National Capital Bank

Founded 1889

2012 Annual Report

THE NATIONAL CAPITAL BANK OF WASHINGTON

HIGHLIGHTS 2012

(Dollars in thousands, except per share data)

	2012	2011	% Change
Annual Results			
Net Income	$4,222	$4,133	2.15%
Net Income per Common Share	14.68	14.37	2.14%
Cash Dividends Paid per Common Share	8.40	6.72	25.00%
Performance Ratios Based on Net Income			
Return on Average Total Assets	0.97%	1.18%	-17.28%
Return on Average Common Shareholders' Equity	10.00%	10.69%	-6.48%
Net Interest Margin - Average Assets	3.21%	3.82%	-15.97%
Cost Efficiency Ratio	50.79%	49.88%	1.82%
(As reported to The Comptroller of Currency)			
Selected Average Balances			
Total Assets	$433,806	$351,260	23.50%
Total Earning Assets	393,363	348,366	12.92%
Total Gross Loans	249,652	263,382	-5.21%
Total Deposits	375,983	295,180	27.37%
Non Interest	98,033	67,960	44.25%
Interest	277,950	227,471	22.19%
Total Repurchase Agreements	14,164	16,506	-14.19%
Total Stockholders' Equity	42,230	38,659	9.24%
Selected Year-End Balances			
Total Assets	$435,420	$368,892	18.03%
Total Earning Assets	426,518	360,141	18.43%
Total Gross Loans	248,849	258,749	-3.83%
Allowance for Loan Losses	1,969	1,927	2.18%
Total Deposits	379,101	311,731	21.61%
Non Interest	98,146	70,904	38.42%
Interest	280,955	240,827	16.66%
Total Repurchase Agreements	14,031	16,449	-14.70%
Total Shareholders' Equity	41,829	40,029	4.50%
Total Shares of Common Stock*	287,652	287,652	0.00%
Capital Ratios			
Average Shareholders' Equity to Average Assets at Year-end	9.73%	11.01%	-6.63%
Shareholders' Equity to Assets at Year-end	9.61%	10.85%	-11.52%
Common Stock, Per Share:			
Book Value	$145.42	$139.15	4.50%
Market Price	258.80	208.32	24.23%
*Average Shares Outstanding	287,652	287,652	0.00%

"A gentle man and a gentleman"

- Vincent D. Cleary, Jr.

Vincent D. Cleary
1938 – 2013

TO OUR SHAREHOLDERS

"Our hard work isn't just about banking … it's about growing our community, making it cleaner and safer, supporting the arts, and celebrating diversity, honor and history."
- Richard A. Didden, Sr., Chairman and CEO • James M. Didden, President

Last year, your Bank was challenged by a number of burdensome external factors imposed by bureaucratic and regulatory sources. Despite these impediments to free market economics, we are pleased to report record earnings for 2012. Net income rose to $4.2 million, a slight increase of 2.15% over the previous year. Assets were up by 18.03%, to an all-time high of $435.4 million while total deposits ballooned to $379.1 million.

TO OUR SHAREHOLDERS

"In the sixty years since I became a customer, your staff has been courteous and helpful in every way, and that's why I remain a customer."
- Joseph F. Spaniol, Jr., customer since 1951

Our reputation for safety, soundness, integrity and unequalled service continued to spread through the communities we serve and we consequently benefitted greatly from their loyalty. NCB's sparsely traded common stock ended the year at $258.50 per share representing a $50.48 increase (+24.23%) over year-end 2011. In addition to regular quarterly dividends of $1.80, your Board thought it was prudent to pay a special dividend of $1.20 in December because of the uncertain tax landscape going forward. The $8.40 paid in 2012 represented a yield of 3.25% based on the Bank's closing price on 12/31/2012. Many corporations with a history of capital strength also thought it was prudent to distribute extra dividends to their shareholders in 2012. It should be noted that this special dividend may well be at the partial expense of regular dividends next year. We invite you to review "Management's Discussion of Operating Results" located on pages 5-12 of this report, or if you prefer to examine the numbers in summary form, please see our "Highlights" section located in the front.

MANAGEMENT'S DISCUSSION OF OPERATING RESULTS

Management is pleased to state that the accompanying report audited by Yount, Hyde & Barbour, P.C., for the year ending December 31, 2012, illustrates continued strong growth in most areas of your Bank. It is important to note that a significant portion of our income came from non-traditional sources. Core banking earnings such as income from loans and deposit service charges are no longer dependable mainstays of our industry. For example, the banking industry "loan to deposit ratio" has fallen from 95% in 2007 to 72% currently. Consequently, we focused on our securities portfolio and collateral areas such as asset management to generate profits both now and in the foreseeable future.

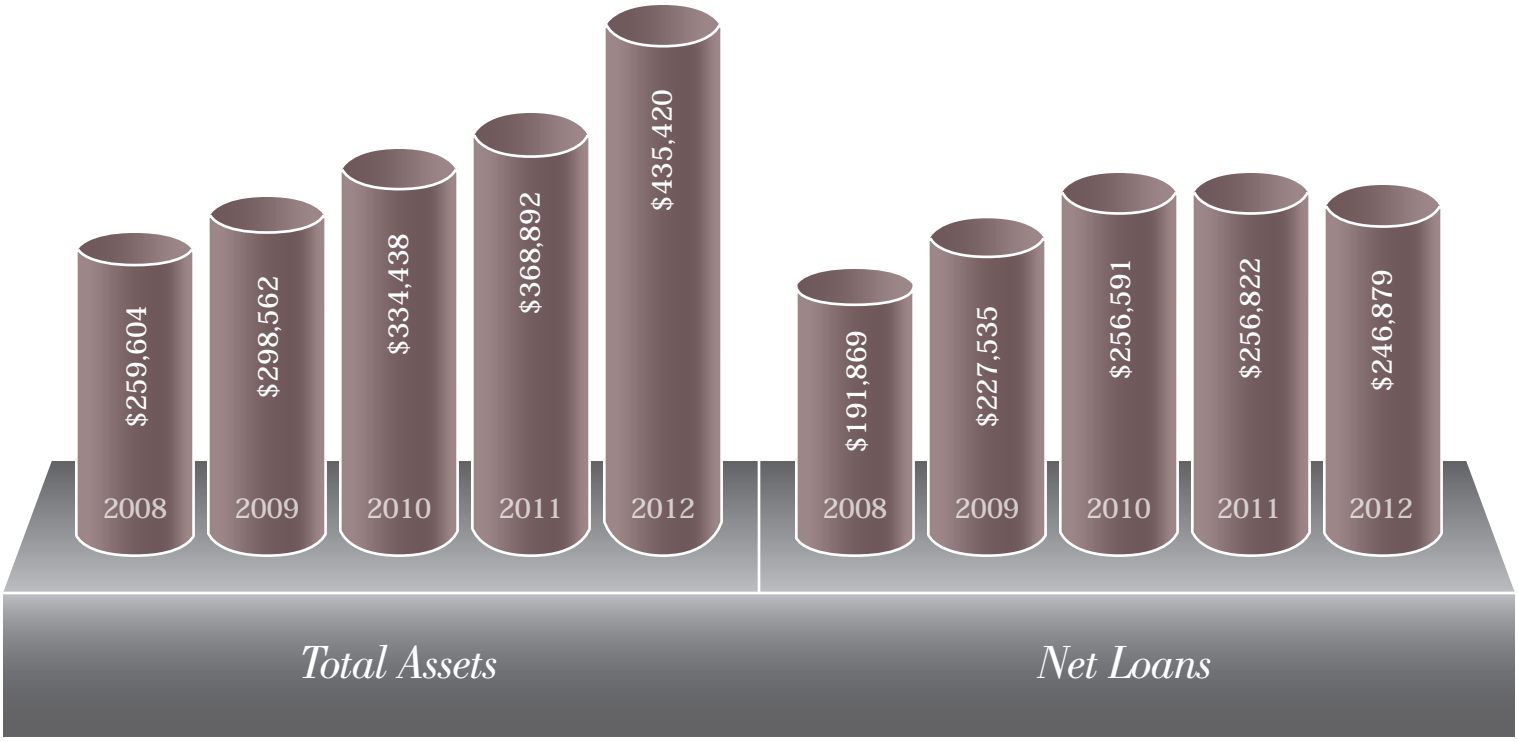
The artificially low rates dictated by the Federal Reserve have decimated net interest margins in our industry and have punished savers and retirees in the process. These low interest rates are likely to persist, keeping pressure on net interest margins, as older assets mature and are replaced with lower yielding loans. As a result, our senior management made the decision to curtail the volume of fixed rate loans to non-customers during

"When I first came to the bank 25 years ago, if you had told me that I would have come to love being a member of this NCB family so much, I might not have believed you."
- Shirley Bailey, employee from 1987 – 2012

"Anyone licensed and trusted with the care of customers' money has the ultimate responsibility of honesty and prudence."
- George A. Didden, Jr., President and CEO from 1943 – 1995

portions of the year so as not to be saddled with historically low interest rate loans that will be a drag on earnings for years to come. When rates eventually rise, we expect to be in an advantageous position. After all, this recovery is the worst in our history – including the Great Depression! In short, we are deliberately sacrificing short term earnings in favor of a long term profitability approach. Although this is a painful process, it is considered necessary if your Bank is to uphold its lofty earnings expectations in the future.

