FIRST UNITED CORP/MD/
Form 10-K
March 14, 2012

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, 2011

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 R

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 R

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 R 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 R No £ (Not Applicable)

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. R

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 R

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

The aggregate market value of the registrant's outstanding voting and non-voting common equity held by non-affiliates as of June 30, 2011: **$27,627,127.**

The number of shares of the registrant's common stock outstanding as of February 29, 2012: **6,182,757**

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2012 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

Table of Contents

PART I

ITEM 1.	Business	3
ITEM 1A.	Risk Factors	13
ITEM 1B.	Unresolved Staff Comments	22
ITEM 2.	Properties	22
ITEM 3.	Legal Proceedings	22
ITEM 4.	Mine Safety Disclosures	22
PART II		
ITEM 5.	Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	23
ITEM 6.	Selected Financial Data	24
ITEM 7.	Management's Discussion & Analysis of Financial Condition & Results of Operations	25
ITEM 7A.	Quantitative and Qualitative Disclosures About Market Risk	50
ITEM 8.	Financial Statements and Supplementary Data	50
ITEM 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	99
ITEM 9A.	Controls and Procedures	99
ITEM 9B.	Other Information	101
PART III		
ITEM 10.	Directors, Executive Officers and Corporate Governance	101
ITEM 11.	Executive Compensation	101

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	102
ITEM 13. Certain Relationships and Related Transactions, and Director Independence	102
ITEM 14. Principal Accountant Fees and Services	102
PART IV	
ITEM 15. Exhibits and Financial Statement Schedules	103
SIGNATURES	103
EXHIBITS	105

[2]

Forward-Looking Statements

This Annual Report on Form 10-K of First United Corporation (“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”, “potential”, or “continue” or 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 decrease 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 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 contained 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 financial holding company registered under the federal Bank Holding Company Act of 1956, as amended (the “BHC Act”). First United 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. First United Corporation is also the parent company of First United Insurance Group, LLC, a Maryland limited liability company (the "Insurance Group") that, through the close of business on December 31, 2011, operated as a full service insurance provider under Maryland law. Effective on January 1, 2012, the Insurance Group sold substantially all of its assets, net of cash, and is no longer an active subsidiary. The operations of, and results for, the Insurance Group are discussed in this Annual Report.

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 owns 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. 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.

At December 31, 2011, we had total assets of approximately $1.39 billion, net loans of approximately $919 million, and deposits of approximately $1.03 billion. Shareholders' equity at December 31, 2011 was approximately $96.7 million.

First United 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 28 banking offices, one call center and 31 Automated Teller Machines ("ATMs") in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Berkeley County, Mineral County, Hardy 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 PrimeVest Financial Services, Inc., a full service broker-dealer. The Bank also provides safe deposit and night depository facilities, and a complete line of insurance products and trust services. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC").

Lending Activities— Our lending activities are conducted through the Bank. Previously, we also made certain consumer loans through the OakFirst Loan Centers. During 2010, management decided to wind down the OakFirst Loan Centers and now 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, and closely monitoring construction projects to control disbursement of funds on loans.

The Bank's residential mortgage portfolio is distributed between variable and fixed rate loans. Many loans are booked at fixed rates in order to meet the Bank's requirements under the Community Reinvestment Act. Other fixed rate residential mortgage loans are originated in a brokering capacity on behalf of other financial institutions, for which the Bank receives a fee. As with any consumer loan, repayment is dependent on the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy. Residential mortgage loans exceeding an internal loan-to-value ratio require private mortgage insurance. Title insurance protecting the Bank's lien priority, as well as fire and casualty insurance, 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 or five 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. 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, 2011 and 2010, the total market value of assets under the supervision of the Bank's Trust Department was approximately $595 million and $590 million, respectively. Trust Department revenues for these years may be found in the Consolidated Statements of Income under the heading "Other operating income", which is contained in Item 8 of Part II of this annual report.

Insurance Activities—Through December 31, 2011, we offered a full range of insurance products and services to customers in our market areas through the Insurance Group. Information about income from insurance activities for each of the years ended December 31, 2011 and 2010 may be found under "Other Operating Income" in the Consolidated Statements of Income included in Item 8 of Part II of this annual report. The Insurance Group sold substantially all of its assets, net of cash, effective on January 1, 2012. More information about the sale can be found in Item 7 – Recent Developments.

COMPETITION

The banking business, in all of its phases, is highly competitive. Within our market areas, we compete with commercial banks, (including local banks and branches or affiliates of other larger banks), savings and loan associations and credit unions for loans and deposits, with consumer finance companies for loans, with insurance companies and their agents for insurance products, and with other financial institutions for various types of products and services. There is also competition for commercial and retail banking business from banks and financial institutions located outside our market areas 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 its customers, and specialized services tailored to meet its customers' needs. In those instances in which we are unable to accommodate a customer's needs, we attempt to arrange for those services to be provided by other financial services providers with which we have a relationship.

The following table sets forth deposit data for the Maryland and West Virginia Counties in which the Bank maintains offices as of June 30, 2011, the most recent date for which comparative information is available.

	Offices (in Market)	Deposits (in thousands)	Market Share
Allegany County, Maryland:			
Susquehanna Bank	5	$ 296,570	43.98 %
Manufacturers & Traders Trust Company	6	158,563	23.52 %
First United Bank & Trust	4	124,309	18.44 %
PNC Bank NA	3	50,338	7.47 %
Standard Bank	2	44,515	6.60 %

Source: FDIC Deposit Market Share Report

Frederick County, Maryland:			
PNC Bank NA	21	1,029,381	27.90%
Branch Banking & Trust Co.	12	687,889	18.64%
Bank Of America NA	6	299,746	8.12 %
Frederick County Bank	4	263,879	7.15 %
Manufacturers & Traders Trust Company	6	238,789	6.47 %
Woodsboro Bank	7	184,112	4.99 %
Capital One NA	6	183,748	4.98 %
First United Bank & Trust	4	142,891	3.87 %
SunTrust Bank	3	128,130	3.47 %
Middletown Valley Bank	4	120,307	3.26 %
BlueRidge Bank	1	119,336	3.23 %
Wells Fargo Bank NA	1	100,331	2.72 %
Sandy Spring Bank	4	88,558	2.40 %
Damascus Community Bank	2	31,286	0.85 %
Columbia Bank	2	26,867	0.73 %
Sovereign Bank	1	24,510	0.66 %
Harvest Bank of Maryland	1	19,795	0.54 %
WoodForest National Bank	1	197	0.01 %

Source: FDIC Deposit Market Share Report

Garrett County, Maryland:			
First United Bank & Trust	6	442,589	67.32%
Susquehanna Bank	2	97,470	14.82%
Manufacturers & Traders Trust Company	5	83,395	12.68%
Clear Mountain Bank	1	26,677	4.06 %
Miners & Merchants Bank	1	7,353	1.12 %

Source: FDIC Deposit Market Share Report

Washington County, Maryland:			
Susquehanna Bank	10	526,986	26.35%
Columbia Bank	11	424,506	21.23%
Manufacturers & Traders Trust Company	11	357,603	17.88%
Centra Bank, Inc.	2	152,861	7.64 %
PNC Bank NA	5	148,780	7.44 %
Sovereign Bank	4	111,103	5.56 %
First United Bank & Trust	3	86,581	4.33 %
Graystone Tower Bank	3	77,695	3.89 %
Citizens National Bank of Berkeley Springs	1	38,840	1.94 %

Capital One NA	2	35,024	1.75 %
Orrstown Bank	1	26,026	1.30 %
Jefferson Security Bank	1	7,932	0.40 %
Middletown Valley Bank	1	5,726	0.29 %

Source: FDIC Deposit Market Share Report

[7]

