

**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 September 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)
Capitol Bancorp Center
200 N. Washington Square
Lansing, Michigan
(Address of principal executive offices)

38-2761672
(IRS Employer Identification No.)

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 October 15, 2008
Common Stock, No par value	17,337,308 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 Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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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 September 30, 2008 and December 31, 2007
(in thousands, except share data)

	(Unaudited) September 30, 2008	December 31, 2007
<u>ASSETS</u>		
Cash and due from banks	\$ 216,245	\$ 196,083
Money market and interest-bearing deposits	41,338	26,924
Federal funds sold	233,760	129,365
	<hr/>	<hr/>
Cash and cash equivalents	491,343	352,372
Loans held for sale	7,334	16,419
Investment securities:		
Available for sale, carried at market value	18,085	14,119
Held for long-term investment, carried at amortized cost which approximates market value	32,091	25,478
	<hr/>	<hr/>
Total investment securities	50,176	39,597
Portfolio loans:		
Loans secured by real estate:		
Commercial	2,074,254	1,917,113
Residential (including multi-family)	851,509	698,960
Construction, land development and other land	813,420	852,595
	<hr/>	<hr/>
Total loans secured by real estate	3,739,183	3,468,668
Commercial and other business-purpose loans	832,669	768,473
Consumer	58,122	48,041
Other	32,298	29,519
	<hr/>	<hr/>
Total portfolio loans	4,662,272	4,314,701
Less allowance for loan losses	(97,585)	(58,124)
	<hr/>	<hr/>
Net portfolio loans	4,564,687	4,256,577
Premises and equipment	60,000	60,031
Accrued interest income	18,387	19,417
Goodwill and other intangibles	73,428	72,722
Other assets	161,992	84,628
	<hr/>	<hr/>
TOTAL ASSETS	\$ 5,427,347	\$ 4,901,763
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>LIABILITIES:</u>		
Deposits:		
Noninterest-bearing	\$ 647,994	\$ 671,688
Interest-bearing	3,635,567	3,173,057
	<hr/>	<hr/>
Total deposits	4,283,561	3,844,745
Debt obligations:		
Notes payable and short-term borrowings	432,536	320,384
Subordinated debentures	167,342	156,130
	<hr/>	<hr/>
Total debt obligations	599,878	476,514
Accrued interest on deposits and other liabilities	30,096	35,161
	<hr/>	<hr/>
Total liabilities	4,913,535	4,356,420
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	160,704	156,198
<u>STOCKHOLDERS' EQUITY:</u>		
Common stock, no par value, 50,000,000 shares authorized; issued and outstanding: 2008 - 17,337,308 shares 2007 - 17,316,568 shares	273,644	272,208
Retained earnings	80,047	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)	(3)	3
	<hr/>	<hr/>
Total stockholders' equity	353,108	389,145
	<hr/>	<hr/>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 5,427,347	\$ 4,901,763

See notes to condensed consolidated financial statements.

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

	Three Month Period		Nine Month Period	
	2008	2007	2008	2007
Interest income:				
Portfolio loans (including fees)	\$ 73,328	\$ 81,117	\$ 224,897	\$ 231,819
Loans held for sale	145	429	681	1,765
Taxable investment securities	154	188	389	589
Federal funds sold	1,259	2,916	3,480	8,569
Other	610	386	1,689	1,387
Total interest income	<u>75,496</u>	<u>85,036</u>	<u>231,136</u>	<u>244,129</u>
Interest expense:				
Deposits	27,149	32,359	84,826	90,955
Debt obligations and other	7,308	6,009	21,144	16,283
Total interest expense	<u>34,457</u>	<u>38,368</u>	<u>105,970</u>	<u>107,238</u>
Net interest income	41,039	46,668	125,166	136,891
Provision for loan losses	53,810	7,890	71,787	15,812
Net interest income (deficiency) after provision for loan losses	(12,771)	38,778	53,379	121,079
Noninterest income:				
Service charges on deposit accounts	1,526	1,232	4,316	3,524
Trust and wealth-management revenue	1,791	1,371	4,999	3,525
Fees from origination of non-portfolio residential mortgage loans	926	1,142	2,910	3,754
Gain on sales of government-guaranteed loans	608	946	1,831	2,296
Gain on sales of other non-portfolio commercial loans	207	371	867	1,000
Realized gains on sale of investment securities available for sale	5	-	50	-
Other	1,888	2,049	5,020	4,440
Total noninterest income	<u>6,951</u>	<u>7,111</u>	<u>19,993</u>	<u>18,539</u>
Noninterest expense:				
Salaries and employee benefits	29,319	27,816	82,597	80,325
Occupancy	4,968	3,831	13,872	10,880
Equipment rent, depreciation and maintenance	3,821	2,239	9,695	7,471
Other	15,684	10,588	40,221	29,835
Total noninterest expense	<u>53,792</u>	<u>44,474</u>	<u>146,385</u>	<u>128,511</u>
Income (loss) before income taxes (benefit) and minority interest	(59,612)	1,415	(73,013)	11,107
Income taxes (benefit)	(20,732)	586	(25,428)	4,696
Income (loss) before minority interest	(38,880)	829	(47,585)	6,411
Minority interest in net losses of consolidated subsidiaries	6,385	5,145	17,904	12,132
NET INCOME (LOSS)	<u>\$ (32,495)</u>	<u>\$ 5,974</u>	<u>\$ (29,681)</u>	<u>\$ 18,543</u>
NET INCOME (LOSS) PER SHARE -- Note E:				
Basic	<u>\$ (1.90)</u>	<u>\$ 0.35</u>	<u>\$ (1.73)</u>	<u>\$ 1.10</u>
Diluted	<u>\$ (1.90)</u>	<u>\$ 0.35</u>	<u>\$ (1.73)</u>	<u>\$ 1.08</u>

See notes to condensed consolidated financial statements.

