

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

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2008
- OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: **001-31708**

CAPITOL BANCORP LTD.

(Exact name of registrant as specified in its charter)

Michigan (State or other jurisdiction of incorporation or organization)	38-2761672 (IRS Employer Identification No.)
Capitol Bancorp Center 200 Washington Square North Lansing, Michigan (Address of principal executive offices)	48933 (Zip Code)

(517) 487-6555
(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 15, 2008
Common Stock, No par value	17,317,094 shares

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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PART I. FINANCIAL INFORMATION

Forward-Looking Statements

Certain of the statements contained in this document, including Capitol's consolidated financial statements, Management's Discussion and Analysis of Financial Condition and Results of Operations and in documents incorporated into this document by reference that are not historical facts, including, without limitation, statements of future expectations, projections of results of operations and financial condition, statements of future economic performance and other forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, are subject to known and unknown risks, uncertainties and other factors which may cause the actual future results, performance or achievements of Capitol and/or its subsidiaries and other operating units to differ materially from those contemplated in such forward-looking statements. The words "intend," "expect," "project," "estimate," "predict," "anticipate," "should," "believe," and similar expressions also are intended to identify forward-looking statements. Important factors which may cause actual results to differ from those contemplated in such forward-looking statements include, but are not limited to: (i) the results of Capitol's efforts to implement its business strategy, (ii) changes in interest rates, (iii) legislation or regulatory requirements adversely impacting Capitol's banking business and/or expansion strategy, (iv) adverse changes in business conditions or inflation, (v) general economic conditions, either nationally or regionally, which are less favorable than expected and that result in, among other things, a deterioration in credit quality and/or loan performance and collectability, (vi) competitive pressures among financial institutions, (vii) changes in securities markets, (viii) actions of competitors of Capitol's banks and Capitol's ability to respond to such actions, (ix) the cost of capital, which may depend in part on Capitol's asset quality, prospects and outlook, (x) changes in governmental regulation, tax rates and similar matters, and (xi) other risks detailed in Capitol's other filings with the Securities and Exchange Commission. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes may vary materially from those indicated. All subsequent written or oral forward-looking statements attributable to Capitol or persons acting on its behalf are expressly qualified in their entirety by the foregoing factors. Investors and other interested parties are cautioned not to place undue reliance on such statements, which speak as of the date of such statements. Capitol undertakes no obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of unanticipated events.

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PART I, ITEM 1

CAPITOL BANCORP LIMITED
Condensed Consolidated Balance Sheets
As of June 30, 2008 and December 31, 2007
(in thousands, except share data)

	(Unaudited) June 30, 2008	December 31, 2007
<u>ASSETS</u>		
Cash and due from banks	\$ 215,686	\$ 196,083
Money market and interest-bearing deposits	26,414	26,924
Federal funds sold	258,179	129,365
	<hr/>	<hr/>
Cash and cash equivalents	500,279	352,372
Loans held for sale	11,314	16,419
Investment securities:		
Available for sale, carried at market value	13,219	14,119
Held for long-term investment, carried at amortized cost which approximates market value	30,165	25,478
	<hr/>	<hr/>
Total investment securities	43,384	39,597
Portfolio loans:		
Loans secured by real estate:		
Commercial	2,022,820	1,917,113
Residential (including multi-family)	805,924	698,960
Construction, land development and other land	840,820	852,595
	<hr/>	<hr/>
Total loans secured by real estate	3,669,564	3,468,668
Commercial and other business-purpose loans	811,290	768,473
Consumer	53,775	48,041
Other	29,893	29,519
	<hr/>	<hr/>
Total portfolio loans	4,564,522	4,314,701
Less allowance for loan losses	(63,904)	(58,124)
	<hr/>	<hr/>
Net portfolio loans	4,500,618	4,256,577
Premises and equipment	61,393	60,031
Accrued interest income	18,621	19,417
Goodwill and other intangibles	73,496	72,722
Other assets	131,295	84,628
	<hr/>	<hr/>
TOTAL ASSETS	\$ 5,340,400	\$ 4,901,763
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>LIABILITIES:</u>		
Deposits:		
Noninterest-bearing	\$ 669,516	\$ 671,688
Interest-bearing	3,488,118	3,173,057
	<hr/>	<hr/>
Total deposits	4,157,634	3,844,745
Debt obligations:		
Notes payable and short-term borrowings	440,485	320,384
Subordinated debentures	154,177	156,130
	<hr/>	<hr/>
Total debt obligations	594,662	476,514
Accrued interest on deposits and other liabilities	35,049	35,161
	<hr/>	<hr/>
Total liabilities	4,787,345	4,356,420
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	167,090	156,198
<u>STOCKHOLDERS' EQUITY:</u>		
Common stock, no par value, 50,000,000 shares authorized; issued and outstanding: 2008 - 17,317,094 shares 2007 - 17,316,568 shares	273,149	272,208
Retained earnings	113,407	117,520
Undistributed common stock held by employee-benefit trust	(580)	(586)
Market value adjustment (net of tax effect) for investment securities available for sale (accumulated other comprehensive income)	(11)	3
	<hr/>	<hr/>
Total stockholders' equity	385,965	389,145
	<hr/>	<hr/>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 5,340,400	\$ 4,901,763

See notes to condensed consolidated financial statements.

CAPITOL BANCORP LIMITED
Condensed Consolidated Statements of Income (Unaudited)
For the Three Months and Six Months Ended June 30, 2008 and 2007
(in thousands, except per share data)

	Three-Month Period		Six-Month Period	
	2008	2007	2008	2007
Interest income:				
Portfolio loans (including fees)	\$ 74,238	\$ 77,178	\$ 151,569	\$ 150,702
Loans held for sale	236	390	536	1,336
Taxable investment securities	102	193	235	401
Federal funds sold	1,008	3,109	2,221	5,653
Other	553	384	1,079	1,001
Total interest income	<u>76,137</u>	<u>81,254</u>	<u>155,640</u>	<u>159,093</u>
Interest expense:				
Deposits	26,989	30,267	57,677	58,596
Debt obligations and other	6,956	5,445	13,836	10,274
Total interest expense	<u>33,945</u>	<u>35,712</u>	<u>71,513</u>	<u>68,870</u>
Net interest income	42,192	45,542	84,127	90,223
Provision for loan losses	9,019	3,990	17,977	7,922
Net interest income after provision for loan losses	33,173	41,552	66,150	82,301
Noninterest income:				
Service charges on deposit accounts	1,457	1,187	2,790	2,292
Trust and wealth-management revenue	1,563	1,117	3,208	2,154
Fees from origination of non-portfolio residential mortgage loans	1,063	1,305	1,984	2,612
Gain on sales of government-guaranteed loans	643	550	1,223	1,350
Gain on sales of other non-portfolio commercial loans	343	309	660	629
Realized gains on sale of investment securities available for sale	2	-	45	-
Other	1,406	1,375	3,132	2,391
Total noninterest income	<u>6,477</u>	<u>5,843</u>	<u>13,042</u>	<u>11,428</u>
Noninterest expense:				
Salaries and employee benefits	27,730	26,437	53,278	52,509
Occupancy	4,500	3,552	8,904	7,049
Equipment rent, depreciation and maintenance	3,008	2,590	5,874	5,232
Other	12,550	9,635	24,537	19,247
Total noninterest expense	<u>47,788</u>	<u>42,214</u>	<u>92,593</u>	<u>84,037</u>
Income (loss) before income taxes (benefit) and minority interest	(8,138)	5,181	(13,401)	9,692
Income taxes (benefit)	(2,701)	2,346	(4,696)	4,110
Income (loss) before minority interest	(5,437)	2,835	(8,705)	5,582
Minority interest in net losses of consolidated subsidiaries	6,060	3,463	11,519	6,987
NET INCOME	<u>\$ 623</u>	<u>\$ 6,298</u>	<u>\$ 2,814</u>	<u>\$ 12,569</u>
NET INCOME PER SHARE -- Note E:				
Basic	<u>\$ 0.04</u>	<u>\$ 0.37</u>	<u>\$ 0.16</u>	<u>\$ 0.75</u>
Diluted	<u>\$ 0.04</u>	<u>\$ 0.37</u>	<u>\$ 0.16</u>	<u>\$ 0.73</u>

See notes to condensed consolidated financial statements.

