Pandora Media, Inc.
Form 4
February 21, 2017

# FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

| | |
|---|---|
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(Print or Type Responses)

1. Name and Address of Reporting Person *
Trimble John

(Last) (First) (Middle)

PANDORA MEDIA, INC., 2101 WEBSTER STREET #1650

(Street)

OAKLAND, CA 94612

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Pandora Media, Inc. [P]

3. Date of Earliest Transaction (Month/Day/Year)
02/16/2017

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chief Revenue Officer

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

**Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned**

| 1.Title of Security (Instr. 3) | 2. Transaction Date (Month/Day/Year) | 2A. Deemed Execution Date, if any (Month/Day/Year) | 3. Transaction Code (Instr. 8) | | 4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5) | | | 5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4) | 6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4) | 7. Nature of Indirect Beneficial Ownership (Instr. 4) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Code | V | Amount | (A) or (D) | Price | | | |
| Common Stock | 02/16/2017 | | S (1) | | 22,502 | D | $ 12.9714 (2) | 294,900 (3) | D | |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

**Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned**
**(*e.g.*, puts, calls, warrants, options, convertible securities)**

| 1. Title of Derivative Security (Instr. 3) | 2. Conversion or Exercise Price of Derivative Security | 3. Transaction Date (Month/Day/Year) | 3A. Deemed Execution Date, if any (Month/Day/Year) | 4. Transaction Code (Instr. 8) | | 5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) | | 6. Date Exercisable and Expiration Date (Month/Day/Year) | | 7. Title and Amount of Underlying Securities (Instr. 3 and 4) | | 8. Price of Derivative Security (Instr. 5) | 9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Code | V | (A) | (D) | Date Exercisable | Expiration Date | Title | Amount or Number of Shares | | |

## Reporting Owners

| Reporting Owner Name / Address | Relationships | | | |
|---|---|---|---|---|
| | Director | 10% Owner | Officer | Other |
| Trimble John<br>PANDORA MEDIA, INC.<br>2101 WEBSTER STREET #1650<br>OAKLAND, CA 94612 | | | Chief Revenue Officer | |

## Signatures

| /s/ Jeremy Liegl, Attorney-in-Fact | 02/21/2017 |
|---|---|
| **Signature of Reporting Person | Date |

## Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

**(1)** Represents the number of shares required to be sold by the Reporting Person to cover tax withholding obligations in connection with the vesting of RSUs. This sale is mandated by the Issuer's election under its equity incentive plans to require the satisfaction of tax withholding obligations to be funded by a "sell to cover" transaction and does not represent a discretionary trade by the Reporting Person.

**(2)** These shares were sold in multiple transactions at the price of $12.9714.

**(3)** Includes 403 shares acquired under the Issuer's Employee Stock Purchase Plan on February 15, 2017.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. D>) (1,780) (662) (592)Amortization of transition asset (30) (30) (10) (10)Amortization of net actuarial loss 280 399 93 133 Amortization of prior service cost 9 9 3 3 Net pension credit included in employee benefits $(432) $(298) $(143) $(111)

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| SERP | For the Nine months ended September 30, | | For the Three months ended September 30, | |
|---|---|---|---|---|
| (In thousands) | 2014 | 2013 | 2014 | 2013 |
| Service cost | $ 71 | $ 91 | $ 23 | $ 31 |
| Interest cost | 172 | 192 | 58 | 64 |
| Amortization of recognized (gain)/loss | (13 ) | 3 | (4 ) | 1 |
| Amortization of prior service cost | 15 | 15 | 5 | 5 |
| Net SERP expense included in employee benefits | $ 245 | $ 301 | $ 82 | $ 101 |

Effective April 30, 2010, the Pension Plan was amended, resulting in a “soft freeze”. The effects of the amendment were to prohibit new entrants into the plan and to cease crediting additional years of service after that date. Effective January 1, 2013, the plan was amended to unfreeze the plan for those employees for whom the sum of (a) their ages, at their closest birthday, plus (b) years of service for vesting purposes equal 80 or greater. The “soft freeze” continues to apply to all other plan participants. Pension benefits for these participants will be managed through discretionary contributions to the 401(k) Profit Sharing Plan. The Corporation anticipates that the plan changes will have a minimal impact on the consolidated financial statements.

The Corporation will assess the need for future annual contributions to the pension plan based upon its funded status and an evaluation of the future benefits to be provided thereunder. The Corporation expects to fund the annual projected benefit payments for the SERP from operations.

**Note 14 - Equity Compensation Plan Information**

At the 2007 Annual Meeting of Shareholders, First United Corporation’s shareholders approved the First United Corporation Omnibus Equity Compensation Plan (the “Omnibus Plan”), which authorizes the issuance of up to 185,000 shares of common stock pursuant to the grant of stock options, stock appreciation rights, stock awards, stock units, performance units, dividend equivalents, and other stock-based awards to employees or directors.

On June 18, 2008, the Board of Directors of First United Corporation adopted a Long-Term Incentive Program (the “LTIP”). This program was adopted as a sub-plan of the Omnibus Plan to reward participants for increasing shareholder value, align executive interests with those of shareholders, and serve as a retention tool for key executives. Under the LTIP, participants are granted shares of restricted common stock of First United Corporation. The amount of an award is based on a specified percentage of the participant’s salary as of the date of grant. These shares will vest if the Corporation meets or exceeds certain performance thresholds. There were no grants of restricted stock outstanding at September 30, 2014.

The Corporation complies with the provisions of ASC Topic 718, *Compensation-Stock Compensation*, in measuring and disclosing stock compensation cost. The measurement objective in ASC Paragraph 718-10-30-6 requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. The cost is recognized in expense over the period in which an employee is required to provide service in exchange for the award (the vesting period). The performance-related shares granted in connection with the LTIP are expensed ratably from the date that the likelihood of meeting the performance measures is probable through the end of a three year vesting period.

The American Recovery and Reinvestment Act of 2009 (the "Recovery Act") imposes restrictions on the type and timing of bonuses and incentive compensation that may be accrued for or paid to certain employees of institutions like First United Corporation that participated in Treasury's Capital Purchase Program. The Recovery Act generally limits bonuses and incentive compensation to grants of long-term restricted stock that, among other requirements, cannot fully vest until the Capital Purchase Program assistance is repaid.

Stock-based awards were made to non-employee directors in May 2014 pursuant to First United Corporation's director compensation policy. Beginning May 2014, each director's annual retainer is paid in 1,000 shares of common stock, with the remainder of $10,000 paid in cash or any portion thereof, in shares of stock. Prior to May 2014, the retainer of the 1,000 shares of stock was paid in shares of stock in the amount of $5,000. A total of 17,779 fully-vested shares of common stock were issued to directors in 2014, which had a fair market value of $8.78 per share. Director stock compensation expense was $95,035 for the nine months ended September 30, 2014 and $65,806 for the nine months ended September 30, 2013. Stock compensation expense was $39,025 and $22,495 for the three months ended September 30, 2014 and 2013, respectively.

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**Note 15 – Letters of Credit and Off Balance Sheet Liabilities**

The Corporation does not issue any guarantees that would require liability recognition or disclosure other than the standby letters of credit issued by the Bank. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Generally, the Bank's letters of credit are issued with expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral and/or personal guarantees supporting these commitments. The Bank had $.9 million of outstanding standby letters of credit at September 30, 2014 and $1.1 million as of December 31, 2013. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payment required by the letters of credit. Management does not believe that the amount of the liability associated with guarantees under standby letters of credit outstanding at September 30, 2014 and December 31, 2013 is material.

**Note 16 – Derivative Financial Instruments**

As a part of managing interest rate risk, the Bank entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities. The Corporation has designated these interest rate swap agreements as cash flow hedges under the guidance of ASC Subtopic 815-30, *Derivatives and Hedging – Cash Flow Hedges*. Cash flow hedges have the effective portion of changes in the fair value of the derivative, net of taxes, recorded in net accumulated other comprehensive income.

In July 2009, the Corporation entered into three interest rate swap contracts totaling $20.0 million notional amount, hedging future cash flows associated with floating rate trust preferred debt. As of September 30, 2014, swap contracts totaling $5.0 million notional amount remained, as the three-year $5.0 million contract matured on June 15, 2012 and the five-year $10.0 million contract matured on June 17, 2014. The seven-year $5 million contract matures June 17, 2016. The fair value of the interest rate swap contract was ($228) thousand at September 30, 2014 and ($457) thousand at December 31, 2013 and was reported in Other Liabilities on the Consolidated Statement of Financial Condition. Cash in the amount of $.9 million was posted as collateral as of September 30, 2014.

For the nine months ended September 30, 2014, the Corporation recorded an increase in the value of the derivatives of $229 thousand and the related deferred tax benefit of $92 thousand in net accumulated other comprehensive loss to reflect the effective portion of cash flow hedges. ASC Subtopic 815-30 requires this amount to be reclassified to earnings if the hedge becomes ineffective or is terminated. There was no hedge ineffectiveness recorded for the nine months ending September 30, 2014. The Corporation does not expect any losses relating to these hedges to be reclassified into earnings within the next 12 months.

Interest rate swap agreements are entered into with counterparties that meet established credit standards and the Corporation believes that the credit risk inherent in these contracts is not significant as of September 30, 2014.

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The table below discloses the impact of derivative financial instruments on the Corporation's Consolidated Financial Statements for the nine- and three- months ended September 30, 2014 and 2013.