As mentioned above, assets ended the year at $435.4 million, up by 18.03%. It is noteworthy that in the last four years assets have registered an increase of almost 70% without the expenses attendant to additional branch locations. Deposits increased by over 21% from last year as our reputation for fair dealing made us a clear choice for those neighbors who have grown tired of reading that their former banks have paid severe penalties for misleading and outright deceitful practices. In June of 2012, less than one in four respondents told Gallup Research that they had faith in big banks – a record low. NCB will never engage in predatory lending or unspecified fees that take advantage of unsuspecting customers. It is our belief that shareholders and other customers deserve an institution that places its reputation for trust and integrity on the line every day. We simply will not be compromised in that mission!



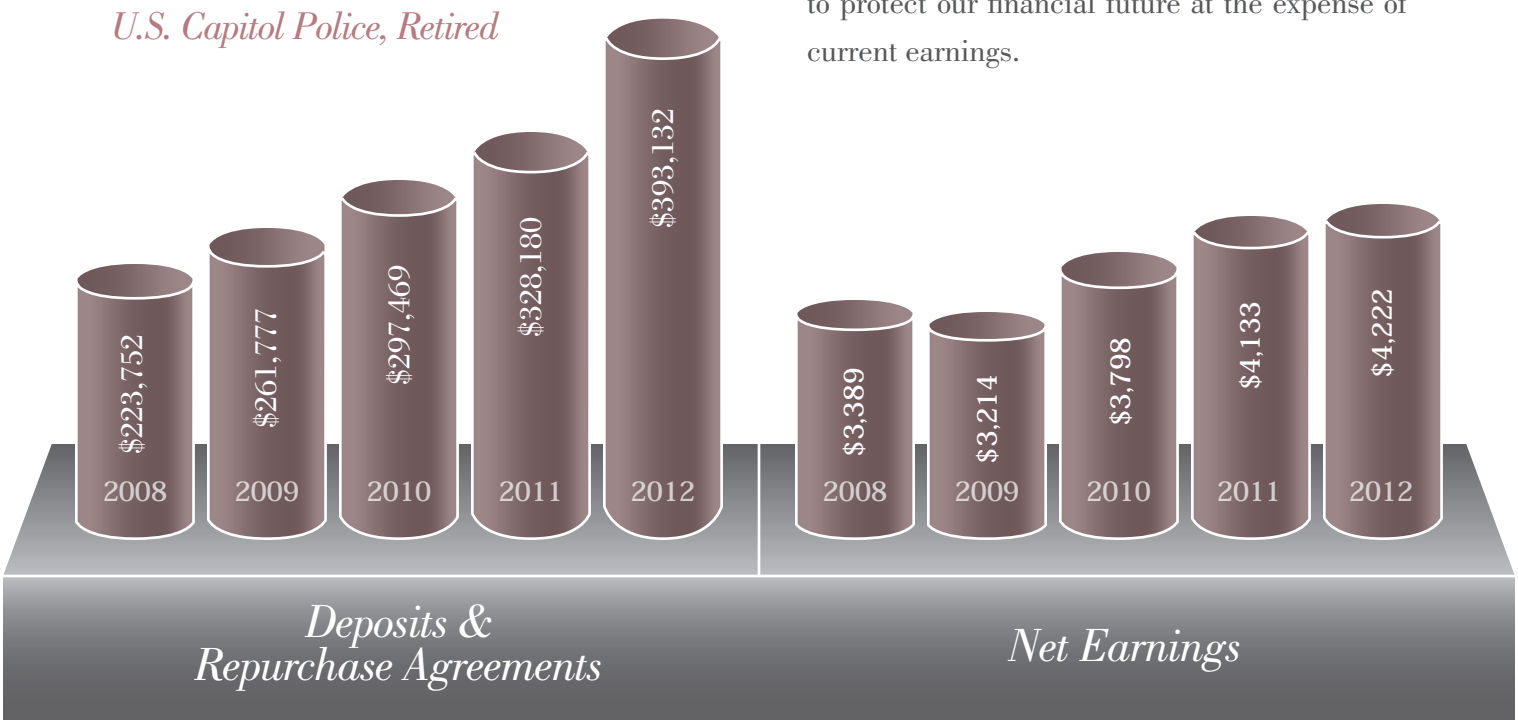
MANAGEMENT'S DISCUSSION OF OPERATING RESULTS

Loan interest and fee income was down by over $1 million as borrowers refinanced at lower rates. We chose not to compete with the unrealistically low rates being offered by some mortgage lenders. This was a conscious decision that should pay dividends when the anemic economic recovery eventually gains traction. Even though loan volume was down by approximately $10 million or 3.83%, management thought that it was prudent to bolster the "reserve for loan losses" balance. This reserve account acts as a cushion against loans that could conceivably go sour in the future. Our Board would have preferred to increase that amount even more but was hampered by the reality that the formula used to determine such amounts does not take into consideration our unique circumstances. Because we have a history of minimal loan losses – and that is a major component of the formula – we could not increase the reserve further without running afoul of generally accepted accounting principles. The loan portfolio is in extremely good condition with no seriously delinquent credits. This stands as a testament to our solid underwriting and collection procedures.

"Supporting Toys for Tots is not something that we have to do, but it's something that we are compelled to do. We are fortunate to have the level of success we have had, and this is our way of closing the circle by showing we care."
- Margaret R. Burness,
Assistant Vice President since 2001

"Our communities benefit immeasurably from all the people who invisibly and quietly do the right thing, day in and day out."
- Gary L. Abrecht, Chief,
U.S. Capitol Police, Retired

We did benefit from strategic gains in our securities portfolio by taking advantage of profitable segments throughout the year, reaping over $750 thousand in gross profits. We re-invested the principal on a laddered basis and still ended the year with unrealized gains in that portfolio of $884 thousand. Although the average returns available on our invested funds are a paltry 1.2%, we did have almost $80 million more to invest than we did last year. These investments are all highly rated and conservatively selected. However, it is evident that we sacrifice significant yield in order to be safe with our depositors' funds. The securities portfolio contains no issues causing even the slightest risk of repayment. This constitutes another example of our philosophy to protect our financial future at the expense of current earnings.