CAPITOL BANCORP LIMITED
Condensed Consolidated Statements of Changes in Stockholders' Equity (Unaudited)
For the Nine Months Ended September 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>Nine Months Ended September 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 subsidiaries	15,927				15,927
Issuance of 276,842 shares of common stock upon exercise of stock options	4,757				4,757
Surrender of 37,392 shares of common stock to facilitate exercise of stock options	(1,098)				(1,098)
Surrender of 18,814 shares of common stock to facilitate vesting of restricted stock	(845)				(845)
Issuance of 37,472 unvested shares of restricted common stock, net of related unearned employee compensation	--				--
Recognition of compensation expense relating to restricted common stock and stock options	1,290				1,290
Tax benefits from share-based payments	1,671				1,671
Issuance of 24,506 shares to employee stock ownership plan	1,132				1,132
Cash dividends paid (\$0.75 per share)		(12,867)			(12,867)
Components of comprehensive income:					
Net income		18,543			18,543
Market value adjustment for investment securities available for sale (net of income tax effect)				77	77
Comprehensive income					18,620
BALANCES AT SEPTEMBER 30, 2007	<u>\$ 272,078</u>	<u>\$ 118,455</u>		<u>\$ (67)</u>	<u>\$ 390,466</u>
<u>Nine Months Ended September 30, 2008</u>					
Balances at January 1, 2008	\$ 272,208	\$ 117,520	\$ (586)	\$ 3	\$ 389,145
Issuance of 109,435 shares of common stock upon exercise of stock options	1,960				1,960
Surrender of 93,964 shares of common stock to facilitate exercise of stock options	(2,090)				(2,090)
Surrender of 14,199 shares of common stock to facilitate vesting of restricted stock	(286)				(286)
Issuance of 31,790 unvested shares of restricted common stock, net of related unearned employee compensation and 12,322 forfeited shares	--				--
Recognition of compensation expense relating to restricted common stock and stock options	1,693				1,693
Tax benefits from share-based payments	161				161
Transfer of 250 shares to employee stock ownership plan	(2)		6		4
Cash dividends paid (\$0.45 per share)		(7,792)			(7,792)
Components of comprehensive loss:					
Net loss		(29,681)			(29,681)
Market value adjustment for investment securities available for sale (net of income tax effect)				(6)	(6)
Comprehensive loss					(29,687)
BALANCES AT SEPTEMBER 30, 2008	<u>\$ 273,644</u>	<u>\$ 80,047</u>	<u>\$ (580)</u>	<u>\$ (3)</u>	<u>\$ 353,108</u>

See notes to condensed consolidated financial statements.

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

	2008	2007
OPERATING ACTIVITIES		
Net income (loss)	\$ (29,681)	\$ 18,543
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Provision for loan losses	71,787	15,812
Depreciation of premises and equipment	8,433	6,641
Amortization of intangibles	376	201
Net amortization (accretion) of investment security premiums (discounts)	(1)	4
Loss (gain) on sale of premises and equipment	158	(118)
Minority interest in net losses of consolidated subsidiaries	(17,904)	(12,132)
Share-based compensation expense	1,693	1,290
Originations and purchases of loans held for sale	(170,646)	(418,857)
Proceeds from sales of loans held for sale	179,731	427,470
Increase in accrued interest income and other assets	(76,153)	(16,631)
Increase (decrease) in accrued interest expense on deposits and other liabilities	(5,065)	3,783
	(37,272)	26,006
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
 INVESTING ACTIVITIES		
Proceeds from sales of investment securities available for sale	974	287
Proceeds from calls, prepayments and maturities of investment securities	14,435	7,731
Purchases of investment securities	(27,171)	(6,797)
Net increase in portfolio loans	(379,897)	(550,081)
Proceeds from sales of premises and equipment	167	396
Purchases of premises and equipment	(8,727)	(10,426)
	(400,219)	(558,890)
NET CASH USED BY INVESTING ACTIVITIES		
 FINANCING ACTIVITIES		
Net increase (decrease) in demand deposits, NOW accounts and savings accounts	(79,524)	184,655
Net increase in certificates of deposit	518,340	230,810
Net borrowings from debt obligations	112,152	68,731
Net proceeds from issuance of subordinated debentures	11,131	55,000
Resources provided by minority interest	22,410	36,115
Net proceeds from issuance of common stock	1,960	4,757
Surrender of common stock to facilitate exercise of stock options	(2,090)	(1,098)
Surrender of common stock to facilitate vesting of restricted stock	(286)	(845)
Tax benefit from share-based payments	161	1,671
Cash dividends paid	(7,792)	(12,867)
	576,462	566,929
NET CASH PROVIDED BY FINANCING ACTIVITIES		
 INCREASE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents at beginning of period	352,372	348,870
	491,343	382,915
CASH AND CASH EQUIVALENTS AT END OF PERIOD		

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 September 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, while effective January 1, 2008, Capitol has not elected the fair value option through September 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.

On October 10, 2008, the FASB issued FSP FAS 157-3 to clarify the application of fair value measurements to the fair value of a financial asset when the market for that asset is not active. This clarifying guidance became effective upon issuance, including prior periods for which financial statements had not been issued, such as the period ended September 30, 2008 for Capitol. This new guidance did not have a material effect on Capitol's September 30, 2008 consolidated financial statements.

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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note C – Fair Value – Continued

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.

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 municipal government securities.

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 September 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 September 30, 2008 were as follows (in \$1,000s):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Securities available for sale	\$ <u>18,085</u>	\$ <u>17,306</u>	\$ <u>779</u>

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

	Total	Significant Other Observable Inputs (Level 2)	Total Gains (Losses)
Impaired loans ⁽¹⁾	\$ <u>98,916</u>	\$ <u>98,916</u>	\$ <u>(7,574)</u>

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note C – Fair Value – Continued

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.

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	(108,935)	15.52 to 20.90	17.94
Cancelled or expired	<u>(14,413)</u>		
Outstanding at September 30	<u>2,389,094</u>	\$ 13.50 to \$ 46.20	<u>\$ 28.20</u>

Stock options were granted in the first nine months of 2007 and 2008, with an aggregate fair value approximating \$1,103,000 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 (168,720) have varying vesting dates from December 31, 2007 through August 2010. Each stock option expires seven years from date of grant. Share-based compensation expense relating to stock options for the nine months ended September 30, 2008 and 2007 approximated \$565,000 and \$116,000, respectively.

