

PUBLIC DISCLOSURE

May 17, 2010

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Bank of the Eastern Shore

904425

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NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the Federal financial supervisory agency concerning the safety and soundness of this financial institution.

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COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

The major factors supporting this rating include:

- The bank's loan-to-deposit ratio is considered reasonable in relation to demand for credit in the market area.
- A substantial majority of mortgage and sampled small business loans originated during the evaluation period were provided to residents and businesses in the bank's assessment area.
- The bank's lending distributions to borrowers of different income levels and to businesses of different sizes are both considered excellent using various proxies for demand.
- The geographic distribution of the bank's mortgage lending is considered excellent, while the small business lending performance is considered reasonable. Overall, the bank's geographic distribution is considered reasonable given area demographics and aggregate data.
- The institution has not received any complaints regarding its CRA performance since the previous evaluation.

SCOPE OF EXAMINATION

The institution was evaluated using the interagency examination procedures developed by the Federal Financial Institutions Examination Council (FFIEC). Based on the number of new loans originated recently by the institution, mortgage and small business loans were identified as primary credit products and their performance is included in the evaluation. In order to comply with minimum sampling requirements, all dwelling secured mortgage loans originated between January 1, 2009, and April 30, 2010 (51) were analyzed in the evaluation. The small business loan performance was based on a statistical sample of 84 loans originated in 2009, out of a universe of 142 transactions.

DESCRIPTION OF INSTITUTION

Bank of the Eastern Shore (BOTES) is headquartered in Cambridge, Maryland, and operates two branch offices within Dorchester County. As of March 31, 2010, the bank reported total assets of \$231.2 million, of which 73.9% were loans. The institution offers a variety of credit and deposit products including loans for consumer, residential mortgage, and business purposes. The loan portfolio as of March 31, 2010, is depicted in the following chart.

Composition of Loan Portfolio

Loan Type	3/31/2010	
	\$(000s)	%
Secured by 1-4 Family dwellings	53,840	30.0
Multifamily	0	0.0
Construction and Development	11,294	6.3
Commercial & Industrial/ NonFarm NonResidential	105,615	58.8
Consumer Loans and Credit Cards	8,330	4.6
Agricultural Loans/ Farmland	534	0.3
All Other	0	0.0
Total	179,613	100.0

As reflected in the preceding table, the largest loan types within the bank’s loan portfolio are commercial & industrial/nonfarm nonresidential loans and loans secured by one- to four-family dwellings. These composition percentages correspond with the number of new loans recently extended by the bank, and consequently led to the selection of mortgage and small business for inclusion in the evaluation.

BOTES received a Satisfactory rating at its previous CRA evaluation dated May 8, 2007.

DESCRIPTION OF THE INSTITUTION’S OPERATIONS IN THE DORCHESTER COUNTY NONMETROPOLITAN ASSESSMENT AREA

The institution’s assessment area consists of all of Dorchester County, Maryland, and includes nine census tracts, of which one is considered low-income, four are moderate-income, and four are middle-income. There are no upper-income census tracts within the assessment area. According to recent (June 30, 2009) data from the FDIC, BOTES ranked first out of nine institutions in local deposit market share with 31.7% of the available deposits within the county.

According to the 2000 census data, this assessment area has a population of 30,674 and a median housing value of \$87,980. The owner-occupancy rate of 60.7% for the market is lower than the statewide level of 62.5%, but higher than the level for nonmetropolitan areas of Maryland at 52%. Within the assessment area, 10.1% of families are considered below the poverty level, which is higher than the rates for both the nonmetropolitan areas of Maryland (7.3%) and the state (6.1%). The 2009 median family income for nonmetropolitan areas of the state equals \$69,200.

The following table provides relevant demographics for the assessment area by both the income level of families and households, as well as the percentages of families and households living in census tracts of varying income levels. The table also displays the distribution of owner-occupied housing units by income level of census tract, as well as Dun and Bradstreet (D&B) business demographic information.