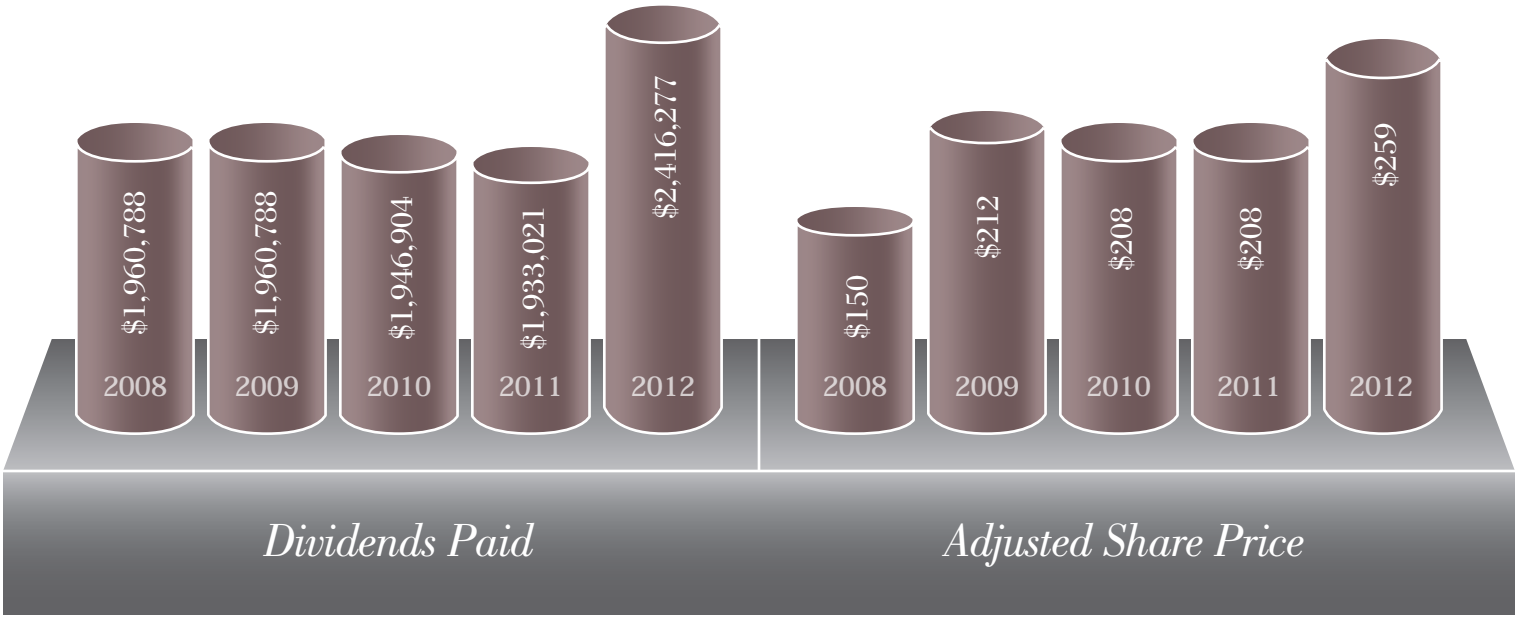
MANAGEMENT'S DISCUSSION OF OPERATING RESULTS

"We don't know what we'd do without the support of NCB. Their sponsorship of our efforts has allowed us to make great progress in redeeming the lives of those who have lost their way."
- Patty Brosmer, President, Capitol Hill Business Improvement District (BID)

Our capital ratios continue to slip modestly. This is more a function of our explosive deposit and asset growth than it is the lack of capital appreciation. Total shareholder equity stood at $41.8 million at year end – a 4.5% increase. It should be remembered that this includes the deduction of $345 thousand due to the payment of the special (extra) dividend. However, when compared to asset growth exceeding 18%, the ratio of tier 1 capital to risk weighted assets went down slightly from 18.98% to 18.92% but still remains among the best in the nation. This is an item that the Board of Directors is constantly monitoring and management is fortunate to have suitable options available to address the situation on both a short and long term basis.

We completed a Strategic Planning session in 2012 where senior officers and Directors met on a weekend to prepare a blueprint for the future. Although we were hampered by regulatory and legislative uncertainties, many items were placed on an agenda of goals to accomplish. Our focus was primarily on strategic business and new product planning while maintaining safe and sound business practices. Compliance, operational and reputation risk evaluation comprise a great portion of each initiative we will undertake. It was noteworthy that over one third of our Directors participated in the planning process. This is the personification of "hands on leadership."

"Being supportive of the next generation, and passing along the lessons we've learned, we help build a future that's even better than what we've enjoyed."
- George A. Didden, III, President and CEO from 1995 – 2007 with young customer



MANAGEMENT'S DISCUSSION OF OPERATING RESULTS

"At SOME (So Others Might Eat), we value empowering those we serve by respecting their human dignity and giving them the tools they need to restore hope in their lives. The affordable housing that SOME develops for families and single adults provides stability while they work to improve their lives."
- Father John Adams, President and CEO, So Others Might Eat

We must again acknowledge the expert advice passed from the Board to our management teams during the year. There is simply no substitute for its active involvement in the affairs of NCB and we are certain that our shareholders benefit mightily from the wisdom they impart. Senior management is most thankful for the hard work of our Executive Committee. Vince Cleary – Chairman, along with Bob Comstock and Bob Donohoe continue to lead us to a higher level of accomplishment and our record setting numbers are a testament to their insistence on attainable goals against a backdrop of safe and sound business practices.

LOOKING FORWARD TO 2013

N.Y. Yankee great, Yogi Berra, once said "I wish I had an answer to that because I'm tired of answering that question."

Sluggish economic growth is mostly the product of political dysfunction on Capitol Hill as evidenced by the deplorable budget impasse. The Federal Reserve has held short term interest rates near zero for four years and expects to keep them there for at least two more years. It has printed money – more than $2 trillion – to keep these rates low. Our government now spends 40 percent more than it takes in and then borrows money to cover the difference. Economists optimistically expect the economy to expand at a tepid 2.3% in 2013. That pace is simply not fast enough to bring down the unemployment rate to an acceptable level. This lack of a growing, productive labor pool threatens to keep GDP below historical averages for an extended period. In many cases, this decline is precipitated by reduced incentives for many individuals to actively seek employment. For example, there are over 30 million more Americans receiving food stamps than in 2000 and 3.8 million more people are receiving disability checks than in 2000. If you pay people to stay home, many will do so rather than accept jobs where the pay doesn't meet their perceived expectations. The Congressional Budget Office recently reported that it will take another $2 trillion in belt-tightening over the next decade to begin to move the federal debt closer to historical levels. In short, our country is well on its way to embracing the principals of a European social democracy that governs from one crisis to another. At least European countries have the ability to borrow from each other to finance their deficits.

We agree with Jeffery M. Lacker, president of The Federal Reserve Bank of Richmond, who has warned that the central bank's extraordinary efforts to stimulate growth tend to be ineffective. In addition, Congress has proved unwilling to fulfill its duty to make the tough choices necessary to control the spending on entitlements. Congressional inaction is setting the U.S. up for the likelihood of persistent inflation going forward. Maybe our government should get out of its own way and allow the free market economy to make the decisions necessary to insure prosperity for our children's future.

It is difficult to predict earnings in 2013 because we are so dependent on crucial variables that our nation still needs to address. It is difficult to prepare a sensible budget for our Board to approve until some of these major issues are

"When people borrow from us, they're signing on for a long-term relationship. And we honor that by being honest and transparent … from beginning to end."
- Laurie Cody, Assistant Vice President

resolved. When businesses and households confront large-scale uncertainty, they tend to wait for more clarity to emerge before making major commitments to spend, invest and hire. In 2013, we confront a mountain of regulatory uncertainty and a fiscal cliff that, if not satisfactorily addressed, could mean a further increase in taxes and a sharp decline in spending. In short, we risk passing the economic, fiscal and financial point of no return. As for National Capital Bank, the sluggish economy, net interest margin compression, increasing regulatory costs and the Federal Reserve's stubborn adherence to its suppressed rate policy that manipulates rates will challenge our net income going forward and it is questionable whether the Bank will set another net income record in 2013.

Our solemn promise for the immediate future is that we will continue to adhere to our core values of safety, integrity and solid shareholder value in the face of a hostile and uncertain future in our industry. However, you may be assured that our time honored beliefs remain steadfast:

We believe in our valued customers who entrust us with their assets.

We believe in our employees who tirelessly give of themselves not only at their desks but in a myriad of community activities.

We believe that by supporting and investing in our neighborhood charitable organizations, the benefits and rewards are reciprocal.

We believe that by demonstrating a culture of good corporate citizenship we will engender long standing loyalty.

We also believe that sound, ethical and transparent management is the only way to conduct a business!

Richard A. Didden

Richard A. Didden
Chairman and CEO

James M. Didden
President

EXECUTIVE COMMITTEE

Standing: James M. Didden, Robert F. Comstock, Robert B. Donohoe
Seated: Richard A. Didden, Vincent D. Cleary, Chairman

2012 BOARD OF DIRECTORS

Vincent D. Cleary
Chairman of the Executive Committee
Cantwell-Cleary Company, Inc.