As of September 30, 2008, stock options outstanding had a weighted average remaining contractual life of 2.82 years. The following table summarizes stock options outstanding segregated by exercise price range and summarizes aggregate intrinsic value as of September 30, 2008:

Exercise Price Range	Number Outstanding	Weighted Average		Aggregate Intrinsic Value
		Exercise Price	Remaining Contractual Life	
\$10.00 to 14.99	2,866	\$ 13.50	0.25 years	\$ 17,167
\$15.00 to 19.99	153,235	16.66	1.78 years	433,655
\$20.00 to 24.99	584,956	21.67	3.04 years	0
\$25.00 to 29.99	585,415	27.09	1.90 years	0
\$30.00 to 34.99	695,115	32.10	2.94 years	0
\$35.00 or more	<u>367,507</u>	37.92	4.17 years	<u>0</u>
Total outstanding	<u>2,389,094</u>			<u>\$ 450,822</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note E – Net Income (Loss) Per Share

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

	Three Month Period		Nine Month Period	
	2008	2007	2008	2007
Numerator—net income (loss) for the period	<u>\$ (32,495)</u>	<u>\$ 5,974</u>	<u>\$ (29,681)</u>	<u>\$ 18,543</u>
Denominator:				
Weighted average number of shares outstanding, excluding unvested restricted shares (denominator for basic earnings per share)	17,145	17,096	17,144	16,919
Effect of dilutive securities:				
Unvested restricted shares	--	--	--	11
Stock options	<u>--</u>	<u>102</u>	<u>--</u>	<u>266</u>
Total effect of dilutive securities	<u>--</u>	<u>102</u>	<u>--</u>	<u>277</u>
Denominator for diluted earnings per share—				
Weighted average number of shares and potential dilution	<u>17,145</u>	<u>17,198</u>	<u>17,144</u>	<u>17,196</u>
Number of antidilutive stock options excluded from diluted earnings per share computation	<u>2,389</u>	<u>1,650</u>	<u>2,389</u>	<u>368</u>

Note F – New Banks and Other Development Activities

Capitol opened four *de novo* banks during the nine months ended September 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.

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. Future new banks and/or additions of other operating units could be either wholly-owned, majority-owned or otherwise controlled by Capitol.

Note G – Proposed Acquisition

In March 2008, Capitol announced the formation of a joint venture to acquire 24% of the common stock of Forethought Federal Savings Bank (Forethought), located in Batesville, Indiana, for cash consideration of approximately \$2.3 million. Forethought is engaged in providing trust-related, pre-need funeral planning products and services to customers in 28 states. The proposed acquisition is subject to regulatory approval.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
CAPITOL BANCORP LIMITED – Continued

Note H – 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 \$5.4 billion at September 30, 2008, an increase of \$526 million from the December 31, 2007 level of \$4.9 billion. The balance sheet includes Capitol and its consolidated subsidiaries (in thousands):

	Total Assets	
	September 30, 2008	December 31, 2007
Arizona Region:		
Arrowhead Community Bank	\$ 84,613	\$ 89,060
Asian Bank of Arizona	37,040	25,017
Bank of Tucson	176,684	187,468
Camelback Community Bank	97,816	84,671
Colonia Bank ⁽³⁾	9,268	
Mesa Bank	226,343	217,861
Southern Arizona Community Bank	90,419	85,158
Sunrise Bank of Albuquerque	78,857	71,726
Sunrise Bank of Arizona	120,671	116,245
Valley First Community Bank	72,371	77,306
Yuma Community Bank	74,458	78,489
Arizona Region Total	1,068,540	1,033,001
California Region:		
Bank of Escondido	99,031	89,557
Bank of Feather River	24,509	17,283
Bank of San Francisco	59,887	68,902
Bank of Santa Barbara	66,253	58,738
Napa Community Bank	144,472	131,457
Point Loma Community Bank	62,231	56,428
Sunrise Bank of San Diego	87,344	81,905
Sunrise Community Bank	34,245	21,113
California Region Total	577,972	525,383
Colorado Region:		
Fort Collins Commerce Bank	75,501	61,083
Larimer Bank of Commerce	79,613	51,906
Loveland Bank of Commerce	31,994	15,941
Mountain View Bank of Commerce ⁽²⁾	30,339	
Colorado Region Total	217,447	128,930
Great Lakes Region:		
Ann Arbor Commerce Bank	366,383	362,429
Bank of Auburn Hills	45,127	44,767
Bank of Maumee	55,059	35,576
Bank of Michigan	73,297	69,909
Brighton Commerce Bank	119,393	108,664
Capitol National Bank	226,243	228,556
Detroit Commerce Bank	102,734	113,243
Elkhart Community Bank	96,661	89,064
Evansville Commerce Bank	66,625	50,819
Goshen Community Bank	79,552	93,173
Grand Haven Bank	118,443	130,492
Kent Commerce Bank	83,712	87,060
Macomb Community Bank	94,020	93,045
Muskegon Commerce Bank	87,468	98,975
Oakland Commerce Bank	96,217	109,370
Ohio Commerce Bank	55,076	35,690
Paragon Bank & Trust	102,352	103,711
Portage Commerce Bank	222,579	189,944
Great Lakes Region Total	2,090,941	2,044,487
Midwest Region:		
Adams Dairy Bank ⁽¹⁾	29,556	
Bank of Belleville	68,472	50,485
Community Bank of Lincoln	42,362	12,960
Summit Bank of Kansas City	51,412	50,142
Midwest Region Total	191,802	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	
	September 30, 2008	December 31, 2007
Nevada Region:		
1 st Commerce Bank	\$ 39,120	\$ 32,091
Bank of Las Vegas	71,776	72,768
Black Mountain Community Bank	152,579	147,433
Desert Community Bank	104,384	101,840
Red Rock Community Bank	<u>126,733</u>	<u>120,750</u>
Nevada Region Total	494,592	474,882
Northeast Region:		
USNY Bank	43,851	17,171
Northwest Region:		
Bank of Bellevue	53,723	45,122
Bank of Everett	39,412	28,946
Bank of Tacoma	39,711	24,325
High Desert Bank	33,632	11,501
Issaquah Community Bank	<u>23,568</u>	<u>13,696</u>
Northwest Region Total	190,046	123,590
Southeast Region:		
Bank of Valdosta	58,679	43,842
Community Bank of Rowan	146,276	117,495
First Carolina State Bank	111,151	115,243
Peoples State Bank	29,130	26,159
Pisgah Community Bank ⁽⁴⁾	28,728	
Sunrise Bank of Atlanta	<u>63,980</u>	<u>48,664</u>
Southeast Region Total	437,944	351,403
Texas Region:		
Bank of Fort Bend	24,067	9,551
Bank of Las Colinas	<u>32,389</u>	<u>11,383</u>
Texas Region Total	56,456	20,934
Parent company and other, net	<u>57,756</u>	<u>68,395</u>
Consolidated Totals	<u>\$ 5,427,347</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 \$348 million, compared to loan growth of about \$542 million during the corresponding period of 2007. Portfolio growth in the interim 2008 period slowed in response to the need to preserve liquidity and capital in the current economic climate. 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 September 30, 2008, 40% of the consolidated loan portfolio relates to banks located within the Great Lakes Region (43% at December 31, 2007) and 60% 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 98% of loan growth occurred in regions outside of the Great Lakes Region.