Assessment Area Demographics

Dorchester, MD NonMA								
Income Categories*	Tract Distribution		Families by Tract		Families < Poverty as a % of Families by Tract		Families by Family Income	
	#	%	#	%	#	%	#	%
Low	1	11.1	939	10.9	210	22.4	2,294	26.7
Moderate	4	44.4	3,026	35.3	352	11.6	1,766	20.6
Middle	4	44.4	4,619	53.8	303	6.6	1,979	23.1
Upper	0	0.0	0	0.0	0	0.0	2,545	29.6
NA	0	0.0	0	0.0	0	0.0		
Total	9	100.0	8,584	100.0	865	10.1	8,584	100.0
	Owner Occupied Units by Tract		Households					
			HHs by Tract		HHs < Poverty by Tract		HHs by HH Income	
	#	%	#	%	#	%	#	%
Low	504	5.7	1,595	12.5	406	25.5	3,911	30.8
Moderate	3,053	34.3	4,703	37.0	710	15.1	2,430	19.1
Middle	5,352	60.1	6,414	50.5	621	9.7	2,431	19.1
Upper	0	0.0	0	0.0	0	0.0	3,940	31.0
NA	0	0.0	0	0.0	0	0.0		
Total	8,909	100.0	12,712	100.0	1,737	13.7	12,712	100.0
	Total Businesses by Tract		Businesses by Tract and Revenue Size					
			Less than or = \$1 Million		Over \$1 Million		Revenue not Reported	
	#	%	#	%	#	%	#	%
Low	194	12.8	181	13.3	5	4.8	8	14.5
Moderate	695	45.8	610	44.9	57	54.8	28	50.9
Middle	628	41.4	567	41.8	42	40.4	19	34.5
Upper	0	0.0	0	0.0	0	0.0	0	0.0
NA	0	0.0	0	0.0	0	0.0	0	0.0
Total	1,517	100.0	1,358	100.0	104	100.0	55	100.0
	Percentage of Total Businesses:			89.5		6.9		3.6

*NA-Tracts without household or family income as applicable

The assessment area, located on the eastern shore region of Maryland, is primarily rural. The western part of Dorchester County borders the Chesapeake Bay shoreline. Major employers in the county include Allen Family Foods (poultry processing), Hyatt Regency Chesapeake Bay Golf Resort, and Dorchester County Hospital. The tourism industry in Dorchester County has a significant economic impact. Water nearly surrounds the entire county, with 1,539 miles of shoreline along rivers and bays offering a wide variety of recreational and tourism opportunities. Given the significant importance of tourism within the county, the unemployment rate fluctuates throughout the year and tends to decrease during the spring and summer months. Current and recent periodic unemployment rates are included in the following table.

Unemployment Rate Trend									
Geographic Area	2008				2009				2010
	March	June	Sept	Dec	March	June	Sept	Dec	March
Dorchester County	6.8%	6.2%	6.4%	9.3%	10.5%	10.1%	10.5%	11.7%	11.7%
Maryland	3.7%	4.4%	4.6%	5.1%	6.8%	7.3%	7.0%	7.1%	7.7%

As reflected in the table, the impact of tourism during warmer months was evident in both 2008 and 2009 for Dorchester County. Also evident is the overall rise in the unemployment rates, likely caused by the recent national economic downturn. The county’s unemployment rate continues to exceed that of the state. Rising and/or high levels of unemployment may adversely affect a bank’s ability to extend credit as unemployed applicants often have diminished repayment capacity.

A local economic development official was contacted to assist in evaluating the bank’s CRA performance. The contact identified the need for small business lending, particularly through the Small Business Administration (SBA) programs, in Dorchester County. The contact feels that local financial institutions, particularly the “larger institutions”, do not seem to be willing to lend to small businesses at this time. The contact stated that there are currently several state and county programs available to attract companies wishing to locate or expand in Dorchester County for participation by local financial institutions.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA:

To evaluate the bank’s lending performance, mortgage and small business lending activity was analyzed. Area demographic and market aggregate data are used as proxies for demand when evaluating the bank’s performance. Aggregate data used as a proxy for the bank’s mortgage lending includes all activity reported by lenders subject to reporting residential mortgage data that originated and/or purchased such loans within the bank’s assessment area. Similarly, the aggregate data used as a proxy for the bank’s small business lending includes all lenders subject to reporting small business data. Demographic data is from the 2000 census, while aggregate data is from calendar year 2008. Aggregate data from 2009 could not be included, as the data is not yet publicly available.

Primary consideration is given to the number (and corresponding percentage) of transactions when assessing lending performance for specific individual loan types. When combining multiple loan products to arrive at an overall conclusion, the perceived level of performance of each product is weighted primarily by the dollar volume that the product contributes to the overall activity considered in the evaluation. All conclusions also take into consideration relevant performance context factors.

While mortgage loan data from calendar year 2009 and January through April 2010 was fully analyzed and considered in the evaluation, unless otherwise noted, only bank data from 2009 is presented in the following distribution tables. In instances where the mortgage loan performance during 2010 varies significantly from performance in 2009, such variances and the corresponding impact on the overall performance are discussed.