Berkeley County, West Virginia:			
Branch Banking & Trust Company	5	337,309	30.10%
Centra Bank, Inc.	4	193,694	17.28%
First United Bank & Trust	5	133,671	11.93%
City National Bank of West Virginia	4	122,168	10.90%
Susquehanna Bank	3	96,589	8.62 %
Jefferson Security Bank	2	67,322	6.01 %
MVB Bank Inc.	1	61,112	5.45 %
Bank of Charles Town	2	50,217	4.48 %
Citizens National Bank of Berkeley Springs	3	37,863	3.38 %
Summit Community Bank	1	14,010	1.25 %
Woodforest National Bank	1	714	0.06 %

Source: FDIC Deposit Market Share Report

Hardy County, West Virginia:			
Summit Community Bank, Inc.	4	489,852	73.84%
Capon Valley Bank	3	117,307	17.68%
Pendleton Community Bank, Inc.	1	25,686	3.87 %
First United Bank & Trust	1	18,965	2.86 %
Grant County Bank	1	11,622	1.75 %

Source: FDIC Deposit Market Share Report

Mineral County, West Virginia:			
First United Bank & Trust	2	75,638	34.42%
Branch Banking & Trust Company	2	70,921	32.27%
Manufacturers & Traders Trust Company	2	39,864	18.14%
Grant County Bank	1	33,358	15.18%

Source: FDIC Deposit Market Share Report

Monongalia County, West Virginia:			
Centra Bank, Inc.	5	434,159	24.28%
Branch Banking & Trust Company	5	418,575	23.41%
Huntington National Bank	7	381,424	21.33%
United Bank	4	170,675	9.54 %
Clear Mountain Bank	5	151,061	8.45 %

Wesbanco Bank, Inc.	5	92,490	5.17 %
First United Bank & Trust	3	83,467	4.67 %
First Exchange Bank	2	29,617	1.66 %
Citizens Bank of Morgantown, Inc.	1	21,376	1.20 %
PNC Bank NA	1	5,380	0.30 %

Source: FDIC Deposit Market Share Report

For further information about competition in our market areas, see the Risk Factor entitled "**We operate in a competitive environment, 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 First United 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

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

The Bank is a Maryland trust company subject to the banking laws of Maryland and to regulation by the Commissioner of Financial Regulation of Maryland (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 First United Corporation are subject to examination by the FRB, 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, OakFirst Loan Center, LLC is subject to licensing and regulation by the Maryland Commissioner, and the Insurance Group was subject to licensing and regulation by various state insurance authorities. Retail sales of insurance products by these insurance affiliates are also subject to the requirements of the Interagency Statement on Retail Sales of Nondeposit Investment Products promulgated in 1994 by the FDIC, the FRB, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

Regulation of Financial Holding Companies

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

merchant banking. Thus, the GLB Act has the effect of broadening the permitted activities of First United Corporation and the Bank.

First United 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, First United Corporation and its non-bank affiliates by the Bank. Section 23B requires that transactions between the Bank and First United Corporation and its non-bank affiliates be on terms and under circumstances that are substantially the same as with non-affiliates.

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

Federal Banking Regulation

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

The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, and principal shareholders or any related interest of such persons, which generally require that such credit extensions be made on substantially the same terms as 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 (“CRA”) requires the FDIC, in connection with its examination of financial institutions within its jurisdiction, to evaluate the record of those financial institutions in meeting the credit needs of their communities, including low and moderate income neighborhoods, consistent with principles of safe and sound banking practices. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank has a CRA rating of “Satisfactory”.

On October 14, 2008, the FDIC announced the creation of the Temporary Liquidity Guarantee Program (the “TLGP”) to decrease the cost of bank funding and, hopefully, normalize lending. This program is comprised of two components.

The first component guarantees senior unsecured debt issued between October 14, 2008 and June 30, 2009. The guarantee will remain in effect until June 30, 2012 for such debts that mature beyond June 30, 2009. The second component, called the Transaction Accounts Guarantee Program ("TAG"), provided full coverage for non-interest bearing transaction deposit accounts, IOLTAs, and NOW accounts with interest rates of 0.25% or less, regardless of account balance, initially until December 31, 2009. The TAG program expired on December 31, 2010. We elected to participate in both programs and paid additional FDIC premiums in 2010 and 2009 as a result. See the section below entitled "Deposit Insurance".

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which made sweeping changes to the financial regulatory landscape and will impact all financial institutions, including First United Corporation and the Bank.

On November 9, 2010, the FDIC issued a final rule to implement Section 343 of the Dodd-Frank Act that provides temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts at all FDIC-insured depository institutions. The coverage is automatic for all FDIC-insured institutions and does not include an opt out option. The separate coverage for noninterest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012.

These new laws, regulations and regulatory actions will cause our regulatory expenses to increase. Additionally, due in part to numerous bank failures throughout the country since 2008, the FDIC imposed an emergency insurance assessment to help restore the Deposit Insurance Fund and further required insured depository institutions to prepay their estimated quarterly risk-based deposit assessments through 2012 on December 30, 2009. Given the current state of the national economy, there can be no assurance that the FDIC will not impose future emergency assessments or further revise

its rate structure.

The Dodd-Frank Act's significant regulatory changes include the creation of a new financial consumer protection agency, known as the Bureau of Consumer Financial Protection (the "Consumer Protection Bureau"), that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer compliance. Moreover, the Dodd-Frank Act permits states to adopt stricter consumer protection laws and states' attorneys general may enforce consumer protection rules issued by the Bureau. The Dodd-Frank Act also imposes more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred securities issuances from counting as Tier 1 capital. These developments may limit our future capital strategies. The Dodd-Frank Act also increases regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate and other hedging transactions.

The Dodd-Frank Act will increase our regulatory compliance burden and costs and may restrict the financial products and services we offer to our customers. In particular, the Dodd-Frank Act will require us to invest significant management attention and resources so that we can evaluate the impact of this law and make any necessary changes to our product offerings and operations.

Capital Requirements

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

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

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

Further information about our capital resources is provided in Item 7 of Part II of this annual report under the heading "Capital Resources". Information about the capital ratios of First United Corporation and of the Bank as of December 31, 2011 is set forth in Note 4 to our audited consolidated financial statements, which are included in Item 8 of Part II of this annual report (the "Consolidated Financial Statements").

Deposit Insurance

The deposits of the Bank are insured to a maximum of $250,000 per depositor through the Deposit Insurance Fund, which is administered by the FDIC, and the Bank is required to pay quarterly deposit insurance premium assessments to the FDIC. The Deposit Insurance Fund was created pursuant to the Federal Deposit Insurance Reform Act of 2005 (the "Reform Act"). This law (i) required the then-existing $100,000 deposit insurance coverage to be indexed for inflation (with adjustments every five years, commencing January 1, 2011), and (ii) increased the deposit insurance coverage for retirement accounts to $250,000 per participant, subject to adjustment for inflation. Effective October 3, 2008, however, the Emergency Economic Stabilization Act of 2008 (the "EESA") was enacted and, among other things, temporarily raised

the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. EESA initially contemplated that the coverage limit would return to $100,000 after December 31, 2009, but the expiration date has since been extended to December 31, 2013. The coverage for retirement accounts did not change and remains at $250,000. On July 21, 2010, as part of the Dodd-Frank Act, the current standard maximum deposit insurance amount was permanently raised to $250,000.

The Reform Act also gave the FDIC greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments. On May 22, 2009, the FDIC imposed an emergency insurance assessment of five basis points in an effort to restore the Deposit Insurance Fund to an acceptable level. On November 12, 2009, the FDIC adopted a final rule requiring insured depository institutions to prepay their estimated quarterly risk-based deposit assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012, on December 30, 2009, along with each institution's risk based deposit insurance assessment for the third quarter of 2009. It was also announced that the assessment rate would increase by 3 basis points effective January 1, 2011. The prepayment is accounted for as a prepaid expense and is amortized quarterly. The prepaid assessment qualifies for a zero risk weight under the risk-based capital requirements. The Bank expensed $2.4 million and $4.0 million in FDIC premiums for 2011 and 2010, respectively. In December 2009, the Bank prepaid approximately $11 million in FDIC premiums and the balance at December 31, 2011 was approximately $5 million.