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

Financial Condition – Continued

The consolidated allowance for loan losses at September 30, 2008 approximated \$98 million or 2.09% of total portfolio loans, a significant 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 September 30			
	Three Month Period		Nine Month Period	
	2008	2007	2008	2007
Allowance for loan losses at beginning of period	\$ 63,904	\$ 49,349	\$ 58,124	\$ 45,414
Loans charged-off:				
Loans secured by real estate:				
Commercial	(2,186)	(843)	(5,630)	(1,139)
Residential (including multi-family)	(2,428)	(1,496)	(5,590)	(2,189)
Construction, land development and other land	(12,128)	(329)	(15,248)	(645)
Total loans secured by real estate	(16,742)	(2,668)	(26,468)	(3,973)
Commercial and other business-purpose loans	(3,753)	(1,849)	(8,051)	(5,038)
Consumer	(73)	(105)	(262)	(316)
Other			(34)	
Total charge-offs	(20,568)	(4,622)	(34,815)	(9,327)
Recoveries:				
Loans secured by real estate:				
Commercial	181	2	899	68
Residential (including multi-family)	130	35	590	163
Construction, land development and other land	17	2	240	16
Total loans secured by real estate	328	39	1,729	247
Commercial and other business-purpose loans	102	119	686	550
Consumer	9	76	74	148
Other				7
Total recoveries	439	234	2,489	952
Net charge-offs	(20,129)	(4,388)	(32,326)	(8,375)
Additions to allowance charged to expense	53,810	7,890	71,787	15,812
Allowance for loan losses at September 30	\$ 97,585	\$ 52,851	\$ 97,585	\$ 52,851
Average total portfolio loans for the period	\$ 4,617,153	\$ 3,908,625	\$ 4,521,165	\$ 3,726,654
Ratio of net charge-offs (annualized) to average portfolio loans outstanding	1.74%	0.45%	0.95%	0.30%

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

Financial Condition – Continued

Interim loan charge-offs for the nine-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 significant increase in the 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. The interim 2008 provision for loan losses is discussed in further detail in the 'Results of Operations' section of this narrative.

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:

	September 30, 2008		December 31, 2007	
	Amount	Percentage of Total Portfolio Loans	Amount	Percentage of Total Portfolio Loans
Loans secured by real estate:				
Commercial	\$ 32,992	0.71%	\$ 21,918	0.51%
Residential (including multi-family)	22,083	0.47%	10,235	0.24%
Construction, land development and other land	<u>17,553</u>	<u>0.38%</u>	<u>11,278</u>	<u>0.26%</u>
Total loans secured by real estate	72,628	1.56%	43,431	1.01%
Commercial and other business-purpose loans	23,594	0.50%	13,727	0.32%
Consumer	1,056	0.02%	667	0.01%
Other	<u>307</u>	<u>0.01%</u>	<u>299</u>	<u>0.01%</u>
 Total allowance for loan losses	 <u>\$ 97,585</u>	 <u>2.09%</u>	 <u>\$ 58,124</u>	 <u>1.35%</u>

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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 still accruing interest and loans on nonaccrual status) and other nonperforming assets are summarized below (in thousands):

	September 30, 2008	December 31, 2007
	<u> </u>	<u> </u>
Nonaccrual loans:		
Loans secured by real estate:		
Commercial	\$ 26,954	\$ 19,016
Residential (including multi-family)	27,543	13,381
Construction, land development and other land	57,864	29,756
Total loans secured by real estate	<u>112,361</u>	<u>62,153</u>
Commercial and other business-purpose loans	10,144	5,782
Consumer	296	66
Other	17	84
Total nonaccrual loans	<u>122,818</u>	<u>68,085</u>
 Past due (≥90 days) loans and accruing interest:		
Loans secured by real estate:		
Commercial	1,434	113
Residential (including multi-family)	931	1,116
Construction, land development and other land	211	2,531
Total loans secured by real estate	<u>2,576</u>	<u>3,760</u>
Commercial and other business-purpose loans	1,560	714
Consumer	144	66
Other	--	5
Total past due loans	<u>4,280</u>	<u>4,545</u>
 Total nonperforming loans	<u>\$ 127,098</u>	<u>\$ 72,630</u>
 Real estate owned and other repossessed assets	<u>59,090</u>	<u>16,680</u>
 Total nonperforming assets	<u>\$ 186,188</u>	<u>\$ 89,310</u>

Nonperforming loans at September 30, 2008 approximated 2.73% of total portfolio loans, an increase from the December 31, 2007 ratio of 1.68%. Nonperforming loans increased \$54 million or 75% during the interim 2008 nine-month period. Of the nonperforming loans at September 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 September 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.

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

Financial Condition – Continued

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 and real estate owned. The fair value measurement of collateral-dependent loans and other real estate owned is dependent primarily upon appraisal of the underlying property value. Fair value measurement has been recently defined in a new accounting standard, Financial Accounting Standards Board Statement No. 157, which became effective January 1, 2008 for Capitol (see Note C of the notes to the condensed consolidated financial statements). Management cautiously monitors real estate values and related appraisal data when evaluating such valuations.

Total nonperforming loans approximated \$127 million at September 30, 2008. Of that total, \$76 million (including some loans carried at the parent level) or 60% were originated by banks within the Great Lakes Region, primarily located in Michigan. Within the Great Lakes Region, nonperforming loans approximated 4% of total portfolio loans at September 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 2.09% of portfolio loans for the region on a combined basis as of September 30, 2008 and ranging as high as 4% or more at certain banks. Those ratios can be contrasted with other banks and geographic regions within the Corporation with lower levels of nonperforming loans. Nonperforming loans have recently increased from December 31, 2007 in other regions, such as the Arizona Region (\$19.2 million, principally related to Mesa Bank) and the Nevada Region (\$10.5 million).