**Derivative in Cash Flow Hedging**

| (In thousands) | Amount of gain recognized in OCI on derivative (effective portion) | Amount of gain or (loss) reclassified from accumulated OCI into income (effective portion) [a] | Amount of gain or (loss) recognized in income or derivative (ineffective portion and amount excluded from effectiveness testing) [b] |
|---|---|---|---|
| Interest rate contracts: | | | |
| Nine months ended: | | | |
| September 30, 2014 | $ 137 | $ 0 | $ 0 |
| September 30, 2013 | 180 | 0 | 0 |
| Three months ended: | | | |
| September 30, 2014 | $ 26 | $ 0 | $ 0 |
| September 30, 2013 | 42 | 0 | 0 |

Notes:

(a) Reported as interest expense
(b) Reported as other income

**Note 17 – Variable Interest Entities (VIE)**

As noted in Note 11, First United Corporation created the Trusts for the purposes of raising regulatory capital through the sale of mandatorily redeemable preferred capital securities to third party investors and common equity interests to First United Corporation. The Trusts are considered Variable Interest Entities ("VIEs"), but are not consolidated because First United Corporation is not the primary beneficiary of the Trusts. At September 30, 2014, the Corporation reported all of the $41.7 million of TPS Debentures issued in connection with these offerings as long-term borrowings (along with the $5.0 million of stand-alone junior subordinated debentures), and it reported its $1.3 million equity interest in the Trusts as "Other Assets".

In November 2009, the Bank became a 99.99% limited partner in Liberty Mews Limited Partnership (the "Partnership"), a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing

units in Garrett County, Maryland. The Partnership was financed with a total of $10.6 million of funding, including a $6.1 million equity contribution from the Bank as the limited partner. The Partnership used the proceeds from these sources to purchase the land and construct a 36-unit low income housing rental complex at a total cost of $10.6 million. The total assets of the Partnership were approximately $9.5 million at September 30, 2014 and $9.7 million at December 31, 2013.

As of December 31, 2011, the Bank had made contributions to the Partnership totaling $6.1 million. The project was completed in June 2011, and the Bank is entitled to $8.4 million in federal investment tax credits over a 10-year period as long as certain qualifying hurdles are maintained. The Bank will also receive the benefit of tax operating losses from the Partnership to the extent of its capital contribution. The investment in the Partnership assists the Bank in achieving its community reinvestment initiatives.

Because the Partnership is considered to be a VIE, management performed an analysis to determine whether its involvement with the Partnership would lead it to determine that it must consolidate the Partnership. In performing its analysis, management evaluated the risks creating the variability in the Partnership and identified which activities most significantly impact the VIE's economic performance. Finally, it examined each of the variable interest holders to determine which, if any, of the holders was the primary beneficiary based on their power to direct the most significant activities and their obligation to absorb potentially significant losses of the Partnership.

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The Bank, as a limited partner, generally has no voting rights. The Bank is not in any way involved in the daily management of the Partnership and has no other rights that provide it with the power to direct the activities that most significantly impact the Partnership's economic performance, which are to develop and operate the housing project in such a manner that complies with specific tax credit guidelines. As a limited partner, there is no recourse to the Bank by the creditors of the Partnership. The tax credits that result from the Bank's investment in the Partnership are generally subject to recapture should the partnership fail to comply with the applicable government regulations. The Bank has not provided any financial or other support to the Partnership beyond its required capital contributions and does not anticipate providing such support in the future. Management currently believes that no material losses are probable as a result of the Bank's investment in the Partnership.

On the basis of management's analysis, the general partner is deemed to be the primary beneficiary of the Partnership. Because the Bank is not the primary beneficiary, the Partnership has not been included in the Corporation's consolidated financial statements.

At September 30, 2014 and December 31, 2013, the Corporation included its total investment in the Partnership in "Other Assets" in its Consolidated Statement of Financial Condition. As of September 30, 2014, the Corporation's commitment in the Partnership was fully funded. The following table presents details of the Bank's involvement with the Partnership at the dates indicated:

| (In thousands) | September 30, 2014 | December 31, 2013 |
| --- | --- | --- |
| Investment in LIHTC Partnership | | |
| Carrying amount on Balance Sheet of: | | |
| Investment (Other Assets) | $ 4,570 | $ 4,980 |
| Maximum exposure to loss | 4,570 | 4,980 |

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**Note 18 – Assets and Liabilities Subject to Enforceable Master Netting Arrangements**

***Interest Rate Swap Agreements ("Swap Agreements")***

The Corporation has entered into interest rate swap agreements to modify the re-pricing characteristics of certain interest-bearing liabilities as a part of managing interest rate risk. The swap agreements have been designated as cash flow hedges, and accordingly, the fair value of the interest rate swap contracts is reported in Other Liabilities on the Consolidated Statement of Financial Condition. The swap agreements were entered into with a third party financial institution. The Corporation is party to master netting arrangements with its financial institution counterparty; however the Corporation does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, in the form of cash, is pledged by the Corporation as the counterparty with net liability positions in accordance with contract thresholds. See Note 16 to the Consolidated Financial Statements for more information.

***Securities Sold Under Agreements to Repurchase ("Repurchase Agreements")***

The Bank enters into agreements under which it sells interests in U.S. securities to certain customers subject to an obligation to repurchase, and on the part of the customers to resell, such interests. Under these arrangements, the Bank may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Bank to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e. secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Consolidated Statement of Condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. There is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Bank does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements. The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Bank be in default (i.e. fails to repurchase the U.S. securities on the maturity date of the agreement). The investment security collateral is held by a third party financial institution in the counterparty's custodial account.

The following table presents the liabilities subject to an enforceable master netting arrangement or repurchase agreements as of September 30, 2014 and December 31, 2013.

Gross Amounts Not Offset in
the Statement of Condition

| (In thousands) | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Statement of Condition | Net Amounts of Liabilities Presented in the Statement of Condition | Financial Instruments | | Cash Collateral Pledged | Net Amount |
|---|---|---|---|---|---|---|---|
| September 30, 2014 | | | | | | | |
| Interest Rate Swap Agreements | $ 228 | $ 0 | $ 228 | $ (228 | ) | $ 0 | $ 0 |
| Repurchase Agreements | $ 47,994 | $ 0 | $ 47,994 | $ (47,994 | ) | $ 0 | $ 0 |
| December 31, 2013 | | | | | | | |
| Interest Rate Swap Agreements | $ 457 | $ 0 | $ 457 | $ (457 | ) | $ 0 | $ 0 |
| Repurchase Agreements | $ 43,676 | $ 0 | $ 43,676 | $ (43,676 | ) | $ 0 | $ 0 |

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**Note 19 – Adoption of New Accounting Standards and Effects of New Accounting Pronouncements**

In August 2014, the FASB issued Accounting Standards Update ("ASU") 2014-14, *Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure,* an amendment of ASC Subtopic 310-40, *Receivables – Troubled Debt Restructurings by Creditors*. ASU 2014-14 specifies that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the loan has a government guarantee that is not separable from the loan before foreclosure; and at the time of foreclosure, the creditor has the intent to convey the real estate to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under the amount of the claim, which must be a fixed amount determined on the basis of the fair value of the real estate. An entity can elect to adopt the amendments in ASU 2014-14 using either a modified retrospective transition method or a prospective transition method. ASU 2014-14 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The Corporation is evaluating the provisions of ASU 2014-14, but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In June 2014, the FASB issued ASU 2014-11, *Repurchase-to Maturity Transactions, Repurchase Financings, and Disclosures,* an amendment of ASC Topic 860, *Transfers and Servicing.* The amendments in ASU 2014-11 require repurchase-to-maturity transactions to be accounted for as secured borrowing transactions on the balance sheet, rather than sales; and for repurchase financing arrangements, require separate accounting for a transfer of a financial asset executed contemporaneously with (or in contemplation of) a repurchase agreement with the same counterparty, which also will generally result in secured borrowing accounting for the repurchase agreement. The ASU also introduces new disclosures to increase transparency about the types of collateral pledged for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings, and requires a transferor to disclose information about transactions accounted for as a sale in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets through an agreement with the transferee. For public entities, the accounting changes and disclosure for certain transactions accounted for as a sale are effective for the first interim or annual period beginning after December 15, 2014. The disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. Earlier application for a public entity is prohibited. The Corporation is evaluating the provisions of ASU 2014-11, but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers,* which establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. ASU 2014-09 specifies that an entity shall recognize revenue when, or as, the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when, or as, the customer obtains control of the asset. Entities are required to disclose qualitative and quantitative information on the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, with early adoption not permitted. The Corporation is evaluating the provisions of ASU 2014-09, but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In January 2014, the FASB issued ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, which provides guidance clarifying when an in substance repossession or foreclosure occurs that would require a loan receivable to be derecognized and the real estate property recognized. ASU 2014-04 specifies the circumstances when a creditor should be considered to have received physical possession of the residential real estate property collateralizing a consumer mortgage loan, and requires interim and annual disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate that are in the process of foreclosure. An entity can elect to adopt the amendments in ASU 2014-04 using either a modified or a retrospective transition method or a prospective transition method. ASU 2014-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The Corporation is evaluating the provisions of ASU 2014-04, but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

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In January 2014, the FASB issued ASU 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*, which provides amendments and guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. The amendments in ASU 2014-01 should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. Additional disclosure requirements are applicable to all reporting entities, regardless of whether the election is made. ASU 2014-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. At December 31, 2013, the Corporation had a single investment in a flow-through limited liability entity that invests in an affordable housing project, for which it currently utilizes the effective yield method to account for its investment. The Corporation is evaluating whether to change its method of accounting as permitted by ASU 2014-01, but believes that the adoption of ASU 2014-01 will not have a material impact on the Corporation’s financial condition or results of operations.