USA PATRIOT ACT

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

Federal Securities Law

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

Governmental Monetary and Credit Policies and Economic Controls

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

SEASONALITY

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

EMPLOYEES

At December 31, 2011, we employed 429 individuals, of whom 341 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 First United 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.

First United 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, First United 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 15%, or $143 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.

In point of fact, 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 FRB, 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. Based on the Bank’s concentration of commercial acquisition and development and construction loans as of December 31, 2011, the Bank may be subject to heightened supervisory scrutiny during future examinations and/or be required to take steps to address our concentration and capital levels. Management cannot predict the extent to which this guidance will impact our operations or capital requirements.

The Bank may experience loan losses in excess of its allowance, 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, 2011, we had classified all but six of our investment securities as available-for-sale pursuant to FASB Accounting Standards Codification 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 will 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.

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 insurance and securities products, comes from other banks, securities and brokerage companies, insurance companies, insurance agents and brokers, and other non-bank financial service providers in our market area. Many of these competitors are much larger in terms of total assets and capitalization, have greater access to capital markets, and/or offer a broader range of financial services than those that we offer. In addition, banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers.

In addition, 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, insurance 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. First United Corporation is subject to supervision by the FRB. The Bank is subject to supervision and periodic examination by the Maryland Commissioner of Financial Regulation, the West Virginia Division of Banking, and the FDIC. Banking regulations, designed primarily for the safety of

depositors, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. First United Corporation and the Bank are also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that either is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Management also cannot predict the nature or the extent of the effect on our business and earnings of future fiscal or monetary policies, economic controls, or new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

Our regulatory expenses will likely increase due to federal laws, rules and programs that have been enacted or adopted in response to the recent banking crisis and the current national recession.

In response to the banking crisis that began in 2008 and the resulting national recession, the federal government took drastic steps to help stabilize the credit market and the financial industry. These steps included the enactment of the EESA, which, among other things, raised the basic limit on federal deposit insurance coverage to $250,000, and the FDIC's adoption of the TLGP, which, under the TAG portion, provides full deposit insurance coverage through December 31, 2012 for non-interest bearing transaction deposit accounts, IOLTAs, and NOW accounts with certain interest rates, regardless of account balance. The TLGP requires participating institutions, like us, to pay 10 basis points per annum for the additional insured deposits. These regulatory actions will cause our regulatory expenses to increase. Additionally, due in part to the

failure of several depository institutions around the country since the banking crisis began, the FDIC imposed an emergency insurance assessment to help restore the Deposit Insurance Fund and further required insured depository institutions to prepay their estimated quarterly risk-based deposit assessments through 2012 on December 30, 2009. Given the current state of the national economy, there can be no assurance that the FDIC will not impose future emergency assessments or further revise its rate structure.

In addition, the Dodd-Frank Act recently became law and implements significant changes in the financial regulatory landscape that will impact all financial institutions, including First United Corporation and the Bank. The Dodd-Frank Act is likely to increase our regulatory compliance burden. It is too early, however, for us to assess the full impact that the Dodd-Frank Act may have on our business, financial condition or results of operations. Many of the Dodd-Frank Act's provisions require subsequent regulatory rulemaking. The Dodd-Frank Act's significant regulatory changes include the creation of the Consumer Protection Bureau a new financial consumer protection agency, known as the Bureau of Consumer Financial Protection, that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer compliance, which will increase our regulatory compliance burden and costs and may restrict the financial products and services we offer to our customers. Moreover, the Dodd-Frank Act permits states to adopt stricter consumer protection laws and states' attorneys general may enforce consumer protection rules issued by the Bureau of Consumer Financial Protection. The Dodd-Frank Act also imposes more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier 1 capital. These restrictions will limit our future capital strategies. The Dodd-Frank Act also increases regulation of derivatives and hedging transactions, which could limit our ability to enter into, or increase the costs associated with, interest rate and other hedging transactions. Although certain provisions of the Dodd-Frank Act, such as direct supervision by the Bureau of Consumer Financial Protection, will not apply to banking organizations with less than $10 billion of assets, such as First United Corporation and the Bank, the changes resulting from the legislation will impact our business. These changes will require us to invest significant management attention and resources to evaluate and make necessary changes.

Recent amendments to the FRB's Regulation E may negatively impact our non-interest income.

On November 12, 2009, the FRB 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 certain non-interest income by approximately 25%, the effect of which is included in service charge income on the statement of operations, in 2011 when compared to 2010.

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.

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.

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

On January 30, 2009, First United Corporation participated in the Troubled Asset Relief Program ("TARP") Capital Purchase Program (the "CPP") adopted by the U.S. Department of Treasury ("Treasury") by selling 30,000 shares of First United Corporation's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") to Treasury and issuing a 10-year common stock purchase warrant (the "Warrant") to Treasury, for a total consideration of $30 million. As part of these transactions, First United Corporation adopted the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds any shares of the Series A Preferred Stock and/or any shares of common stock acquired upon exercise of the warrant. On February 17, 2009, the American Reinvestment and Recovery Act of 2009 (the "Recovery Act") was signed into law, which, among other things, imposed additional executive compensation restrictions on institutions that participate in the TARP CPP for so long as any TARP CPP assistance remains outstanding. Among these restrictions is a prohibition against making most severance payments to our "senior executive officers" (our Chairman, Chief Executive Officer and President and the two next most highly compensated executive officers) and to our next five most highly compensated employees. The restrictions also limit the type, timing and amount of bonuses, retention awards and incentive compensation that may be paid to certain employees. These restrictions, coupled with the competition we face from other institutions, including institutions that do not participate in TARP, may make it more difficult for us to attract and/or retain exceptional key employees.

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 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. Although we are a financial holding company, this law may increase the competition we face from larger banks and other companies, especially considering the fact that we have agreed with the FRB to not engage in additional financial holding company activities until the Bank is considered both "well capitalized" and "well managed". 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 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.

The Bank has been sued in a class-action lawsuit, and this suit will likely subject the Bank to significant legal costs and could subject the Bank to significant money damages in the event that the Bank does not prevail.

During the fourth quarter 2011, the Bank was named as a defendant in a class-action lawsuit brought in the Circuit Court for Montgomery County, Maryland (the "Class-Action Suit") by two related residential customers who refinanced their residential mortgage loan through the Bank. The Bank originated and closed the loan using a common "table funding" process in which the Bank was named as the lender in the loan documents, but a third-party funded the loan and became the owner of the loan by taking immediate assignment of the loan documents from the Bank when the proceeds were disbursed. The plaintiffs' primary claim is that the Bank's use of a table funding process caused it to be both a mortgage broker and a mortgage lender and that, as a consequence, certain fees collected by the Bank constituted impermissible finder's fees under Maryland's Loans-Finder's Fee statute. This statute prohibits a mortgage broker from charging a finder's fee in any transaction in which the broker is also the mortgage lender. The Bank intends to vigorously defend the Class-Action Suit, as it believes that the plaintiffs' claims have no merit because, among other reasons, the Bank was not acting as a mortgage broker and, in any event, the Bank is exempt from the statute. The Bank will incur legal fees in defending this suit, and those fees could be significant. There can be no assurance that the Bank will prevail in the Class-Action Suit, and a disposition of the plaintiffs' claims that is adverse to the Bank could subject the Bank to money damages equal to, for each loan, three times the amount of the impermissible finder's fee or $500, whichever is greater. The legal fees that the Bank will pay to defend this suit and the total amount of money damages that the Bank might pay in the event it loses the Class-Action Suit cannot be predicted with any degree of certainty.

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

First United Corporation and the Bank have entered into informal agreements with their regulators that limit their abilities to pay dividends and make other distributions on outstanding securities, and First United Corporation has deferred the payment of certain dividends and distributions pursuant to these agreements.

