SEVERN BANCORP INC
Form 10-Q
May 12, 2015

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

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2015
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 0-49731

SEVERN BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland	52-1726127
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

200 Westgate Circle, Suite 200

Annapolis, Maryland	21401
(Address of principal executive offices)	(Zip Code)

410-260-2000
(Registrant's telephone number, including area code)

N/A
(Former name, former address and formal 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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 definition 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of the close of business on May 12, 2015: 10,088,879 shares.

SEVERN BANCORP, INC. AND SUBSIDIARIES
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PART I– FINANCIAL INFORMATION

Item 1. Financial Statements

SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)
(dollars in thousands, except per share amounts)

	March 31, 2015	December 31, 2014
ASSETS		
Cash and due from banks	$39,102	$24,866
Interest-bearing deposits in other banks	12,542	8,469
Cash and cash equivalents	51,644	33,335
Investment securities held to maturity (fair value: $58,860 at March 31, 2015; $60,123 at December 31, 2014)	57,919	59,616
Loans held for sale	13,059	7,165
Loans receivable, net of allowance for loan losses of $8,964 and $9,435, respectively	618,627	633,882
Premises and equipment, net	24,986	25,159
Foreclosed real estate	2,211	1,947
Federal Home Loan Bank stock, at cost	5,583	5,936
Accrued interest receivable and other assets	7,599	9,288
Total assets	$781,628	$776,328
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits	$546,535	$543,814
Long-term borrowings	115,000	115,000
Subordinated debentures	24,119	24,119
Accrued interest payable and other liabilities	11,699	9,585
Total liabilities	697,353	692,518
Stockholders’ Equity		
Preferred stock, $0.01 par value, 1,000,000 shares authorized:		
Preferred stock series “A”, 437,500 shares issued and outstanding; $3,500 liquidation preference	4	4
Preferred stock series “B”, 23,393 shares issued and outstanding; $23,393 liquidation preference	-	-
Common stock, $0.01 par value, 20,000,000 shares authorized; 10,087,879 and 10,067,379 shares issued and outstanding, respectively	101	101
Additional paid-in capital	76,043	75,848
Retained earnings	8,127	7,857
Total stockholders' equity	84,275	83,810
Total liabilities and stockholders' equity	$781,628	$776,328

The accompanying notes to consolidated financial statements are an integral part of these statements.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(dollars in thousands, except per share data)

	For the Three Months Ended March 31, 2015	2014
Interest Income		
Loans, including fees	$7,546	$7,642
Securities, taxable	233	194
Other	81	86
Total interest income	7,860	7,922
Interest Expense		
Deposits	1,004	986
Long-term/short-term borrowings and subordinated debentures	1,197	1,129
Total interest expense	2,201	2,115
Net interest income	5,659	5,807
Provision for loan losses	100	200
Net interest income after provision for loan losses	5,559	5,607
Non-interest Income		
Mortgage banking activities	470	201
Real estate commissions	107	260
Real estate management fees	158	254
Other	165	261
Total non-interest income	900	976
Non-Interest Expenses		
Compensation and related expenses	3,810	3,637
Occupancy	425	433
Legal	62	104
Foreclosed real estate, net	(65)	(53)
FDIC assessments and regulatory expense	318	352
Professional fees	266	191
Office supplies	57	93
Online charges	209	223
Credit report and appraisal fees	130	173
Other	381	553
Total non-interest expenses	5,593	5,706
Income before income tax provision	866	877
Income tax provision	1	10
Net income	$865	$867
Amortization of discount on preferred stock	(68)	(68)
Dividends on preferred stock	(527)	(493)
Net income available to common stockholders	$270	$306

Basic income per share	$0.03	$0.03
Diluted income per share	$0.03	$0.03

The accompanying notes to consolidated financial statements are an integral part of these statements.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)
(dollars in thousands, except per share data)

Three Months Ended March 31, 2015

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
Balance - December 31, 2014	$ 4	$ 101	$ 75,848	$ 7,857	$ 83,810
Net Income	-	-	-	865	865
Exercise of stock options (20,500 shares)	-	-	93	-	93
Stock-based compensation	-	-	34	-	34
Dividend declared on Series B preferred stock	-	-	-	(527)	(527)
Amortization of discount on Series B preferred stock	-	-	68	(68)	-
Balance – March 31, 2015	$ 4	$ 101	$ 76,043	$ 8,127	$ 84,275