Robert F. Comstock
Attorney at Law

Donald A. Didden
Executive Vice President (Retired)

James M. Didden
President

Kathryn H. Didden
Investor

Richard A. Didden
Chairman and CEO

Robert B. Donohoe
Senior Vice President
The Donohoe Companies, Inc.

William J. Durkin
Attorney at Law

James A. Monk
Cofounder & Secretary
Good Samaritan Foundation

George T. Pedas
Attorney at Law

James Pedas
Co-Owner
Circle Management

William T. Pedas
Vice President
Circle Management

Dorothee D. Riederer
Investor

Heman M. Ward
Real Estate Development

Rev. Wesley S. Williams, Jr. LLD
President and Co-Chairman
Lockhart Companies Inc.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
The National Capital Bank of Washington
Washington, D.C.

Report on the Financial Statements

We have audited the accompanying financial statements of The National Capital Bank of Washington which comprise the balance sheets as of December 31, 2012 and 2011, the related statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The National Capital Bank of Washington as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
February 20, 2013

The National Capital Bank of Washington

Balance Sheets
December 31, 2012 and 2011

Assets		**2012**		2011
Cash and due from banks	**$**	**6,578,034**	$	5,931,956
Interest-bearing deposits		**14,090,804**		17,779,706
Total cash and cash equivalents		**20,668,838**		23,711,662
Investment securities:				
Available-for-sale, at fair value		**163,524,911**		83,557,848
Restricted stock, at cost		**53,950**		53,950
Total investment securities		**163,578,861**		83,611,798
Loans receivable, net of allowance for loan losses of $1,969,280 (2012) and $1,926,780 (2011)		**246,879,279**		256,822,436
Bank premises and equipment, net		**2,583,933**		2,625,158
Accrued interest and other assets		**1,709,296**		2,121,155
Total Assets	**$**	**435,420,207**	$	368,892,209
Liabilities and Stockholders' Equity				
Liabilities:				
Deposits:				
Non-interest-bearing	**$**	**98,146,378**	$	70,903,763
Interest-bearing		**280,954,136**		240,827,494
Total deposits		**379,100,514**		311,731,257
Securities sold under agreements to repurchase		**14,030,777**		16,448,800
Accrued interest and other liabilities		**459,560**		683,246
Total Liabilities		**393,590,851**		328,863,303
Commitments and contingent liabilities		**-**		-
Stockholders' Equity:				
Common stock, $1.25 par value per share - 400,000 shares authorized, 287,652 issued and outstanding at December 31, 2012 and 2011		**359,565**		359,565
Additional paid-in capital		**1,438,260**		1,438,260
Retained earnings		**39,506,198**		37,700,629
Accumulated other comprehensive income		**525,333**		530,452
Total Stockholders' Equity		**41,829,356**		40,028,906
Total Liabilities and Stockholders' Equity	**$**	**435,420,207**	$	368,892,209

See Notes to Financial Statements.

The National Capital Bank of Washington

Statements of Income
Years Ended December 31, 2012 and 2011

	2012	2011
Interest Income:		
Loans, including fees	$ 11,697,475	$ 12,698,926
Investment securities	1,891,728	1,527,430
Interest-bearing deposits	63,719	52,809
Total interest income	13,652,922	14,279,165
Interest Expense:		
Deposits	1,016,771	1,150,642
Securities sold under agreements to repurchase and short-term borrowings	13,717	16,953
Total interest expense	1,030,488	1,167,595
Net Interest Income	12,622,434	13,111,570
Provision for Loan Losses	292,500	427,500
Net Interest Income after Provision for Loan Losses	12,329,934	12,684,070
Noninterest Income:		
Service charges on deposit accounts	380,865	396,450
Other service charges and fees	82,288	78,513
Rental income	1,352,099	1,353,999
Asset management fees	503,318	521,228
Net gain (loss) on sale of securities	767,671	(47,903)
Other income	396,687	432,119
Total noninterest income	3,482,928	2,734,406
Noninterest Expense:		
Salaries and employee benefits	4,884,398	4,620,707
Occupancy expense	826,260	847,761
Equipment expense	217,332	222,628
Professional fees	535,381	456,698
FDIC assessments	198,646	287,770
Insurance	56,049	61,488
Other expense	2,127,371	2,060,856
Total noninterest expense	8,845,437	8,557,908
Income Before Income Taxes	6,967,425	6,860,568
Provision for Income Taxes	2,745,579	2,727,822
Net Income	$ 4,221,846	$ 4,132,746
Basic and Diluted Earnings Per Share of Common Stock	$ 14.68	$ 14.37
Average Shares Outstanding	287,652	287,652

The National Capital Bank of Washington

Statements of Comprehensive Income
Years Ended December 31, 2012 and 2011

		2012		2011
Net Income	**$**	**4,221,846**	$	4,132,746
Other comprehensive income (loss):				
Unrealized gains on securities available for sale, net of tax of $308,024 and $749,773, respectively		**451,032**		1,097,869
Reclassification adjustment, net of tax of ($311,520) and $19,439, respectively		**(456,151)**		28,464
Total other comprehensive income (loss)		**(5,119)**		1,126,333
Total Comprehensive Income	**$**	**4,216,727**	$	5,259,079

See Notes to Financial Statements.

The National Capital Bank of Washington

Statements of Changes in Stockholders' Equity
Years Ended December 31, 2012 and 2011

	Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Earnings	Income (Loss)	Total
Balances, December 31, 2010	287,652	$ 359,565	$ 1,438,260	$ 35,500,904	$ (595,881)	$ 36,702,848
Net income				4,132,746		4,132,746
Other comprehensive income, net of tax					1,126,333	1,126,333
Cash dividends declared ($6.72 per share)				(1,933,021)		(1,933,021)
Balances, December 31, 2011	**287,652**	**$ 359,565**	**$ 1,438,260**	**$ 37,700,629**	**$ 530,452**	**$ 40,028,906**
Net income				**4,221,846**		**4,221,846**
Other comprehensive (loss), net of tax					**(5,119)**	**(5,119)**
Cash dividends declared ($8.40 per share)				**(2,416,277)**		**(2,416,277)**
Balances, December 31, 2012	**287,652**	**$ 359,565**	**$ 1,438,260**	**$ 39,506,198**	**$ 525,333**	**$ 41,829,356**

See Notes to Financial Statements.

The National Capital Bank of Washington

Statements of Cash Flows
Years Ended December 31, 2012 and 2011

		2012		2011
Cash Flows From Operating Activities:				
Net income	$	4,221,846	$	4,132,746
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		291,056		252,513
Provision for loan losses		292,500		427,500
Accretion and amortization on investments, net		171,642		37,076
Deferred income tax expense (benefit)		45,539		(166,734)
Realized loss on disposal of fixed assets		5,384		1,098
Realized (gain) loss on sales/calls of available-for-sale securities		(767,671)		47,903
Net change in:				
Accrued interest and other assets		369,816		359,053
Accrued interest and other liabilities		(223,686)		92,873
Net cash provided by operating activities		4,406,426		5,184,028
Cash Flows From Investing Activities:				
Loan originations and principal payments, net		9,650,657		(658,838)
Activity in available-for-sale securities:				
Purchases		(221,067,984)		(78,249,249)
Sales, maturities, paydowns, and calls		141,688,335		55,218,516
Purchase of premises and equipment		(255,215)		(349,528)
Net cash used in investing activities		(69,984,207)		(24,039,099)
Cash Flows From Financing Activities:				
Increase in interest accounts, demand deposits and savings accounts		67,062,493		23,960,709
Increase in time deposits		306,764		5,098,382
Net increase (decrease) in repurchase agreements		(2,418,023)		1,652,547
Dividends paid		(2,416,277)		(1,933,021)
Net cash provided by financing activities		62,534,957		28,778,617
Increase (Decrease) in Cash and Cash Equivalents		(3,042,824)		9,923,546
Cash and Cash Equivalents, Beginning of Year		23,711,662		13,788,116
Cash and Cash Equivalents, End of Year	$	20,668,838	$	23,711,662
Supplemental Disclosures of Cash Flow Information				
Cash paid during the year for:				
Interest	$	1,040,338	$	1,169,606
Taxes	$	2,626,810	$	2,895,000
Unrealized gain (loss) on securities available for sale	$	(8,615)	$	1,895,545

See Notes to Financial Statements.