First United Corporation is a party to an informal agreement with the Federal Reserve Bank of Richmond (the "Reserve Bank") pursuant to which First United Corporation agreed not to pay dividends on outstanding shares of its common stock or the Series A Preferred Stock, make interest payments under the junior subordinated debentures underlying the trust preferred securities issued by the Trusts (the "TPS Debentures"), or take any other action that reduces regulatory capital without the prior approval of the Reserve Bank. The Bank is a party to a similar agreement with the FDIC and the Maryland Commissioner of Financial Regulation. 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. On November 15, 2010, First United Corporation elected, at the request of the Reserve Bank pursuant to its agreement, to defer cash dividend payments on its common stock and to defer regularly scheduled quarterly cash dividend payments under the Series A Preferred Stock, starting with the dividend payment due November 15, 2010. On December 15, 2010, at the request of the Reserve Bank pursuant to its agreement, the Corporation elected to defer regularly scheduled quarterly interest payments with respect to an aggregate of $41.73 million of the TPS Debentures, starting with the interest payments due in March 2011, and this deferral requires the Trusts to defer regular quarterly dividend payments on their trust preferred securities. Both the deferral of dividends on the Series A Preferred Stock and the deferral of interest on the TPS Debentures are permitted under the terms of those securities and do not constitute events of default. During the deferral periods, dividends on the Series A Preferred Stock and interest under the TPS Debentures, and dividends on the related trust preferred securities, continue to accrue and must be paid at the time First United Corporation recommences regular payments. Although First United Corporation intends to periodically reevaluate the deferral of, and, in consultation with its regulators, consider reinstating, these payments when appropriate, no assurances can be given as to when, or if, these payments will recommence.

Even if First United Corporation were to conclude at a later date that its financial condition and results of operations warrant the recommencement of these payments, there can be no guarantee that our regulators will agree with our conclusion. Moreover, 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 First United 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 First United 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.

Accordingly, holders of shares of First United Corporation's common stock and shares of the Series A Preferred Stock should not expect to receive cash dividends for the foreseeable future.

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 terms of the Series A Preferred Stock limit First United Corporation's ability to pay dividends and make other distributions on its capital securities, and First United Corporation's deferral of dividend payments under the Series A Preferred Stock has triggered additional dividend restrictions.

Under the terms of the transaction documents relating to First United Corporation's issuance of Series A Preferred Stock and the warrant to the Treasury, First United Corporation's ability to declare or pay dividends on shares of its capital securities is limited. Specifically, First United Corporation is unable to declare dividends on common stock, other stock ranking junior to the Series A Preferred Stock, or preferred stock ranking on a parity with the Series A Preferred Stock, and First United Corporation is also prohibited from repurchasing shares of such common stock, junior stock or parity stock,

if First United Corporation is in arrears on the Series A Preferred Stock dividends. As noted above, First United Corporation has elected to defer cash dividends on the Series A Preferred Stock, so no cash dividends or other distributions on, or repurchases of, the common stock are currently permitted. First United Corporation cannot predict when, or if, it will be able to pay accrued and future dividends on the Series A Preferred Stock. Accordingly, the holders of First United Corporation's common stock and the Series A Preferred Stock should not expect to receive cash dividends for the foreseeable future.

Because First United Corporation has failed to make six quarterly dividend payments on the Series A Preferred Stock, the holders thereof have the right to elect up to two additional directors to First United Corporation's board of directors.

Subject to the declaration thereof by First United Corporation's board of directors, the terms of the Series A Preferred Stock provide for the payment of quarterly cash dividends on February 15th, May 15th, August 15th and November 15th of each year. Dividends will accrue regardless of whether the board declares a dividend on any such date. 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 First United Corporation's board of directors will automatically be increased by two, from 13 directors to 15 directors (based on the current board structure). 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. First United Corporation currently does not have any outstanding stock with voting rights on par with the Series A Preferred Stock. As discussed above, the Corporation has deferred the payment of cash dividends on the Series A Preferred Stock for six quarterly dividend periods, since November 15, 2010. The Treasury has not informed us that it intends to elect Preferred Stock Directors. If it were to do so, however, the holders of the common stock would not be entitled to vote on the election of those Preferred Stock Directors.

First United Corporation's ability to pay dividends on its capital securities is also subject to the terms of its outstanding debentures, and First United Corporation's deferral of interest payments under the TPS Debentures has also triggered dividend restrictions.

In March 2004, First United 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. In December 2004, First United Corporation issued $5.0 million of additional junior subordinated debentures that were not tied to trust preferred securities offerings. Between December 2009 and January 2010, First United 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 these debentures require us to make quarterly payments of interest to the holders of the debentures.

Under the TPS Debentures, First United Corporation has the ability to defer payments of interest for up to 20 consecutive quarterly periods. As noted above, First United Corporation elected to defer interest payments under all of its TPS Debentures on December 15, 2010. Accordingly, First United Corporation is not currently permitted to pay dividends or make distributions on, or repurchase, redeem or otherwise acquire, any shares of the common stock or the Series A Preferred Stock. First United Corporation cannot predict when, or if, it will resume making interest payments under the TPS Debentures. Holders of shares of the common stock and the Series A Preferred Stock should not expect to receive cash dividends for the foreseeable future.

Applicable banking and Maryland laws impose additional restrictions on the ability of First United 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 First United Corporation and the Bank.

In the past, First United Corporation’s ability to pay dividends to shareholders has been largely dependent upon the receipt of dividends from the Bank. Since December 2009, First United Corporation has used its cash to pay dividends. In December 2010, however, First United Corporation contributed substantially all of its excess cash to the Bank to strengthen the Bank’s capital levels. Accordingly, in the event that First United 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, First United 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 First United Corporation's board of directors. Thus, even at times when First United 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 shares of common stock, Series A Preferred Stock, and the Warrant are not insured.

The shares of First United Corporation's common stock, including the shares underlying the Warrant, the shares of the Series A Preferred Stock, and 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. First United Corporation does not intend to apply for listing of the Series A Preferred Stock on any securities exchange or for inclusion of the Series A Preferred Stock in any automated quotation system unless requested by the Treasury. 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 First United Corporation's securities will develop or be sustained in the future. Accordingly, holders of First United Corporation's securities may not be able to sell such securities at the volumes, prices, or times that they desire.

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

First United 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 First United Corporation's board of directors to deal with attempts to acquire control of First United 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 First United 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 First United Corporation’s securities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

First United Corporation is a “smaller reporting company” and, thus, this Item 1B is not applicable.

ITEM 2. PROPERTIES

The headquarters of First United 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 First United Corporation. The Bank owns 21 of its banking offices and leases seven, which includes one specialty office. As of December 31, 2011, First United Corporation also leased six offices of non-bank subsidiaries. Total rent expense on the leased offices and properties was $.6 million in 2011.

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.

[22]

PART II

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

Shares of First United Corporation's common stock are listed on the NASDAQ Global Select Market under the symbol "FUNC". As of February 27, 2012, First United Corporation had 1,889 shareholders of record. The high and low sales prices for, and the cash dividends declared on, the shares of First United Corporation's common stock for each quarterly period of 2011 and 2010 are set forth below. On March 12, 2012, the closing sales price of the common stock as reported on the NASDAQ Global Select Market was $4.76 per share.