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 September 30, 2008, potential problem loans (including the previously-mentioned nonperforming loans) approximated \$411 million or about 8.8% 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 nine months of 2008.

Real estate owned and other repossessed assets increased \$42.4 million to \$59.1 million during the nine months ended September 30, 2008. Most of this increase related to a group of residential construction loans in the Arizona Region aggregating \$30.1 million.

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.

**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	
	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007
Arizona Region:								
Arrowhead Community Bank	\$ 76,404	\$ 81,836	\$ 1,505	\$ 818	\$ 2,686	\$ 361	1.97%	1.00%
Asian Bank of Arizona	32,396	21,514	720	405	689	314	2.22%	1.88%
Bank of Tucson	155,899	168,427	1,350	1,385	2,993	752	0.87%	0.82%
Camelback Community Bank	83,344	79,869	660	800	92	451	0.79%	1.00%
Colonia Bank ⁽³⁾	5,291		79				1.49%	
Mesa Bank	156,197	202,511	2,834	1,760	19,736	3,699	1.81%	0.87%
Southern Arizona Community Bank	81,186	78,467	751	792		600	0.93%	1.01%
Sunrise Bank of Albuquerque	71,880	67,192	826	866	237	183	1.15%	1.29%
Sunrise Bank of Arizona	111,156	112,211	1,075	1,125	1,933	4,250	0.97%	1.00%
Valley First Community Bank	63,427	71,689	1,002	653	1,490		1.58%	0.91%
Yuma Community Bank	63,482	66,092	650	525	582	600	1.02%	0.79%
Arizona Region Total	900,662	949,808	11,452	9,129	30,438	11,210	1.27%	0.96%
California Region:								
Bank of Escondido	61,054	54,707	648	560	848	311	1.06%	1.02%
Bank of Feather River	20,769	13,345	291	187			1.40%	1.40%
Bank of San Francisco	54,490	44,989	780	695	339	392	1.43%	1.54%
Bank of Santa Barbara	59,812	52,340	1,042	741	1,306		1.74%	1.42%
Napa Community Bank	126,096	100,253	1,750	1,069		1,459	1.39%	1.07%
Point Loma Community Bank	50,663	49,607	750	695	795		1.48%	1.40%
Sunrise Bank of San Diego	74,092	74,526	932	908	1,497	2,386	1.26%	1.22%
Sunrise Community Bank	25,594	17,624	385	255			1.50%	1.45%
California Region Total	472,570	407,391	6,578	5,110	4,785	4,548	1.39%	1.25%
Colorado Region:								
Fort Collins Commerce Bank	67,908	59,388	947	889	48		1.39%	1.50%
Larimer Bank of Commerce	72,824	50,927	1,065	765			1.46%	1.50%
Loveland Bank of Commerce	26,089	15,253	627	229	1,266		2.40%	1.50%
Mountain View Bank of Commerce ⁽²⁾	24,632		358				1.45%	
Colorado Region Total	191,453	125,568	2,997	1,883	1,314		1.57%	1.50%
Great Lakes Region:								
Ann Arbor Commerce Bank	328,154	332,624	4,113	4,504	3,473	5,161	1.25%	1.35%
Bank of Auburn Hills	40,509	36,586	933	820	2,818	1,293	2.30%	2.24%
Bank of Maumee	46,747	32,102	738	482	75		1.58%	1.50%
Bank of Michigan	66,650	63,448	988	952		370	1.48%	1.50%
Brighton Commerce Bank	100,026	99,627	1,250	1,018	1,277	18	1.25%	1.02%
Capitol National Bank	212,419	206,449	6,231	3,421	9,269	3,449	2.93%	1.66%
Detroit Commerce Bank	97,481	108,992	1,683	1,355	4,204	3,948	1.73%	1.24%
Elkhart Community Bank	90,410	83,754	1,888	1,282	4,043	2,677	2.09%	1.53%
Evansville Commerce Bank	58,493	48,113	883	720	276	80	1.51%	1.50%
Goshen Community Bank	74,779	70,799	1,215	874	148	491	1.62%	1.23%
Grand Haven Bank	106,493	122,208	3,346	2,644	5,675	6,970	3.14%	2.16%
Kent Commerce Bank	74,972	83,357	2,042	1,527	1,778	2,456	2.72%	1.83%
Macomb Community Bank	87,183	87,670	3,992	2,283	11,406	11,846	4.58%	2.60%
Muskegon Commerce Bank	77,276	90,031	2,353	1,762	4,295	2,362	3.04%	1.96%
Oakland Commerce Bank	84,293	99,770	2,561	1,816	14,956	3,803	3.04%	1.82%
Ohio Commerce Bank	44,883	29,110	673	437			1.50%	1.50%
Paragon Bank & Trust	90,133	91,481	2,067	1,431	4,910	2,220	2.29%	1.56%
Portage Commerce Bank	192,272	179,219	2,172	1,812	929	1,127	1.13%	1.01%
Great Lakes Region Total	1,873,173	1,865,340	39,128	29,140	69,532	48,271	2.09%	1.56%
Midwest Region:								
Adams Dairy Bank ⁽¹⁾	26,853		403				1.50%	
Bank of Belleville	62,156	46,951	892	700			1.44%	1.49%
Community Bank of Lincoln	37,805	10,501	574	168			1.52%	1.60%
Summit Bank of Kansas City	42,495	45,165	624	641			1.47%	1.42%
Midwest Region Total	169,309	102,617	2,493	1,509			1.47%	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	
	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007	Sept 30, 2008	Dec 31, 2007
Nevada Region:								
1 st Commerce Bank	\$ 31,078	\$ 27,030	\$ 885	\$ 393	\$ 2,631		2.85%	1.45%
Bank of Las Vegas	63,665	61,662	905	751	2,315		1.42%	1.22%
Black Mountain Community Bank	145,772	137,308	1,816	1,415	1,582	\$ 659	1.25%	1.03%
Desert Community Bank	90,983	90,050	1,190	837	1,642	356	1.31%	0.93%
Red Rock Community Bank	<u>110,202</u>	<u>106,559</u>	<u>1,188</u>	<u>977</u>	<u>3,380</u>	<u>64</u>	<u>1.08%</u>	<u>0.92%</u>
Nevada Region Total	441,700	422,609	5,984	4,373	11,550	1,079	1.35%	1.03%
Northeast Region:								
USNY Bank	35,977	12,421	540	187			1.50%	1.51%
Northwest Region:								
Bank of Bellevue	47,297	37,364	970	665	192	222	2.05%	1.78%
Bank of Everett	31,605	24,170	510	418			1.61%	1.73%
Bank of Tacoma	36,691	19,639	645	285			1.76%	1.45%
High Desert Bank	28,424	9,080	392	126			1.38%	1.39%
Issaquah Community Bank	<u>19,732</u>	<u>6,598</u>	<u>293</u>	<u>93</u>			<u>1.48%</u>	<u>1.41%</u>
Northwest Region Total	163,749	96,851	2,810	1,587	192	222	1.72%	1.64%
Southeast Region:								
Bank of Valdosta	50,663	41,629	761	619			1.50%	1.49%
Community Bank of Rowan	112,388	96,271	1,686	1,444	675		1.50%	1.50%
First Carolina State Bank	88,799	94,047	1,300	1,157	1,188	829	1.46%	1.23%
Peoples State Bank	21,138	13,609	320	247	815	86	1.51%	1.81%
Pisgah Community Bank ⁽⁴⁾	18,949		284				1.50%	
Sunrise Bank of Atlanta	<u>55,079</u>	<u>45,024</u>	<u>1,018</u>	<u>760</u>	<u>308</u>		<u>1.85%</u>	<u>1.69%</u>
Southeast Region Total	347,016	290,580	5,369	4,227	2,986	915	1.55%	1.45%
Texas Region:								
Bank of Fort Bend	19,292	3,140	298	46			1.54%	1.47%
Bank of Las Colinas	<u>25,960</u>	<u>9,830</u>	<u>375</u>	<u>144</u>			<u>1.44%</u>	<u>1.46%</u>
Texas Region Total	45,252	12,970	673	190			1.49%	1.46%
Parent company and other, net	<u>21,411</u>	<u>28,546</u>	<u>19,561</u>	<u>789</u>	<u>6,301</u>	<u>6,385</u>		
Consolidated totals	<u>\$ 4,662,272</u>	<u>\$ 4,314,701</u>	<u>\$ 97,585</u>	<u>\$ 58,124</u>	<u>\$127,098</u>	<u>\$ 72,630</u>	<u>2.09%</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.