CAPITOL BANCORP LIMITED
Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
For the Six Months Ended June 30, 2008 and 2007
(in thousands, except share data)

	Common Stock	Retained Earnings	Undistributed Common Stock Held by Employee- Benefit Trust	Accumulated Other Comprehensive Income (Loss)	Total
<u>Six Months Ended June 30, 2007</u>					
Balances at January 1, 2007	\$ 249,244	\$ 112,779		\$ (144)	\$ 361,879
Issuance of 371,314 shares of common stock to acquire minority interest in subsidiary	15,927				15,927
Issuance of 220,135 shares of common stock upon exercise of stock options, net of common stock surrendered to facilitate exercise	3,327				3,327
Surrender of 16,814 shares of common stock to facilitate vesting of restricted stock	(756)				(756)
Recognition of compensation expense relating to restricted common stock	784				784
Tax benefits from share-based payments	1,634				1,634
Issuance of 24,506 shares to employee stock ownership plan	1,132				1,132
Cash dividends paid (\$0.50 per share)		(8,544)			(8,544)
Components of comprehensive income:					
Net income		12,569			12,569
Market value adjustment for investment securities available for sale (net of income tax effect)				(35)	(35)
Comprehensive income					12,534
BALANCES AT JUNE 30, 2007	\$ 271,292	\$ 116,804		\$ (179)	\$ 387,917
<u>Six Months Ended June 30, 2008</u>					
Balances at January 1, 2008	\$ 272,208	\$ 117,520	\$ (586)	\$ 3	\$ 389,145
Issuance of 3,174 shares of common stock upon exercise of stock options	54				54
Surrender of 14,138 shares of common stock to facilitate vesting of restricted stock	(285)				(285)
Issuance of 18,312 unvested shares of restricted common stock, net of related unearned employee compensation and 6,822 forfeited shares	--				--
Recognition of compensation expense relating to restricted common stock and stock options	1,172				1,172
Tax benefits from share-based payments	2				2
Transfer of 250 shares to employee stock ownership plan	(2)		6		4
Cash dividends paid (\$0.40 per share)		(6,927)			(6,927)
Components of comprehensive income:					
Net income		2,814			2,814
Market value adjustment for investment securities available for sale (net of income tax effect)				(14)	(14)
Comprehensive income					2,800
BALANCES AT JUNE 30, 2008	\$ 273,149	\$ 113,407	\$ (580)	\$ (11)	\$ 385,965

See notes to condensed consolidated financial statements.

CAPITOL BANCORP LTD.
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the Six Months Ended June 30, 2008 and 2007
(in thousands)

	2008	2007
OPERATING ACTIVITIES		
Net income	\$ 2,814	\$ 12,569
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan losses	17,977	7,922
Depreciation of premises and equipment	5,005	4,434
Amortization of intangibles	241	159
Net amortization of investment security premiums	6	2
Loss (gain) on sale of premises and equipment	44	(137)
Minority interest in net losses of consolidated subsidiaries	(11,519)	(6,987)
Share-based compensation expense	1,172	784
Originations and purchases of loans held for sale	(120,855)	(288,104)
Proceeds from sales of loans held for sale	125,960	301,341
Increase in accrued interest income and other assets	(46,239)	(6,374)
Increase (decrease) in accrued interest on deposits and other liabilities	(112)	1,181
	(112)	1,181
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	(25,506)	26,790
INVESTING ACTIVITIES		
Proceeds from sales of investment securities available for sale	840	
Proceeds from calls, prepayments and maturities of investment securities	10,761	6,382
Purchases of investment securities	(16,004)	(3,898)
Net increase in portfolio loans	(262,018)	(317,082)
Proceeds from sales of premises and equipment	126	332
Purchases of premises and equipment	(6,537)	(7,203)
	(272,832)	(321,469)
NET CASH USED BY INVESTING ACTIVITIES	(272,832)	(321,469)
FINANCING ACTIVITIES		
Net increase in demand deposits, NOW accounts and savings accounts	50,514	118,949
Net increase in certificates of deposit	262,375	145,912
Net proceeds from debt obligations	118,101	28,780
Net proceeds from issuance of subordinated debentures		55,000
Resources provided by minority interest	22,411	11,968
Net proceeds from issuance of common stock	54	3,327
Surrender of common stock to facilitate vesting of restricted stock	(285)	(756)
Tax benefit from share-based payments	2	1,634
Cash dividends paid	(6,927)	(8,544)
	446,245	356,270
NET CASH PROVIDED BY FINANCING ACTIVITIES	446,245	356,270
INCREASE IN CASH AND CASH EQUIVALENTS	147,907	61,591
Cash and cash equivalents at beginning of period	352,372	348,870
	500,279	410,461
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 500,279	\$ 410,461

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED

Note A – Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Capitol Bancorp Ltd. (Capitol or the Corporation) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all information and footnotes necessary for a fair presentation of consolidated financial position, results of operations and cash flows in conformity with generally accepted accounting principles.

The condensed consolidated financial statements do, however, include all adjustments of a normal recurring nature (in accordance with Rule 10-01(b)(8) of Regulation S-X) which Capitol considers necessary for a fair presentation of the interim periods.

The results of operations for the periods ended June 30, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

The consolidated balance sheet as of December 31, 2007 was derived from audited consolidated financial statements as of that date. Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

Note B – Implementation of New Accounting Standards

In June 2007, the Financial Accounting Standards Board (FASB) ratified an Emerging Issues Task Force (EITF) consensus regarding *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards*. This new guidance became effective for Capitol on January 1, 2008 and did not have a material effect on Capitol's consolidated financial statements upon implementation.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, which provides a definition of fair value for accounting purposes, establishes a framework for measuring fair value and expands related financial statement disclosures. In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure, on an item-by-item basis, specified financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are required to be reported in earnings at each reporting date. Statement No. 159 is applied prospectively and has been implemented by Capitol effective January 1, 2008. Capitol has not elected the fair value option through June 30, 2008. Statement No. 157 does not require any new fair value measurements and was initially effective for the Corporation beginning January 1, 2008. Capitol's disclosures relating to SFAS No. 157 are set forth in Note C. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2. FSP FAS 157-2 defers the effective date of SFAS No. 157 until January 1, 2009 for nonfinancial assets and nonfinancial liabilities except those items recognized or disclosed at fair value on an annual or more frequently recurring basis. The effect of these new standards' adoption was not material to Capitol's consolidated financial statements in 2008.

Note C – Fair Value

As discussed in Note B, SFAS No. 157 was implemented by Capitol effective January 1, 2008. SFAS No. 157 establishes a hierarchy that prioritizes the use of fair value inputs used in valuation methodologies into the following three levels:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note C – Fair Value--Continued

Level 3: Significant unobservable inputs that reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following is a description of Capitol's valuation methodologies used to measure and disclose the fair values of its financial assets and liabilities on a recurring or nonrecurring basis:

Investment securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, when available. If quoted prices are not available, fair values are measured using independent pricing models. Level 1 securities include those traded on an active exchange as well as U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include private collateralized mortgage obligations.

Mortgage loans held for sale: Mortgage loans held for sale are carried at the lower of cost or fair value and are measured on a nonrecurring basis. Mortgage loans held for sale written down to fair value are included in the table below (none at June 30, 2008). Fair value is based on independent quoted market prices, where applicable, or the prices for other mortgage whole loans with similar characteristics.

Loans: The Corporation does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral dependent loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of the collateral.

The balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 were as follows (in \$1,000s):

	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>
Securities available for sale	\$ <u>13,219</u>	\$ <u>12,439</u>	\$ <u>780</u>

The balances of assets and liabilities measured at fair value on a nonrecurring basis as of June 30, 2008 were as follows (in \$1,000s):

	<u>Total</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Total Gains (Losses)</u>
Impaired loans ⁽¹⁾	\$ <u>52,244</u>	\$ <u>52,244</u>	\$ <u>(2,760)</u>

⁽¹⁾ Represents carrying value and related write-downs for which adjustments are based on the appraised value of the collateral.

Capitol will apply the fair value measurement and disclosure provisions of SFAS No. 157 effective January 1, 2009 to nonfinancial assets and liabilities measured on a nonrecurring basis. The Corporation measures the fair value of the following on a nonrecurring basis: (1) long-lived assets, (2) foreclosed assets, (3) the reporting unit under step one of its goodwill impairment test and (4) indefinite lived assets.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note D – Stock Options

Stock option activity for the interim 2008 period is summarized as follows:

	Number of Stock Options Outstanding	Exercise Price Range	Weighted Average Exercise Price
Outstanding at January 1	2,460,082	\$ 13.50 to \$ 46.20	\$ 27.85
Granted	52,360	20.12 to 20.12	20.12
Exercised	(2,674)	16.40 to 16.40	16.40
Cancelled or expired	<u>(13,113)</u>		
Outstanding at June 30	<u>2,496,655</u>	\$ 13.50 to \$ 46.20	<u>\$ 27.76</u>

Stock options were granted in the first six months of 2007 and 2008, with an aggregate fair value approximating \$174,000 and \$255,000, respectively. Stock options granted in the interim 2008 period have a vesting date of December 31, 2008, and the stock options granted in the interim 2007 period (18,720) became vested at December 31, 2007. Each stock option expires seven years from date of grant. Share-based compensation expense relating to stock options for the six months ended June 30, 2008 approximated \$411,000.