	High	Low	Dividends Declared
2011			
1st Quarter	$4.93	$2.76	$ .000
2nd Quarter	6.00	2.92	.000
3rd Quarter	5.50	3.38	.000
4th Quarter	4.81	2.93	.000
2010			
1st Quarter	$7.36	$4.66	$ .010
2nd Quarter	7.12	3.80	.010
3rd Quarter	5.04	3.32	.010
4th Quarter	5.00	3.06	.000

As a result of First United Corporation's deferral of cash dividends under its Series A Preferred Stock in November 2010 and its December 2010 decision to defer interest payments under its TPS Debentures, First United Corporation is currently prohibited from declaring or paying cash dividends on outstanding shares of common stock. Subject to the restrictions imposed on First United Corporation by banking and corporate laws and the terms of its other securities, the payment of dividends on the shares of common stock and the amounts thereof are at the discretion of First United 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 First United Corporation's subsidiaries, especially the Bank, to declare dividends to the Corporation. The ability of the Bank to declare dividends is limited by federal and state banking laws and state corporate laws. A complete discussion of these 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 20 to the Consolidated Financial Statements, both of which are incorporated herein by reference. There can be no guarantee that dividends will be declared in any future fiscal quarter.

Issuer Repurchases

Neither First United Corporation nor any of its affiliates (as defined by Exchange Act Rule 10b-18) repurchased any shares of First United Corporation's common stock during the fourth quarter of 2011.

Equity Compensation Plan Information

Pursuant to the SEC's Regulation S-K Compliance and Disclosure Interpretation 106.01, the information regarding First United 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 the five years 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)	2011	2010	2009	2008	2007
Balance Sheet Data					
Total Assets	$1,390,865	$1,696,445	$1,743,796	$1,639,104	$1,478,909
Net Loans	919,214	987,615	1,101,794	1,120,199	1,035,962
Investment Securities	245,023	229,687	273,784	354,595	304,908
Deposits	1,027,784	1,301,646	1,304,166	1,222,889	1,126,552
Long-term Borrowings	207,044	243,100	270,544	277,403	178,451
Shareholders’ Equity	96,656	95,640	100,566	72,690	104,665
Operating Data					
Interest Income	$59,496	$70,747	$85,342	$95,216	$93,565
Interest Expense	21,206	29,164	32,104	43,043	49,331
Net Interest Income	38,290	41,583	53,238	52,173	44,234
Provision for Loan Losses	9,157	15,726	15,588	12,925	2,312
Other Operating Income	15,115	15,356	15,390	15,766	16,697
Net Securities Impairment Losses	(19)	(8,364)	(26,693)	(2,724)	0
Net Gains/(Losses) – Other	620	(6,014)	411	727	(1,605)
Other Operating Expense	41,858	45,049	46,578	40,573	38,475
Income/(Loss) Before Taxes	2,991	(18,214)	(19,820)	12,444	18,539
Income Tax (benefit)/expense	(635)	(8,017)	(8,496)	3,573	5,746
Net Income/(Loss)	$3,626	$(10,197)	$(11,324)	$8,871	$12,793
Accumulated preferred stock dividend and discount accretion	(1,609)	(1,559)	(1,430)	0	0
Net income available to/(loss) attributable to common shareholders	$2,017	$(11,756)	$(12,754)	$8,871	$12,793
Per Share Data					
Basic net Income/(Loss) per common share	$.33	$(1.91)	$(2.08)	$1.45	$2.08
Diluted net Income/(Loss) per common share	$.33	$(1.91)	$(2.08)	$1.45	$2.08
Dividends Paid	.00	.13	.80	.80	.78
Book Value	10.80	10.68	11.49	11.89	17.05
Significant Ratios					
Return on Average Assets	.24%	(.58)%	(.67)%	.55%	.90%
Return on Average Equity	3.71%	(10.10)%	(11.02)%	9.31%	12.70%
Dividend Payout Ratio	0%	(7.85)%	(43.21)%	55.17%	37.50%
Average Equity to Average Assets	6.55%	5.73%	6.06%	5.95%	7.10%
Total Risk-based Capital Ratio	13.05%	11.57%	11.20%	12.18%	12.51%

Tier I Capital to Risk Weighted Assets	11.30	%	9.74	%	9.60	%	10.59	%	11.40	%
Tier I Capital to Average Assets	9.10	%	7.34	%	8.53	%	8.10	%	8.91	%

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, 2011, which are included in Item 8 of Part II of this annual report.

Recent Developments

Effective on January 1, 2012, the Insurance Group sold substantially all of its assets, net of cash, to an unrelated third party (the "Acquirer") for $3.6 million. Prior to that date, the Insurance Group operated as a full service insurance agency with offices in Maryland and West Virginia. As part of this sale, we agreed that we would not compete with the Acquirer for insurance business other than with respect to insurance related to our banking, trust, lending, consumer finance company, and/or securities sales businesses. We also agreed to not solicit the Acquirer's customers or any person who was a customer of the Insurance Group at any time within three years prior to the sale. These restrictions will terminate on January 1, 2017. As a result of these agreements, we anticipate that our insurance activities for the foreseeable future will be limited to the sale of credit-related insurance products and the sale, through our networking arrangements, of annuities. Also as part of the sale, we agreed, until January 1, 2013, to refer insurance business to the Acquirer. To the extent permitted by law, we will be entitled to a referral fee, equal to 10% of the commission payable to the Acquirer, when our referrals result in the sale of an insurance policy of a type not previously sold to the customer by the Acquirer. Total revenues for 2011 were $2.4 million and pre-tax operating expenses, net of amortization expense and expenses related to the sale were $2.2 million. Management does not expect the sale of the Insurance Group's assets or the referral arrangement to have a material impact on our future financial condition or results of operations.

Overview

First United Corporation is a financial holding company which, through the Bank and its non-bank subsidiaries, provides an array of financial products and services primarily to customers in four Western Maryland counties and four Northeastern West Virginia counties. Its principal operating subsidiary is the Bank, which consists of a community banking network of 28 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 $2.0 million for the year ended December 31, 2011, compared to a net loss attributable to common shareholders of $11.8 million for the same period of 2010. Basic and diluted net income per common share for the year ended December 31, 2011 were $.33, compared to basic and diluted

net loss per common share of $1.91 for the same period of 2010. The change in earnings, from a net loss for the year ended December 31, 2010 to net income for the year ended December 31, 2011, resulted primarily from a $6.6 million reduction in provision for loan losses and a $3.8 million reduction in net losses from sales of securities and other real estate owned. In addition, $19,000 in non-cash other-than-temporary impairment ("OTTI") charges were realized for the year ended December 31, 2011, compared to $8.4 million for the same period of 2010. During 2011, we also recognized a gain of $1.4 million from the sale of a portion of the indirect auto loan portfolio. The decreases in expenses and the gain on the sale of indirect auto loans were offset by a decrease of $7.4 million in income tax benefit and a decline in net interest income of $3.3 million. The decrease in net interest income was driven by an $11.7 million reduction in interest income on a fully tax-equivalent ("FTE") basis attributable to lower levels of loans, the sale of a portion of the indirect auto portfolio and the lower interest rate environment. The net interest margin for the year ended December 31, 2011, on an FTE basis, increased to 2.96% from 2.71% for the year ended December 31, 2010. The increase in the net interest margin was driven primarily by the strategic plan to reduce cash levels by paying off certain liabilities that matured during 2011 and to change the composition of our deposit mix, focusing on lower cost core deposits.

The provision for loan losses was $9.2 million for the year ended December 31, 2011, compared to $15.7 million for fiscal year 2010. The lower provision expense was primarily due to a leveling in the credit quality of our loan portfolio. Management continued to make specific allocations for impaired loans where it was determined that the collateral supporting the loans is not adequate to cover the loan balance, and management adjusted the qualitative factors affecting the allowance for loan losses (the "ALL") to reflect changes in the economic environment.

Interest expense on our interest-bearing liabilities decreased $8.0 million during 2011 when compared to 2010 due primarily to a planned decrease of $260.1 million in average interest-bearing deposits and a $39.1 million decrease in average debt outstanding. Management used cash to repay wholesale deposits and FHLB advances. The decline in expense was also due to the low interest rate environment and our strategy to provide special pricing only to full relationship customers.