Results of Operations

Summary

The net loss for the third quarter 2008 approximated \$32.5 million, compared to net income of \$6.0 million in the corresponding period of 2007. The net loss per share was \$1.90 for the three months ended September 30, 2008, compared to earnings per share of \$0.35 in the corresponding 2007 period. The net loss for the nine months ended September 30, 2008 was \$29.7 million, compared to net income of \$18.5 million in the corresponding period of 2007. The net loss per share was \$1.73 for the nine months ended September 30, 2008, compared to earnings per share of \$1.08 in the corresponding 2007 period.

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

Results of Operations – Continued

The primary reason for the interim 2008 loss was a large provision for loan losses recorded during the three months ended September 30, 2008 as the Corporation carefully assesses the implications and impact of declining property values and weak bank performance, particularly within the Great Lakes Region. The provision for loan losses increased \$45.9 million to \$53.8 million for the three months ended September 30, 2008, compared to \$7.9 million for the corresponding period of 2007.

Analytical Review

The provision for loan losses for the nine-month period in 2008 was \$71.8 million, compared to \$15.8 million for the same period in 2007. Provisions for loan losses increased significantly in the 2008 period in response to the additional provision at Capitol, 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 nine months of 2008 totaled \$125.2 million, a 9% decrease compared to \$136.9 million in 2007. Net interest income for the three months ended September 30, 2008 totaled \$41 million, a 12% decrease compared to \$46.7 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 3.30% for the three months ended September 30, 2008, a 0.20% decrease compared to 3.50% for the three months ended June 30, 2008 and a 1.12% decrease compared to 4.42% for the three months ended September 30, 2007. Several other causal factors impacted the 2008 margin, including elevated levels of nonperforming loans, higher levels of liquidity, 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 nine months ended September 30, 2008 was \$20 million, an increase of \$1.5 million, or 8%, over the same period in 2007. Noninterest income for the three months ended September 30, 2008 was \$7 million, a slight decrease from the \$7.1 million for the corresponding period in 2007. The increase for the nine-month 2008 period was due to increases of \$1.5 million in trust and wealth-management revenue and \$792,000 from service charges on deposit accounts. Fees from origination of non-portfolio residential mortgage loans totaled \$926,000 for the third quarter of 2008 and \$2.9 million for the nine-month period, reduced from \$1.1 million and \$3.8 million for the comparable periods in 2007, respectively, due to lower loan origination volume associated with a weak residential real estate economy.

Noninterest expense totaled \$146.4 million for the nine-month 2008 period and \$53.8 million for the third quarter of 2008, compared to \$128.5 million and \$44.5 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, costs of problem loan administration and other real estate write-downs 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.

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

Results of Operations – Continued

Also included in noninterest expense in the interim 2008 periods is a restructuring charge of \$2.5 million relating to the Corporation's announced plans to combine some of its Michigan banks, reducing from 13 to 9 the number of bank charters within the state. This regionalization effort in eastern and western Michigan is expected to generate operational efficiencies approximating \$3.3 million annually, beginning with the fourth quarter of 2008. On the west side of Michigan, Grand Haven Bank (total assets of \$118.4 million) will combine with Muskegon Commerce Bank (\$87.5 million), and Kent Commerce Bank (\$83.7 million) will merge with Paragon Bank & Trust (\$102.4 million) in Holland. All back-office and operational activities for the four institutions will continue to be consolidated at Capitol, while additional formerly independent activities (i.e., credit and loan administration) will also be consolidated. The two resultant institutions will continue to operate in and service the markets of Grand Haven, Muskegon, Grand Rapids and Holland. On Michigan's east side, Detroit Commerce Bank (\$102.7 million), Macomb Community Bank (\$94.0 million) and Oakland Commerce Bank (\$96.2 million) will merge into one entity. Each of these merger transactions are subject to regulatory approval.