The National Capital Bank of Washington

Notes to Financial Statements

Note 1. Nature of Banking Activities and Significant Accounting Policies

Nature of Operations: The National Capital Bank of Washington (the Bank) operates under a national bank charter and provides full banking services principally to customers in the Washington, D.C. metropolitan area. As a national bank, the Bank is subject to regulations of the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Use of Estimates: In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the fair value of financial instruments.

Investment Securities: Debt and equity securities are segregated into the following three categories: trading, held-to-maturity, and available-for-sale. Trading securities are purchased and held principally for the purpose of reselling them within a short period of time. Unrealized gains and losses on trading securities are included in earnings. As of December 31, 2012 and 2011, the Bank did not hold any trading or held-to-maturity securities.

Securities classified as held-to-maturity are accounted for at amortized cost and require the Bank to have both the positive intent and ability to hold these securities to maturity. Securities not classified as either trading or held-to-maturity are considered to be available-for-sale and are carried at fair value. Unrealized gains and losses on available-for-sale securities are reported, net of taxes, in accumulated other comprehensive income until realized. Realized gains or losses on the sale of securities are reported in earnings and are determined using the adjusted cost of the specific security sold. Interest income is accrued on the investment's face value. Purchase premium and discounts are recognized in interest income using the interest method over the term of the securities.

Investment securities are impaired when fair value is less than cost. An impairment is considered "other than temporary" if any of the following conditions are met: the Bank intends to sell the security, it is more likely than not that the Bank will be required to sell the security before the recovery of its amortized cost basis, or the Bank does not expect to recover the security's entire amortized cost basis (even if the Bank does not intend to sell). The Bank does not have any securities impairment that is considered "other than temporary" at December 31, 2012 and 2011.

Loans: Loans are reported at their recorded investment, which is the principal amount outstanding, as adjusted for net deferred fees or cost of loan originations. The balance of the allowance for loan losses is netted against the recorded investment in loans on the balance sheet. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the yield on the related loans using the interest method. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on all classes of loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal in accordance with the loan's contractual terms, or when a loan becomes contractually past due by ninety days or more with respect to principal or interest. All interest accrued but not collected for loans placed on non-accrual or charged off is reversed against interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest. Loans are considered past due when the borrower is not current with their payments in accordance with the contractual terms of their loan agreement.

Allowance For Loan Losses: An allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks that are probable within the loan portfolio. The allowance is based upon management's continuing assessment of various factors affecting the collectibility of loans, including current economic conditions, past credit experience, the value of the underlying collateral, and such other factors as in management's judgment deserve current recognition in estimating probable credit losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Loans deemed uncollectible are charged off and deducted from the allowance, while subsequent recoveries are credited to the allowance. For real estate loans delinquent after 180 days, the Bank obtains a new valuation. Any outstanding balance greater than the new valuation, less estimated selling costs will be charged off. Commercial, installment, and credit card loans delinquent after 120 days will be charged off unless there is fraudulent activity or bankruptcy proceedings in which loans will be charged off sooner.

The National Capital Bank of Washington

Notes to Financial Statements

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued): The allowance consists of specific, general and unallocated components. For loans that are classified as impaired, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management has an established internally developed methodology to determine the adequacy of the allowance for loan losses that assesses the risks inherent in the loan portfolio. For purposes of determining the allowance for loan losses, management has segmented certain loans in the portfolio by product type. The loan portfolio is segmented based on risk characteristics into the following segments: real estate, commercial, installment and credit cards. Particular characteristics associated with each segment are detailed below:

- Real Estate: Loans secured by commercial real estate carry risks associated with the success of the business and ability to generate a positive cash flow sufficient to service debts and changes in the value of the collateral. Residential real estate loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral. Real estate security diminishes risks only to the extent that a market exists for the subject collateral.
- Commercial: These loans not secured by real estate carry risks associated with the successful operation of a business and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral where depreciation occurs and the valuation is less precise. In addition, these loans may be unsecured.
- Installment: These loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. These loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.
- Credit cards: These loans are unsecured and carry risk associated with the continued credit-worthiness of the borrower. These loans are immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.

As the first step in determining the general component of the allowance for loan losses, management uses the average of the highest two years of net charge-off experience during the last four years for each segment of the portfolio. The historical loss percentage calculated is applied to the quarter end balance of each portfolio segment. The historical component is further adjusted by management's evaluation of various conditions per segment including the economy, concentrations of credit risk, trends in portfolio growth, changes in lending practice, changes in experience and depth of lending staff, changes in value and severity of past due loans and adversely classified loans, changes in collateral value of real estate loans and the effects of external factors including competition, legal and regulatory risks.

To determine the specific reserve component of the allowance for loan losses, management evaluates all impaired loans to determine the amount of anticipated loss. The Bank evaluates all segments of loans for impairment except for installment loans and credit card loans. Accordingly, the Bank does not separately identify installment loans and credit card loans for impairment disclosures, unless such loans are the subject of a restructuring agreement. A loan is considered impaired when management determines that it is probable that the Bank will be unable to collect all amounts due according to the original contractual terms of the loan agreement. Impaired loans are carried at the estimated present value of total expected future cash flows, discounted at the loan's effective rate, or the fair value of the collateral, if the loan is collateral-dependent, or if less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs and unamortized premium or discount).

There were no changes in the Bank's allowance for loan loss methodology during 2012 or 2011.

Troubled Debt Restructurings: In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. There were no loans classified as TDRs as of December 31, 2012 and 2011.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Premises and Equipment: Land is carried at cost. Property and equipment are stated at cost, less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range between 3 and 31 years.

Maintenance and repairs of property and equipment are charged to operations, and major improvements are capitalized. Upon retirement, sale, or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts, and gain or loss is included in noninterest income and noninterest expenses, respectively.

Foreclosed Assets: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets. As of and during the years ended December 31, 2012 and 2011, the Bank did not have any foreclosed assets.

Earnings Per Share Of Common Stock: The Bank has a simple capital structure, with no potential common stock outstanding, such as stock options or warrants. Earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the year.

Income Taxes: Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on the currently enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period adjusted for the change during the period in deferred tax assets and liabilities.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits along with any associated interest and penalties that would be payable to the taxing authorities upon examination. As of December 31, 2012 and 2011, there was no liability recorded for unrecognized tax benefits.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income.

Advertising Costs: Advertising costs are expensed as incurred. Advertising costs were $160,870 and $167,999 for the years ended December 31, 2012 and 2011, respectively.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Cash and Cash Equivalents: For purposes of the statement of cash flows, cash equivalents are highly liquid investments with original maturities of three months or less and include cash and due from banks and federal funds sold. Included in cash and due from banks on the balance sheets were restricted funds on required deposit with the Federal Reserve Bank totaling $7,452,000 and $5,162,000 at December 31, 2012 and 2011, respectively.

In addition, the Bank maintains cash balances in other correspondent banks that may exceed federally insured limits. The Bank has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk.

The National Capital Bank of Washington

Notes to Financial Statements

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Interest-Bearing Deposits in Banks: Interest-bearing deposits in banks mature within one year and are carried at cost.

Rental Income: Rental income is recognized when earned in accordance with the terms of the respective leases on a straight-line basis for the period of occupancy using the average monthly rental. Accordingly, rental income is recognized over the terms of the respective leases.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. However, certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported in a separate Statement of Comprehensive Income. Such items, along with net income, are components of comprehensive income. All the Bank's other comprehensive income relates to unrealized gains and losses on available-for-sale securities for the years ended December 31, 2012 and 2011.

Reclassifications: Certain 2011 balances have been reclassified to conform to the 2012 financial statement presentation.

Recent Accounting Pronouncements:

In April 2011, the FASB issued ASU 2011-03, "Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements." The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU is the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application is not permitted. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220) – Presentation of Comprehensive Income." The new guidance amends disclosure requirements for the presentation of comprehensive income. The amended guidance eliminates the option to present components of other comprehensive income ("OCI") as part of the statement of changes in shareholders' equity. All changes in OCI must be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The guidance does not change the items that must be reported in OCI. The Bank adopted this guidance effective 2012 and has elected to present two separate but consecutive financial statements.

