the same repricing period will adjust to a change in interest rates. It also allows the use of different assumptions in a falling versus a rising rate environment. The period considered by the NII modeling is the next eight quarters.

NPV / EVE modeling focuses on the change in the market value of equity. NPV / EVE is defined as the market value of assets less the market value of liabilities plus/minus the market value of any off-balance sheet positions. By effectively looking at the present value of all future cash flows on or off the balance sheet, NPV / EVE modeling takes a longer-term view of interest rate risk. This complements the shorter-term view of the NII modeling.

Measures of NII at risk produced by simulation analysis are indicators of an institution’s short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year.

They do not necessarily indicate the long-term prospects or economic value of the institution.

Based on the simulation analysis performed at December 31, 2014 and 2013, management estimated the following changes in net interest income, assuming the indicated rate changes:

| (Dollars in thousands) | 2014 | 2013 |
|---|---|---|
| +400 basis points | $1,998 | $2,025 |
| +300 basis points | $1,807 | $1,806 |
| +200 basis points | $1,711 | $1,653 |
| +100 basis points | $883 | $879 |
| -100 basis points | $(2,262) | $(2,847) |

This estimate is based on assumptions that may be affected by unforeseeable changes in the general interest rate environment and any number of unforeseeable factors. Rates on different assets and liabilities within a single maturity category adjust to changes in interest rates to varying degrees and over varying periods of time. The relationships between lending rates and rates paid on purchased funds are not constant over time. Management can respond to current or anticipated market conditions by lengthening or shortening the Bank’s sensitivity through loan repricings or changing its funding mix. The rate of growth in interest-free sources of funds will influence the level of interest-sensitive funding sources. In addition, the absolute level of interest rates will affect the volume of earning assets and funding sources. As a result of these limitations, the interest-sensitive gap is only one factor to be considered in estimating the net interest margin.

*Impact of Inflation* – Our assets and liabilities are primarily monetary in nature, and as such, future changes in prices do not affect the obligations to pay or receive fixed and determinable amounts of money. During inflationary periods, monetary assets lose value in terms of purchasing power and monetary liabilities have corresponding purchasing power gains. The concept of purchasing power is not an adequate indicator of the impact of inflation on financial institutions because it does not incorporate changes in our earnings.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this item is incorporated herein by reference to Item 7 of Part II of this annual report under the heading "Market Risk and Interest Sensitivity".

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA


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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

First United Corporation

Oakland, Maryland

We have audited the accompanying consolidated statement of financial condition of First United Corporation and Subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of First United Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First United Corporation and Subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Baker Tilly Virchow Krause, LLP

Pittsburgh, Pennsylvania
March 9, 2015

**First United Corporation and Subsidiaries**

**Consolidated Statement of Financial Condition**

**(In thousands, except per share amounts)**

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Assets | | |
| Cash and due from banks | $27,554 | $32,895 |
| Interest bearing deposits in banks | 7,897 | 10,168 |
| Cash and cash equivalents | 35,451 | 43,063 |
| Investment securities – available-for-sale (at fair value) | 221,117 | 336,589 |
| Investment securities – held to maturity (fair value of $110,771 at December 31, 2014 and $3,590 at December 31, 2013, respectively) | 109,449 | 3,900 |
| Restricted investment in bank stock, at cost | 7,524 | 7,913 |
| Loans | 839,991 | 810,240 |
| Allowance for loan losses | (12,065 ) | (13,594 ) |
| Net loans | 827,926 | 796,646 |
| Premises and equipment, net | 25,629 | 26,905 |
| Goodwill | 11,004 | 11,004 |
| Bank owned life insurance | 33,504 | 32,956 |
| Deferred tax assets | 25,907 | 29,209 |
| Other real estate owned | 12,932 | 17,031 |
| Accrued interest receivable and other assets | 21,853 | 28,830 |
| Total Assets | $1,332,296 | $1,334,046 |
| | | |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Non-interest bearing deposits | $201,188 | $175,863 |
| Interest bearing deposits | 780,135 | 801,540 |
| Total deposits | 981,323 | 977,403 |
| | | |
| Short-term borrowings | 39,801 | 43,676 |
| Long-term borrowings | 182,606 | 182,672 |
| Accrued interest payable and other liabilities | 19,567 | 28,412 |
| Total Liabilities | 1,223,297 | 1,232,163 |
| | | |
| Shareholders' Equity: | | |
| Preferred stock – no par value; | | |
| Authorized 2,000 shares of which 30 shares of Series A, $1,000 per share liquidation preference, 5% cumulative increasing to 9% cumulative on February 15, 2014, were issued and outstanding on December 31, 2014 and 2013 (discount of $0 and $6, respectively) | 30,000 | 29,994 |
| Common Stock – par value $.01 per share; | | |
| Authorized 25,000 shares; issued and outstanding 6,228 shares at December 31, 2014 and 6,211 shares at December 31, 2013 | 62 | 62 |

| | | |
|---|---|---|
| Surplus | 21,795 | 21,661 |
| Retained earnings | 77,375 | 74,379 |
| Accumulated other comprehensive loss | (20,233 ) | (24,213 ) |
| Total Shareholders' Equity | 108,999 | 101,883 |
| Total Liabilities and Shareholders' Equity | $1,332,296 | $1,334,046 |