Three Months Ended March 31, 2014

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
Balance - December 31, 2013	$ 4	$ 101	$ 75,374	$ 7,290	$ 82,769
Net Income	-	-	-	867	867
Stock-based compensation	-	-	59	-	59
Dividend declared on Series B preferred stock	-	-	-	(493)	(493)
Amortization of discount on Series B preferred stock	-	-	68	(68)	-
Balance – March 31, 2014	$ 4	$ 101	$ 75,501	$ 7,596	$ 83,202

The accompanying notes to consolidated financial statements are an integral part of these statements.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(dollars in thousands)

	For the Three Months Ended March 31, 2015	2014
Cash Flows from Operating Activities		
Net income	$865	$867
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization of deferred loan fees	(297)	(232)
Net amortization of premiums and discounts	91	48
Provision for loan losses	100	200
Provision for depreciation	280	283
Gain on sale of mortgage loans	(470)	(352)
Gain on sale of foreclosed real estate	(99)	(96)
Proceeds from loans sold to others	29,473	16,115
Loans originated for sale	(34,897)	(18,193)
Stock-based compensation expense	34	59
Decrease in accrued interest receivable and other assets	1,689	230
Increase in accrued interest payable and other liabilities	1,587	1,189
Net cash (used in) provided by operating activities	(1,644)	118
Cash Flows from Investing Activities		
Proceeds from maturing investment securities held to maturity	1,000	1,000
Principal collected on mortgage-backed securities held to maturity	606	78
Net decrease (increase) in loans	14,466	(916)
Proceeds from sale of foreclosed real estate	821	3,507
Investment in premises and equipment	(107)	(257)
Redemption of FHLB stock	353	299
Net cash provided by investing activities	17,139	3,711

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) CONTINUED
(dollars in thousands)

	For the Three Months Ended March 31,	
	2015	2014
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	2,721	(8,285)
Proceeds from exercise of options	93	-
Net cash provided by (used in) financing activities	2,814	(8,285)
Increase (decrease) in cash and cash equivalents	18,309	(4,456)
Cash and cash equivalents at beginning of year	33,335	98,376
Cash and cash equivalents at end of period	$51,644	$93,920
Supplemental disclosure of cash flows information:		
Cash paid during period for:		
Interest	$1,994	$1,992
Income taxes	$1	$7
Transfer of loans to foreclosed real estate	$986	$-

The accompanying notes to consolidated financial statements are an integral part of these statements.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 - Principles of Consolidation

The unaudited consolidated financial statements include the accounts of Severn Bancorp, Inc. (“Bancorp”), and its wholly-owned subsidiaries, SBI Mortgage Company and SBI Mortgage Company’s subsidiary, Crownsville Development Corporation, and its subsidiary, Crownsville Holdings I, LLC, and Severn Savings Bank, FSB (the “Bank”), and the Bank’s subsidiaries, Louis Hyatt, Inc., Homeowners Title and Escrow Corporation, Severn Financial Services Corporation, SSB Realty Holdings, LLC, SSB Realty Holdings II, LLC, and HS West, LLC. All intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Note 2 - Basis of Presentation

Bancorp follows accounting standards set by the Financial Accounting Standards Board, commonly referred to as the “FASB”. The FASB sets generally accepted accounting principles in the United States (“GAAP”) that Bancorp follows. References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC.

The accompanying unaudited consolidated financial statements have been prepared in accordance with GAAP for interim financial information and in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the disclosures required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the results of operations for the interim periods presented have been made. Such adjustments were of a normal recurring nature. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2015 or any other interim period. The unaudited consolidated financial statements for the three months ended March 31, 2015 should be read in conjunction with the audited consolidated financial statements and related notes, which were included in Bancorp’s Annual Report on Form 10-K for the fiscal year ended December 31, 2014. These consolidated financial statements consider events that occurred through the date the consolidated financial statements were issued.

Note 3 - Cash Flow Presentation

In the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal Home Loan Bank of Atlanta (“FHLB Atlanta”) overnight deposits, and federal funds sold. Generally, federal funds are sold for one-day periods.

Note 4 – Reclassifications

Amounts in the prior year’s consolidated financial statements have been reclassified whenever necessary to conform to the current year’s presentation. Such reclassifications had no impact on net income.

Note 5 - Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding for each period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by Bancorp relate to outstanding stock options, warrants, and convertible preferred stock, and are determined using the treasury stock method.