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss (“NOL”) carryforward, a similar tax loss, or a tax credit carryforward exists. The ASU is intended to eliminate diversity in practice resulting from a lack of guidance on this topic in current GAAP. Under the ASU, an entity generally must present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for an NOL carryforward, a similar tax loss, or a tax credit carryforward. The Corporation adopted the provisions of ASU 2013-11 effective January 1, 2014. As the Corporation has no unrecognized tax benefits, the adoption of ASU 2013-11 did not have any impact on the Corporation’s financial condition or results of operations.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

INTRODUCTION

The following discussion and analysis is intended as a review of material changes in and significant factors affecting the financial condition and results of operations of the First United Corporation and its consolidated subsidiaries for the periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and the notes thereto contained in Item 1 of Part I of this report. Unless the context clearly suggests otherwise, references in this report to “us”, “we”, “our”, and “the Corporation” are to First United Corporation and its consolidated subsidiaries.

FORWARD-LOOKING STATEMENTS

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

FIRST UNITED CORPORATION

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered under the Federal Bank Holding Company Act of 1956, as amended. Until September 24, 2014, First United Corporation operated as a financial holding company under the Gramm-Leach-Bliley Act. Effective on that date, First United Corporation terminated its financial holding company election because the Corporation is not engaged, and does not anticipate engaging in the foreseeable future, in any activity that requires the election. Accordingly, the termination is not expected to have any material impact on our financial condition or results of operations. 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 Agency") that, through the close of business on December 31, 2011, operated as a full service insurance agency. Effective on January 1, 2012, the Insurance Agency sold substantially all of its assets, net of cash, to a third-party and is no longer an active subsidiary. 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. Until March 27, 2013, the Bank also owned a majority interest in Cumberland Liquidation Trust, a Maryland statutory trust formed for the purposes of servicing and disposing of real estate that secured a loan made by another bank and in which the Bank held a participation interest, but this entity was dissolved on such date. 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 September 30, 2014, the Corporation had total assets of $1.3 billion, net loans of $812.9 million, and deposits of $973.0 million. Shareholders' equity at September 30, 2014 was $112.3 million.

The Corporation maintains an Internet site 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.

ESTIMATES AND CRITICAL ACCOUNTING POLICIES

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. (See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of Part II of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2013). On an on-going basis, management evaluates estimates, including those related to loan losses and intangible assets, other-than-temporary impairment ("OTTI") of investment securities, income taxes, fair value of investments and pension plan assumptions. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the consolidated financial statements.

*Allowance for Loan Losses*

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

*Goodwill and Other Intangible Assets*

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350, *Intangibles - Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. The $11 million recorded as goodwill at September 30, 2014 is primarily related to the Bank's 2003 acquisition of Huntington National Bank branches and is not subject to periodic amortization.

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

Our goodwill relates to 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 ultimately supported 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.

*Accounting for Income Taxes*

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

Management regularly reviews the carrying amount of the Corporation's net deferred tax assets to determine if the establishment of a valuation allowance is necessary. If management determines, based on the available evidence, that

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

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

*Other-Than-Temporary Impairment of Investment Securities*

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320, *Investments – Debt and Equity Securities* (Section 320-10-35), management assesses whether (a) the Corporation has the intent to sell a security being evaluated and (b) it is more likely than not that the 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 (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the fair value of the security, (4) changes in the rating of the security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest or principal payments, and (7) 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 Investment Securities section of the Consolidated Balance Sheet Review.

*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. The Corporation measures the fair market values of its 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 9 to the consolidated financial statements presented elsewhere in this report.

*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 13 to the consolidated financial statements presented elsewhere in this report.

Other than as discussed above, management does not believe that any material changes in our critical accounting policies have occurred since December 31, 2013.

SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data for the nine-month periods ended September 30, 2014 and 2013 and is qualified in its entirety by the detailed information and unaudited financial statements, including the notes thereto, included elsewhere in this quarterly report.

| | As of or For the Nine months ended September 30, | |
|---|---|---|
| | 2014 | 2013 |
| Per Share Data | | |

| | | | | |
|---|---|---|---|---|
| Basic and diluted net income per common share | $ 0.32 | | $ 0.69 | |
| Book Value | $ 13.21 | | $ 11.18 | |
| | | | | |
| Significant Ratios | | | | |
| Return on Average Assets [a] | 0.39 | % | 0.56 | % |
| Return on Average Equity [a] | 4.79 | % | 7.52 | % |
| Average Equity to Average Assets | 8.18 | % | 7.50 | % |

Note: [a] Annualized

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RESULTS OF OPERATIONS

*Overview*

Consolidated net income available to common shareholders was $2.0 million for the first nine months of 2014, compared to $4.3 million for the same period of 2013. Basic and diluted net income per common share for the first nine months of 2014 was $.32, compared to basic and diluted net income per common share of $.69 for the same period of 2013. The decrease in earnings was due to a decrease of $3.4 million in interest income, primarily interest on loans, and an increase in provision expense of $1.8 million, offset by an increase of $.5 million in other operating income, a decrease of $.6 million in interest expense, and a $1.6 million decrease in other operating expenses. The increase in other operating income was primarily attributable to an increase of $.9 million in gains on sales of securities. The decrease in other operating expenses was due to a decrease of $.6 million in Other Real Estate Owned ("OREO") expenses and a decrease of $.7 million in other miscellaneous expenses. The net interest margin for the first nine months of 2014, on a fully tax equivalent ("FTE") basis, decreased to 3.02% from 3.37% for the first nine months of 2013 due primarily to loans repricing at lower rates and new loans booked at lower rates due to the continued low rate environment and pricing competition in our market areas. The net interest margin for the year ended December 31, 2013, on an FTE basis, was 3.25%.

The provision for loan losses increased to $1.6 million for the nine months ended September 30, 2014 compared to $(.2) for the nine months ended September 30, 2013. The increase was driven by rolling historical loss rates and the qualitative factors as well as a $.8 million recovery on a large commercial real estate credit during the third quarter of 2013. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the ALL have been adjusted based on the current economic environment and the characteristics of the loan portfolio.

Interest expense on our interest-bearing liabilities decreased $.2 million during the nine months ended September 30, 2014 when compared to the same period of 2013 due to a decrease of $10.1 million in average interest-bearing deposits as well as a 5 basis point decrease in the average rate and a decrease of 15 basis points on long-term borrowings. During the first nine months of 2014, our management and retail staff focus has shifted our deposit mix away from higher cost certificates of deposit and towards lower cost money market and transaction accounts. We expect this shift to continue through the remainder of 2014.

Other operating income increased $.5 million during the first nine months of 2014 when compared to the same period of 2013. This increase was primarily attributable to $1.1 million in gains on the sale of securities for the first nine months of 2014 compared to $.3 million for the first nine months of 2013. This increase was offset by a reduction in OREO rental income of $.3 million due to the sale of a property.

Operating expenses decreased $1.6 million in the first nine months of 2014 when compared to the same period of 2013. This decrease was due to a decrease of $.6 million in OREO expenses relating to an increase in the valuation allowance during the first nine months of 2013 in order to better position the properties for retail sale. Declines in other miscellaneous expenses such as miscellaneous loan fees, deferred compensation, and personnel related expenses also contributed to the decrease.

Consolidated net income available to common shareholders was $.7 million, or $.10 per common share, for the third quarter of 2014, compared to $1.4 million, or $.22 per common share, for the same period of 2013. The decrease in earnings for the third quarter of 2014 compared to the third quarter of 2013 was due to a decrease in net interest income of $2.2 million, a $1.8 million increase in provision expense, and an increase of $.2 million in dividends attributable to the increase in rate from 5.0% to 9.0% on the Series A Preferred Stock. These items were offset by a $3.1 million decrease in other operating expenses. The decrease in other operating expenses for the third quarter of 2014 was primarily attributable to a $2.3 million reduction in OREO expenses as discussed above. Declines in other miscellaneous expenses such as miscellaneous loan fees, deferred compensation, and personnel related expenses also contributed to the decrease. The net interest margin for the third quarter of 2014, on a FTE basis, was 2.96%, compared to 3.77% for the same period of 2013. The decline in the net interest margin for the third quarter was due primarily to the decline in loan yields from loans repricing at lower rates and new loans booked at lower rates due to pricing competition in our market areas.

Other operating income remained consistent during the third quarter of 2014 when compared to the same period of 2013. The increase in gains on sales of securities was offset by reductions in other income such as OREO rental income.

Operating expenses decreased $3.1 million in the third quarter of 2014 when compared to the same period of 2013. This decrease was due primarily to a decrease of $2.3 million in OREO expenses relating to the valuation allowance in OREO in the third quarter of 2013 as noted above. Declines in other miscellaneous expenses such as miscellaneous loan fees, deferred compensation, and personnel related expenses also contributed to the decrease.

*Net Interest Income*

Net interest income is the largest source of operating revenue and 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. FTE income is determined 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 following table sets forth the average balances, net interest income and expense, and average yields and rates of our interest-earning assets and interest-bearing liabilities for the nine-month periods ended September 30, 2014 and 2013:

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | | 2013 | | |
| (in thousands) | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| Interest-earning assets: | | | | | | |
| Loans | $816,144 | $28,172 | 4.62 % | $851,559 | $32,977 | 5.17 % |
| Investment securities | 343,288 | 7,204 | 2.81 % | 273,470 | 5,848 | 2.84 % |
| Other interest earning assets | 52,839 | 276 | 0.70 % | 76,675 | 254 | 0.44 % |
| Total earning assets | $1,212,271 | 35,652 | 3.93 % | $1,201,704 | 39,079 | 4.34 % |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing deposits | $791,534 | 3,489 | 0.59 % | $801,644 | 3,860 | 0.64 % |
| Short-term borrowings | 45,009 | 46 | 0.14 % | 46,532 | 45 | 0.12 % |
| Long-term borrowings | 182,646 | 4,699 | 3.44 % | 182,710 | 4,919 | 3.59 % |
| Total interest-bearing liabilities | $1,019,189 | 8,234 | 1.08 % | $1,030,886 | 8,824 | 1.13 % |
| Net interest income and spread | | $27,418 | 2.85 % | | $30,255 | 3.21 % |
| Net interest margin | | | 3.02 % | | | 3.37 % |

Note: Interest income and yields are presented on a fully taxable equivalent basis using a 40% tax rate.