As of June 30, 2008, stock options outstanding had a weighted average remaining contractual life of 2.98 years and no aggregate intrinsic value. The following table summarizes stock options outstanding segregated by exercise price range as of June 30, 2008:

Exercise Price Range	Number Outstanding	Weighted Average	
		Exercise Price	Remaining Contractual Life
\$10.00 to 14.99	2,866	\$ 13.50	0.51 years
\$15.00 to 19.99	224,476	16.60	1.68 years
\$20.00 to 24.99	621,276	21.63	3.14 years
\$25.00 to 29.99	585,415	27.09	2.15 years
\$30.00 to 34.99	695,115	32.10	3.19 years
\$35.00 or more	<u>367,507</u>	37.92	4.42 years
Total outstanding	<u>2,496,655</u>		

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note E – Net Income Per Share

The computations of basic and diluted earnings per share were based on the following (in 1,000s) for the periods ended June 30:

	Three Month Period		Six Month Period	
	2008	2007	2008	2007
Numerator—net income for the period	\$ <u>623</u>	\$ <u>6,298</u>	\$ <u>2,814</u>	\$ <u>12,569</u>
Denominator:				
Weighted average number of shares outstanding, excluding unvested restricted shares (denominator for basic earnings per share)	17,144	16,961	17,143	16,829
Effect of dilutive securities:				
Unvested restricted shares	33	15	27	42
Stock options	<u>--</u>	<u>208</u>	<u>9</u>	<u>351</u>
Total effect of dilutive securities	<u>33</u>	<u>223</u>	<u>36</u>	<u>393</u>
Denominator for diluted earnings per share—				
Weighted average number of shares and potential dilution	<u>17,177</u>	<u>17,184</u>	<u>17,179</u>	<u>17,222</u>
Number of antidilutive stock options excluded from diluted earnings per share computation	<u>2,494</u>	<u>1,063</u>	<u>2,269</u>	<u>368</u>

Note F – New Banks and Other Development Activities

Capitol opened four *de novo* banks during the six months ended June 30, 2008. Adams Dairy Bank, located in Blue Springs, Missouri, opened in January, Mountain View Bank of Commerce, located in Westminster, Colorado, opened in February, Colonia Bank, located in Phoenix, Arizona, opened in April and Pisgah Community Bank, located in Asheville, North Carolina, opened in May. Each is majority owned by bank-development subsidiaries controlled by Capitol.

Bank development efforts were under consideration at June 30, 2008 in several states including pre-development exploratory discussions, lease and employment negotiations and preparation of preliminary regulatory applications for formation and/or acquisition of community banks. As of June 30, 2008, Capitol had 4 applications pending for additional *de novo* community banks in Arizona, North Carolina, Ohio and Oklahoma.

Capitol's operating strategy focuses on the ongoing growth and maturity of its existing banks, coupled with new bank expansion in selected markets as opportunities arise. Accordingly, Capitol may invest in, acquire or otherwise develop additional banks in future periods, subject to economic conditions, regulatory approval and other factors, although the timing of such additional banking units, if any, is uncertain. Such future new banks and/or additions of other operating units could be either wholly-owned, majority-owned or otherwise controlled by Capitol.

Note G – Pending Sale of Four Michigan Banks

On March 31, 2008, Capitol announced that it had entered into a definitive agreement to sell four affiliate western Michigan banks to Northstar Financial Group Inc., a Michigan-based, privately-held financial holding company, for cash consideration of approximately \$52 million. Total assets of the four banks (Grand Haven Bank, Kent Commerce Bank, Muskegon Commerce Bank and Paragon Bank & Trust) approximated \$417.6 million as of June 30, 2008. No material gain or loss is expected to be reported upon completion of the sale, if consummated. The combined operating results of those banks for the six months ended June 30, 2008 was a net loss approximating \$1.2 million. The pending sale is subject to regulatory approval and other contingencies.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note H – Proposed Acquisition of Bank

In March 2008, Capitol announced the formation of a joint venture to acquire 51% of the common stock of Forethought Federal Savings Bank (Forethought), located in Batesville, Indiana, for cash consideration of approximately \$5 million. Forethought is engaged in providing trust-related, preneed funeral planning products and services to customers in 28 states. The proposed acquisition is subject to regulatory approval.

Note I – Impact of New Accounting Standards

In December 2007, the FASB issued Statement No. 141(R), *Business Combinations*, to further enhance the accounting and financial reporting related to business combinations. Statement No. 141(R) establishes principles and requirements for how the acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree, (2) recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase, (3) requires that acquisition-related and restructuring costs be recognized separately from the acquisition, generally charged to expense when incurred and (4) determines information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. Statement No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The effects of the Corporation's adoption of Statement No. 141(R) will depend upon the extent and magnitude of acquisitions after December 31, 2008.

Also in December 2007, the FASB issued Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*, to create accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Statement No. 160 establishes accounting and reporting standards that require (1) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheet within equity, but separate from the parent's equity, (2) the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income, (3) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently, (4) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary to be initially measured at fair value and (5) entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. Statement No. 160 applies to fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, and early adoption is prohibited. Management has not completed its review of this new guidance.

In March 2008 the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of FASB Statement No. 133. This new guidance revises the presentation and disclosure of derivatives and hedging activities and will be effective for Capitol on January 1, 2009. Although management has not completed its review of the new standard, implementation is not expected to have a material impact on Capitol's consolidated financial statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, to clarify the sources of accounting principles used in the preparation of financial statements in the United States. This new guidance is expected to become effective in 2008 and is not expected to have a material effect on Capitol's consolidated financial statements upon implementation.

The FASB has also recently issued several proposals to amend, supersede or interpret existing accounting standards which may impact Capitol's financial statements at a later date, such as a proposed amendment to Statement No. 128, *Earnings per Share*, among other things. Capitol's management has not completed its analysis of such new guidance (as proposed, where applicable) although it anticipates the potential impact (if finalized, where applicable) would not be material to Capitol's consolidated financial statements.

A variety of proposed or otherwise potential accounting standards are currently under study by standard-setting organizations and various regulatory agencies. Because of the tentative and preliminary nature of these proposed standards, management has not determined whether implementation of such proposed standards would be material to Capitol's consolidated financial statements.

PART I, ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Financial Condition

Total assets approximated \$5.3 billion at June 30, 2008, an increase of \$439 million from the December 31, 2007 level of \$4.9 billion. The balance sheet includes Capitol and its consolidated subsidiaries:

	Total Assets	
	June 30, 2008	December 31, 2007
Arizona Region:		
Arrowhead Community Bank	\$ 87,561	\$ 89,060
Asian Bank of Arizona	33,034	25,017
Bank of Tucson	179,728	187,468
Camelback Community Bank	90,884	84,671
Colonia Bank ⁽³⁾	8,865	
Mesa Bank	227,105	217,861
Southern Arizona Community Bank	90,854	85,158
Sunrise Bank of Albuquerque	78,634	71,726
Sunrise Bank of Arizona	126,690	116,245
Valley First Community Bank	73,744	77,306
Yuma Community Bank	<u>73,831</u>	<u>78,489</u>
Arizona Region Total	1,070,930	1,033,001
California Region:		
Bank of Escondido	99,591	89,557
Bank of Feather River	20,716	17,283
Bank of San Francisco	63,940	68,902
Bank of Santa Barbara	69,193	58,738
Napa Community Bank	136,220	131,457
Point Loma Community Bank	56,733	56,428
Sunrise Bank of San Diego	94,838	81,905
Sunrise Community Bank	<u>27,602</u>	<u>21,113</u>
California Region Total	568,833	525,383
Colorado Region:		
Fort Collins Commerce Bank	70,595	61,083
Larimer Bank of Commerce	74,202	51,906
Loveland Bank of Commerce	26,343	15,941
Mountain View Bank of Commerce ⁽²⁾	<u>22,891</u>	
Colorado Region Total	194,031	128,930
Great Lakes Region:		
Ann Arbor Commerce Bank	361,630	362,429
Bank of Auburn Hills	47,117	44,767
Bank of Maumee	51,622	35,576
Bank of Michigan	70,002	69,909
Brighton Commerce Bank	110,375	108,664
Capitol National Bank	230,182	228,556
Detroit Commerce Bank	105,206	113,243
Elkhart Community Bank	90,028	89,064
Evansville Commerce Bank	66,026	50,819
Goshen Community Bank	79,996	93,173
Grand Haven Bank	129,660	130,492
Kent Commerce Bank	87,965	87,060
Macomb Community Bank	94,125	93,045
Muskegon Commerce Bank	95,502	98,975
Oakland Commerce Bank	108,110	109,370
Ohio Commerce Bank	49,446	35,690
Paragon Bank & Trust	104,519	103,711
Portage Commerce Bank	<u>212,858</u>	<u>189,944</u>
Great Lakes Region Total	2,094,369	2,044,487
Midwest Region:		
Adams Dairy Bank ⁽¹⁾	26,642	
Bank of Belleville	64,726	50,485
Community Bank of Lincoln	34,871	12,960
Summit Bank of Kansas City	<u>45,908</u>	<u>50,142</u>
Midwest Region Total	172,147	113,587

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

Summary of total assets – continued:

	Total Assets	
	June 30, 2008	December 31, 2007
Nevada Region:		
1 st Commerce Bank	\$ 38,042	\$ 32,091
Bank of Las Vegas	72,729	72,768
Black Mountain Community Bank	155,281	147,433
Desert Community Bank	106,879	101,840
Red Rock Community Bank	<u>121,637</u>	<u>120,750</u>
Nevada Region Total	494,568	474,882
Northeast Region:		
USNY Bank	34,436	17,171
Northwest Region:		
Bank of Bellevue	49,653	45,122
Bank of Everett	33,192	28,946
Bank of Tacoma	33,969	24,325
High Desert Bank	26,214	11,501
Issaquah Community Bank	<u>18,489</u>	<u>13,696</u>
Northwest Region Total	161,517	123,590
Southeast Region:		
Bank of Valdosta	58,449	43,842
Community Bank of Rowan	130,516	117,495
First Carolina State Bank	111,681	115,243
Peoples State Bank	30,033	26,159
Pisgah Community Bank ⁽⁴⁾	19,653	
Sunrise Bank of Atlanta	<u>60,256</u>	<u>48,664</u>
Southeast Region Total	410,588	351,403
Texas Region:		
Bank of Fort Bend	19,858	9,551
Bank of Las Colinas	<u>28,502</u>	<u>11,383</u>
Texas Region Total	48,360	20,934
Other, net	<u>90,621</u>	<u>68,395</u>
Consolidated Totals	<u>\$ 5,340,400</u>	<u>\$ 4,901,763</u>

- (1) Commenced operations in January 2008 and is 51%-owned by Capitol Development Bancorp Limited V, a controlled subsidiary of Capitol.
- (2) Commenced operations in February 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.
- (3) Commenced operations in April 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.
- (4) Commenced operations in May 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.

Portfolio loans, the single largest asset category, increased during the 2008 period by approximately \$250 million, compared to loan growth of about \$313 million during the corresponding period of 2007. The majority of portfolio loan growth occurred in commercial loans, consistent with the banks' emphasis on commercial lending activities.

Geographic diversification of Capitol's balance sheet has become increasingly important. Prior to 1996, all of Capitol's banking operations were located in Michigan. As of June 30, 2008, 42% of the consolidated loan portfolio relates to banks located within the Great Lakes Region (43% at December 31, 2007). More importantly at that date, 58% of the consolidated loan portfolio relates to banks located in other regions of the country (57% at December 31, 2007). The reason why this is important is that Capitol's diversification efforts will add stability to earnings by further reducing a disproportionate geographic concentration within a specific region. The pace of asset growth has been significant in the interim period of 2008, inasmuch as 96% of loan growth occurred in regions outside of the Great Lakes Region. Adding further to geographic balance, Capitol announced earlier the pending sale of four Michigan banks which, if consummated, would reduce its Michigan asset concentration by approximately 20%; the pending sale is discussed in further detail later in this narrative.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

The consolidated allowance for loan losses at June 30, 2008 approximated \$64 million or 1.40% of total portfolio loans, an increase from the 1.35% ratio at the beginning of the year.

The allowance for loan losses is maintained at a level believed adequate by management to absorb potential losses inherent in the loan portfolio at the balance sheet date. Management's determination of the adequacy of the allowance is based on evaluation of the portfolio (including potential impairment of individual loans and concentrations of credit), past loss experience, current economic conditions, volume, amount and composition of the loan portfolio and other factors. The allowance is increased by provisions charged to operations and reduced by net charge-offs. The table below summarizes portfolio loan balances and activity in the allowance for loan losses for the interim periods (in thousands):

	Periods Ended June 30			
	Three Month Period		Six Month Period	
	2008	2007	2008	2007
Allowance for loan losses at January 1	\$ 61,666	\$ 47,052	\$ 58,124	\$ 45,414
Loans charged-off:				
Loans secured by real estate:				
Commercial	(2,772)	(137)	(3,444)	(296)
Residential (including multi-family)	(1,013)	(338)	(3,163)	(693)
Construction, land development and other land	(1,761)	(114)	(3,120)	(316)
Total loans secured by real estate	(5,546)	(589)	(9,727)	(1,305)
Commercial and other business-purpose loans	(2,496)	(1,382)	(4,297)	(3,189)
Consumer	(55)	(97)	(189)	(211)
Other	(34)	--	(34)	--
Total charge-offs	(8,131)	(2,068)	(14,247)	(4,705)
Recoveries:				
Loans secured by real estate:				
Commercial	600	7	718	66
Residential (including multi-family)	376	64	460	128
Construction, land development and other land	197	13	223	14
Total loans secured by real estate	1,173	84	1,401	208
Commercial and other business-purpose loans	153	257	583	431
Consumer	24	27	65	72
Other	--	7	1	7
Total recoveries	1,350	375	2,050	718
Net charge-offs	(6,781)	(1,693)	(12,197)	(3,987)
Additions to allowance charged to expense	9,019	3,990	17,977	7,922
Allowance for loan losses at June 30	\$ 63,904	\$ 49,349	\$ 63,904	\$ 49,349
Average total portfolio loans for period ended June 30	\$ 4,541,327	\$ 3,708,267	\$ 4,472,508	\$ 3,633,402
Ratio of net charge-offs (annualized) to average portfolio loans outstanding	0.60%	0.18%	0.55%	0.22%

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

Interim loan charge-offs for the six-month 2008 period, which increased significantly compared to 2007, are not necessarily indicative of future charge-off levels because of the variability in asset quality and resolution of nonperforming loans. The increase in provision for loan losses in 2008 was associated primarily with Michigan banks, due to growth in nonperforming loans and a sustained difficult and uncertain economic climate in Michigan.

The amounts of the allowance for loan losses allocated in the following table (dollars in thousands) are based on management's estimate of losses inherent in the portfolio at the balance-sheet date and should not be interpreted as an indication of future charge-offs:

	June 30, 2008		December 31, 2007	
	Amount	Percentage of Total Portfolio Loans	Amount	Percentage of Total Portfolio Loans
Loans secured by real estate:				
Commercial	\$ 22,114	0.48%	\$ 21,918	0.51%
Residential (including multi-family)	12,586	0.28%	10,235	0.24%
Construction, land development and other land	12,885	0.28%	11,278	0.26%
Total loans secured by real estate	47,585	1.04%	43,431	1.01%
Commercial and other business-purpose loans	15,159	0.33%	13,727	0.32%
Consumer	788	0.02%	667	0.01%
Other	372	0.01%	299	0.01%
Total allowance for loan losses	\$ 63,904	1.40%	\$ 58,124	1.35%

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

Nonperforming loans (i.e., loans which are 90 days or more past due and loans on nonaccrual status) and other nonperforming assets are summarized below (in thousands):

	June 30, 2008	December 31, 2007
Nonaccrual loans:		
Loans secured by real estate:		
Commercial	\$ 23,379	\$ 19,016
Residential (including multi-family)	17,293	13,381
Construction, land development and other land	40,790	29,756
Total loans secured by real estate	81,462	62,153
Commercial and other business-purpose loans	8,716	5,782
Consumer	137	66
Other	18	84
Total nonaccrual loans	90,333	68,085
Past due (≥90 days) loans:		
Loans secured by real estate:		
Commercial	--	113
Residential (including multi-family)	1,409	1,116
Construction, land development and other land	3,613	2,531
Total loans secured by real estate	5,022	3,760
Commercial and other business-purpose loans	346	714
Consumer	10	66
Other	--	5
Total past due loans	5,378	4,545
Total nonperforming loans	\$ 95,711	\$ 72,630
Real estate owned and other repossessed assets	44,991	16,680
Total nonperforming assets	\$ 140,702	\$ 89,310

Nonperforming loans at June 30, 2008 approximated 2.10% of total portfolio loans, an increase from the December 31, 2007 ratio of 1.68%. Nonperforming loans increased \$23 million or 32% during the interim 2008 six-month period. Of the nonperforming loans at June 30, 2008, about 90% were real estate secured. Those loans, when originated, had appropriate loan-to-value ratios based upon real estate market conditions at that time and, accordingly, have loss exposure which would be expected to be minimal; however, underlying real estate values depend upon current economic conditions and liquidation strategies. Most other nonperforming loans were generally secured by other business assets. Nonperforming loans at June 30, 2008 were in various stages of resolution for which management believes such loans are adequately collateralized or otherwise appropriately considered in its determination of the adequacy of the allowance for loan losses. Due to local and regional economic conditions, there is uncertainty in future real estate values, appraisal results and the resulting potential impact on valuation of collateral-dependent loans. Management cautiously monitors real estate values and related appraisal data when evaluating such valuations.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

Total nonperforming loans approximated \$96 million at June 30, 2008. Of that total, \$65 million (including some loans carried at the parent level) or 68% were originated by banks within the Great Lakes Region, primarily located in Michigan. Within the Great Lakes Region, nonperforming loans approximated 3.20% of total portfolio loans at June 30, 2008. Responsive to the elevated level of nonperforming loans within the Great Lakes Region, higher levels of allowances for loan losses have been established, approximating 1.80% of portfolio loans for the region on a combined basis as of June 30, 2008 and ranging as high as 3% or more at certain banks. Those ratios can be contrasted with other banks and geographic regions within the Corporation with substantially lower levels of nonperforming loans.