Not included in the diluted earnings per share calculation for the three month periods ended March 31, 2015 and March 31, 2014, because they were anti-dilutive, were 172,000 and 125,000 shares, respectively, of common stock issuable upon exercise of outstanding stock options, 556,976 shares of common stock issuable upon the exercise of a warrant and 437,500 shares of common stock issuable upon conversion of Bancorp's Series A Preferred Stock.

	Three Months Ended March 31,	
	2015	2014
Common shares – weighted average (basic)	10,070,796	10,066,679
Common share equivalents – weighted average	22,455	36,474
Common shares – diluted	10,093,251	10,103,153

Note 6 - Guarantees

Bancorp does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. See Note 10.

Note 7 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on Bancorp's consolidated financial statements.

Federal banking agencies have adopted proposals that have substantially amended the regulatory capital rules applicable to Bancorp and the Bank. The amendments implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. The amended rules establish new higher capital ratio requirements, narrow the definitions of capital, impose new operating restrictions on banking organizations with insufficient capital buffers and increase the risk weighting of certain assets. The amended rules were effective with respect to Bancorp and the Bank in January 2015, with certain requirements to be phased in beginning in 2016.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The following table presents the Bank's capital position:

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 7 - Regulatory Matters – Continued

	Actual at March 31 2015		Actual at December 31, 2014		To Be Well Capitalized Under Prompt Corrective Provisions	
Tangible (1)	14.0	%	13.8	%	N/	A
Tier 1 Capital (2)	19.5	%	19.4	%	8.0	%
Common Equity Tier 1 (2)	19.5	%	N/	A	6.5	%
Core (1)	14.0	%	13.8	%	5.0	%
Total Capital (2)	19.5	%	20.6	%	10.0	%

(1) To adjusted total assets.
(2) To risk-weighted assets.

On April 23, 2013, the Bank was notified by the Office of the Comptroller of the Currency (“OCC”) that the OCC established minimum capital ratios for the Bank requiring it to immediately maintain a Tier 1 Leverage Capital Ratio to Adjusted Total Assets of at least 10% and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least 15%. The Bank was in compliance with these requirements as of March 31, 2015.

Note 8 - Stock-Based Compensation

Bancorp has a stock-based compensation plan for directors, officers, and other key employees of Bancorp. The aggregate number of shares of common stock that may be issued with respect to the awards granted under the plan is 500,000 plus any shares forfeited under Bancorp’s old stock-based compensation plan. Under the terms of the stock-based compensation plan, Bancorp has the ability to grant various stock compensation incentives, including stock options, stock appreciation rights, and restricted stock. The stock-based compensation is granted under terms and conditions determined by the Compensation Committee of the Board of Directors. Under the stock-based compensation plan, stock options generally have a maximum term of ten years, and are granted with an exercise price at least equal to the fair market value of the common stock on the date the options are granted. Generally, options granted to directors of Bancorp vest immediately, and options granted to officers and employees vest over a five-year period, although the Compensation Committee has the authority to provide for different vesting schedules.

Bancorp follows FASB ASC 718, “Compensation – Stock Compensation”, to account for stock-based compensation. FASB ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the statement of operations at fair value. FASB ASC 718 requires an entity to recognize the expense of employee services received in share-based payment transactions and measure the expense based on the grant date fair value of the award. The expense is recognized over the period during which an employee is required to provide service in exchange for the award.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 8 - Stock-Based Compensation - Continued

There were no options granted during the three months ended March 31, 2015 and 2014.

Stock-based compensation expense for the three months ended March 31, 2015 and 2014 totaled $34,000 and $59,000, respectively. There were 20,500 options exercised during the three months ended March 31, 2015 and no options exercised the three months ended March 31, 2014.

Information regarding Bancorp's stock-based compensation plan as of and for the three months ended March 31, 2015 is as follows:

	2015	
	Shares	Weighted Average Price
Options outstanding, December 31, 2014	328,200	$ 4.33
Options granted	-	-
Options exercised	(20,500)	$ 4.53
Options forfeited	(49,400)	$ 4.13
Options outstanding, March 31, 2015	258,300	$ 4.36
Options exercisable, March 31, 2015	75,901	$ 4.12

The aggregate intrinsic value of the options outstanding as of March 31, 2015 and December 31, 2014 was $162,694 and $122,160, respectively. The aggregate intrinsic value of the options exercisable as of March 31, 2015 and December 31, 2014 was $65,000 and $60,000 respectively.