Other operating income increased $14.7 million during 2011 when compared to 2010. This increase was primarily attributable to an $8.4 million decrease in non-cash credit-related OTTI charges, and a decrease of $6.1 million in net losses related to sales of securities, sales and write downs of other real estate owned and a gain recognized on the sale of a portion of the indirect auto loan portfolio. Operating expenses decreased $3.2 million during 2011 when compared to the same period of 2010. This decrease was due primarily to a $1.1 million decline in salaries and benefits related to a reduction in full-time equivalents through attrition and reduced pension expense and a decline of $1.7 million in FDIC premiums attributable to the repayment of brokered deposits.

Comparing December 31, 2011 to December 31, 2010, outstanding loans decreased by $38.6 million (3.8%), net of the sale of $32.5 million of the indirect auto portfolio. CRE loans decreased $12.4 million as a result of the payoff of several large loans, charge-offs of loan balances and ongoing scheduled principal payments. Commercial and industrial ("C&I") loans increased $8.7 million and residential mortgages declined $9.5 million. Acquisition and development loans decreased $14.0 million due to principal repayments and charge offs. The decrease in the residential mortgage portfolio was attributable to regularly scheduled principal payments on existing loans and management's decision to use secondary market outlets such as Fannie Mae for the majority of new, longer-term, fixed-rate residential loan originations. The consumer loan portfolio declined $43.9 million due primarily to the sale of $32.5 million of retail installment contracts in our indirect auto loan portfolio and $11.4 million of repayment activity in the indirect auto portfolio which exceeded new production due to special financing offered by the automotive manufacturers, credit unions and certain large regional banks. At December 31, 2011, approximately 64% of the commercial loan portfolio was collateralized by real estate, compared to approximately 71% at December 31, 2010.

Interest income on loans in 2011 decreased by $8.8 million (on an FTE basis) when compared to 2010 due to the decrease in interest rates and the decline the in loan balances during 2011. Interest income on the investment securities decreased by $2.7 million (on an FTE basis) due to reinvesting called securities at lower rates. (Additional information on the composition of interest income is available in Table 1 that appears on page 32).

Total deposits decreased $273.9 million during 2011 when compared to deposits at December 31, 2010. The decline in deposits was due to a strategic decision to use cash to repay wholesale deposits and FHLB advances. The repayment of approximately $161 million in wholesale deposits was offset by increases of $28.7 million in non-interest bearing deposits, $9.0 million in traditional savings accounts and $2.1 million in retail money market accounts. Time deposits less than $100,000 declined $62.3 million while time deposits greater than $100,000 decreased $196.9 million. The decrease was due to a $160.4 million decline in brokered certificates of deposit and

CDARS® participation, and a decrease of $36.5 million in retail certificates of deposit.

Interest expense decreased $8.0 million in 2011 when compared to 2010. The decline was due to an overall reduction in interest rates on time deposits driven by our decision to increase special rates only for full relationship customers, the shorter duration of the portfolio, lower balances and the increase in non-interest bearing deposits. The overall net interest margin increased during 2011 to 2.96% from 2.71% in 2010 on a fully taxable equivalent basis.

Other Operating Income/Other Operating Expense – Other operating income, exclusive of losses, decreased $.2 million during the year ended December 31, 2011 when compared to fiscal year 2010. Service charge income decreased $.7 million due primarily to a reduction in non-sufficient funds ("NSF") fees resulting from newly enacted regulation of overdraft fees. Debit card income increased $.5 million during 2011 when compared to 2010 due to increased consumer spending and higher customer awareness of our rewards program. Trust department income increased $.3 million during 2011 when compared to 2010 due to a slight increase in assets under management and the fees received on those accounts and increased fees collected on estate administration. Assets under management were approximately $595 million at December 31, 2011, a 1% increase over December 31, 2010.

Net gains of $.6 million were reported through other income during 2011, compared to net losses of $14.4 million during 2010. There were $19,000 in losses during 2011 that were attributable to non-cash OTTI charges on the investment portfolio, down from the $8.4 million during fiscal year 2010. The reduced OTTI charges resulted from the improvement in the financial industry, the debt securities of which make up the primary collateral for the securities in our collateralized

debt obligation ("CDO") portfolio. Net gains of $.9 million from sales of investments, the $1.4 million gain from the sale of our indirect auto loan portfolio and $.3 million of gains on sales of other real estate owned were offset by $2.0 million in write-downs of other real estate owned.

Other operating expenses decreased $3.2 million (7%) for the year ended December 31, 2011 when compared to the year ended December 31, 2010. The decrease was primarily due to a $1.1 million decline in salaries and benefits, resulting primarily from a reduction of full-time equivalent employees through attrition and reduced pension expense, and a $1.7 million decline in FDIC premiums attributable to the repayment of brokered deposits.

Dividends – During 2011, First United Corporation did not declare or pay any dividends on the shares of its common stock on account of the board of directors' decision in November 2010 to defer quarterly cash dividends on the Series A Preferred Stock. There were no dividends paid on the Series A Preferred Stock in 2011. In 2010, First United Corporation paid a total of $.8 million in cash dividends on the shares of common stock and a total of $1.1 million in cash dividends on the Series A Preferred Stock.

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.

Critical Accounting Policies and Estimates

This discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States 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, including those related to loan losses and intangible assets. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the Consolidated Financial Statements.

Allowance for Loan Losses, 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 allowance is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payment on loans. Estimates for loan losses are arrived at by analyzing risks associated with 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 and Other Intangible Assets

Accounting Standards Codification (“ASC”) Topic 350, *Intangibles – Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. We have $1.6 million related to acquisitions of insurance “books of business” which are subject to amortization. The $12.9 million in recorded goodwill is primarily related to the acquisition of Huntington National Bank branches that occurred in 2003 and the acquisition of insurance books of business in 2008 that are not subject to periodic amortization.

[27]

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 First United 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.

Throughout 2011, consistent with First United Corporation's peer group, the shares of First United Corporation common stock traded below its book value. At December 31, 2011, First United Corporation's stock price was significantly below its 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 First United 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 First United 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 First United 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 First United Corporation's forward five-year operating budget, incorporating conservative growth and mix assumptions;
- A discount rate of 11.0% based on the most recent [third quarter of 2011] Cost of Capital Report from Morningstar/Ibbotson Associates for the Commercial Banking Sector adjusted for a size and risk premium of 302 basis points;

- A price to tangible book multiple of 1.12, which was the median multiple of commercial bank mergers and acquisitions during 2011 for selling banks and holding companies with non-performing assets to average assets between 4.0% and 6.0%, as provided by Sheshunoff & Co.; and
- A capitalization rate of 8.0% (discount rate of 11.0% adjusted for a conservative growth rate of 3.0%).

The resulting fair value of the income approach resulted in the fair value of First United Corporation exceeding the carrying value by 66%. 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 0.41 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, 2011 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

First United Corporation accounts for income taxes by recording deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and

timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws.

A valuation allowance is recognized to reduce any deferred tax assets that based upon available information, it is more-likely-than-not all, or any portion, of the deferred tax asset will not be realized. Assessing the need for, and amount of, a valuation allowance for deferred tax assets requires significant judgment and analysis of evidence regarding realization of the deferred tax assets. In most cases, the realization of deferred tax assets is dependent upon the recognition of deferred tax liabilities and generating a sufficient level of taxable income in future periods, which can be difficult to predict. Our largest deferred tax assets involve differences related to ALL and unrealized losses on investment securities. Given the nature of our deferred tax assets, management determined no valuation allowances were needed at December 31, 2011 or December 31, 2010 except for a state valuation allowance for certain state deferred tax assets associated with our Parent Company.

Management expects that First United 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

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

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

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320 (Section 320-10-35), management assesses whether (i) it has the intent to sell a security being evaluated and (ii) it is more likely than not that First United Corporation 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 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 23 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 17 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, 2010.

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 earned on interest-earning assets and the interest expense incurred on interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to 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 a fully taxable equivalent basis) for the 2011 and 2010.