In addition to the identification of nonperforming loans involving borrowers with payment performance difficulties (i.e., nonaccrual loans and loans past due 90 days or more), management utilizes an internal loan review process to identify other potential problem loans which may warrant additional monitoring or other attention. This loan review process is a continuous activity which periodically updates internal loan ratings. At inception, all loans are individually assigned a rating which grades the credits on a risk basis, based on the financial strength of the borrower and guarantors and other factors such as nature of the borrower's business climate, local economic conditions and other subjective factors. The loan rating process is fluid and subjective.

Potential problem loans include loans which are generally performing as agreed; however, because of loan reviews and/or lending staff's risk assessment, increased monitoring is deemed appropriate. In addition, some loans are assigned a more adverse classification, with specific performance issues or other risk factors requiring close management and development of specific remedial action plans.

At June 30, 2008, potential problem loans (including the previously-mentioned nonperforming loans) approximated \$316 million, or about 6.9% of total consolidated portfolio loans, compared to approximately \$219 million or about 5.1% at December 31, 2007. These potential problem loans do not necessarily have significant loss exposure (nor are they necessarily deemed 'impaired'), but rather are identified by management in this manner to aid in loan administration and risk management. Management has considered these loans in its evaluation of the adequacy of the allowance for loan losses. Management believes, however, that current general economic conditions in some markets may result in higher levels of future loan losses in comparison to previous years, as experienced in the first six months of 2008.

Real estate owned and other repossessed assets increased \$28.3 million to \$45.0 million during the six months ended June 30, 2008. Most of this increase related to residential construction loans in the Arizona Region.

Foreclosure laws in Michigan generally favor borrowers rather than lenders and, accordingly, foreclosure and redemption periods (i.e., the number of months it takes for a financial institution to obtain clear title to freely market the real estate) takes much longer than many other states. Further, once the property is available to the bank for sale or liquidation, market conditions, as they are currently (particularly in Michigan), may not be conducive to rapid marketing of the properties.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

The following comparative analysis summarizes each bank's total portfolio loans, allowance for loan losses, nonperforming loans and ratio of the allowance as a percentage of portfolio loans (dollars in thousands):

	Total Portfolio Loans		Allowance for Loan Losses		Nonperforming Loans		Allowance as a Percentage of Total Portfolio Loans	
	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007
Arizona Region:								
Arrowhead Community Bank	\$ 80,455	\$ 81,836	\$ 1,379	\$ 818	\$ 1,403	\$ 361	1.71%	1.00%
Asian Bank of Arizona	28,882	21,514	650	405	689	314	2.25%	1.88%
Bank of Tucson	154,487	168,427	1,406	1,385	1,401	752	0.91%	0.82%
Camelback Community Bank	83,216	79,869	744	800	1,160	451	0.89%	1.00%
Colonia Bank ⁽³⁾	1,920		29				1.51%	
Mesa Bank	169,170	202,511	1,945	1,760	8,947	3,699	1.15%	0.87%
Southern Arizona Community Bank	83,606	78,467	830	792		600	0.99%	1.01%
Sunrise Bank of Albuquerque	70,078	67,192	775	866	289	183	1.11%	1.29%
Sunrise Bank of Arizona	114,683	112,211	1,135	1,125		4,250	0.99%	1.00%
Valley First Community Bank	66,292	71,689	1,017	653	1,379		1.53%	0.91%
Yuma Community Bank	66,233	66,092	525	525	427	600	0.79%	0.79%
Arizona Region Total	919,022	949,808	10,435	9,129	15,695	11,210	1.14%	0.96%
California Region:								
Bank of Escondido	57,674	54,707	633	560	882	311	1.10%	1.02%
Bank of Feather River	17,221	13,345	241	187			1.40%	1.40%
Bank of San Francisco	52,178	44,989	730	695	339	392	1.40%	1.54%
Bank of Santa Barbara	59,106	52,340	1,006	741	614		1.70%	1.42%
Napa Community Bank	118,506	100,253	1,485	1,069		1,459	1.25%	1.07%
Point Loma Community Bank	50,599	49,607	790	695	167		1.56%	1.40%
Sunrise Bank of San Diego	76,831	74,526	940	908	1,623	2,386	1.22%	1.22%
Sunrise Community Bank	23,023	17,624	345	255			1.50%	1.45%
California Region Total	455,138	407,391	6,170	5,110	3,625	4,548	1.36%	1.25%
Colorado Region:								
Fort Collins Commerce Bank	63,774	59,388	954	889			1.50%	1.50%
Larimer Bank of Commerce	68,749	50,927	1,000	765			1.45%	1.50%
Loveland Bank of Commerce	22,589	15,253	339	229			1.50%	1.50%
Mountain View Bank of Commerce ⁽²⁾	19,569		286				1.46%	
Colorado Region Total	174,681	125,568	2,579	1,883			1.48%	1.50%
Great Lakes Region:								
Ann Arbor Commerce Bank	324,962	332,624	4,054	4,504	2,933	5,161	1.25%	1.35%
Bank of Auburn Hills	40,190	36,586	1,050	820	1,834	1,293	2.61%	2.24%
Bank of Maumee	45,402	32,102	688	482	50		1.52%	1.50%
Bank of Michigan	64,830	63,448	980	952		370	1.51%	1.50%
Brighton Commerce Bank	101,280	99,627	1,015	1,018	254	18	1.00%	1.02%
Capitol National Bank	207,968	206,449	4,408	3,421	6,204	3,449	2.12%	1.66%
Detroit Commerce Bank	96,734	108,992	1,914	1,355	2,934	3,948	1.98%	1.24%
Elkhart Community Bank	89,338	83,754	1,467	1,282	3,132	2,677	1.64%	1.53%
Evansville Commerce Bank	58,563	48,113	885	720	243	80	1.51%	1.50%
Goshen Community Bank	73,233	70,799	995	874	253	491	1.36%	1.23%
Grand Haven Bank	115,149	122,208	2,336	2,644	8,070	6,970	2.03%	2.16%
Kent Commerce Bank	78,065	83,357	1,365	1,527	800	2,456	1.75%	1.83%
Macomb Community Bank	88,503	87,670	3,418	2,283	12,819	11,846	3.86%	2.60%
Muskegon Commerce Bank	79,689	90,031	2,020	1,762	3,946	2,362	2.53%	1.96%
Oakland Commerce Bank	86,197	99,770	2,530	1,816	10,421	3,803	2.94%	1.82%
Ohio Commerce Bank	41,844	29,110	629	437			1.50%	1.50%
Paragon Bank & Trust	93,359	91,481	1,913	1,431	5,031	2,220	2.05%	1.56%
Portage Commerce Bank	191,045	179,219	2,129	1,812	1,074	1,127	1.11%	1.01%
Great Lakes Region Total	1,876,351	1,865,340	33,796	29,140	59,998	48,271	1.80%	1.56%
Midwest Region:								
Adams Dairy Bank ⁽¹⁾	23,667		357				1.51%	
Bank of Belleville	56,894	46,951	827	700			1.45%	1.49%
Community Bank of Lincoln	28,348	10,501	448	168			1.58%	1.60%
Summit Bank of Kansas City	40,928	45,165	620	641			1.51%	1.42%
Midwest Region Total	149,837	102,617	2,252	1,509			1.50%	1.47%

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Financial Condition – Continued

Summary of loan information – continued:

	Total Portfolio Loans		Allowance for Loan Losses		Nonperforming Loans		Allowance as a Percentage of Total Portfolio Loans	
	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007	June 30, 2008	Dec 31, 2007
Nevada Region:								
1 st Commerce Bank	\$ 32,642	\$ 27,030	\$ 524	\$ 393	\$ 1,456		1.61%	1.45%
Bank of Las Vegas	63,444	61,662	900	751	1,241		1.42%	1.22%
Black Mountain Community Bank	138,976	137,308	1,770	1,415	2,626	\$ 659	1.27%	1.03%
Desert Community Bank	91,026	90,050	1,190	837	712	356	1.31%	0.93%
Red Rock Community Bank	<u>106,642</u>	<u>106,559</u>	<u>1,205</u>	<u>977</u>	<u>3,052</u>	<u>64</u>	<u>1.13%</u>	<u>0.92%</u>
Nevada Region Total	432,730	422,609	5,589	4,373	9,087	1,079	1.29%	1.03%
Northeast Region:								
USNY Bank	30,195	12,421	455	187			1.51%	1.51%
Northwest Region:								
Bank of Bellevue	41,031	37,364	955	665	192	222	2.33%	1.78%
Bank of Everett	28,033	24,170	475	418			1.69%	1.73%
Bank of Tacoma	29,711	19,639	475	285			1.60%	1.45%
High Desert Bank	20,321	9,080	277	126			1.36%	1.39%
Issaquah Community Bank	<u>15,759</u>	<u>6,598</u>	<u>237</u>	<u>93</u>			<u>1.50%</u>	<u>1.41%</u>
Northwest Region Total	134,855	96,851	2,419	1,587	192	222	1.79%	1.64%
Southeast Region:								
Bank of Valdosta	49,661	41,629	734	619			1.48%	1.49%
Community Bank of Rowan	106,105	96,271	1,592	1,444			1.50%	1.50%
First Carolina State Bank	91,055	94,047	1,100	1,157	858	829	1.21%	1.23%
Peoples State Bank	19,450	13,609	320	247	337	86	1.65%	1.81%
Pisgah Community Bank ⁽⁴⁾	14,077		211				1.50%	
Sunrise Bank of Atlanta	<u>51,869</u>	<u>45,024</u>	<u>859</u>	<u>760</u>	<u>876</u>		<u>1.66%</u>	<u>1.69%</u>
Southeast Region Total	332,217	290,580	4,816	4,227	2,071	915	1.45%	1.45%
Texas Region:								
Bank of Fort Bend	14,692	3,140	214	46			1.46%	1.47%
Bank of Las Colinas	<u>21,649</u>	<u>9,830</u>	<u>300</u>	<u>144</u>			<u>1.39%</u>	<u>1.46%</u>
Texas Region Total	36,341	12,970	514	190			1.41%	1.46%
Other, net	<u>23,156</u>	<u>28,546</u>	<u>(5,121)</u>	<u>789</u>	<u>5,043</u>	<u>6,385</u>		
Consolidated totals	<u>\$ 4,564,523</u>	<u>\$ 4,314,701</u>	<u>\$ 63,904</u>	<u>\$ 58,124</u>	<u>\$ 95,711</u>	<u>\$ 72,630</u>	<u>1.40%</u>	<u>1.35%</u>

- (1) Commenced operations in January 2008 and is 51%-owned by Capitol Development Bancorp Limited V, a controlled subsidiary of Capitol.
- (2) Commenced operations in February 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.
- (3) Commenced operations in April 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.
- (4) Commenced operations in May 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued

Results of Operations

Summary

Second quarter 2008 earnings were \$623,000, a decrease of 90% compared to the corresponding period of 2007. Diluted earnings per share were \$0.04 for the three months ended June 30, 2008, a decrease of 89% compared to \$0.37 in 2007. Net income for the six months ended June 30, 2008 was \$2.8 million, a decrease of 78% compared to the corresponding period of 2007. Diluted earnings per share were \$0.16 for the six months ended June 30, 2008, a decrease of 78% compared to \$0.73 in the corresponding 2007 period.

The primary reason for the interim 2008 earnings decline was weak bank performance, particularly within the Great Lakes Region. On a combined basis, Capitol's Great Lakes Region banks reported a loss of \$986,000 for the six month 2008 period compared to modest net income of \$3.2 million in the 2007 period. Within this group of banks, Capitol's mature wholly-owned Michigan-based banks reported an earnings decrease of \$4.7 million from the corresponding 2007 period. The principal reason for the Michigan banks' earnings decrease was due to loan loss provisions.

Analytical Review

The provision for loan losses for the six-month period in 2008 was \$18 million, compared to \$7.9 million for the same period in 2007. The provision for loan losses for the three months ended June 30, 2008 was \$9 million as compared to \$4 million during the corresponding 2007 period. Provisions for loan losses increased significantly in the 2008 period in response to higher levels of loan charge-offs and in concert with growth in nonperforming loans. The provisions for loan losses are based upon management's analysis of the adequacy of the allowance for loan losses, as previously discussed. The significant increase in the provision for loan losses compared to the preceding year had a material adverse effect on operating results for the interim 2008 periods.

Net interest income for the first six months of 2008 totaled \$84.1 million, a 7% decrease compared to \$90.2 million in 2007. Net interest income for the three months ended June 30, 2008 totaled \$42.2 million, a 7% decrease compared to \$45.5 million in 2007. This decrease resulted from net interest margin compression, although earning asset growth remained strong during the interim 2008 periods.

In a changing interest-rate environment, rates of interest on loans reprice more rapidly than interest rates paid on deposits. In the first half of 2008, net interest margins decreased primarily as a result of actions by the Federal Reserve Board of Governors to decrease market rates of interest by 225 basis-points. As the Federal Reserve Board's most recent actions have decreased rates, which results in rapid repricing of prime-rate based loans, interest rate changes on deposits have lagged, reducing net interest margins in the near term. The net interest margin approximated 3.50% for the three months ended June 30, 2008, a 0.12% decrease compared to 3.62% for the three months ended March 31, 2008 and a 1.03% decrease compared to 4.53% for the three months ended June 30, 2007. Several other causal factors impacted the 2008 margin, including elevated levels of nonperforming loans, competitive pressures at the bank level in pricing of loans and deposits, impact of a steepening yield curve, migration of noninterest-bearing deposits to interest-bearing accounts and higher interest costs related to debt obligations. It is difficult to speculate on future changes in net interest margin.

Noninterest income for the six months ended June 30, 2008 was \$13 million, an increase of \$1.6 million, or 14%, over the same period in 2007. Noninterest income for the three months ended June 30, 2008 was \$6.5 million, an 11% increase from the same period in 2007. The increase for the six-month 2008 period was due to increases of \$1.1 million in trust and wealth-management revenue and \$498,000 from service charges on deposit accounts. Fees from origination of non-portfolio residential mortgage loans totaled \$1.1 million for the second quarter of 2008 and \$2 million for the six-month period, reduced from \$1.3 million and \$2.6 million for the comparable periods in 2007, respectively, due to lower loan origination volume associated with a weak residential real estate economy.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Results of Operations – Continued

Noninterest expense totaled \$92.6 million for the six-month 2008 period and \$47.8 million for the second quarter of 2008, compared to \$84 million and \$42.2 million, respectively, for the comparable periods in 2007. The increase in noninterest expense is associated with adding four new banks in 2008 and eleven banks in 2007, growth in the size of previously-existing banks and increases in general operating costs. Increases in occupancy, equipment rent, depreciation and maintenance in 2008 relate primarily to the growth in the size of the mature banks within the consolidated group, the development of Capitol's wealth management unit and the addition of *de novo* banks.

The largest element of noninterest expense is salaries and employee benefits, which approximated \$53.3 million for the six months ended June 30, 2008, a slight increase from \$52.5 million in the corresponding period of 2007.

The more significant elements of other noninterest expense consisted of the following (in thousands) for the periods ended June 30:

	Three Month Period		Six Month Period	
	2008	2007	2008	2007
Costs associated with foreclosed properties and other real estate owned	\$ 1,181	\$ 115	\$ 2,092	\$ 243
Preopening and start-up costs	1,086	368	2,038	1,296
FDIC insurance premiums and other regulatory fees	933	650	1,870	1,221
Advertising	857	926	1,633	1,662
Directors' fees	756	676	1,558	1,359
Paper, printing and supplies	782	715	1,552	1,367
Travel, lodging and meals	853	758	1,486	1,343
Professional fees	784	614	1,272	1,120
Bank services (ATMs, telephone banking and Internet banking)	626	504	1,181	1,061
Loan and collection expense	487	431	1,033	1,044
Communications	541	428	1,049	833
Postage	348	279	658	542
Taxes other than income taxes	137	439	511	928
Courier service	232	240	472	476
Dues and memberships	238	219	459	446
Insurance expense	146	116	293	214
Contracted labor	124	134	244	266
Publications	45	34	90	69
Other	2,394	1,989	5,046	3,757
Total	<u>\$ 12,550</u>	<u>\$ 9,635</u>	<u>\$ 24,537</u>	<u>\$ 19,247</u>

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Results of Operations – Continued

Operating results (dollars in thousands) were as follows:

	Six Months Ended June 30							
	Total Revenues		Net Income		Return on Average Equity ⁽¹⁾		Return on Average Assets ⁽¹⁾	
	2008	2007	2008	2007	2008	2007	2008	2007
Arizona Region:								
Arrowhead Community Bank	\$ 3,303	\$ 4,267	\$ (222)	\$ 649		15.62%		1.56%
Asian Bank of Arizona	953	818	(535)	(326)				
Bank of Tucson	6,783	7,984	1,978	2,368	22.17%	28.42%	2.15%	2.64%
Camelback Community Bank	3,012	3,417	509	448	11.07%	10.28%	1.15%	1.03%
Colonia Bank ⁽⁴⁾	25		(376)					
Mesa Bank	7,985	10,046	744	2,076	7.84%	22.86%	0.69%	2.02%
Southern Arizona Community Bank	3,041	3,435	582	581	12.84%	12.98%	1.34%	1.32%
Sunrise Bank of Albuquerque	2,640	2,983	171	245	4.69%	7.75%	0.46%	0.75%
Sunrise Bank of Arizona	4,177	4,845	(180)	374		6.50%		0.64%
Valley First Community Bank	2,559	2,669	(646)	256		6.53%		0.74%
Yuma Community Bank	2,745	2,999	365	532	9.39%	13.88%	0.96%	1.48%
Arizona Region Total	<u>37,223</u>	<u>43,463</u>	<u>2,390</u>	<u>7,203</u>				
California Region:								
Bank of Escondido	2,564	2,847	175	310	2.42%	4.42%	0.37%	0.75%
Bank of Feather River	584		(326)					
Bank of San Francisco	1,880	1,248	12	(204)	0.28%		0.04%	
Bank of Santa Barbara	2,080	1,988	(170)	(146)				
Napa Community Bank	4,240	4,487	467	626	6.59%	9.89%	0.74%	1.10%
Point Loma Community Bank	1,872	1,984	114	34	3.16%	0.99%	0.42%	0.14%
Sunrise Bank of San Diego	2,847	3,458	168	163	3.17%	3.09%	0.38%	0.40%
Sunrise Community Bank	753	346	(377)	(657)				
California Region Total	<u>16,820</u>	<u>16,358</u>	<u>63</u>	<u>126</u>				
Colorado Region:								
Fort Collins Commerce Bank	2,275	2,375	364	369	8.06%	8.80%	1.13%	1.33%
Larimer Bank of Commerce	2,055	363	140	(544)	3.76%		0.46%	
Loveland Bank of Commerce	646		(116)					
Mountain View Bank of Commerce ⁽³⁾	358		(611)					
Colorado Region Total	<u>5,334</u>	<u>2,738</u>	<u>(223)</u>	<u>(175)</u>				
Great Lakes Region:								
Ann Arbor Commerce Bank	11,918	12,488	1,746	1,756	12.20%	13.70%	0.98%	1.09%
Bank of Auburn Hills	1,459	1,573	(459)	(31)				
Bank of Maumee	1,373	473	(507)	(627)				
Bank of Michigan	2,477	2,327	268	(94)	8.05%		0.78%	
Brighton Commerce Bank	3,792	4,069	434	309	8.89%	6.80%	0.80%	0.59%
Capitol National Bank	7,723	9,040	954	1,126	9.98%	12.00%	0.84%	0.94%
Detroit Commerce Bank	3,768	4,542	(1,130)	443		9.72%		0.83%
Elkhart Community Bank	2,870	3,378	272	375	6.18%	8.64%	0.60%	0.90%
Evansville Commerce Bank	1,997	1,051	(174)	(385)				
Goshen Community Bank	2,675	2,949	261	216	6.64%	5.87%	0.66%	0.58%
Grand Haven Bank	4,048	4,788	176	367	3.35%	6.71%	0.27%	0.58%
Kent Commerce Bank	2,943	3,411	(407)	69		1.63%		0.17%
Macomb Community Bank	2,665	3,386	(1,512)	(515)				
Muskegon Commerce Bank	2,885	3,608	(760)	(565)				
Oakland Commerce Bank	3,139	4,881	(956)	54		1.08%		0.09%
Ohio Commerce Bank	1,272	556	(111)	(402)				
Paragon Bank & Trust	3,624	3,530	(185)	21		0.38%		0.04%
Portage Commerce Bank	7,278	7,623	1,104	1,112	12.85%	13.86%	1.10%	1.23%
Great Lakes Region Total	<u>67,906</u>	<u>73,673</u>	<u>(986)</u>	<u>3,229</u>				
Midwest Region								
Adams Dairy Bank ⁽²⁾	672		(511)					
Bank of Belleville	1,743	962	4	(321)	0.11%		0.01%	
Community Bank of Lincoln	816		(326)					
Summit Bank of Kansas City	1,547	1,404	40	(252)	1.14%		0.18%	
Midwest Region Total	<u>4,778</u>	<u>2,366</u>	<u>(793)</u>	<u>(573)</u>				

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Results of Operations – Continued

Operating results – continued:

	Six Months Ended June 30							
	Total Revenues		Net Income		Return on Average Equity ⁽¹⁾		Return on Average Assets ⁽¹⁾	
	2008	2007	2008	2007	2008	2007	2008	2007
Nevada Region:								
1 st Commerce Bank	\$ 1,141	\$ 690	\$ (291)	\$ (270)				
Bank of Las Vegas	2,437	2,997	37	329	0.86%	7.33%	0.10%	0.92%
Black Mountain Community Bank	5,433	6,136	881	1,300	11.95%	18.94%	1.16%	1.83%
Desert Community Bank	3,765	3,969	176	583	3.50%	12.59%	0.35%	1.26%
Red Rock Community Bank	<u>3,971</u>	<u>4,622</u>	<u>480</u>	<u>873</u>	7.06%	13.31%	0.82%	1.62%
Nevada Region Total	16,747	18,414	1,283	2,815				
Northeast Region:								
USNY Bank	712		(409)					
Northwest Region:								
Bank of Bellevue	1,432	1,510	(196)	(125)				
Bank of Everett	993	917	(656)	(304)				
Bank of Tacoma	931	480	(399)	(663)				
High Desert Bank	574		(380)					
Issaquah Community Bank	<u>536</u>		<u>(326)</u>					
Northwest Region Total	4,466	2,907	(1,957)	(1,092)				
Southeast Region:								
Bank of Valdosta	1,640	1,051	(43)	(227)				
Community Bank of Rowan	3,726	2,503	427	(177)	8.75%		0.72%	
First Carolina State Bank	3,319	3,527	208	262	4.09%	4.48%	0.38%	0.56%
Peoples State Bank	916	1,142	27	144	1.06%	5.97%	0.21%	1.03%
Pisgah Community Bank ⁽⁵⁾	69		(560)					
Sunrise Bank of Atlanta	<u>2,305</u>	<u>1,786</u>	<u>(200)</u>	<u>(110)</u>				
Southeast Region Total	11,975	10,009	(141)	(108)				
Texas Region:								
Bank of Fort Bend	353		(462)					
Bank of Las Colinas	<u>511</u>		<u>(339)</u>					
Texas Region Total	864		(801)					
Other, net	<u>1,857</u>	<u>593</u>	<u>4,388</u>	<u>1,144</u>				
Consolidated totals	<u>\$ 168,682</u>	<u>\$ 170,521</u>	<u>\$ 2,814</u>	<u>\$ 12,569</u>	<u>1.45%</u>	<u>6.65%</u>	<u>0.11%</u>	<u>0.59%</u>

(1) Annualized for periods presented.

(2) Commenced operations in January 2008 and is 51%-owned by Capitol Development Bancorp Limited V, a controlled subsidiary of Capitol.

(3) Commenced operations in February 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.

(4) Commenced operations in April 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.

(5) Commenced operations in May 2008 and is 51%-owned by Capitol Development Bancorp Limited VII, a controlled subsidiary of Capitol.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued

Liquidity and Capital Resources

The principal funding source for asset growth and loan origination activities is deposits. Total deposits increased \$313 million for the six months ended June 30, 2008, compared to a \$265 million increase in the corresponding period of 2007. Growth occurred in most interest-bearing deposit categories, with the majority coming from time deposit accounts. Capitol's banks generally do not significantly rely on brokered deposits as a key funding source. Brokered deposits approximated \$682 million as of June 30, 2008, or about 16% of total deposits, an increase of \$149 million during the interim 2008 period, as the banks have sought to add these funds selectively based on maturity and interest-rate opportunities, to aid in matching the repricing of funding sources and assets.

Noninterest-bearing deposits approximated 16% of total deposits at June 30, 2008, a slight decrease from 17% at December 31, 2007, and a decrease of \$2.2 million in the 2008 interim period compared to a decrease of \$13 million during the 2007 period. Levels of noninterest-bearing deposits can, however, fluctuate based on customers' transaction activity.

During the 2008 period, interest-bearing accounts increased about \$315 million which, coupled with borrowings, served as the primary funding source for loan growth. Because of the growth in interest-bearing deposits, coupled with higher relative rates on those balances (particularly with time deposit accounts) and decreased noninterest-bearing deposits, net interest margins have decreased.

Interim 2008 deposit growth was deployed primarily into commercial loans, consistent with the banks' emphasis on commercial lending activities.

Cash and cash equivalents amounted to \$500.3 million or 9% of total assets at June 30, 2008, compared to \$352.4 million or 7.2% of total assets at December 31, 2007. As liquidity levels vary continuously based on customer activities, amounts of cash and cash equivalents can vary widely at any given point in time. Management believes the banks' liquidity position at June 30, 2008 is adequate to fund loan demand and meet depositor needs.

In addition to cash and cash equivalents, an additional source of long-term liquidity is the banks' marketable investment securities. Liquidity needs have not historically necessitated the sale of investments in order to meet funding requirements and the banks have not engaged in active trading of their investments. At June 30, 2008, Capitol's banks had approximately \$13 million of investment securities classified as available for sale which can be utilized to meet various liquidity needs as they arise.