The following table summarizes the nonvested options in Bancorp's stock option plan as of March 31, 2015.

	Shares	Weighted Average Grant Date Exercise Price
Nonvested options outstanding, December 31, 2014	198,505	$ 4.44
Nonvested options granted	-	-
Nonvested options vested	(16,106)	$ 4.34
Nonvested options forfeited	-	-
Nonvested options outstanding, March 31, 2015	182,399	$ 4.45

As of March 31, 2015, there was $493,000 of total unrecognized stock-based compensation expense related to nonvested stock options, which is expected to be recognized over a period of fifty-five months.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 9 - Investment Securities

The amortized cost and fair value of investment securities held to maturity are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2015:				
US Treasury securities	$ 26,118	$ 543	$ -	$ 26,661
US Agency securities	17,029	266	-	17,295
US Government sponsored mortgage-backed securities	14,772	132	-	14,904
Total	$ 57,919	$ 941	$ -	$ 58,860
December 31, 2014:				
US Treasury securities	$ 27,140	$ 465	$ 29	$ 27,576
US Agency securities	17,044	130	57	17,117
US Government sponsored mortgage-backed securities	15,432	48	50	15,430
Total	$ 59,616	$ 643	$ 136	$ 60,123

As of March 31, 2015 and December 31, 2014, there were $4,239,000 and $4,244,000, respectively, of US Treasury securities or mortgage-backed securities pledged by Bancorp as collateral for borrowers' letters of credit with Anne Arundel County.

There were no securities in a gross unrealized loss position at March 31, 2015. The following table shows fair value and unrealized losses, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2014. Seven US Treasury securities, ten Agency securities and five Mortgage-backed securities were in a gross unrealized loss position at December 31, 2014. Management believes that the unrealized losses in 2014 were the result of interest rate levels differing from those existing at the time of purchase of the securities and actual and estimated prepayment speeds. The Bank does not consider any of these securities to be other than temporarily impaired at December 31, 2014, because the unrealized losses were related primarily to changes in market interest rates and widening of sector spreads and were not necessarily related to the credit quality of the issuers of the securities.

In addition, the Bank does not intend to sell, nor does it believe it will be more likely than not that it will be required to sell, any impaired securities prior to a recovery of amortized cost.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 9 - Investment Securities – Continued

	Less than 12 months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014:	(dollars in thousands)					
US Treasury securities	$6,953	$ 29	$ -	$ -	$6,953	$ 29
US Agency securities	10,024	57	-	-	10,024	57
US Government sponsored mortgage-backed securities	13,405	50	-	-	13,405	50
Total	$30,382	$ 136	$ -	$ -	$30,382	$ 136

The amortized cost and estimated fair value of debt securities at March 31, 2015, by contractual maturity are shown in the following table. Actual maturities may differ from contractual maturities, because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Held to Maturity (dollars in thousands)	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$7,021	$ 7,082
Due from one year to five years	33,208	33,723
Due from five years to ten years	2,918	3,151
US Government sponsored mortgage-backed securities	14,772	14,904
	$57,919	$ 58,860

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable

Loans receivable, included unfunded commitments consist of the following:

	March 31 2015	December 31 2014
	(dollars in thousands)	
Residential mortgage, total	$309,904	$309,461
Individually evaluated for impairment	28,880	28,535
Collectively evaluated for impairment	281,024	280,926
Construction, land acquisition and development, total	81,418	84,325
Individually evaluated for impairment	919	917
Collectively evaluated for impairment	80,499	83,408
Land, total	30,043	30,426
Individually evaluated for impairment	1,948	2,039
Collectively evaluated for impairment	28,095	28,387
Lines of credit, total	17,651	19,251
Individually evaluated for impairment	453	454
Collectively evaluated for impairment	17,198	18,797
Commercial real estate, total	185,367	198,539
Individually evaluated for impairment	4,462	6,309
Collectively evaluated for impairment	180,905	192,230
Commercial non-real estate, total	10,042	10,167
Individually evaluated for impairment	269	274
Collectively evaluated for impairment	9,773	9,893
Home equity, total	26,233	28,750
Individually evaluated for impairment	3,147	3,551
Collectively evaluated for impairment	23,086	25,199
Consumer, total	990	1,040
Individually evaluated for impairment	12	12
Collectively evaluated for impairment	978	1,028
Total Loans	661,648	681,959
Less		
Unfunded commitments included above	(31,429)	(36,162)
	630,219	645,797
Individually evaluated for impairment	40,090	42,091
Collectively evaluated for impairment	590,129	603,706
	630,219	645,797