Net interest income on an FTE basis decreased $2.8 million (9.4%) during the first nine months of 2014 over the same period in 2013 due to a $3.4 million (8.8%) decrease in interest income, which was partially offset by a $.6 million (6.7%) decrease in interest expense. The decrease in interest income was primarily due to the $35.4 million (4.2%) reduction in the average balance of loans and a decrease of 55 basis points on yields when comparing the first nine months of 2014 to the same period of 2013. The reduction in loan yields is attributable to loans repricing at lower

rates and new loans booked at lower rates. The decline in interest income was partially offset by a decline in interest expense due to the reduction in the average rate on interest-bearing deposits and a decrease of 15 basis points on long-term borrowings. We saw a decrease in the net interest margin in the first nine months of 2014 to 3.02% when compared to 3.25% for the year ended December 31, 2013 and 3.37% for the first nine months of 2013.

When comparing the nine months ended September 30, 2014 to the same period of 2013, there was an overall $10.6 million increase in average interest-earning assets, driven by an increase of $69.8 million in investment securities, offset by a $35.4 million reduction in loans and a $23.8 million decrease in other interest-earning assets, primarily cash.

Interest expense decreased during the first nine months of 2014 when compared to the same period of 2013 due primarily to an overall reduction in the average rate paid on interest-bearing liabilities. The overall effect was a 5 basis point decrease in the average rate paid and a decrease of $11.7 million on our average interest-bearing liabilities, from 1.13% for the nine months ended September 30, 2013 to 1.08% for the same period of 2014.

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The following table sets forth the average balances, net interest income and expense, and average yields and rates of our interest-bearing assets and interest-bearing liabilities for the three months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | | | 2013 | | | |
| (in thousands) | Average Balance | Interest | Average Rate | | Average Balance | Interest | Average Rate | |
| Interest-Earning Assets: | | | | | | | | |
| Loans | $824,268 | $9,456 | 4.55 | % | $834,576 | $11,940 | 5.67 | % |
| Investment securities | 318,491 | 2,175 | 2.71 | % | 300,790 | 2,216 | 2.92 | % |
| Other interest earning assets | 71,795 | 100 | 0.55 | % | 58,168 | 73 | 0.16 | % |
| Total earning assets | $1,214,554 | 11,731 | 3.83 | % | $1,193,534 | 14,229 | 4.72 | % |
| | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | |
| Interest-bearing deposits | $786,638 | 1,154 | 0.58 | % | $818,902 | 1,251 | 0.59 | % |
| Short-term borrowings | 47,181 | 16 | 0.13 | % | 51,383 | 16 | 0.11 | % |
| Long-term borrowings | 182,631 | 1,502 | 3.26 | % | 182,697 | 1,666 | 3.61 | % |
| Total interest-bearing liabilities | $1,016,450 | 2,672 | 1.04 | % | $1,052,982 | 2,933 | 1.11 | % |
| | | | | | | | | |
| Net interest income and spread | | $9,059 | 2.79 | % | | $11,296 | 3.61 | % |
| Net interest margin | | | 2.96 | % | | | 3.77 | % |

Note: Interest income and yields are presented on a fully taxable equivalent basis using a 40% tax rate.

Net interest income on an FTE basis decreased $2.2 million (19.8%) during the third quarter of 2014 over the same period in 2013 due to a $2.5 million (17.5%) decrease in interest income, offset by a decrease of $.3 million (8.9%) in interest expense. The decrease in interest income was impacted by the decrease in loan balances as well as a 112 basis point decrease in the average rate of loans when comparing the two periods. The decrease in average rate is primarily attributable to loans repricing at lower rates and new loans booked at lower rates due to the continued low rate environment as well as pricing competition in our market areas. We saw a decrease in the net interest margin in the third quarter of 2014 to 2.96% when compared to 3.77% for the three months ended September 30, 2013.

Interest expense decreased during the third quarter of 2014 when compared to the same period of 2013 due to the overall reduction in average interest-bearing liabilities of $36.5 million and the 35 basis point reduction in the average rate paid on long-term borrowings. This reduction in balances was due to the reduction of $32.3 million in interest-bearing deposits as management continued to focus on shifting the deposit mix and reducing certificates of deposit and a $4.2 million decrease in short-term borrowings. The overall effect was a 7 basis point decrease in the average rate paid on our average interest-bearing liabilities, from 1.11% for the three months ended September 30, 2013 to 1.04% for the same period of 2014.

*Provision for Loan Losses*

The provision for loan losses was $1.6 million for the first nine months of 2014 compared to $(.2) for the nine months ended September 30, 2013. Although, through the first nine months of 2014, we continued to experience a reduction in our total rolling historical loss rates and the qualitative factors utilized in the determination of the ALL, as well as continued reduction in the level of classified and impaired assets (discussed below in the section entitled "FINANCIAL CONDITION" under the heading "Allowance and Provision for Loan Losses"), provision expense was higher due to the recovery of $.8 million on a large commercial real estate loan during the first nine months of 2013. Management strives to ensure that the ALL reflects a level commensurate with the risk inherent in our loan portfolio.

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*Other Operating Income*

Other operating income, exclusive of gains, decreased $.4 million during the first nine months of 2014 when compared to the same period of 2013. Service charge income decreased $.4 million in the first nine months of 2014 when compared to the first nine months of 2013 due to reduced NSF fees. The reduction in NSF fees is due to the increased regulations on fees.

Net gains of $1.1 million were reported through other income in the first nine months of 2014, compared to net gains of $.3 million during the same period of 2013. The increase in net gains during the first nine months of 2014 when compared to the same period of 2013 was due to a net gain of $1.1 million realized on sales of investment securities.

Other operating income, exclusive of gains, decreased $.3 million during the third quarter of 2014 when compared to the same period of 2013 due to a decline in service charge income of $.2 million primarily from a reduction in NSF fee income and a reduction of other income of $.1 million.

Net gains of $.2 million were reported through other income in the third quarter of 2014, compared to net losses of $.1 million during the same period of 2013. This increase in gains was due to the gain on the sale of one CDO investment. As a result of the activity spurred by the Volcker Rule, which was clarified during the first quarter of 2014, we had the opportunity to take advantage of the market and sell this security at a gain to book value.

The following table shows the major components of other operating income for the nine- and three-month periods ended September 30, 2014 and 2013, exclusive of net gains:

| | Income as % of Total Other Operating Income For the Nine months ended September 30, | | | | Income as % of Total Other Operating Income For the Three months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| Service charges | 23 | % | 27 | % | 24 | % | 26 | % |
| Trust department | 42 | % | 38 | % | 43 | % | 39 | % |
| Debit card Income | 16 | % | 15 | % | 17 | % | 14 | % |
| Bank owned life insurance | 8 | % | 8 | % | 8 | % | 7 | % |
| Brokerage income | 6 | % | 6 | % | 6 | % | 7 | % |
| Other income | 5 | % | 6 | % | 2 | % | 7 | % |
| | 100 | % | 100 | % | 100 | % | 100 | % |

*Other Operating Expenses*

Operating expenses decreased $1.6 million in the first nine months of 2014 when compared to the same period of 2013. This decrease was due to a decrease of $.6 million in OREO expenses relating to an increase in the valuation allowance during the first nine months of 2013 in order to better position the properties for retail sale. Declines in other miscellaneous expenses such as miscellaneous loan fees, deferred compensation, and personnel related expenses also contributed to the decrease.

Operating expenses decreased $3.1 million in the third quarter of 2014 when compared to the same period of 2013. This decrease was due primarily to a decrease of $2.3 million in OREO expenses relating to the valuation allowance in OREO in the third quarter of 2013 as noted above. Declines in other miscellaneous expenses such as miscellaneous loan fees, deferred compensation, and personnel related expenses also contributed to the decrease.

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The composition of other operating expenses for the nine- and three-month periods ended September 30, 2014 and 2013 is illustrated in the following table.

| | Expense as % of Total Other Operating Expenses For the Nine months ended September 30, | | | | Expense as % of Total Other Operating Expenses For the Three months ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| Salaries and employee benefits | 48 | % | 46 | % | 50 | % | 39 | % |
| FDIC premiums | 4 | % | 4 | % | 5 | % | 4 | % |
| Occupancy, equipment and data processing | 20 | % | 19 | % | 20 | % | 16 | % |
| Other real estate owned | 7 | % | 9 | % | 5 | % | 22 | % |
| Other | 21 | % | 22 | % | 20 | % | 19 | % |
| | 100 | % | 100 | % | 100 | % | 100 | % |

*Provision for Income Taxes*

In reporting interim financial information, income tax provisions should be determined under the procedures set forth in ASC Topic 740, *Income Taxes* (Section 740-270-30). This guidance provides that at the end of each interim period, an entity should make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. The rate so determined should be used in providing for income taxes on a current year-to-date basis. The effective tax rate should reflect anticipated investment tax credits, capital gains rates, and other available tax planning alternatives. In arriving at this effective tax rate, however, no effect should be included for the tax related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect in reports for the interim period or for the fiscal year.

The effective tax rate for the first nine months of 2014 was 19.8%, compared to an effective tax rate of 24.9% for the first nine months of 2013. Our effective income tax rates differed from the 35% federal statutory rate due to the effects of tax-exempt income on loans, securities and bank-owned life insurance, as well as the low income housing tax credits.