*See notes to consolidated financial statements*

**First United Corporation and Subsidiaries**

**Consolidated Statement of Income**

**(In thousands, except share and per share amounts)**

| | Year ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Interest income | | |
| Interest and fees on loans | $37,486 | $42,258 |
| Interest on investment securities | | |
| Taxable | 6,981 | 5,557 |
| Exempt from federal income tax | 1,542 | 1,756 |
| Total investment income | 8,523 | 7,313 |
| Other | 377 | 343 |
| Total interest income | 46,386 | 49,914 |
| Interest expense | | |
| Interest on deposits | 4,603 | 5,076 |
| Interest on short-term borrowings | 63 | 62 |
| Interest on long-term borrowings | 6,204 | 6,594 |
| Total interest expense | 10,870 | 11,732 |
| Net interest income | 35,516 | 38,182 |
| Provision for loan losses | 2,513 | 380 |
| Net interest income after provision for loan losses | 33,003 | 37,802 |
| Other operating income | | |
| Changes in fair value on impaired securities | 6,560 | 4,173 |
| Portion of gain recognized in other comprehensive income (before taxes) | (6,560) | (4,173) |
| Net securities impairment losses recognized in operations | 0 | 0 |
| Net gains – other | 1,053 | 229 |
| Total net gains | 1,053 | 229 |
| Service charges | 2,933 | 3,469 |
| Trust department | 5,343 | 5,020 |
| Debit card income | 2,034 | 1,954 |
| Bank owned life insurance | 1,392 | 1,035 |
| Brokerage commissions | 800 | 806 |
| Other | 564 | 853 |
| Total other income | 13,066 | 13,137 |
| Total other operating income | 14,119 | 13,366 |
| Other operating expenses | | |
| Salaries and employee benefits | 19,518 | 19,946 |
| FDIC premiums | 1,842 | 1,875 |
| Equipment | 2,508 | 2,595 |
| Occupancy | 2,468 | 2,628 |
| Data processing | 3,198 | 3,069 |
| Professional services | 1,287 | 1,495 |

| | | |
|---|---|---|
| Other real estate owned expenses | 2,318 | 2,909 |
| Contract labor | 669 | 615 |
| Line rentals | 656 | 652 |
| Other | 5,790 | 6,687 |
| Total other operating expenses | 40,254 | 42,471 |
| Income before income tax expense | 6,868 | 8,697 |
| Provision for income tax expense | 1,271 | 2,222 |
| Net Income | 5,597 | 6,475 |
| Accumulated preferred stock dividends and discount accretion | (2,601 ) | (1,778 ) |
| Net Income Available to Common Shareholders | $2,996 | $4,697 |
| Basic and diluted net income per common share | $0.48 | $0.76 |
| Weighted average number of basic and diluted shares outstanding | 6,222,440 | 6,206,819 |

*See notes to consolidated financial statements*

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**First United Corporation and Subsidiaries**

**Consolidated Statement of Comprehensive Income**

**(In thousands, except per share data)**

| | Year Ended December 31, | |
|---|---|---|
| Comprehensive Income | 2014 | 2013 |
| Net Income | $5,597 | $6,475 |
| Other comprehensive income/(loss), net of tax and reclassification adjustments: | | |
| Net unrealized gains on investments with OTTI | 3,944 | 2,413 |
| Net unrealized gains/ (losses) on all other AFS securities | 8,737 | (8,326) |
| Net unrealized losses on HTM securities | (2,255) | 0 |
| Net unrealized gains on cash flow hedges | 155 | 233 |
| Net unrealized (losses)/gains on pension plan liability | (6,304) | 3,174 |
| Net unrealized (losses)/gains on SERP liability | (297) | 116 |
| Other comprehensive income/(loss), net of tax | 3,980 | (2,390) |
| Comprehensive Income | $9,577 | $4,085 |

*See notes to consolidated financial statements*

**First United Corporation and Subsidiaries**

**Consolidated Statement of Changes in Shareholders' Equity**

**(In thousands)**

| | Preferred Stock | Common Stock | Surplus | Retained Earnings | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at January 1, 2013 | $ 29,925 | $ 62 | $ 21,573 | $ 69,682 * | $ (21,823) | $ 99,419 |
| Net income | | | | 6,475 | | 6,475 |
| Other comprehensive loss | | | | | (2,390) | (2,390) |
| Stock based compensation | | | 88 | | | 88 |
| Preferred stock discount accretion | 69 | | | (69) | | 0 |
| Preferred stock dividends deferred | | | | (1,709) | | (1,709) |
| Balance at December 31, 2013 | 29,994 | 62 | 21,661 | 74,379 | (24,213) | 101,883 |
| Net income | | | | 5,597 | | 5,597 |
| Other comprehensive income | | | | | 3,980 | 3,980 |
| Stock based compensation | | | 134 | | | 134 |
| Preferred stock discount accretion | 6 | | | (6) | | 0 |
| Preferred stock dividends paid | | | | (2,595) | | (2,595) |
| Balance at December 31, 2014 | $ 30,000 | $ 62 | $ 21,795 | $ 77,375 | $ (20,233) | $ 108,999 |

* - Includes prior period correction discussed in Note 1

*See notes to consolidated financial statements*