(Dollars in thousands)	2011	2010
Interest income	$61,029	$72,730
Interest expense	21,206	29,164
Net interest income	$39,823	$43,566

Net interest margin %	2.96	%	2.71	%

Net interest income on an FTE basis decreased $3.7 million during the year ended December 31, 2011 over the same period in 2010 due to an $11.7 million (16.1%) decrease in interest income, which was partially offset by an $8.0 million (27.3%) decrease in interest expense. The decrease in net interest income resulted primarily from a lower level of loans and the lower interest rate environment in 2011 when compared to 2010.

Average interest-earning assets decreased by $264.7 million during 2011. The average yield on our average earning assets increased slightly to 4.54% at December 31, 2011 from 4.52% at December 31, 2010. This increase was due primarily to our strategy to deploy excess liquidity, invested at lower rates, to repay brokered and wholesale funding at their stated maturities rather than renew.

Interest expense decreased during 2011 when compared to 2010 due to an overall reduction in interest rates paid on time deposits, driven by our decision to provide special rates only to full relationship customers, as well as lower balances and the shorter duration of the portfolio. The overall decrease of $299.2 million in average interest-bearing liabilities in 2011 when compared to 2010 decreased the average rate paid from 1.89% at December 31, 2010 to 1.71% at December 31, 2011.

As shown below, the composition of total interest income between 2011 and 2010 reflects a slight shift toward interest and fees on loans from investment securities.

	% of Total Interest Income	
	2011	2010
Interest and fees on loans	88 %	86 %
Interest on investment securities	11 %	13 %
Other	1 %	1 %

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 2011, 2010 and 2009. 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 2011, 2010 and 2009. 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								
	2011			2010			2009		
(Dollars in thousands)	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Assets									
Loans	$953,774	$52,343	5.49 %	$1,074,080	$61,115	5.69 %	$1,132,569	$68,271	6.03 %
Investment Securities:									
Taxable	173,811	4,081	2.35	148,565	5,524	3.72	224,647	13,106	5.83
Non taxable	76,237	4,228	5.55	94,728	5,518	5.83	98,960	5,962	6.02
Total	250,048	8,309	3.32	243,293	11,042	4.54	323,607	19,068	5.89
Federal funds sold	109,287	265	.24	190,878	422	.22	48,979	96	.20
Interest-bearing deposits with other banks	19,922	15	.08	87,860	104	.12	34,389	28	.08
Other interest earning assets	11,797	97	.82	13,453	47	.35	13,819	15	.11
Total earning assets	1,344,828	61,029	4.54 %	1,609,564	72,730	4.52 %	1,553,363	87,478	5.63 %
Allowance for loan losses	(21,495)			(22,530)			(14,960)		
Non-earning assets	167,896			176,265			157,741		
Total Assets	$1,491,229			$1,763,299			$1,696,144		
Liabilities and Shareholders' Equity									
Interest-bearing demand deposits	$98,395	$134	.14 %	$115,478	$387	.34 %	$107,869	$195	.18 %
Interest-bearing money markets	224,303	748	.33	286,639	2,418	.84	283,430	2,802	.99
Savings deposits	100,598	277	.28	83,734	566	.68	76,703	498	.65
Time deposits:									
Less than $100k	290,651	5,650	1.94	366,922	7,802	2.13	323,409	9,241	2.86
$100k or more	267,648	5,090	1.90	388,945	6,910	1.78	355,589	7,480	2.10
Short-term borrowings	41,780	236	.56	45,055	283	.63	44,473	318	.72
Long-term borrowings	217,112	9,071	4.18	252,889	10,798	4.27	274,718	11,570	4.21
Total interest-bearing liabilities	1,240,487	21,206	1.71 %	1,539,662	29,164	1.89 %	1,466,191	32,104	2.19 %
	135,365			109,145			110,883		

Non-interest-bearing deposits								
Other liabilities	17,662			13,507			16,240		
Shareholders' Equity	97,715			100,985			102,830		
Total Liabilities and Shareholders' Equity	$1,491,229			$1,763,299			$1,696,144		
Net interest income and spread		$39,823	2.83%		$43,566	2.63%		$55,374	3.44%
Net interest margin			2.96%			2.71%			3.56%

Notes:

(1) The above table reflects the average rates earned or paid stated on an FTE basis assuming a tax rate of 35% for 2011, 2010 and 2009. The FTE adjustments for the years ended December 31, 2011, 2010 and 2009 were $1,533, $1,983 and $1,613, respectively.

(2) The average balances of non-accrual loans for the years ended December 31, 2011, 2010 and 2009, which were reported in the average loan balances for these years, were $39,806, $42,506 and $39,851, 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.

[32]

Interest Variance Analysis (1)

Table 2

	2011 Compared to 2010			2010 Compared to 2009		
(In thousands and tax equivalent basis)	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Loans	$(6,605)	$(2,167)	$(8,772)	$(3,328)	$(3,828)	$(7,156)
Taxable Investments	593	(2,036)	(1,443)	(2,829)	(4,753)	(7,582)
Non-taxable Investments	(1,026)	(264)	(1,290)	(247)	(197)	(444)
Federal funds sold	(196)	39	(157)	313	13	326
Other interest earning assets	(624)	586	(38)	247	(139)	108
Total interest income	(7,858)	(3,842)	(11,700)	(5,844)	(8,904)	(14,748)
Interest Expense:						
Interest-bearing demand deposits	(23)	(230)	(253)	26	166	192
Interest-bearing money markets	(206)	(1,465)	(1,671)	27	(411)	(384)
Savings deposits	47	(336)	(289)	47	21	68
Time deposits less than $100	(1,480)	(672)	(2,152)	925	(2,364)	(1,439)
Time deposits $100 or more	(2,305)	485	(1,820)	593	(1,163)	(570)
Short-term borrowings	(18)	(29)	(47)	4	(39)	(35)
Long-term borrowings	(1,495)	(232)	(1,727)	(932)	160	(772)
Total interest expense	(5,480)	(2,479)	(7,959)	690	(3,630)	(2,940)
Net interest income	$(2,378)	$(1,363)	$(3,741)	$(6,534)	$(5,274)	$(11,808)

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 $9.2 million for the year ended December 31, 2011, compared to $15.7 million for fiscal year 2010. The lower provision for loan losses resulted primarily from stabilization in our total rolling historical loss rates and qualitative factors utilized in the determination of the ALL and stabilization in the level of classified assets. Approximately $.6 million of the lower provision for 2011 was related to the sale of $32.5 million of our indirect auto portfolio in the second quarter 2011. 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)	2011	2010	% Change	
Service charges on deposit accounts	$3,019	$3,765	-19.8	%
Other service charge income	652	641	1.7	%
Debit card income	2,125	1,580	34.5	%
Trust department income	4,413	4,096	7.7	%
Insurance commissions	2,424	2,712	-10.6	%
Bank owned life insurance (BOLI)	1,030	1,019	1.1	%
Brokerage commissions	767	694	10.5	%
Other income	685	849	-19.3	%
Total other operating income	$15,115	$15,356	-1.6	%

As the table above illustrates, other operating income decreased by $.2 million in 2011 when compared to 2010, exclusive of net losses. The decline in service charges on deposit accounts was due primarily to a reduction in NSF fees, increased charge-off overdrafts and the new overdraft regulation implemented in August 2010 as a result of the Dodd-Frank Act. The creation of the Consumer Protection Bureau and its proposed regulation of overdraft fees and interchange fees

could have a material and adverse impact on our future service charge income. At this time, management cannot predict whether and when this regulation will be finalized and, if so, the extent to which it will reduce service charge income. We also experienced decreases in other income such as fee income from our investments in Maryland and West Virginia title companies.

Debit card income increased due to increased consumer spending and higher customer awareness of our rewards program. Insurance commissions decreased in 2011 when compared to 2010 due primarily to reduced premiums.

Trust department income increased during 2011 when compared to 2010 due to a slight increase in assets under management and the fees received on those account, and increased fees on estate administration. Assets under management were $595 million and $590 million for 2011 and 2010, respectively. Brokerage commissions also increased during 2011 by 10.5% when compared to 2010.