**FINANCIAL CONDITION**

*Balance Sheet Overview*

Total assets remained stable at $1.3 billion at September 30, 2014 and December 31, 2013. During the first nine months of 2014, cash and interest-bearing deposits in other banks increased $8.1 million, the investment portfolio decreased $10.7 million, and gross loans increased $14.7 million. We sold investments during this time period in order to reduce interest rate volatility and to provide funding for higher yielding loans. OREO balances decreased $5.4 million due to sales of properties. Total liabilities decreased by approximately $12.5 million during the first nine months of 2014 due primarily to a decrease of $12.4 million in other liabilities. Other liabilities decreased as a result of cash payments of accrued dividends and interest on the Trust Preferred debentures and Series A Preferred Stock dividend. Comparing September 30, 2014 to December 31, 2013, shareholders' equity increased $10.9 million as a result of a decrease of $8.8 million in accumulated other comprehensive loss.

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*Loan Portfolio*

The following table presents the composition of our loan portfolio at the dates indicated:

| (dollars in thousands) | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| Commercial real estate | $ 253,087 | 30 % | $ 267,978 | 33 % |
| Acquisition and development | 96,986 | 12 % | 107,250 | 13 % |
| Commercial and industrial | 89,358 | 11 % | 59,788 | 7 % |
| Residential mortgage | 361,365 | 44 % | 350,906 | 44 % |
| Consumer | 24,129 | 3 % | 24,318 | 3 % |
| Total Loans | $ 824,925 | 100 % | $ 810,240 | 100 % |

Comparing September 30, 2014 to December 31, 2013, outstanding loans increased by $14.7 million (1.8%). Commercial Real Estate (“CRE”) loans decreased $14.9 million as a result of the payoff of two large loans of approximately $15 million during the third quarter. Acquisition and development (“A&D”) loans decreased $10.3 million due to regularly scheduled principal payments and payoffs. Commercial and industrial (“C&I”) loans increased $29.6 million due to new loan relationships, primarily one large relationship in the first quarter of 2014. Residential mortgages increased by $10.5 million due to increased production of loans primarily in our 10/1 and 7/1 adjustable rate mortgage program. The Bank continues to use Fannie Mae for the majority of new, longer-term, fixed-rate residential loan originations. The consumer portfolio decreased slightly by $.2 million due to repayment activity in the indirect auto portfolio offsetting new production. At September 30, 2014, approximately 47% of the commercial loan portfolio was collateralized by real estate, compared to approximately 57% at December 31, 2013.

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*Risk Elements of Loan Portfolio*

The following table presents the risk elements of our loan portfolio at the dates indicated. Management is not aware of any potential problem loans other than those listed in this table or discussed below.

| (dollars in thousands) | September 30, 2014 | % of Applicable Portfolio | December 31, 2013 | % of Applicable Portfolio |
|---|---|---|---|---|
| Non-accrual loans: | | | | |
| Commercial real estate | $ 5,634 | 2.23 % | $ 7,433 | 2.77 % |
| Acquisition and development | 4,648 | 4.79 % | 5,632 | 5.25 % |
| Commercial and industrial | 228 | 0.26 % | 191 | 0.32 % |
| Residential mortgage | 3,403 | 0.94 % | 4,126 | 1.18 % |
| Consumer | 0 | 0.00 % | 14 | 0.06 % |
| Total non-accrual loans | $ 13,913 | 1.69 % | $ 17,396 | 2.15 % |
| | | | | |
| Accruing Loans Past Due 90 days or more: | | | | |
| Commercial real estate | $ 187 | | $ 65 | |
| Acquisition and development | 87 | | 282 | |
| Commercial and industrial | 0 | | 133 | |
| Residential mortgage | 1,052 | | 730 | |
| Consumer | 29 | | 24 | |
| Total loans past due 90 days or more | $ 1,355 | | $ 1,234 | |
| | | | | |
| Total non-accrual and accruing loans past due 90 days or more | $ 15,268 | | $ 18,630 | |
| | | | | |
| Restructured Loans (TDRs): | | | | |
| Performing | $ 7,702 | | $ 10,567 | |
| Non-accrual (included above) | 7,678 | | 7,380 | |
| Total TDRs | $ 15,380 | | $ 17,947 | |
| | | | | |
| Other real estate owned | $ 11,588 | | $ 17,031 | |
| | | | | |
| Impaired loans without a valuation allowance | $ 24,390 | | $ 24,296 | |
| Impaired loans with a valuation allowance | 4,420 | | 9,013 | |
| Total impaired loans | $ 28,810 | | $ 33,309 | |
| | | | | |
| Valuation allowance related to impaired loans | $ 1,162 | | $ 2,283 | |

Performing loans considered to be impaired (including performing troubled debt restructurings, or TDRs), as defined and identified by management, amounted to $14.9 million at September 30, 2014 and $15.9 million at December 31,

2013. Loans are identified as impaired when, based on current information and events, management determines that we will be unable to collect all amounts due according to contractual terms. These loans consist primarily of A&D loans and CRE loans. The fair values are generally determined based upon independent third party appraisals of the collateral or discounted cash flows based upon the expected proceeds. Specific allocations have been made where management believes there is insufficient collateral to repay the loan balance if liquidated and there is no secondary source of repayment available.

The level of performing impaired loans (other than performing TDRs) increased $1.8 million during the nine months ended September 30, 2014, due to payoffs and principal reductions of $1.2 million, as well as the reclassification of two mortgage loans totaling $.3 million out of impaired status due to improved performance, offset by the addition of a $3.1 million non-owner occupied real estate loan, as well as two mortgage loans totaling $.2 million that were formerly reported as TDRs. Management will continue to monitor all loans that have been removed from an impaired status and take appropriate steps to ensure that satisfactory performance is sustained.

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The following table presents the details of impaired loans that are TDRs by class as of September 30, 2014 and December 31, 2013:

| (in thousands) | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Number of Contracts | Recorded Investment | Number of Contracts | Recorded Investment |
| Performing | | | | |
| Commercial real estate | | | | |
| Non owner-occupied | 2 | $ 272 | 2 | $ 257 |
| All other CRE | 1 | 2,871 | 2 | 3,313 |
| Acquisition and development | | | | |
| 1-4 family residential construction | 1 | 912 | 1 | 1,547 |
| All other A&D | 4 | 2,175 | 7 | 3,867 |
| Commercial and industrial | 1 | 366 | 2 | 614 |
| Residential mortgage | | | | |
| Residential mortgage – term | 6 | 1,106 | 6 | 969 |
| Residential mortgage – home equity | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 |
| Total performing | 15 | $ 7,702 | 20 | $ 10,567 |
| Non-accrual | | | | |
| Commercial real estate | | | | |
| Non owner-occupied | 1 | $ 458 | 1 | $ 448 |
| All other CRE | 4 | 2,493 | 3 | 2,217 |
| Acquisition and development | | | | |
| 1-4 family residential construction | 0 | 0 | 0 | 0 |
| All other A&D | 7 | 4,277 | 4 | 4,075 |
| Commercial and industrial | 1 | 228 | 0 | 0 |
| Residential mortgage | | | | |
| Residential mortgage – term | 1 | 222 | 3 | 640 |
| Residential mortgage – home equity | 0 | 0 | 0 | 0 |
| Consumer | 0 | 0 | 0 | 0 |
| Total non-accrual | 14 | 7,678 | 11 | 7,380 |
| Total TDRs | 29 | $ 15,380 | 31 | $ 17,947 |

The level of TDRs decreased $2.6 million during the nine months ended September 30, 2014. One loan totaling $.1 million was added to performing TDRs, one loan totaling $.4 million was added to non-performing TDRs, and seven loans already in performing TDRs were re-modified. Two loans totaling $.2 million that had been modified prior to December 31, 2013 are no longer reported as performing TDRs because the borrowers had made at least six consecutive payments and were current at the time of reclassification. There were charge-offs totaling $1.3 million to three non-performing A&D loans during the nine months ended September 30, 2014 and $1.6 million in net principal payments and payoffs were received during the same time period.

*Allowance and Provision for Loan Losses*

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

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

The following table presents a summary of the activity in the ALL for the nine months ended September 30:

| (dollars in thousands) | 2014 | 2013 |
|---|---|---|
| Balance, January 1 | $13,594 | $16,047 |
| Charge-offs: | | |
| Commercial real estate | (85) | (233) |
| Acquisition and development | (2,423) | (276) |
| Commercial and industrial | (213) | (1,051) |
| Residential mortgage | (682) | (317) |
| Consumer | (380) | (375) |
| Total charge-offs | (3,783) | (2,252) |
| Recoveries: | | |
| Commercial real estate | 11 | 1,004 |
| Acquisition and development | 104 | 33 |
| Commercial and industrial | 22 | 68 |
| Residential mortgage | 183 | 154 |
| Consumer | 308 | 258 |
| Total recoveries | 628 | 1,517 |
| Net credit losses | (3,155) | (735) |
| Provision for loan losses | 1,629 | (161) |
| Balance at end of period | $12,068 | $15,151 |
| | | |
| Allowance for loan losses to loans outstanding (as %) | 1.46 % | 1.81 % |
| Net charge-offs to average loans outstanding during the period, annualized (as %) | 0.52 % | 0.12 % |

The ALL decreased to $12.1 million at September 30, 2014, from $13.6 million at December 31, 2013 and $15.2 million at September 30, 2013. The provision for loan losses increased to $1.6 million for the first nine months of 2014 compared to $(.2) for the same period of 2013. Net charge-offs increased to $3.2 million for the nine months ended September 30, 2014, compared to $.7 million for the nine months ended September 30, 2013. The ratio of the ALL to loans outstanding as of September 30, 2014 was 1.46%, which was less than the 1.81% for the same period last year, due primarily to improving historical and qualitative factors.