Because the analysis includes mortgage data from a 16-month time period (January 2009 thru April 2010) to comply with minimum required sample guidelines, and only a sample of small business loans from 2009, understanding the relative size of the bank’s mortgage and small business lending is an important performance context factor. During 2009, the bank originated approximately \$7.3 million in mortgage loans within its assessment area. During the same time period, it is estimated that the bank originated an equal dollar volume of small business loans within its assessment area. Accordingly, BOTES’s mortgage and small business loan performances are weighted equally in the analysis.

Loan-To-Deposit Ratio

A bank's loan-to-deposit ratio is one measure of its lending relative to its capacity. As of March 31, 2010, the bank's loan-to-deposit ratio equaled 88.3% and averaged 93.5% for the 16-quarter period also ending March 31, 2010. In comparison, the average quarterly loan-to-deposit ratios for all banks headquartered in nonmetropolitan areas of Maryland and of similar asset size to BOTES ranged from 85.9% to 94% for the 15-quarter period ending December 31, 2009. Since March 31, 2006, bank assets, loans, and deposits have increased by 23.5%, 26.7% and 16.9%, respectively. Given that loan growth has exceeded deposit growth during the evaluation period, and the most recent ratio reflects a slightly downward trend compared with the average loan-to-deposit ratio, the bank's ratio is considered reasonable given its financial condition, size, branch locations, and local credit needs.

Lending In Assessment Area

BOTES's mortgage lending activity between January 2009 and April 2010 and a sample of small business loans from 2009 is represented in the following table.

Comparison of Credit Extended Inside and Outside of Assessment Area(s)

Loan Type	Inside				Outside			
	#	%	\$(000)	%	#	%	\$(000)	%
Mortgage Loans*	49	96.1	9,588	94.8	2	3.9	526	5.2
Small Business*	77	91.7	3,872	90.4	7	8.3	414	9.6
TOTAL LOANS	126	93.3	13,460	93.5	9	6.7	940	6.5

*The number and dollar amount of loans reflects a sample of such loans originated during the evaluation period and does not reflect loan data collected or reported by the institution.

As indicated in the table, a substantial majority of both the number (93.3%) and dollar amount (93.5%) of mortgage and sampled small business loans were provided to borrowers located in the bank's assessment area. Overall, BOTES's level of lending within its assessment area is considered highly responsive to community credit needs.

Lending to Borrowers of Different Incomes and To Businesses of Different Sizes

The bank's lending to borrowers of different incomes and to businesses of different sizes is considered excellent overall, and is reflective of excellent distributions for both mortgage and small business lending.

Distribution of Mortgage Loans by Income Level of Borrower

Dorchester, MD NonMA (2009)								
Income Categories	Bank				Aggregate			
	#	%	\$(000s)	% \$	#	%	\$(000s)	% \$
	Mortgage Loans							
Low	6	18.8	404	5.9	NA	NA	NA	NA
Moderate	10	31.3	1,209	17.5	NA	NA	NA	NA
Middle	5	15.6	988	14.3	NA	NA	NA	NA
Upper	11	34.4	4,296	62.3	NA	NA	NA	NA
Total	32	100.0	6,896	100.0	NA	NA	NA	NA
Unknown	0		0		NA		NA	

Percentage's (%) are calculated on all loans where incomes are known

As indicated in the preceding table for 2009, 18.8% of BOTES’s residential real estate loans were to low-income borrowers. This level of lending lags the percentage of area low-income families (26.7%) but significantly exceeds the 2008 aggregate lending level to such borrowers (9.4%). The bank’s level of lending to moderate-income borrowers (31.3%) significantly exceeds both the percentage of moderate-income families (20.6%), as well as the level of aggregate lending (23.7%) to such families within the assessment area. The lending performance of the bank’s 2010 mortgage loans is substantially similar. Overall, this level of lending is considered excellent.

Distribution of Lending by Loan Amount and Size of Business

Dorchester, MD NonMA (2009)								
by Revenue	Bank				Aggregate*			
	#	%	\$(000s)	% \$	#	%	\$(000s)	% \$
\$1 Million or Less	69	89.6	3,131	80.8	NA	NA	NA	NA
Over \$1 Million	8	10.4	742	19.2	NA	NA	NA	NA
Unknown	0	0.0	0	0.0	NA	NA	NA	NA
by Loan Size	Bank				Aggregate*			
\$100,000 or less	69	89.6	2,315	59.8	NA	NA	NA	NA
\$100,001-\$250,000	7	9.1	1,274	32.9	NA	NA	NA	NA
\$250,001-\$1 Million	1	1.3	283	7.3	NA	NA	NA	NA
Total	77	100.0	3,872	100.0	NA	NA	NA	NA

* No data is available for Aggregate loans with Revenues over \$1 million and those with Unknown revenues

According to 2009 D&B data, 89.5% of businesses within the assessment area have revenues of \$1 million or less. Aggregate small business data indicates that 35.1% of reported small business loans in 2008 were to businesses having revenues of \$1 million or less. The remaining portion of businesses had revenues exceeding \$1 million or revenue data was not determined. As indicated in the preceding table, 89.6% of the institution’s small business loans were to businesses with revenues of \$1 million or less. This level of lending is considered excellent.