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The amendments in this ASU require an entity to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. In addition, the amendments require a cross-reference to other disclosures currently required for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. Companies should apply these amendments for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. The Bank is currently assessing the impact that ASU 2011-03 will have on its financial statements.

Note 2. Investment Securities

Investment securities are summarized as follows at December 31:

	2012			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available-for-sale:				
Debt securities:				
U.S. Treasury & Agency obligations	**$ 149,926,101**	**$ 1,049,575**	**$ (349,467)**	**150,626,209**
Mortgage-backed securities	**6,214,708**	**153,559**	**-**	**6,368,267**
	$ 156,140,809	**$ 1,203,134**	**$ (349,467)**	**$ 156,994,476**
Equity securities:				
Mutual funds	**6,500,000**	**30,435**	**-**	**6,530,435**
Total securities available-for-sale	**$ 162,640,809**	**$ 1,233,569**	**$ (349,467)**	**$ 163,524,911**
Restricted stock, at cost	**$ 53,950**	**$ -**	**$ -**	**$ 53,950**

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
U.S. Treasury & Agency obligations	$ 81,902,085	$ 868,713	$ (38,640)	82,732,158
Mortgage-backed securities	763,046	62,644	-	825,690
	$ 82,665,131	$ 931,357	$ (38,640)	$ 83,557,848
Restricted stock, at cost	$ 53,950	$ -	$ -	$ 53,950

As of December 31, 2012, twenty-five U.S. Treasury & Agency Obligations with a fair value of $71,354,553 had gross unrealized losses of $349,467. These securities have been in a continuous loss position for less than twelve months. All other securities have gross unrealized gains. As of December 31, 2011, nine U.S. Treasury & Agency Obligations with a fair value of $22,961,360 had gross unrealized losses of $38,640. These securities were in a continuous loss position for less than twelve months. All other securities have gross unrealized gains.

As of December 31, 2012 and 2011, the Bank's unrealized losses in investments securities are related to interest rate fluctuations. Since the Bank does not intend to sell any of the investments before recovery of its amortized cost basis and has the ability and intent to hold these investments to maturity, the Bank does not consider these investments to be other-than-temporarily impaired.

The National Capital Bank of Washington

Notes to Financial Statements

Note 2. Investment Securities (Continued)

The amortized cost and estimated fair value of debt securities at December 31, 2012, by contractual maturity are shown in the table that follows. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or prepaid without any penalties. Therefore, these securities are not included in the maturity categories in the following summary.

	Available-for-Sale	
	Amortized Cost	Fair Value
Due after one year through five years	$ 43,097,197	$ 43,271,801
Due after five years through ten years	91,946,301	92,392,809
Due after ten years	14,882,603	14,961,599
Mortgage-backed securities	6,214,708	6,368,267
	$ 156,140,809	$ 156,994,476

Investment securities with an amortized cost of $33,519,686 and $82,665,131 and fair market value of $34,002,040 and $83,557,848, were pledged to secure repurchase agreements and for other purposes as required or permitted by law at December 31, 2012 and 2011, respectively.

For the years ended December 31, 2012 and 2011, proceeds from sales of securities available-for-sale amounted to $12,421,585 and $3,950,781, respectively; gross unrealized gains were $767,671 and $1,316, respectively; and gross unrealized losses were $0 and $49,219, respectively. The tax benefit (expense) applicable to these net realized gains and losses were ($311,520) and $19,439, respectively.

Note 3. Loans Receivable

Loans receivable consisted of the following at December 31:

	2012	2011
Real estate loans:		
Residential real estate	$ 174,459,538	$ 176,940,101
Commercial real estate	34,327,891	39,321,377
Commercial	35,940,106	36,165,660
Installment	2,997,281	5,219,358
Credit cards	757,212	750,160
	248,482,028	258,396,656
Net deferred loan costs	366,531	352,560
Allowance for loan losses	(1,969,280)	(1,926,780)
Total	$ 246,879,279	$ 256,822,436

The Bank is principally engaged in banking in the Washington, D.C. metropolitan area. The Bank primarily grants commercial and residential loans, the majority of which are secured by real estate. Although the Bank has a diversified portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the economy of the Washington, D.C. metropolitan area.

Note 3. Loans Receivable (Continued)

A summary of transactions in the allowance for loan losses is as follows for the years ended December 31, 2012 and 2011:

Allowance for Loan Losses:	**Real Estate**	**Commercial**	**Installment**	**Credit Cards**	**Total**
Balance, December 31, 2011	**$ 1,323,540**	**$ 547,766**	**$ 24,491**	**$ 30,983**	**$ 1,926,780**
Loans charged off	**-**	**(250,000)**	**-**	**(3,863)**	**(253,863)**
Recoveries	**-**	**-**	**-**	**3,863**	**3,863**
Net loans charged off	**-**	**(250,000)**	**-**	**-**	**(250,000)**
Provision for loan losses	**(111,894)**	**414,676**	**(10,538)**	**256**	**292,500**
Balance, December 31, 2012	**$ 1,211,646**	**$ 712,442**	**$ 13,953**	**$ 31,239**	**$ 1,969,280**
Ending balance: individually evaluated for impairment	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Ending balance: collectively evaluated for impairment	**$ 1,211,646**	**$ 712,442**	**$ 13,953**	**$ 31,239**	**$ 1,969,280**
Loans Receivable:					
Balance, December 31, 2012	**$ 208,787,429**	**$ 35,940,106**	**$ 2,997,281**	**$ 757,212**	**$ 248,482,028**
Ending balance: individually evaluated for impairment	**$ 1,149,354**	**$ 363,698**	**$ -**	**$ -**	**$ 1,513,052**
Ending balance: collectively evaluated for impairment	**$ 207,638,075**	**$ 35,576,408**	**$ 2,997,281**	**$ 757,212**	**$ 246,968,976**

Allowance for Loan Losses:	Real Estate	Commercial	Installment	Credit Cards	Total
Balance, December 31, 2010	$ 1,213,054	$ 222,200	$ 36,846	$ 27,900	$ 1,500,000
Loans charged off	-	-	-	(720)	(720)
Recoveries	-	-	-	-	-
Net loans charged off	-	-	-	(720)	(720)
Provision for loan losses	110,486	325,566	(12,355)	3,803	427,500
Balance, December 31, 2011	$ 1,323,540	$ 547,766	$ 24,491	$ 30,983	$ 1,926,780
Ending balance: individually evaluated for impairment	$ -	$ 200,000	$ -	$ -	$ 200,000
Ending balance: collectively evaluated for impairment	$ 1,323,540	$ 347,766	$ 24,491	$ 30,983	$ 1,726,780
Loans Receivable:					
Balance, December 31, 2011	$ 216,261,478	$ 36,165,660	$ 5,219,358	$ 750,160	$ 258,396,656
Ending balance: individually evaluated for impairment	$ -	$ 800,438	$ -	$ -	$ 800,438
Ending balance: collectively evaluated for impairment	$ 216,261,478	$ 35,365,222	$ 5,219,358	$ 750,160	$ 257,596,218

Management evaluates the credit quality of all loans, except credit cards, based on an internal grading system that estimates the capability of the borrower to repay the contractual terms of their loan agreement as scheduled or at all. The Bank's internal risk grading is based on experiences with similarly graded loans. Management analyzes risk grades on an ongoing basis. In addition, risk grades are validated by an independent loan review performed on a quarterly basis.

The National Capital Bank of Washington

Notes to Financial Statements

Note 3. Loans Receivable (Continued)

The Bank's internally assigned grades are as follows:

- Pass – Loans are supported by adequate financial statements, adequately secured by collateral and borrower demonstrates the ability to repay from normal business operations.
- Special Mention – Loans with no immediate problem, but trends exist with the borrower or the borrower's industry that warrant close watch. This category also includes loans that are currently performing, but have experienced problems in the past.
- Substandard – Loans meeting any of the following conditions: (1) Loans where problems have arisen with the current net worth and/or paying capacity of the borrower, or the collateral pledged, if any, to cause the Bank to further protect its position; (2) Loans having a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; (3) Loans having the distinct possibility that the Bank will sustain some loss if the deficiencies are not satisfactorily corrected.
- Doubtful – Loans classified doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and therefore improbable.
- Loss – Loans classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though full or partial recovery may be affected in the future.