The ratio of net charge-offs to average loans for the nine months ended September 30, 2014 was an annualized .52%, compared to an annualized .12% for the same period in 2013 and .34% for the year ended December 31, 2013. The

CRE portfolio had an annualized net charge-off rate as of September 30, 2014 of .04% compared to an annualized net recovery rate of .27% as of December 31, 2013. The annualized net charge-off rate for A&D loans as of September 30, 2014 was 3.03% due to partial charge-offs of several consumer lot loans and one commercial A&D loan, compared to an annualized net charge-off rate of 1.78% as of December 31, 2013. The ratio for C&I loans improved to .34% at September 30, 2014 compared to 1.53% for December 31, 2013. The residential mortgage ratios were .19% and .08% for September 30, 2014 and December 31, 2013, respectively, and the consumer loan ratios were .40% and .83% for September 30, 2014 and December 31, 2013, respectively.

Accruing loans past due 30 days or more declined to 1.11% of the loan portfolio at September 30, 2014, compared to 2.10% at December 31, 2013. The decrease for the first nine months of 2014 was primarily due to a decrease of $7.6 million in past-due accruing residential mortgage term loans. Other improvements in the levels of past-due loans were attributable to a combination of a slowly improving economy and vigorous collection efforts by the Bank.

Comparing the nine-month periods ended September 30, 2014 and September 30, 2013, total non-accrual loan balances have declined. Non-accrual loans totaled $13.9 million as of September 30, 2014, compared to $17.4 million as of December 31, 2013 and $14.8 million as of September 30, 2013. Non-accrual loans which have been subject to a partial charge-off totaled $4.9 million as of September 30, 2014, compared to $1.9 million as of December 31, 2013.

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Management believes that the ALL at September 30, 2014 is adequate to provide for probable losses inherent in our loan portfolio. Amounts that will be recorded for the provision for loan losses in future periods will depend upon trends in the loan balances, including the composition of the loan portfolio, changes in loan quality and loss experience trends, potential recoveries on previously charged-off loans and changes in other qualitative factors. Management also applies interest rate risk, collateral value and debt service sensitivity analyses to the Commercial real estate loan portfolio and obtains new appraisals on specific loans under defined parameters to assist in the determination of the periodic provision for loan losses.

*Investment Securities*

At September 30, 2014, the total amortized cost basis of the available-for-sale investment portfolio was $235.2 million, compared to a fair value of $222.8 million. Unrealized gains and losses on securities available-for-sale are reflected in accumulated other comprehensive loss, a component of shareholders' equity. The amortized cost basis of the held to maturity portfolio was $107.0 million compared to a fair value of $106.4 million.

The following table presents the composition of our securities portfolio at amortized cost and fair values at the dates indicated:

| | September 30, 2014 | | | | December 31, 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Amortized Cost | Fair Value (FV) | FV as % of Total | | Amortized Cost | Fair Value (FV) | FV as % of Total | |
| Securities Available-for-Sale: | | | | | | | | |
| U.S. Treasury Bills | $29,631 | $29,618 | 13 | % | $0 | $0 | 0 | % |
| U.S. government agencies | 39,088 | 38,759 | 17 | % | 97,242 | 92,035 | 27 | % |
| Residential mortgage-backed agencies | 46,573 | 46,123 | 21 | % | 116,933 | 112,444 | 33 | % |
| Commercial mortgage-backed agencies | 26,737 | 26,545 | 12 | % | 31,025 | 29,905 | 9 | % |
| Collateralized mortgage obligations | 9,286 | 9,368 | 4 | % | 30,468 | 29,390 | 9 | % |
| Obligations of state and political subdivisions | 46,784 | 48,016 | 22 | % | 55,505 | 55,277 | 17 | % |
| Collateralized debt obligations | 37,066 | 24,406 | 11 | % | 37,146 | 17,538 | 5 | % |
| Total available for sale | $235,165 | $222,835 | 100 | % | $368,319 | $336,589 | 100 | % |
| Securities Held to Maturity: | | | | | | | | |
| U.S. government agencies | $24,476 | $24,398 | 23 | % | $0 | $0 | 0 | % |
| Residential mortgage-backed agencies | 55,572 | 55,402 | 52 | % | 0 | 0 | 0 | % |
| Commercial mortgage-backed agencies | 16,476 | 16,548 | 16 | % | 0 | 0 | 0 | % |
| Collateralized mortgage obligations | 7,712 | 7,602 | 7 | % | 0 | 0 | 0 | % |
| Obligations of state and political subdivisions | 2,725 | 2,476 | 2 | % | 3,900 | 3,590 | 100 | % |
| Total held to maturity | $106,961 | $106,426 | 100 | % | $3,900 | $3,590 | 100 | % |

Total investment securities available-for-sale decreased $113.8 million since December 31, 2013. At September 30, 2014, the securities classified as available-for-sale included a net unrealized loss of $12.3 million, which represents the difference between the fair value and amortized cost of securities in the portfolio. The decline in available-for-sale securities was due to the movement of approximately $107.0 million of securities classified as available-for-sale to the held to maturity category during the second quarter, as well as sales and maturities within the available-for-sale category.

During the second quarter of 2014, management completed an analysis on the investment portfolio and identified the securities that had the most price volatility particularly in the hypothetical scenario in which the interest rate change by 300 basis points. These securities were reclassified to the held to maturity category, which at that time, locked in an unrealized loss of approximately $4.0 million. This unrealized loss will continue to be reported as a separate component of shareholders' equity as accumulated other comprehensive income and will be amortized over the remaining life of the securities as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

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As discussed in Note 9 to the consolidated financial statements presented elsewhere in this report, the Corporation measures fair market values based on the fair value hierarchy established in ASC Topic 820, *Fair Value Measurements and Disclosures*. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Level 3 prices or valuation techniques require inputs that are both significant to the valuation assumptions and are not readily observable in the market (i.e. supported with little or no market activity). These Level 3 instruments are valued based on both observable and unobservable inputs derived from the best available data, some of which is internally developed, and considers risk premiums that a market participant would require.

Approximately $198.4 million of the available-for-sale portfolio was valued using Level 2 pricing, and had net unrealized gains of $.3 million at September 30, 2014. The remaining $24.4 million of the securities available-for-sale represents the entire collateralized debt obligation (“CDO”) portfolio, which was valued using significant unobservable inputs (Level 3 assets). The $13.9 million in unrealized losses associated with this portfolio relates to 14 of the 17 pooled trust preferred securities that comprise the CDO portfolio. Unrealized losses of $8.3 million represent non-credit related OTTI charges on 13 of the securities, while $5.6 million of unrealized losses relates to five securities which have had no credit related OTTI. The unrealized losses on these securities were primarily attributable to continued depression in the marketability and liquidity associated with CDOs.

The following table provides a summary of the trust preferred securities in the CDO portfolio and the credit status of these securities as of September 30, 2014.

**Level 3 Investment Securities Available for Sale**

**(Dollars in Thousands)**

| Investment Description | | First United Level 3 Investments | | | | Security Credit Status | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Deal | Class | Amortized Cost | Fair Market Value | Unrealized Gain/(Loss) | Lowest Credit Rating | Original Collateral | Deferrals/ Defaults as % of Original Collateral | Performing Collateral | Collateral Support | Collateral Support as % of Performing Collateral | Number of Performing Issuers/Total Issuers |
| Preferred Term Security XI* | B-1 | 1,337 | 741 | (596 ) | C | 635,775 | 16.44% | 386,605 | (53,228 ) | -13.77% | 44 / 57 |
| Preferred Term Security XVI* | C | 439 | 1,418 | 979 | C | 606,040 | 32.43% | 336,800 | (101,787) | -30.22% | 37 / 54 |
| Preferred Term Security | C | 3,055 | 1,567 | (1,488 ) | C | 676,565 | 22.51% | 440,984 | (41,011 ) | -9.30 % | 51 / 71 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| XVIII* | | | | | | | | | | | |
| Preferred Term Security XVIII | C | 2,177 | 1,045 | (1,132) | C | 676,565 | 22.51% | 440,984 | (41,011) | -9.30% | 51 / 71 |
| Preferred Term Security XIX* | C | 3,094 | 1,611 | (1,483) | C | 700,535 | 14.22% | 478,061 | (73,086) | -15.29% | 50 / 62 |
| Preferred Term Security XIX* | C | 1,341 | 691 | (650) | C | 700,535 | 14.22% | 478,061 | (73,086) | -15.29% | 50 / 62 |
| Preferred Term Security XIX* | C | 1,339 | 691 | (648) | C | 700,535 | 14.22% | 478,061 | (73,086) | -15.29% | 50 / 62 |
| Preferred Term Security XIX* | C | 2,248 | 1,151 | (1,097) | C | 700,535 | 14.22% | 478,061 | (73,086) | -15.29% | 50 / 62 |
| Preferred Term Security XXII* | C-1 | 4,067 | 2,718 | (1,349) | C | 1,386,600 | 20.12% | 967,100 | (46,411) | -4.80% | 65 / 88 |
| Preferred Term Security XXII* | C-1 | 1,627 | 1,087 | (540) | C | 1,386,600 | 20.12% | 967,100 | (46,411) | -4.80% | 65 / 88 |
| Preferred Term Security XXIII | C-1 | 1,966 | 955 | (1,011) | C | 1,467,000 | 20.45% | 892,411 | (35,452) | -3.97% | 87 / 109 |
| Preferred Term Security XXIII* | D-1 | 2,512 | 2,695 | 183 | C | 1,467,000 | 20.45% | 892,411 | (35,452) | -3.97% | 87 / 109 |
| Preferred Term Security XXIII* | D-1 | 837 | 899 | 62 | C | 1,467,000 | 20.45% | 892,411 | (152,401) | -17.08% | 87 / 109 |
| Preferred Term Security XXIV* | C-1 | 1,027 | 598 | (429) | C | 1,050,600 | 32.70% | 638,304 | (184,301) | -28.87% | 56 / 85 |
| Preferred Term Security I-P-I | B-2 | 2,000 | 1,507 | (493) | CCC- | 351,000 | 9.26% | 155,800 | 13,966 | 8.96% | 14 / 16 |
| Preferred Term | B-1 | 3,000 | 1,887 | (1,113) | CCC- | 325,000 | 0.00% | 158,000 | 34,691 | 21.96% | 17 / 17 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Security I-P-IV | | | | | | | | | | | |
| Preferred Term Security I-P-IV | B-1 | 5,000 | 3,145 | (1,855) | CCC- | 325,000 | 0.00 % | 158,000 | 34,691 | 21.96 % | 17 / 17 |
| Total Level 3 Securities Available for Sale | | 37,066 | 24,406 | (12,660) | | | | | | | |