Geographic Distribution of Loans

The bank’s mortgage geographic distribution performance is considered excellent overall, while its small business geographic distribution performance is considered reasonable. When considering the performance of both loan products on a combined basis, BOTES’s overall geographic distribution performance is considered reasonable.

Distribution of Mortgage Loans by Income Level of Census Tract

Dorchester, MD NonMA (2009)								
Income Categories	Bank				Aggregate			
	#	%	\$(000s)	% \$	#	%	\$(000s)	% \$
	Mortgage Loans							
Low	4	12.5	400	5.8	NA	NA	NA	NA
Moderate	15	46.9	3,341	48.4	NA	NA	NA	NA
Middle	13	40.6	3,156	45.8	NA	NA	NA	NA
Upper	0	0.0	0	0.0	NA	NA	NA	NA
NA*	0	0.0	0	0.0	NA	NA	NA	NA
Total	32	100.0	6,896	100.0	NA	NA	NA	NA

*NA-Tracts without household or family income as applicable; or a small county

Loans where the geographic location is unknown are excluded from this table.

Within the assessment area, 5.7% and 34.3% of all owner-occupied housing units are located in low- and moderate-income geographies, respectively. According to 2008 aggregate data, 6.5% and 34.2% of all reported real estate loans were to borrowers residing in low- and moderate-income geographies, respectively. The bank's 2009 level of lending in the low-income geography (12.5%) and moderate-income geographies (46.9%) significantly exceeds both proxies for demand. Performance of the bank's 2010 mortgage loans is substantially similar, and overall, this performance level is considered excellent.

Distribution of Small Business Loans by Income Level of Census Tract

Dorchester, MD NonMA (2009)								
Income Categories	Bank				Aggregate			
	#	%	\$(000s)	% \$	#	%	\$(000s)	% \$
Low	3	3.9	38	1.0	NA	NA	NA	NA
Moderate	37	48.1	1,893	48.9	NA	NA	NA	NA
Middle	37	48.1	1,942	50.1	NA	NA	NA	NA
Upper	0	0.0	0	0.0	NA	NA	NA	NA
NA*	0	0.0	0	0.0	NA	NA	NA	NA
Total	77	100.0	3,872	100.0	NA	NA	NA	NA

*NA-Tracts without household or family income as applicable; or a small county

Loans where the geographic location is unknown are excluded from this table.

The bank's lending to businesses located in the low-income geography (3.9%) lags both the 2008 small business aggregate data (7%) and the percentage of area businesses (12.8%) located in such areas. Lending in moderate-income geographies (48.1%) exceeds both the percentage of businesses located in such areas (45.8%) and the 2008 small business aggregate data (42.4%). Overall, BOTES's level of lending to small businesses in low-and moderate-income areas is considered reasonable.

Fair Lending or Other Illegal Credit Practices Review

No evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs was identified. Adequate policies, procedures, and training programs have been developed to support nondiscrimination in lending activities.

GLOSSARY

Aggregate lending: The number of loans originated and purchased by all reporting lenders in specified income categories as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

Census tract: A small subdivision of metropolitan and other densely populated counties. Census tract boundaries do not cross county lines; however, they may cross the boundaries of metropolitan statistical areas. Census tracts usually have between 2,500 and 8,000 persons, and their physical size varies widely depending upon population density. Census tracts are designed to be homogeneous with respect to population characteristics, economic status, and living conditions to allow for statistical comparisons.

Community development: All Agencies have adopted the following language. Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or, activities that revitalize or stabilize low- or moderate-income geographies.

Effective September 1, 2005, the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation have adopted the following additional language as part of the revitalize or stabilize definition of community development. Activities that revitalize or stabilize-

- (i) Low-or moderate-income geographies;
- (ii) Designated disaster areas; or
- (iii) Distressed or underserved nonmetropolitan middle-income geographies designated by the Board, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, based on-
 - a. Rates of poverty, unemployment, and population loss; or
 - b. Population size, density, and dispersion. Activities that revitalize and stabilize geographies designated based on population size, density, and dispersion if they help to meet essential community needs, including needs of low- and moderate-income individuals.