The Bank's credit card portfolio is evaluated based on payment activity. All credit cards as of December 31, 2012 and December 31, 2011 were current.

The following table represents the credit quality of loan by class:

December 31, 2012	Pass	Special Mention	Substandard	Doubtful	Loss
Real estate loans:					
Residential real estate	$ 174,459,538	$ -	$ -	$ -	$ -
Commercial real estate	29,770,521	3,408,016	1,149,354	-	-
Commercial	35,474,506	101,902	363,698	-	-
Installment	2,997,281	-	-	-	-
Total	$ 242,701,846	$ 3,509,918	$ 1,513,052	$ -	$ -

	Performing	Non-Performing
Credit cards	$ 757,212	$ -

December 31, 2011	Pass	Special Mention	Substandard	Doubtful	Loss
Real estate loans:					
Residential real estate	$ 174,228,072	$ -	$ -	$ -	$ -
Commercial real estate	38,452,411	2,712,029	-	-	-
Commercial	35,430,446	803,742	800,438	-	-
Installment	5,219,358	-	-	-	-
Total	$ 253,330,287	$ 3,515,771	$ 800,438	$ -	$ -

	Performing	Non-Performing
Credit cards	$ 750,160	$ -

Note 3. Loans Receivable (Continued)

There were no loans past due in excess of 30 days or troubled debt restructurings as of December 31, 2012. There were no loans modified as troubled debt restructurings and no troubled debt restructuring defaults during the year ended December 31, 2012. For purposes of this disclosure, a troubled debt restructuring payment default occurs when, within twelve months of the original modification, either the troubled debt restructuring is placed on non-accrual status or a charge-off has occurred.

As of December 31, 2012, there was one commercial real estate loan with a balance of $1,149,354 and one commercial loan with a balance of $363,698 that were on non-accrual and classified as impaired with no valuation allowance. The commercial real estate loan had a year-to-date average balance of $1,162,013 and the commercial loan had a year-to-date average balance of $604,167. There was no interest recognized on impaired loans during the year ended December 31, 2012.

There were no loans past due in excess of 30 days, nonaccrual loans, or troubled debt restructurings as of December 31, 2011. As of December 31, 2011, there was one commercial loan with a balance of $800,438 that was classified as impaired with a valuation allowance of $200,000.

Note 4. Premises and Equipment

Premises and equipment are comprised of the following at December 31:

	2012	2011
Land and buildings	**$ 5,164,971**	$ 5,164,031
Furniture and equipment	**1,924,659**	1,854,645
	7,089,630	7,018,676
Accumulated depreciation	**(4,505,697)**	(4,393,518)
Premises and equipment, net	**$ 2,583,933**	$ 2,625,158
Depreciation on property and equipment charged to expense	**$ 291,056**	$ 252,513

Note 5. Deposits

Deposits as of December 31, are summarized as follows:

	2012		2011	
	Balance	**Weighted Average Interest Rate %**	Balance	Weighted Average Interest Rate %
Non-interest-bearing	**$ 98,146,378**	**-**	$ 70,903,763	-
Interest-bearing:				
Interest checking	**77,164,155**	**0.05**	66,354,437	0.05
Money market accounts	**121,319,806**	**0.25**	99,238,510	0.29
Savings accounts	**19,717,919**	**0.10**	12,789,055	0.10
Certificates of deposit:				
Less than $100,000	**18,151,073**	**0.84**	17,567,457	1.13
$100,000 or more	**44,601,183**	**0.91**	44,878,035	1.30
Total interest-bearing	**280,954,136**		240,827,494	
Total deposits	**$ 379,100,514**		$ 311,731,257	
Interest paid during the year on certificates of deposit of $100,000 or more	**$ 503,158**		$ 583,582	

The National Capital Bank of Washington

Notes to Financial Statements

Note 5. Deposits (Continued)

At December 31, 2012, the scheduled maturities of certificates of deposit are as follows:

2013	$	40,752,001
2014		20,642,043
2015		1,358,212
	$	62,752,256

Note 6. Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase of $14,030,777 and $16,448,800 at December 31, 2012 and 2011 mature within one to ninety days from the transaction date and are secured by U.S. Government securities with a fair value of $23,600,524 and $68,847,135 at December 31, 2012 and 2011, respectively. The weighted average interest rate on these agreements was .10 and .05 percent at December 31, 2012 and December 31, 2011, respectively. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Bank may be required to provide additional collateral based on the fair value of the underlying securities.

Note 7. Borrowings

During 2012, the Bank renewed a $9,000,000 line of credit agreement with another financial institution. The interest rate on this agreement is equal to the prevailing federal funds rate. During 2012 and 2011, the Bank's outstanding balances did not exceed $9,000,000 for any period of the borrowing and no balances were outstanding as of December 31, 2012 or 2011. The Bank also has access to the Federal Reserve Bank of Richmond's discount window.

Note 8. Defined Contribution Plan

The Bank has a defined contribution plan that covers substantially all of the Bank's full-time employees. Participants can contribute up to 15%, or the maximum amount allowable by law, of their annual compensation and receive a dollar for dollar matching employer contribution of up to 4% of their annual compensation. Related expenses were $120,274 and $121,715 for the years ended December 31, 2012 and 2011, respectively.

Note 9. Stockholders' Equity

Restriction on dividends:
The amount of dividends that the Bank can pay without approval from the Office of the Comptroller of the Currency is limited to its retained net income for the current year plus its retained net income for the preceding two years. At December 31, 2012, the Bank's retained earnings available for the payment of dividends was $5,856,704. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

Note 10. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 Capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012 and 2011, that the Bank met all capital adequacy requirements to which it is subject.

Note 10. Regulatory Matters (Continued)

As of December 31, 2012, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table that follows. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's required and actual capital amounts and ratios are set forth in the following table:

	Actual		**For Capital Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Active Provisions**	
	Amount		**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2012:						
Total Capital [to Risk Weighted Assets]	**$ 43,288,000**	**19.82%**	**$ 17,469,000**	**≥8%**	**$ 21,836,000**	**≥10%**
Tier 1 Capital [to Risk Weighted Assets]	**41,304,000**	**18.92%**	**8,734,000**	**≥4%**	**13,101,000**	**≥6%**
Tier 1 Capital [to Average Assets]	**41,304,000**	**9.74%**	**12,720,000**	**≥3%**	**21,201,000**	**≥5%**

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Active Provisions	
	Amount		Amount	Ratio	Amount	Ratio
As of December 31, 2011:						
Total Capital [to Risk Weighted Assets]	$ 41,426,000	19.91%	$ 16,648,000	≥8%	$ 20,810,000	≥10%
Tier 1 Capital [to Risk Weighted Assets]	39,499,000	18.98%	8,324,000	≥4%	12,486,000	≥6%
Tier 1 Capital [to Average Assets]	39,499,000	10.95%	10,817,000	≥3%	18,029,000	≥5%

Note 11. Income Taxes

The Bank files income tax returns in the U.S. federal jurisdiction and the District of Columbia. With few exceptions, the Bank is no longer subject to U.S. federal and state income tax examinations by tax authorities for years prior to 2009.

The provision for income taxes consists of the following for the years ended December 31:

	2012	2011
Current income tax expense:		
Federal income tax	**$ 2,142,137**	$ 2,294,600
Local income tax	**557,903**	599,956
Total current income tax expense	**2,700,040**	2,894,556
Deferred income tax expense (benefit)	**45,539**	(166,734)

The National Capital Bank of Washington

Notes to Financial Statements

Note 11. Income Taxes (Continued)

A reconciliation of the statutory income tax to the income tax expense included in the financial statements is as follows for the years ended December 31:

		2012		2011
Income before income tax	**$**	**6,967,425**	$	6,860,568
Federal tax rate		**34%**		34%
Tax expense at statutory rate		**2,368,925**		2,332,593
Differences resulting from:				
District of Columbia franchise tax, net of federal tax effect		**365,373**		386,616
Nondeductible expenditures		**10,015**		5,544
Other		**1,266**		3,069
Provision for income taxes	**$**	**2,745,579**	$	2,727,822
Effective tax rate		**39.41%**		39.76%

The tax effects of items comprising the Bank's net deferred tax assets (liabilities) at December 31 are as follows:

		2012		2011
Accumulated depreciation	**$**	**(95,192)**	$	(86,871)
Deferred loan costs		**(148,753)**		(143,083)
Allowance for loan losses		**799,213**		781,964
Unrealized (gain) on available-for-sale securities		**(358,769)**		(362,264)
Other		**(4,758)**		44,039
Net deferred tax asset	**$**	**191,741**	$	233,785

Note 12. Fair Value Measurements

The Bank follows authoritative accounting guidance to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The guidance clarifies that fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The guidance provides key considerations in determining the fair value of a financial asset when the market for that financial asset is not active.