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

The terms of the debentures underlying trust preferred securities allow the issuer of the debentures to defer interest payments for up to 20 quarters, and, in such case, the terms of the related trust preferred securities allow their issuers to defer dividend payments for up to 20 quarters. Some of the issuers of the trust preferred securities in our investment portfolio have defaulted and/or deferred payments ranging from 9.26% to 32.70% of the total collateral balances underlying the securities. The securities were designed to include structural features that provide investors with credit enhancement or support to provide default protection by subordinated tranches. These features include over-collateralization of the notes or subordination, excess interest or spread which will redirect funds in situations where collateral is insufficient, and a specified order of principal payments. There are securities in our portfolio that are under-collateralized, which does represent additional stress on our tranche. However, in these cases, the terms of the securities require excess interest to be redirected from subordinate tranches as credit support, which provides additional support to our investment.

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Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of ASC Topic 320 (Section 320-10-35), management must assess whether (a) the Corporation has the intent to sell the security and (b) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair value of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses. The other losses are recognized in other comprehensive income. In estimating OTTI charges, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) adverse conditions specifically related to the security, an industry, or a geographic area, (3) the historic and implied volatility of the security, (4) changes in the rating of a security by a rating agency, (5) recoveries or additional declines in fair value subsequent to the balance sheet date, (6) failure of the issuer of the security to make scheduled interest payments, and (7) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Due to the duration and the significant market value decline in the pooled trust preferred securities held in our portfolio, we performed more extensive testing on these securities for purposes of evaluating whether or not an OTTI has occurred.

The market for these securities as of September 30, 2014 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as no new CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities, or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the “Treasury”), are very depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (a) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at September 30, 2014, (b) an income valuation approach technique (i.e. present value) that maximizes the use of relevant unobservable inputs and minimizes the use of observable inputs will be equally or more representative of fair value than a market approach, and (c) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management utilizes an independent third party to prepare both the evaluations of OTTI and the fair value determinations for the CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between December 31, 2013 and September 30, 2014.

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

market that exists is for stand-alone trust preferred securities. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

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

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

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

The Volcker Rule defines an "ownership interest" as an equity, partnership or other similar interest. The CDOs are debt securities (promissory notes) issued by corporations that call for regularly-scheduled payments of principal and interest, with interest calculated either at a fixed-rate or at a rate that is tied to LIBOR. Accordingly, none of the CDOs represent an equity or partnership interest in the issuers. In their adopting rule release, the agencies stated that debt securities evidencing "typical extensions of credit" – those that "provide for payment of stated principal and interest calculated at a fixed rate or at a floating rate based on an index or interbank rate" – do not generally meet the definition of "other similar interest". To be considered an "other similar interest", a debt security must exhibit one or more of the following characteristics on a current, future, or contingent basis:

1. It has the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund;
2. It has the right under the terms of the interest to receive a share of the income, gains or profits of the covered fund, regardless of whether the right is pro rata with other owners or holders of interests;
3. It has the right to receive the underlying assets of the covered fund after all other interests have been redeemed and/or paid in full, excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event;
4. It has the right to receive all or a portion of excess spread;
5. Its terms provide that the amounts payable by the covered fund with respect to the interest could be reduced based on losses arising from the underlying assets of the covered fund;
6. It receives income on a pass-through basis from the covered fund, or has a rate of return that is determined by reference to the performance of the underlying assets of the covered fund; or
7. It is any synthetic right to have, receive or be allocated any of the rights above.

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

In conclusion, as of December 31, 2013, all CDO securities owned by the Company are not subject to application of the Volcker Rule and therefore reaffirm our intent of the ability to hold.

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

The risk-based capital ratios require that banks set aside additional capital for securities that are rated below investment grade. Securities rated one level below investment grade require a 200% risk weighting. Additional methods are applicable to securities rated more than one level below investment grade. As of September 30, 2014, the Company did not hold any investments that require the 200% risk weighting.

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*Deposits*

The following table presents the composition of our deposits as of the dates indicated:

| (dollars in thousands) | September 30, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| Non-interest bearing demand deposits | $ 197,612 | 20 | % | $ 175,863 | 18 | % |
| Interest-bearing deposits: | | | | | | |
| Demand | 132,951 | 14 | % | 142,346 | 14 | % |
| Money Market: | | | | | | |
| Retail | 213,183 | 22 | % | 215,842 | 22 | % |
| Savings deposits | 126,856 | 13 | % | 116,710 | 12 | % |
| Time deposits less than $100,000: | | | | | | |
| Retail | 151,906 | 16 | % | 169,136 | 17 | % |
| Brokered/CDARS | 525 | 0 | % | 0 | 0 | % |
| Time deposits $100,000 or more: | | | | | | |
| Retail | 145,394 | 15 | % | 151,928 | 16 | % |
| Brokered/CDARS | 4,606 | 0 | % | 5,578 | 1 | % |
| Total Deposits | $ 973,033 | 100 | % | $ 977,403 | 100 | % |

Total deposits decreased $4.4 million during the first nine months of 2014 when compared to deposits at December 31, 2013. With the continued focus of our retail staff to change the mix of the deposit portfolio, we have seen increases in core deposits and reductions in certificates of deposit. Non-interest bearing deposits increased $21.7 million. Traditional savings accounts increased $10.2 million due to continued growth in our Prime Saver product. Total demand deposits decreased $9.4 million and total money market accounts decreased $2.7 million. Time deposits less than $100,000 declined $16.7 million and time deposits greater than $100,000 decreased $7.5 million.

*Borrowed Funds*

The following table presents the composition of our borrowings at the dates indicated:

| (In thousands) | September 30, 2014 | December 31, 2013 |
|---|---|---|
| Securities sold under agreements to repurchase | $ 47,994 | $ 43,676 |
| Total short-term borrowings | $ 47,994 | $ 43,676 |
| | | |
| FHLB advances | $ 135,893 | $ 135,942 |
| Junior subordinated debt | 46,730 | 46,730 |

| Total long-term borrowings | $ 182,623 | $ 182,672 |
|---|---|---|

Total short-term borrowings increased by approximately $4.3 million during the first nine months of 2014 due primarily to increases in our Treasury Management products. Long-term borrowings decreased by $49.0 thousand during the first nine months of 2014 due to the scheduled monthly amortization of long-term advances.

*Liquidity Management*

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

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

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

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

1. Unsecured Fed Funds lines of credit with upstream correspondent banks (M&T Bank, PNC Bank, Atlantic Community Banker's Bank, Community Banker's Bank, SunTrust and Zions National Bank).
2. Secured advances with the FHLB of Atlanta, which are collateralized by eligible one to four family residential mortgage loans, home equity lines of credit, commercial real estate loans, various securities and pledged cash.
3. Secured line of credit with the Fed Discount Window for use in borrowing funds up to 90 days, using municipal securities as collateral.
4. Brokered deposits, including CDs and money market funds, provide a method to generate deposits quickly. These deposits are strictly rate driven but often provide the most cost effective means of funding growth.
5. One Way Buy CDARS funding – a form of brokered deposits that has become a viable supplement to brokered deposits obtained directly.

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

*Market Risk and Interest Sensitivity*

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

At September 30, 2014, we were asset sensitive.

Our interest rate risk management goals are:

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

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

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

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

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

Measures of NII at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

*Capital Resources*

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdrawal demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not adequate to fund our capital requirements, we can rely on the funding sources identified above under the heading "Liquidity Management". At September 30, 2014, the Bank had $70.0 million available through unsecured lines of credit with correspondent banks, $28.9 million through a secured line of credit with the Fed Discount Window and approximately $.1 million at the FHLB**.** Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

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

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

The following table presents our capital ratios:

| | September 30, 2014 | | December 31, 2013 | | Required for Capital Adequacy Purposes | | Required to be Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| Total Capital (to risk-weighted assets) | | | | | | | | |
| Consolidated | 15.43 | % | 15.29 | % | 8.00 | % | 10.00 | % |
| First United Bank & Trust | 15.73 | % | 16.17 | % | 8.00 | % | 10.00 | % |
| Tier 1 Capital (to risk-weighted assets) | | | | | | | | |
| Consolidated | 14.06 | % | 13.65 | % | 4.00 | % | 6.00 | % |
| First United Bank & Trust | 14.56 | % | 14.89 | % | 4.00 | % | 6.00 | % |
| Tier 1 Capital (to average assets) | | | | | | | | |
| Consolidated | 11.04 | % | 10.97 | % | 4.00 | % | 5.00 | % |
| First United Bank & Trust | 11.42 | % | 11.93 | % | 4.00 | % | 5.00 | % |

As of September 30, 2014, the most recent notification from the regulators categorized First United Corporation and the Bank as “well capitalized” under the regulatory framework for prompt corrective action. On a consolidated basis, all capital ratios increased from December 31, 2013 to September 30, 2014. The consolidated total risk-based capital ratios include $39.7 million of TPS Debentures which qualified as Tier 1 capital at September 30, 2014 under guidance issued by the Board of Governors of the Federal Reserve System.