Other Operating Expense

Other operating expense for 2011 decreased by $3.2 million (7.1%) when compared to 2010. The following table shows the major components of other operating expense for the past two years and the percentage changes during these years:

(Dollars in thousands)	2011	2010	% Change	
Salaries and employee benefits	$20,225	$21,307	-5.1	%
Other expenses	7,426	8,409	-11.7	%
FDIC premiums	2,362	4,017	-41.2	%
Equipment	3,015	3,197	-5.7	%
Occupancy	2,804	2,977	-5.8	%
Data processing	2,744	2,637	4.1	%
Professional services	1,575	1,388	13.5	%
Other real estate owned expense	858	589	45.7	%
Miscellaneous loan fees	849	528	60.8	%
Total other operating expense	$41,858	$45,049	-7.1	%

The $1.1 million decrease in salaries and employee benefits during 2011 when compared to 2010 resulted primarily from a reduction of full-time equivalent employees through attrition and reduced service costs in the pension plan. Professional services expenses increased by 13.5% due primarily to increases in legal and consulting expenses. Other expenses decreased by 11.7% due primarily to decreases in marketing, postage and contract labor expenses. FDIC premiums decreased 41.2% as a result of reduced balances in deposits and a change in the deposit mix. The reduction in equipment expense resulted from a decrease in depreciation. Other real estate owned expenses increased 45.7% due

primarily to an increase in other real estate owned properties in 2011. Miscellaneous loan fees increased 60.8% from 2010 to 2011 due primarily to an increase in problem loans.

Applicable Income Taxes

Due to improved operating results in 2011, we recognized a smaller net tax benefit of $.6 million in 2011, compared to a net tax benefit of $8.0 million in 2010. The decrease resulted primarily from the change in earnings, from a net loss in 2010 to net income for 2011. The net tax benefit in 2010 resulted primarily from the $8.4 million non-cash OTTI charges on our investment portfolio and the increased loan loss provision. See Note 16 to the Consolidated Financial Statements under the heading “Income Taxes” for a detailed analysis of our deferred tax assets and liabilities. A valuation allowance has been provided for the $1.4 million in state tax loss carry forwards included in deferred tax assets, which will expire commencing in 2030.

We have concluded that no valuation allowance is necessary for our remaining federal and state net deferred tax assets at December 31, 2011, as it is more likely than not that they will be realized based on the following:

- the expected reversal of all but $1.0 million of the total $4.6 million of deferred tax liabilities at December 31, 2011 in such a manner so as to substantially utilize the dollar for dollar impact against the deferred tax assets at December 31, 2011;

[34]

- 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 $6.0 million and recurring annual decreases in unfavorable permanent items.

We will need to generate future taxable income of approximately $75 million to fully utilize the 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

Our total assets were $1.39 billion at December 31, 2011, representing a decrease of $305.6 million (18.0%) from assets at December 31, 2010. The decrease resulted from a strategic decision to right-size our balance sheet to better reflect our current capital levels.

The total interest-earning asset mix at December 31, 2011 shows a slight increase in the percentage of loans and investments and a decline in cash and cash equivalents as a percentage of total assets from 2010 to 2011. These changes resulted from the implementation of our strategy to use our excess liquidity to repay, rather than renew, brokered and wholesale funding obligations at their stated maturities during the year. The mix for each year is illustrated below:

	Year End Percentage of Total Assets			
	2011		2010	
Cash and cash equivalents	5	%	18	%
Net loans	66	%	58	%
Investments	18	%	14	%

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

	Year End Percentage of Total Liabilities			
	2011		2010	
Total deposits	79	%	81	%
Total borrowings	19	%	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, Hardy County, Mineral County, and Monongalia County in West Virginia; and the surrounding regions of West Virginia and Pennsylvania. We have policies and procedures designed to mitigate credit risk and to maintain the quality of our loan portfolio. These policies include underwriting standards for new credits as well as continuous monitoring and reporting policies for asset quality and the adequacy of the allowance for loan losses. These policies, coupled with ongoing training efforts, have provided effective checks and balances for the risk associated with the lending process. Lending authority is based on the type of the loan, and the experience of the lending officer.

Commercial loans are collateralized primarily by real estate and, to a lesser extent, equipment and vehicles. Unsecured commercial loans represent an insignificant portion of total commercial loans. Residential mortgage loans are collateralized by the related property. 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)	2011	2010	2009	2008	2007
Commercial real estate	$336.2	$348.6	$326.8	$322.4	$232.1
Acquisition and development	142.9	156.9	231.7	227.0	231.0
Commercial and industrial	78.7	70.0	81.3	77.7	81.5
Residential mortgage	347.2	356.7	373.2	382.0	357.3
Consumer	33.7	77.6	108.9	125.4	141.4
Total Loans	$938.7	$1,009.8	$1,121.9	$1,134.5	$1,043.3

Comparing December 31, 2011 to December 31, 2010, outstanding loans decreased by $38.6 million (3.8%), net of the sale of $32.5 million of the indirect auto portfolio. CRE loans decreased $12.4 million as a result of the payoff of several large loans, charge-offs of loan balances and ongoing scheduled principal payments. Commercial and industrial (“C&I”) loans increased $8.7 million and residential mortgages declined $9.5 million. Acquisition and development loans decreased $14.0 million due primarily to principal repayments and charge offs. The decrease in the residential mortgage portfolio was attributable to regularly scheduled principal payments on existing loans and management’s decision to use secondary market outlets such as Fannie Mae for the majority of new, longer-term, fixed-rate residential loan originations. The consumer portfolio declined $43.9 million due primarily to the sale of $32.5 million of retail installment contracts in our indirect auto loan portfolio and $11.4 million of repayment activity in the indirect auto portfolio exceeded new production due to special financing offered by the automotive manufacturers, credit unions and certain large regional banks. At December 31, 2011, approximately 64% of the commercial loan portfolio was collateralized by real estate, compared to approximately 71% at December 31, 2010.

At December 31, 2011, adjustable interest rate loans made up 63% of total loans, compared to 62% at December 31, 2010. Fixed–interest rate loans made up 37% of the total loan portfolio at December 31, 2011, compared to 38% of

total loans at December 31, 2010.

Comparing loans at December 31, 2010 to loans at December 31, 2009, our loan portfolio decreased $112.1 million (10%). CRE loans increased $21.8 million, as management focused on growing the small business loan portfolio and as certain acquisition and development ("A&D") loans, which decreased $74.8 million, were completed and transferred to permanent financing. The A&D category also declined due to charged-off balances, foreclosures, and working some troubled credits out of the Bank. Commercial and industrial loans declined $11.3 million and residential mortgage declined $16.5 million. The decrease in the residential mortgage portfolio was attributable to the increased amount of loan refinancing that were occurring as consumers sought long-term fixed rate loans. We do not retain these long-term fixed rate loans, but use secondary market and Fannie Mae outlets to satisfy these loan requests. The consumer portfolio declined $31.3 million as repayment activity in the indirect auto portfolio exceeded new production resulting from the continued slowdown in economic activity and management's decision not to compete with the special financing offered by the automotive manufacturers.

The following table sets forth the maturities, based upon contractual dates, for selected loan categories as of December 31, 2011:

Maturities of Loan Portfolio at December 31, 2011

Table 4

(In thousands)	Maturing Within One Year	After One But Within Five Years	Maturing After Five Years	Total
Commercial Real Estate	$ 48,244	$ 48,806	$ 239,184	$ 336,234
Acquisition and Development	53,750	25,437	63,684	142,871
Commercial and Industrial	23,460	23,422	31,815	78,697
Residential Mortgage	17,433	6,672	323,115	347,220
Consumer	6,787	22,974	3,911	33,672
Total Loans	$ 149,674	$ 127,311	$ 661,709	$ 938,694

Classified by Sensitiv