Several of Capitol's banks have secured lines of credit with regional Federal Home Loan Banks. Borrowings thereunder approximated \$411 million and additional borrowing capacity approximated \$216 million at June 30, 2008. These facilities are used from time to time as a lower-cost funding source versus various rates and maturities of time deposits available within banks' individual communities. Total notes payable and short-term borrowings were \$440 million at June 30, 2008, including \$15 million borrowed by Capitol on a line of credit from an unrelated financial institution which was repaid in early July 2008.

Stockholders' equity, as a percentage of total assets, approximated 7.23% at June 30, 2008 and 7.94% at December 31, 2007. As of June 30, 2008, Capitol's total capital funds (i.e., the sum of stockholders' equity, minority interests in consolidated subsidiaries and subordinated debentures) approximated \$707 million or 13.24% of total assets.

On March 31, 2008, Capitol announced that it had entered into a definitive agreement to sell four affiliate western Michigan banks to Northstar Financial Group Inc., a Michigan-based, privately-held financial holding company, for cash consideration of approximately \$52 million. Total assets of the four banks (Grand Haven Bank, Kent Commerce Bank, Muskegon Commerce Bank and Paragon Bank & Trust) approximated \$417.6 million as of June 30, 2008. No material gain or loss is expected to be reported upon completion of the sale, if consummated. The combined operating results of those banks for the six months ended June 30, 2008 was a net loss approximating \$1.2 million. The pending sale is subject to regulatory approval and other contingencies. Proceeds from the sale, if consummated, will enable redeployment of capital to other regions for bank development and other corporate purposes.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS – Continued

Liquidity and Capital Resources – Continued

In March 2008, Capitol announced the formation of a joint venture to acquire 51% of the common stock of Forethought Federal Savings Bank (Forethought), located in Batesville, Indiana, for cash consideration of approximately \$5 million. Forethought is engaged in providing trust-related, preneed funeral planning products and services to customers in 28 states. The proposed acquisition is subject to regulatory approval.

In July 2008, Capitol completed a public offering of \$38.1 million of 10.5% trust preferred securities issued by Capitol Trust XII. Several of Capitol's bank subsidiaries purchased securities in this offering. Net proceeds from the offering approximated \$14 million. Capitol also completed a private placement of 9% senior notes in June 2008 approximating \$14 million.

Capitol and its banks are subject to complex regulatory capital requirements, which require maintaining certain minimum capital ratios. These ratio measurements, in addition to certain other requirements, are used by regulatory agencies to determine the level of regulatory intervention and enforcement applied to financial institutions. Management believes Capitol and each of its banks are in compliance with regulatory requirements and are expected to maintain such compliance.

Trends Affecting Operations

One of the most significant trends which can impact the financial condition and results of operations of financial institutions is changes in market rates of interest.

Changes in interest rates, either up or down, have an impact on net interest income (plus or minus), depending on the direction and timing of such changes. At any point in time, there is a difference between interest rate-sensitive assets and interest rate-sensitive liabilities. This means that when interest rates change, the timing and magnitude of the effect of such interest rate changes can alter the relationship between asset yields and the cost of funds.

The Board of Governors of the Federal Reserve, which influences interest rates, has changed interbank borrowing rates four times during the first half of 2008 by an aggregate 225 basis-point decrease (rates were unchanged during the corresponding 2007 period). The Board of Governors of the Federal Reserve has also expressed concerns about a variety of economic conditions, as well as possible further reductions of interest rates in future periods. Home mortgage rates have recently fluctuated and residential real estate markets have cooled in various regions, which adversely impacts fee income from the origination of residential mortgages. There has been widespread media coverage of subprime and other residential mortgage “meltdown” issues; Capitol believes its exposure to the residential real estate crisis to be minimal due to its practice of selling residential mortgage loan production to the secondary market. Many of Capitol's banks' commercial loans are variable-rate and, accordingly, rate decreases may result in lower interest income to Capitol in the near term; however, depositors will continue to expect reasonable rates of interest on their accounts, potentially compressing net interest margins further. The future outlook on interest rates and their impact on Capitol's interest income, interest expense and net interest income is uncertain.

Start-up banks generally incur operating losses during their early periods of operations. Start-up banks formed in 2008 and beyond may similarly negatively impact profitability; however, the effect may be muted due to Capitol's utilization of a tiered ownership structure which reduces the effect of those losses on Capitol's consolidated results of operations.

General economic conditions also have a significant impact on both the results of operations and the financial condition of financial institutions. As mentioned previously, general economic conditions within the state of Michigan are uncertain and are likely to continue to have an effect on Capitol's banks and their customers in what has been described in the media as a one-state recession. It is likely that, absent significant catalysts, Michigan's economic recovery may take an extended period of time.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS – Continued**

Trends Affecting Operations – Continued

Media reports raising questions about the health of the domestic economy and the possibility of a national recession have continued in 2008. During the interim 2008 periods, nonperforming assets have increased; however, it is difficult to predict future movements in levels of nonperforming assets and related loan losses as economic conditions, locally and nationally, evolve.

Impact of New Accounting Standards

There are several new accounting standards either becoming effective or being issued in 2008. They are listed and discussed in Notes B and I of the accompanying condensed consolidated financial statements.

Critical Accounting Policies

Capitol's critical accounting policies are described on pages F-29 – F-30 of the financial section of its 2007 Annual Report. In the circumstances of Capitol, management believes its "critical accounting policies" are those which encompass the use of estimates in determining the allowance for loan losses (because of inherent subjectivity), accounting for goodwill and other intangibles (due to inherent subjectivity in evaluating potential impairment) and its consolidation policy.

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PART I, ITEM 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information about Capitol's quantitative and qualitative disclosures about market risk were included in Capitol's annual report on Form 10-K for the year ended December 31, 2007. Capitol does not believe that there has been a material change in the nature or categories of market risk exposure, except as noted in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section herein (Part I, Item 2), under the caption, "Trends Affecting Operations."

PART I, ITEM 4

CONTROLS AND PROCEDURES

Capitol maintains disclosure controls and procedures designed to provide reasonable assurance that the information Capitol must disclose in its filings with the Securities and Exchange Commission is recorded, processed, summarized and reported on a timely basis. Capitol's Chief Executive Officer and Chief Financial Officer have reviewed and evaluated Capitol's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, Capitol's disclosure controls and procedures, in all material respects, are effective in bringing to their attention on a timely basis material information relating to Capitol required to be included in Capitol's periodic filings under the Exchange Act.

No change in Capitol's internal control over financial reporting occurred during Capitol's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect Capitol's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Capitol and its subsidiaries are parties to certain ordinary, routine litigation incidental to their business. In the opinion of management, liabilities arising from such litigation would not have a material effect on Capitol's consolidated financial position or results of operations.

Item 1A. Risk Factors.

There were no material changes from the risk factors set forth in Part I, Item 1A, "Risk Factors," of Capitol's Form 10-K for the year ended December 31, 2007, during the six months ended June 30, 2008. Refer to that section of Capitol's Form 10-K for disclosures regarding the risks and uncertainties related to Capitol's business.

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

- (a) On June 30, 2008 Capitol completed a private offering of Series A Subordinated 9% Promissory Notes, bearing interest at 9%, with a maturity of five years totaling \$14 million, pursuant to an exemption under Regulation D. Such offering was made solely to "accredited investors" who are affiliated with or associates of Capitol or its subsidiaries. Proceeds from the offering will be used for bank development and other corporate purposes.
- (b) Not applicable.
- (c) None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

- (a) Capitol's annual meeting of shareholders was held on April 23, 2008.
- (b) The following matters were voted upon at the annual meeting of shareholders:
 - (1) The election of the nominees for the board of directors was voted on by the shareholders. The nominees, all of whom were elected, are listed below. The following votes were tabulated:

	<u>For</u>	<u>Against</u>
<u>Class I Directors</u> (nominees to serve until 2011 annual meeting)		
Paul R. Ballard	13,727,828	502,152
Michael F. Hannley	13,783,773	446,206
Richard A. Henderson	13,781,970	448,010
Lewis D. Johns	12,753,666	1,476,313
Lyle W. Miller	13,761,314	468,666
Cristin K. Reid	13,758,852	471,128

- (2) Shareholders voted on ratifying the appointment of BDO Seidman, LLP as independent auditors for the year ending December 31, 2008. The following votes were tabulated:

	<u>For</u>	<u>Against</u>	<u>Abstain</u>
	14,173,831	27,874	28,272

PART II. OTHER INFORMATION – Continued

Item 5. Other Information.

None.

Item 6. Exhibits:

(a) <u>Exhibit No.</u>	(b) <u>Description of Exhibit</u>
31.1	Certification of Chief Executive Officer, Joseph D. Reid, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, Lee W. Hendrickson, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, Joseph D. Reid, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer, Lee W. Hendrickson, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

CAPITOL BANCORP LTD.
(Registrant)

/s/ Joseph D. Reid
Joseph D. Reid
Chairman and CEO
(duly authorized to sign on behalf of the
registrant)

/s/ Lee W. Hendrickson
Lee W. Hendrickson
Chief Financial Officer

Date: July 31, 2008

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