Allowance for loan losses	(8,964)	(9,435)
Deferred loan origination fees and costs, net	(2,628)	(2,480)
Net Loans	$618,627	$633,882

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Note 10 – Loans Receivable - Continued

The inherent credit risks within the portfolio vary depending upon the loan class as follows:

Residential mortgage loans are secured by one to four family dwelling units. The loans have limited risk as they are secured by first mortgages on the unit, which are generally the primary residence of the borrower, at a loan to value ratio of 80% or less.

Construction, land acquisition and development loans are underwritten based upon a financial analysis of the developers and property owners and construction cost estimates, in addition to independent appraisal valuations. These loans will rely on the value associated with the project upon completion. These cost and valuation estimates may be inaccurate. Construction loans generally involve the disbursement of substantial funds over a short period of time with repayment substantially dependent upon the success of the completed project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank is forced to foreclose on a project prior to or at completion, due to a default, there can be no assurance that the Bank will be able to recover all of the unpaid balance of the loan as well as related foreclosure and holding costs. In addition, the Bank may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time. Sources of repayment of these loans typically are permanent financing expected to be obtained upon completion or sales of developed property. These loans are closely monitored by onsite inspections and are considered to be of a higher risk than other real estate loans due to their ultimate repayment being sensitive to general economic conditions, availability of long-term financing, interest rate sensitivity, and governmental regulation of real property.

Land loans are underwritten based upon the independent appraisal valuations as well as the estimated value associated with the land upon completion of development. These cost and valuation estimates may be inaccurate. These loans are considered to be of a higher risk than other real estate loans due to their ultimate repayment being sensitive to general economic conditions, availability of long-term financing, interest rate sensitivity, and governmental regulation of real property.

Line of credit loans are subject to the underwriting standards and processes similar to commercial non-real estate loans, in addition to those underwriting standards for real estate loans. These loans are viewed primarily as cash flow dependent and secondarily as loans secured by real-estate and/or other assets. Repayment of these loans is generally dependent upon the successful operation of the property securing the loan or the principal business conducted on the property securing the loan. Line of credit loans may be adversely affected by conditions in the real estate markets or the economy in general. Management monitors and evaluates line of credit loans based on collateral and risk-rating criteria.

Commercial real estate loans are subject to the underwriting standards and processes similar to commercial and industrial loans, in addition to those underwriting standards for real-estate loans. These loans are viewed primarily as cash flow dependent and secondarily as loans secured by real estate. Repayment of these loans is generally dependent upon the successful operation of the property securing the loan or the principal business conducted on the property securing the loan. Commercial real estate loans may be adversely affected by conditions in the real estate markets or the economy in general. Management monitors and evaluates commercial real estate loans based on collateral and risk-rating criteria. The Bank also utilizes third-party experts to provide environmental and market valuations. The nature of commercial real estate loans makes them more difficult to monitor and evaluate.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 – Loans Receivable - Continued

Commercial non-real estate loans are underwritten after evaluating historical and projected profitability and cash flow to determine the borrower's ability to repay their obligation as agreed. Commercial and industrial loans are made primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral supporting the loan facility. Accordingly, the repayment of a commercial and industrial loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Home equity loans are subject to the underwriting standards and processes similar to residential mortgages and are secured by one to four family dwelling units. Home equity loans have greater risk than residential mortgages as a result of the Bank being in a second lien position in the event collateral is liquidated.

Consumer loans consist of loans to individuals through the Bank's retail network and are typically unsecured or secured by personal property. Consumer loans have a greater credit risk than residential loans because of the difference in the underlying collateral, if any. The application of various federal and state bankruptcy and insolvency laws may limit the amount that can be recovered on such loans.

The loan portfolio segments and loan classes disclosed above are the same because this is the level of detail management uses when the original loan is recorded and is the level of detail used by management to assess and monitor the risk and performance of the portfolio. Management has determined that this level of detail is adequate to understand and manage the inherent risks within each portfolio segment and loan class.