Consumer loan(s): A loan(s) to one or more individuals for household, family, or other personal expenditures. A consumer loan does not include a home mortgage, small business, or small farm loan. This definition includes the following categories: motor vehicle loans, credit card loans, home equity loans, other secured consumer loans, and other unsecured consumer loans.

Family: Includes a householder and one or more other persons living in the same household who are related to the householder by birth, marriage, or adoption. The number of family households always equals the number of families; however, a family household may also include non-relatives living with the family. Families are classified by type as either a married-couple family or other family, which is further classified into 'male householder' (a family with a male householder and no wife present) or 'female householder' (a family with a female householder and no husband present).

Full-scope review: Performance under the Lending Test (and if applicable, consideration of investments and services) is analyzed considering performance context, quantitative factors (for example, geographic distribution, borrower distribution, and total number and dollar amount of investments), and qualitative factors (for example, innovativeness, complexity, and responsiveness).

Geography: A census tract delineated by the United States Bureau of the Census in the most recent decennial census.

Home Mortgage Disclosure Act (HMDA): The statute that requires certain mortgage lenders that do business or have banking offices in a metropolitan statistical area to file annual summary reports of their mortgage lending activity. The reports include such data as the race, gender, and the income of applications, the amount of loan requested, and the disposition of the application (for example, approved, denied, and withdrawn).

Home mortgage loans: Includes home purchase and home improvement loans as defined in the HMDA regulation. This definition also includes multifamily (five or more families) dwelling loans, loans for the purchase of manufactured homes and refinancings of home improvement and home purchase loans.

Household: Includes all persons occupying a housing unit. Persons not living in households are classified as living in group quarters. In 100 percent tabulations, the count of households always equals the count of occupied housing units.

Limited-scope review: Performance under the Lending Test (and if applicable, consideration of investments and services) is analyzed using only quantitative factors (for example, geographic distribution, borrower distribution, total number and dollar amount of investments, and branch distribution).

Low-income: Individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography.

Market share: The number of loans originated and purchased by the institution as a percentage of the aggregate number of loans originated and purchased by all reporting lenders in the metropolitan area/assessment area.

Metropolitan area (MA): A metropolitan statistical area (MSA) or a metropolitan division (MD) as defined by the Office of Management and Budget. A MSA is a core area containing at least one urbanized area of 50,000 or more inhabitants, together with adjacent communities having a high degree of economic and social integration with that core. A MD is a division of a MSA based on specific criteria including commuting patterns. Only a MSA that has a population of at least 2.5 million may be divided into MDs.

Middle-income: Individual income that is at least 80 percent and less than 120 percent of the area median income, or a median family income that is at least 80 percent and less than 120 percent, in the case of a geography.

Moderate-income: Individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 percent and less than 80 percent, in the case of a geography.

Multifamily: Refers to a residential structure that contains five or more units.

Other products: Includes any unreported optional category of loans for which the institution collects and maintains data for consideration during a CRA examination. Examples of such activity include consumer loans and other loan data an institution may provide concerning its lending performance.

Owner-occupied units: Includes units occupied by the owner or co-owner, even if the unit has not been fully paid for or is mortgaged.

Qualified investment: A qualified investment is defined as any lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

Rated area: A rated area is a state or multistate metropolitan area. For an institution with domestic branches in only one state, the institution's CRA rating would be the state rating. If an institution maintains domestic branches in more than one state, the institution will receive a rating for each state in which those branches are located. If an institution maintains domestic branches in two or more states within a multistate metropolitan area, the institution will receive a rating for the multistate metropolitan area.

Small loan(s) to business(es): A loan included in 'loans to small businesses' as defined in the Consolidated Report of Condition and Income (Call Report) and the Thrift Financial Reporting (TFR) instructions. These loans have original amounts of \$1 million or less and typically are either secured by nonfarm or nonresidential real estate or are classified as commercial and industrial loans. However, thrift institutions may also exercise the option to report loans secured by nonfarm residential real estate as "small business loans" if the loans are reported on the TFR as nonmortgage, commercial loans.

Small loan(s) to farm(s): A loan included in 'loans to small farms' as defined in the instructions for preparation of the Consolidated Report of Condition and Income (Call Report). These loans have original amounts of \$500,000 or less and are either secured by farmland, or are classified as loans to finance agricultural production and other loans to farmers.

Upper-income: Individual income that is more than 120 percent of the area median income, or a median family income that is more than 120 percent, in the case of a geography.