The largest element of noninterest expense is salaries and employee benefits, which approximated \$82.6 million for the nine months ended September 30, 2008, a slight increase from \$80.3 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 September 30:

	Three Month Period		Nine Month Period	
	2008	2007	2008	2007
Costs associated with foreclosed properties and other real estate owned	\$ 2,040	\$ 206	\$ 4,132	\$ 449
FDIC insurance premiums and other regulatory fees	1,029	696	2,899	1,917
Restructuring accrual for Michigan bank regionalization	2,500		2,500	
Advertising	838	792	2,471	2,454
Paper, printing and supplies	648	643	2,200	2,010
Travel, lodging and meals	707	706	2,193	2,049
Directors' fees	616	725	2,174	2,084
Professional fees	858	551	2,130	1,671
Preopening and start-up costs		1,602	2,038	2,898
Bank services (ATMs, telephone banking and Internet banking)	687	517	1,868	1,578
Communications	585	432	1,634	1,265
Loan and collection expense	410	392	1,443	1,436
Postage	335	283	993	825
Dues and memberships	245	203	704	649
Courier service	220	253	692	729
Taxes other than income taxes	147	448	658	1,376
Insurance expense	158	119	451	333
Contracted labor	101	98	345	364
Publications	43	32	133	101
Other	3,517	1,890	8,563	5,647
Total	\$ 15,684	\$ 10,588	\$ 40,221	\$ 29,835

**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:

	Nine Months Ended September 30							
	Total Revenues		Net Income (Loss)		Return on Average Equity ⁽¹⁾		Return on Average Assets ⁽¹⁾	
	2008	2007	2008	2007	2008	2007	2008	2007
Arizona Region:								
Arrowhead Community Bank	\$ 4,784	\$ 6,231	\$ (720)	\$ 774		12.48%		1.22%
Asian Bank of Arizona	1,467	1,301	(685)	(404)				
Bank of Tucson	10,006	11,972	2,897	3,496	21.43%	27.52%	2.13%	2.60%
Camelback Community Bank	4,536	5,129	764	722	11.00%	10.90%	1.12%	1.09%
Colonia Bank ⁽⁴⁾	80		(551)					
Mesa Bank	11,058	14,979	(8,211)	3,109		22.60%		1.99%
Southern Arizona Community Bank	4,482	5,197	411	823	6.05%	12.25%	0.62%	1.23%
Sunrise Bank of Albuquerque	3,955	4,605	199	470	3.62%	9.61%	0.35%	0.92%
Sunrise Bank of Arizona	6,201	7,111	(322)	444		5.11%		0.52%
Valley First Community Bank	3,628	4,006	(587)	259		4.36%		0.50%
Yuma Community Bank	4,043	4,498	468	746	7.96%	12.92%	0.82%	1.38%
Arizona Region Total	<u>54,240</u>	<u>65,029</u>	<u>(6,337)</u>	<u>10,439</u>				
California Region:								
Bank of Escondido	3,789	4,326	241	369	2.22%	3.48%	0.34%	0.58%
Bank of Feather River	955		(463)					
Bank of San Francisco	2,807	2,195	39	(358)	0.61%		0.08%	
Bank of Santa Barbara	3,083	3,090	(198)	(205)				
Napa Community Bank	6,551	7,032	914	1,066	8.47%	11.02%	0.94%	1.21%
Point Loma Community Bank	2,828	3,071	244	69	4.46%	1.30%	0.57%	0.18%
Sunrise Bank of San Diego	4,174	5,358	166	372	2.07%	4.68%	0.25%	0.59%
Sunrise Community Bank	1,182	726	(522)	(805)				
California Region Total	<u>25,369</u>	<u>25,798</u>	<u>421</u>	<u>508</u>				
Colorado Region:								
Fort Collins Commerce Bank	3,424	3,517	536	495	7.81%	7.74%	1.06%	1.23%
Larimer Bank of Commerce	3,279	1,201	299	(586)	5.27%		0.60%	
Loveland Bank of Commerce	1,035		(371)					
Mountain View Bank of Commerce ⁽³⁾	746		(711)					
Colorado Region Total	<u>8,484</u>	<u>4,718</u>	<u>(247)</u>	<u>(91)</u>				
Great Lakes Region:								
Ann Arbor Commerce Bank	17,657	19,058	2,382	2,790	11.03%	14.25%	0.89%	1.13%
Bank of Auburn Hills	2,123	2,418	(599)	(215)				
Bank of Maumee	2,119	946	(604)	(856)				
Bank of Michigan	3,707	3,603	426	(38)	8.41%		0.81%	
Brighton Commerce Bank	5,582	6,166	348	455	4.72%	6.60%	0.42%	0.57%
Capitol National Bank	11,214	13,499	233	1,587	1.61%	11.20%	0.14%	0.89%
Detroit Commerce Bank	5,401	6,786	(1,162)	413		5.96%		0.51%
Elkhart Community Bank	4,354	5,149	210	650	3.18%	9.88%	0.30%	1.03%
Evansville Commerce Bank	3,020	1,851	(201)	(540)				
Goshen Community Bank	3,946	4,490	252	330	4.23%	5.90%	0.42%	0.58%
Grand Haven Bank	5,597	7,248	(2,302)	500		6.10%		0.52%
Kent Commerce Bank	4,235	5,045	(1,241)	100		2.27%		0.16%
Macomb Community Bank	3,926	5,088	(3,412)	(842)				
Muskegon Commerce Bank	4,175	5,427	(1,598)	(746)				
Oakland Commerce Bank	4,501	7,234	(1,230)	(102)				
Ohio Commerce Bank	1,991	1,031	(117)	(568)				
Paragon Bank & Trust	5,370	6,157	(725)	(25)				
Portage Commerce Bank	10,953	11,580	1,787	1,740	13.62%	14.36%	1.16%	1.26%
Great Lakes Region Total	<u>99,871</u>	<u>112,776</u>	<u>(7,553)</u>	<u>4,633</u>				
Midwest Region								
Adams Dairy Bank ⁽²⁾	1,121		(569)					
Bank of Belleville	2,706	1,648	23	(434)	0.45%		0.05%	
Community Bank of Lincoln	1,402		(511)					
Summit Bank of Kansas City	2,333	2,408	(10)	(352)				
Midwest Region Total	<u>7,562</u>	<u>4,056</u>	<u>(1,067)</u>	<u>(786)</u>				