Authoritative accounting guidance specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

Note 12. Fair Value Measurements (Continued)

The following describes the valuation techniques used by the Bank to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available-for-sale: Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances of financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 and 2011:

		Fair Value Measurements at December 31, 2012 Using		
Description	**Fair Value as of December 31, 2012**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets:				
Available for sale securities:				
U.S treasury & agency obligations	**$ 150,626,209**	**$ -**	**$ 150,626,209**	**$ -**
Mortgage-backed securities	**6,368,267**	**-**	**6,368,267**	**-**
Mutual funds	**6,530,435**	**6,530,435**	**-**	**-**
Total available for sale securities	**$ 163,524,911**	**$ 6,530,435**	**$ 156,994,476**	**$ -**

		Fair Value Measurements at December 31, 2011 Using		
Description	Fair Value as of December 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Available for sale securities:				
U.S treasury & agency obligations	$ 82,732,158	$ -	$ 82,732,158	$ -
Mortgage-backed securities	825,690	-	825,690	-
Total available for sale securities	$ 83,557,848	$ -	$ 83,557,848	$ -

Certain financial and nonfinancial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The National Capital Bank of Washington

Notes to Financial Statements

Note 12. Fair Value Measurements (Continued)

The following describes the valuation techniques used by the Bank to measure certain financial and nonfinancial assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. If the value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Statements of Income.

Other Real Estate Owned (OREO): OREO fair value measurements are the same as impaired loans which are described above. The Bank had no OREO at December 31, 2012 and 2011.

The following table presents the balances of financial and nonfinancial assets measured at fair value on a nonrecurring basis as of December 31, 2012 and 2011:

		Fair Value Measurements at December 31, 2012 Using		
Description	**Fair Value as of December 31, 2012**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets:				
Impaired loans	**$ 1,513,052**	**$ -**	**$ 1,513,052**	**$ -**

		Fair Value Measurements at December 31, 2011 Using		
Description	Fair Value as of December 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Impaired loans	$ 600,438	$ -	$ 600,438	$ -

Note 12. Fair Value Measurements (Continued)

Authoritative accounting guidance requires disclosures of the estimated fair values of financial instruments, which is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. The assumptions used by management are more fully detailed on the following page. It should be noted that different assumptions could significantly affect these estimates and the net realizable values could be materially different from the estimates presented below.

The fair value estimates presented below are based on pertinent information available as of December 31, 2012 and 2011. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that the Bank could realize in a current market transaction. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

		Fair Value Measurements at December 31, 2012 Using			
	Carrying Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total Fair Value
Financial Assets:					
Cash and cash equivalents	$ 20,668,838	$ 20,668,838	$ -	$ -	$ 20,668,838
Investment securities	163,578,861	6,530,435	157,048,426	-	163,578,861
Loans, net	246,879,279	-	255,282,016	-	255,282,016
Accrued interest receivable	938,909	-	938,909	-	938,909
Financial Liabilities:					
Deposits	379,100,514	98,146,378	281,085,472	-	379,231,850
Securities sold under agreement to repurchase	14,030,777		14,030,777	-	14,030,777
Accrued interest payable	31,035	-	31,035	-	31,035

	December 31, 2011	
	Carrying Value	Fair Value
Financial Assets:		
Cash and cash equivalents	$ 23,711,662	$ 23,711,662
Investment securities	83,611,798	83,611,798
Loans, net	256,822,436	267,836,486
Accrued interest receivable	901,183	901,183
Financial Liabilities:		
Deposits	311,731,257	312,256,914
Securities sold under agreement to repurchase	16,448,800	16,448,800

The National Capital Bank of Washington

Notes to Financial Statements

Note 12. Fair Value Measurements (Continued)

The Bank had determined the fair value of its financial instruments using the following assumptions:

Cash and Cash Equivalents and Accrued Interest Receivable and Payable – The fair value of cash and cash equivalents and accrued interest receivable and payable was estimated to equal the carrying value due to the short-term nature of these financial instruments.

Investment Securities – The fair value of securities was estimated based on quoted market prices, dealer quotes, and prices obtained from independent pricing services. The carrying value of restricted stock approximates fair value based on the redemption provisions of the respective entity.

Loans – The fair value of loans receivable was estimated by discounting estimated future cash flows using current rates on loans with similar credit risks and terms.

Deposits – The fair value of demand and savings deposits was estimated to equal the carrying value due to the short-term nature of the financial instruments. The fair value of time deposits was estimated by discounting estimated future cash flows using current rates on time deposits with similar maturities.

Short-Term Borrowings – The carrying amounts of borrowing under repurchase agreements, and other short-term borrowings maturing within ninety days, approximate their fair values.

Off-Balance-Sheet-Instruments – The estimated fair value of fee income on letters of credit at December 31, 2012 and 2011 was insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2012 and 2011.

Note 13. Financial Instruments With Off-Balance Sheet Risk

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit, commitments under credit card arrangements, and commercial and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and commercial and standby letters of credit is represented by the contractual amount of those obligations. The Bank uses the same policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The contract amounts of these financial instruments at December 31 are as follows:

		2012		2011
Commitments to extend credit – credit cards	**$**	**3,290,000**	$	3,166,000
Commitments to extend credit – other loans		**67,665,000**		59,618,000
Commercial and standby letters of credit		**975,000**		1,883,000
	$	**71,930,000**	$	64,667,000

Commitments to extend credit are agreements to lend to a customer as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include inventory, real estate, equipment, securities, cash, and income-producing commercial properties. Credit card commitments are unsecured.

Note 13. Financial Instruments With Off-Balance Sheet Risk (Continued)

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and, generally, have terms of one year or less. 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 supporting these commitments. In the event the customer does not perform in accordance with the terms of the agreement with the third-party, the Bank would be required to fund the commitment. The maximum potential amount of future payments the Bank could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Bank would be entitled to seek recovery from the customer. At December 31, 2012 and 2011, no amounts have been recorded as liabilities for the Bank's potential obligations under these guarantees.

Note 14. Commitments and Contingencies

In the ordinary course of business, the Bank has various outstanding commitments and contingent liabilities that are not reflected in the accompanying financial statements. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the financial condition of the Bank.

Note 15. Related Party Transactions

In the normal course of banking business, loans are made to executive officers and directors. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectibility or present other unfavorable features. At December 31, 2012 and 2011, these loans totaled $9,567,000 and $8,787,000, respectively.

In addition, the Bank held deposits of $21,755,000 and $17,653,000 from officers and directors at December 31, 2012 and 2011.

Note 16. Concentrations of Credit

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The concentrations of credit by type of loan are set forth in Note 3. Commercial and standby letters of credit were granted primarily to commercial borrowers.

Note 17. Subsequent Events

The Bank evaluated subsequent events that have occurred after the balance sheet date, but before the financial statements are issued. There are two types of subsequent events (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose about that date.

Subsequent events have been considered through February 20, 2013, the date financial statements were available to be issued. Based on the evaluation, the Bank did not identify any recognized or nonrecognized subsequent events that would have required adjustment to or disclosure in the audited financial statements.

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Executive Vice President

Debra A. Keats
Senior Vice President

William C. Cornelius, Sr.
Vice President

Lin C. Cotman, Jr.
Vice President and Controller

R. Andrew Didden, Jr.
Vice President, Investments

David M. Glaser
Vice President

John B. Gordon
Vice President

Bob D. Hall, II
Vice President and HR Director

Sheryl C. Smith
Vice President and Compliance Officer

James H. Thompson, III
Vice President and Cashier

Margaret R. Burness
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