Allowance for Loan Losses - An allowance for loan losses is provided through charges to income in an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. Determining the amount of the allowance for loan losses requires the use of estimates and assumptions, which is permitted under GAAP. Actual results could differ significantly from those estimates. Management believes the allowance for losses on loans is adequate. While management uses available information to estimate losses on loans, future additions to the allowances may be necessary based on changes in economic conditions, particularly in the state of Maryland. In addition, various regulatory agencies, periodically review the Bank's allowance for losses on loans as an integral part of their examination process. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. When a real estate secured loan becomes impaired, a decision is made as to whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

Note 10 – Loans Receivable - Continued

For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

For such loans that are classified as impaired, an allowance is established when the current market value of the underlying collateral less its estimated disposal costs is lower than the carrying value of that loan. For loans that are not solely collateral dependent, an allowance is established when the present value of the expected future cash flows of the impaired loan is lower than the carrying value of that loan. The general component relates to loans that are classified as doubtful, substandard or special mention that are not considered impaired, as well as non-classified loans. The general reserve is based on historical loss experience adjusted for qualitative factors. These qualitative factors include:

- Levels and trends in delinquencies and nonaccruals;
- Inherent risk in the loan portfolio;
- Trends in volume and terms of the loan;
- Effects of any change in lending policies and procedures;
- Experience, ability and depth of management;
- National and local economic trends and conditions;
- Effect of any changes in concentration of credit; and
- Industry conditions.

A loan is considered impaired if it meets either of the following two criteria:

- Loans that are 90 days or more in arrears (nonaccrual loans); or
- Loans where, based on current information and events, it is probable that a borrower will be unable to pay all amounts due according to the contractual terms of the loan agreement.

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans classified as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

A loan is considered a troubled debt restructuring when for economic or legal reasons relating to the borrowers financial difficulties Bancorp grants a concession to the borrower that it would not otherwise consider. Loan modifications made with terms consistent with current market conditions that the borrower could obtain in the open market are not considered troubled debt restructurings.

Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Note 10 – Loans Receivable - Continued

With respect to all loan segments, management does not charge off a loan, or a portion of a loan, until one of the following conditions have been met:

- The loan has been foreclosed on. Once the loan has been transferred from the Loans Receivable to Foreclosed Real Estate, a charge off is recorded for the difference between the recorded amount of the loan and the net value of the underlying collateral.

- An agreement to accept less than the recorded balance of the loan has been made with the borrower. Once an agreement has been finalized, and any proceeds from the borrower are received, a charge off is recorded for the difference between the recorded amount of the loan and the net value of the underlying collateral.

- The loan is considered to be impaired collateral dependent and its collateral valuation is less than the recorded balance. The loan is written down for accounting purposes by the amount of the difference between the recorded balance and collateral value.

Prior to the above conditions, a loan is assessed for impairment when: (i) a loan becomes 90 days or more in arrears or (ii) based on current information and events, it is probable that the borrower will be unable to pay all amounts due according to the contractual terms of the loan agreement. If a loan is considered to be impaired, it is then determined to be either cash flow or collateral dependent. For a cash flow dependent loan, if based on management’s calculation of discounted cash flows, a reserve is needed, a specific reserve is recorded. That reserve is included in the Allowance for Loan Losses in the Consolidated Statement of Financial Condition.

Over the last several years, Bancorp has experienced an increase in the number of extension requests for commercial real estate and construction loans, some of which have related repayment guarantees. An extension may be granted to allow for the completion of the project, marketing or sales of completed units, or to provide for permanent financing, and is based on a re-underwriting of the loan and management's assessment of the borrower's ability to perform according to the agreed-upon terms. Typically, at the time of an extension, borrowers are performing in accordance with contractual loan terms. Extension terms generally do not exceed 12 to 18 months and typically require that the borrower provide additional economic support in the form of partial repayment, additional collateral or guarantees. In cases where the fair value of the collateral or the financial resources of the borrower are deemed insufficient to repay the loan, reliance may be placed on the support of a guarantee, if applicable. However, such guarantees are not relied on when evaluating a loan for impairment and never considered the sole source of repayment.

Bancorp evaluates the financial condition of guarantors based on the most current financial information available. Most often, such information takes the form of (i) personal financial statements of net worth, cash flow statements and tax returns (for individual guarantors) and (ii) financial and operating statements, tax returns and financial projections (for legal entity guarantors). Bancorp’s evaluation is primarily focused on various key financial metrics, including net worth, leverage ratios, and liquidity. It is Bancorp's policy to update such information annually, or more frequently as warranted, over the life of the loan.