At the Bank level, the ratios declined slightly from December 31, 2013 to September 30, 2014 primarily because of the Bank’s payment of approximately $9.8 million in cash dividends to First United Corporation, which were used to make quarterly interest payments under First United Corporation’s junior subordinated debentures (“TPS Debentures”) and quarterly dividends on its outstanding shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (“Series A Preferred Stock”) in the first, second and third quarters of 2014.

The recently-adopted Basel III capital rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and which refine the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation under the final rules will be: (a) a new common equity Tier 1 capital ratio of 4.5%; (b) a Tier 1 capital ratio of 6% (increased from 4%); (c) a total capital ratio of 8% (unchanged from current rules); and (d) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a “capital conservation buffer” above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (1) a common equity Tier 1 capital ratio of 7.0%, (2) a Tier 1 capital ratio of 8.5%, and (3) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions. These

rules are discussed in detail in the Annual Report of First United Corporation on Form 10-K for the year ended December 31, 2013. We believe that we would be in compliance with these requirements as set forth in the final rules if they were currently effective.

In January 2009, pursuant to the Treasury's Troubled Asset Relief Program Capital Purchase Program, First United Corporation sold 30,000 shares of its Series A Preferred Stock and a Warrant to purchase 326,323 shares of its common stock, having an exercise price of $13.79 per share, to the Treasury for an aggregate purchase price of $30 million. The proceeds from this transaction count as Tier 1 capital and the Warrant qualifies as tangible common equity. Information about the terms of these securities is provided in Note 10 to the consolidated financial statements.

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The terms of the Series A Preferred Stock call for the payment, if declared by the Board of Directors of First United Corporation, of a quarterly cash dividend on February 15th, May 15th, August 15th and November 15th of each year. On November 15, 2010, at the request of the Reserve Bank, the Board of Directors of First United Corporation voted to suspend quarterly cash dividends on the Series A Preferred Stock beginning with the dividend payment due November 15, 2010. During the suspension, dividends of $.4 million per dividend period continued to accrue. In April 2014, First United Corporation received approval from the Reserve Bank to terminate this deferral by making the quarterly dividend payment due to the Treasury in May 2014 and paying all unpaid dividends that accrued during the suspension period. Cumulative deferred dividends on the Series A Preferred Stock of approximately $6.5 million were paid on May 15, 2014. In July 2014, First United Corporation received approval from the Reserve Bank to make the quarterly dividend payment due in August 2014. A dividend payment of $.7 million was paid on August 15, 2014. In November 2014, First United Corporation received approval from the Reserve Bank to make the quarterly dividend payment due in November 2014. Until further notice from the Reserve Bank, First United Corporation is required to obtain the Reserve Bank's prior approval before making any future quarterly dividend payment. In considering a request for approval, the Reserve Bank will consider, among other things, the Corporation's financial condition and its quarterly results of operations. In addition, First United Corporation's ability to make future quarterly dividend payments on the Series A Preferred Stock will depend in large part on its receipt of dividends from the Bank, and the Bank may make dividend payments only with the prior approval of the Federal Deposit Insurance Corporation (the "FDIC") and the Maryland Commissioner of Financial Regulation (the "Maryland Commissioner"). If First United Corporation and/or the Bank do not obtain the regulatory approvals required for a particular quarterly dividend, then First United Corporation would have to again suspend quarterly dividend payments, which would result in a prohibition against paying any dividends or other distributions on the outstanding shares of First United Corporation's common stock during the suspension period. As a result of these limitations, no assurance can be given that First United Corporation will make any future quarterly dividend payment on the Series A Preferred Stock.

At the request of the Federal Reserve Bank of Richmond (the "Reserve Bank") in December 2010, First United Corporation's Board of Directors elected to defer quarterly interest payments under the TPS Debentures beginning with the payments due in March 2011. In February 2014, First United Corporation received approval from the Reserve Bank to terminate this deferral by making the quarterly interest payments due to the Trusts in March 2014 and paying all deferred interest for prior quarters. In connection with this deferral termination, deferred interest of approximately $1.024 million as well as $77,166 of current interest was paid to Trust I on March 17, 2014, deferred interest of approximately $2.048 million as well as $154,325 in current interest was paid to Trust II on March 17, 2014, and deferred interest of approximately $3.763 million as well as $266,650 in current interest was paid to Trust III on March 15, 2014. In April 2014, First United Corporation received approval from the Federal Reserve Bank to make the quarterly interest payments due in June 2014, and interest of $78,604 was paid to Trust I on June 17, 2014, $157,202 in interest was paid to Trust II on June 17, 2014, and $266,650 in interest was paid to Trust III on June 16, 2014. In July 2014, First United Corporation received approval from the Federal Reserve Bank to make the quarterly interest payments due in September 2014 and interest of $78,572 was paid to Trust I on September 17, 2014, $157,136 in interest was paid to Trust II on September 17, 2014, and $266,650 in interest was paid to Trust III on September 15, 2014. In November 2014, First United Corporation received approval from the Federal Reserve Bank to make the quarterly interest payments due in December 2014. Until further notice from the Reserve Bank, First United Corporation is required to obtain the Reserve Bank's prior approval before making any future interest payments under the TPS Debentures. In considering a request for approval, the Reserve Bank will consider, among other things, the Corporation's financial condition and its quarterly results of operations. In addition to this pre-approval requirement, First United Corporation's ability to make future quarterly interest payments under the TPS Debentures will depend in large part on its receipt of dividends from the Bank, and the Bank may make dividend payments only with the prior approval of the FDIC and the Maryland Commissioner. As a result of these limitations, no assurance can be given that

First United Corporation will make the quarterly interest payments due under the TPS Debentures in any future quarter. In the event that First United Corporation and/or the Bank do not receive the approvals necessary for First United Corporation to make future quarterly interest payments, First United Corporation will have to again elect to defer interest payments. The terms of the TPS Debentures permit First United Corporation to elect to defer payments of interest for up to 20 consecutive quarterly periods, provided that no event of default exists under the TPS Debentures at the time of the election. An election to defer interest payments is not considered a default under the TPS Debentures.

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

*Contractual Obligations, Commitments and Off-Balance Sheet Arrangements*

Loan commitments are made to accommodate the financial needs of our customers. Letters of credit commit us to make payments on behalf of customers when certain specified future events occur. The credit risks inherent in loan commitments and letters of credit are essentially the same as those involved in extending loans to customers, and these arrangements are subject to our normal credit policies. Loan commitments and letters of credit totaled $104.1 million and $.9 million, respectively, at September 30, 2014, compared to $97.7 million and $1.1 million, respectively, at December 31, 2013. We are not a party to any other off-balance sheet arrangements.

See Note 12 to the consolidated financial statements presented elsewhere in this report for further disclosure on Borrowed Funds. There have been no other significant changes to contractual obligations as presented at December 31, 2013.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our primary market risk is interest rate fluctuation and we have procedures in place to evaluate and mitigate this risk. This market risk and our procedures are described above in Item 2 of Part I of this report under the caption "*Market Risk and Interest Sensitivity*", and in Item 7 of Part II of First United Corporation's Annual Report on Form 10-K for the year ended December 31, 2013 under the caption "Market Risk and Interest Sensitivity". Management believes that no material changes in our procedures used to evaluate and mitigate these risks have occurred since December 31, 2013. We believe the investment portfolio restructuring has better positioned the Corporation for a rising interest rate environment.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 with the SEC, such as this Quarterly Report, is recorded, processed, summarized and reported within the periods specified in those rules and forms, and that such information is accumulated and communicated to our management, including First United Corporations principal executive officer ("CEO") and the principal accounting officer ("CFO"), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls as of September 30, 2014 was carried out under the supervision and with the participation of management, including the CEO and the CFO. Based on that evaluation, management, including the CEO and the CFO, has concluded that our disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

During the first nine months of 2014, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

None.

**Item 1A. Risk Factors**

The risks and uncertainties to which our financial condition and operations are subject are discussed in detail in Item 1A of Part I of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013 and Item 1A of Part II of its Quarterly Report on Form 10-Q for the quarter ended September 30, 2014. Management does not believe that any material changes in our risk factors have occurred since they were last disclosed.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The exhibits filed or furnished with this quarterly report are listed in the Exhibit Index that follows the signatures, which index is incorporated herein by reference.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST UNITED CORPORATION

Date: November 10, 2014 /s/ William B. Grant
William B. Grant, Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

Date November 10, 2014 /s/ Carissa L. Rodeheaver
Carissa L. Rodeheaver, President,
Chief Financial Officer, Treasurer and Secretary
(Principal Accounting Officer)

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EXHIBIT INDEX

| Exhibit | Description |
| --- | --- |
| 31.1 | Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith) |
| 31.2 | Certifications of the Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith) |
| 32 | Certification of the Principal Executive Officer and the Principal Accounting Office pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith) |
| 101.INS | XBRL Instance Document (filed herewith) |
| 101.SCH | XBRL Taxonomy Extension Schema (filed herewith) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase (filed herewith) |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase (filed herewith) |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase (filed herewith) |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase (filed herewith) |

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