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

Results of Operations – Continued

Operating results – continued:

	Nine Months Ended September 30							
	Total Revenues		Net Income (Loss)		Return on Average Equity ⁽¹⁾		Return on Average Assets ⁽¹⁾	
	2008	2007	2008	2007	2008	2007	2008	2007
Nevada Region:								
1 st Commerce Bank	\$ 1,776	\$ 1,188	\$ (660)	\$ (423)				
Bank of Las Vegas	3,710	4,542	112	493	1.71%	7.30%	0.21%	0.90%
Black Mountain Community Bank	8,093	9,233	1,390	1,976	12.49%	18.83%	1.22%	1.85%
Desert Community Bank	5,622	6,076	485	891	6.37%	12.60%	0.63%	1.25%
Red Rock Community Bank	<u>5,891</u>	<u>6,990</u>	<u>672</u>	<u>1,266</u>	6.56%	12.72%	0.75%	1.51%
Nevada Region Total	25,092	28,029	1,999	4,203				
Northeast Region:								
USNY Bank	1,249	149	(583)	(743)				
Northwest Region:								
Bank of Bellevue	2,181	2,410	(179)	(66)				
Bank of Everett	1,541	1,403	(779)	(433)				
Bank of Tacoma	1,485	868	(629)	(884)				
High Desert Bank	955	4	(581)	(330)				
Issaquah Community Bank	<u>857</u>	<u>125</u>	<u>(494)</u>	<u>(394)</u>				
Northwest Region Total	7,019	4,810	(2,662)	(2,107)				
Southeast Region:								
Bank of Valdosta	2,413	1,802	(55)	(326)				
Community Bank of Rowan	5,553	4,228	698	(229)	9.38%		0.76%	
First Carolina State Bank	4,785	5,517	31	404	0.37%	4.57%	0.04%	0.55%
Peoples State Bank	1,326	1,705	5	226	0.13%	6.15%	0.03%	1.08%
Pisgah Community Bank ⁽⁵⁾	357		(700)					
Sunrise Bank of Atlanta	<u>3,462</u>	<u>2,757</u>	<u>(310)</u>	<u>(260)</u>				
Southeast Region Total	17,896	16,009	(331)	(185)				
Texas Region:								
Bank of Fort Bend	629		(669)					
Bank of Las Colinas	<u>887</u>		<u>(470)</u>					
Texas Region Total	1,516		(1,139)					
Parent company and other, net	<u>2,831</u>	<u>1,294</u>	<u>(12,182)</u>	<u>2,672</u>	—	—	—	—
Consolidated totals	<u>\$ 251,129</u>	<u>\$ 262,668</u>	<u>\$ (29,681)</u>	<u>\$ 18,543</u>	—	6.48%	—	0.57%

- (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.

Liquidity and Capital Resources

The principal funding source for asset growth and loan origination activities is deposits. Total deposits increased \$439 million for the nine months ended September 30, 2008, compared to a \$415 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 \$950 million as of September 30, 2008, or about 22% of total deposits, an increase of \$418 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.

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

Liquidity and Capital Resources – Continued

Noninterest-bearing deposits approximated 15% of total deposits at September 30, 2008, a decrease from 17% at December 31, 2007, and a decrease of \$24 million in the 2008 interim period compared to a decrease of \$15 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 \$463 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.

During the interim 2008 period, management has emphasized increasing liquidity. Cash and cash equivalents amounted to \$491.3 million or 9.1% of total assets at September 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 September 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 September 30, 2008, Capitol's banks had approximately \$18 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 \$415 million and additional borrowing capacity approximated \$227 million at September 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 \$432.5 million at September 30, 2008.

Stockholders' equity, as a percentage of total assets, approximated 6.51% at September 30, 2008 and 7.94% at December 31, 2007. As of September 30, 2008, Capitol's total capital funds (i.e., the sum of stockholders' equity, minority interests in consolidated subsidiaries and subordinated debentures) approximated \$681 million or 12.55% of total assets.

In March 2008, Capitol announced the formation of a joint venture to acquire 24% of the common stock of Forethought Federal Savings Bank (Forethought), located in Batesville, Indiana, for cash consideration of approximately \$2.3 million. Forethought is engaged in providing trust-related, pre-need 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 \$11.1 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.

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

Liquidity and Capital Resources – Continued

In early October 2008, the Emergency Economic Stabilization Act of 2008 was signed into law. The Act has numerous provisions designed to aid the availability of credit, the domestic economy and the financial institution industry. One recently announced facet of the Act's implementation is the capital injection program for banks and bank holding companies offered by the U.S. Department of Treasury. Capitol is currently reviewing the Treasury Department's capital purchase program, which provides for the government's purchase of preferred stock from bank holding companies, such as Capitol. Capitol's articles of incorporation do not currently provide for the issuance of preferred stock and a special meeting of shareholders has been scheduled for November 17, 2008 for the purpose of voting on an amendment to the articles of incorporation to permit the issuance of preferred stock. In connection with the special meeting and the proposal to amend Capitol's articles of incorporation to authorize the issuance of preferred stock, Capitol plans to file a definitive proxy statement with the SEC. Investors and security holders of Capitol are advised to read the proxy statement and any other relevant documents filed with the SEC when they become available because those documents will contain important information about the special meeting and the proposal to amend Capitol's articles of incorporation to authorize the issuance of preferred stock. The final, definitive proxy statement will be mailed to shareholders of Capitol. The preliminary proxy statement is, and the definitive proxy statement and other relevant documents will be, available for free at the SEC's web site at <http://www.sec.gov>. Free copies of the preliminary proxy statement, the definitive proxy statement, when it becomes available, and Capitol's other filings with the SEC may also be obtained from Capitol. Free copies of Capitol's filings may be obtained by directing a request to Capitol Bancorp Ltd., Capitol Bancorp Center, 200 N. Washington Square, Fourth Floor, Lansing, Michigan 48933 Attention: Secretary.

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). In October 2008, further rate decreases totaling 100 basis-points were announced. 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 deteriorated 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 generally 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. 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 H 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 (Capitol's annual review of goodwill for potential impairment is performed in the fourth quarter of the year) 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 nine months ended September 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) None.
- (b) Not applicable.
- (c) None.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

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: October 30, 2008

INDEX TO EXHIBITS

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