Note 10 – Loans Receivable – Continued

While Bancorp does not specifically track the frequency with which it has pursued guarantor performance under a guarantee, its underwriting process, both at origination and upon extension, as applicable, includes an assessment of the guarantor's reputation, creditworthiness and willingness to perform. Historically, when Bancorp has found it necessary to seek performance under a guarantee, it has been able to effectively mitigate its losses. As stated above, Bancorp’s ability to seek performance under a guarantee is directly related to the guarantor's reputation, creditworthiness and willingness to perform. When a loan becomes impaired, repayment is sought from both the underlying collateral and the guarantor (as applicable). In the event that the guarantor is unwilling or unable to perform, a legal remedy is pursued.

Construction loans are funded, at the request of the borrower, typically not more than once per month, based on the extent of work completed, and are monitored, throughout the life of the project, by independent professional construction inspectors and Bancorp's commercial real estate lending department. Interest is advanced to the borrower, upon request, based upon the progress of the project toward completion. The amount of interest advanced is added to the total outstanding principal under the loan commitment. Should the project not progress as scheduled, the adequacy of the interest reserve necessary to carry the project through to completion is subject to close monitoring by management. Should the interest reserve be deemed to be inadequate, the borrower is required to fund the deficiency. Similarly, once a loan is fully funded, the borrower is required to fund all interest payments.

Construction loans are reviewed for extensions upon expiration of the loan term. Provided the loan is performing in accordance with contractual terms, extensions may be granted to allow for the completion of the project, marketing or sales of completed units, or to provide for permanent financing. Extension terms generally do not exceed 12 to 18 months.

In general, Bancorp's construction loans are used to finance improvements to commercial, industrial or residential property. Repayment is typically derived from the sale of the property as a whole, the sale of smaller individual units, or by a take-out from a permanent mortgage. The term of the construction period generally does not exceed two years. Loan commitments are based on established construction budgets which represent an estimate of total costs to complete the proposed project including both hard (direct) costs (building materials, labor, etc.) and soft (indirect) costs (legal and architectural fees, etc.). In addition, project costs may include an appropriate level of interest reserve to carry the project through to completion. If established, such interest reserves are determined based on (i) a percentage of the committed loan amount, (ii) the loan term, and (iii) the applicable interest rate. Regardless of whether a loan contains an interest reserve, the total project cost statement serves as the basis for underwriting and determining which items will be funded by the loan and which items will be funded through borrower equity. Bancorp has not advanced additional interest reserves to keep a loan from becoming nonperforming.

Bancorp recognized $57,000 and $5,000 of interest income and capitalized interest in its loan portfolio from interest reserves during the three months ended March 31, 2015 and 2014, respectively. None of the loans where interest reserves were recorded as capitalized interest were non-performing.

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Note 10 - Loans Receivable - Continued

The following is a summary of the allowance for loan losses for the three month periods ended March 31, 2015 and 2014 (dollars in thousands):

	Total	Residential Mortgage	Construction Acquisition Development	Land	Lines of Credit	Commercial Real Estate	Commercial Non-Real Estate	Home Equity	Consumer
Three months March 2015									
Beginning Balance	$9,435	$4,664	$362	$646	$12	$2,504	$280	$963	$4
Provision	100	(22)	6	(308)	(5)	294	78	58	(1)
Charge-offs	(626)	(168)	-	-	-	-	(1)	(457)	-
Recoveries	55	17	-	-	10	-	25	3	-
Ending Balance	$8,964	$4,491	$368	$338	$17	$2,798	$382	$567	$3
Ending balance related to:									
Allowance on loans individually evaluated for impairment	$2,254	$1,969	$-	$49	$-	$220	$14	$-	$2
Allowance on loans collectively evaluated for impairment	$6,710	$2,522	$368	$289	$17	$2,578	$368	$567	$1
Three months March 2014									
Beginning Balance	$11,739	$6,282	$411	$1,345	$35	$2,527	$135	$1,002	$2
Provision	200	(161)	196	(176)	2	349	43	(53)	-
Charge-offs	(752)	(587)	-	-	-	-	(1)	(164)	-
Recoveries	38	11	-	-	-	25	2	-	-
Ending Balance	$11,225	$5,545	$607	$1,169	$37	$2,901	$179	$785	$2
Ending balance related to:									
Allowance on loans individually evaluated for impairment	$2,546	$2,245	$-	$64	$-	$237	$-	$-	$-
Allowance on loans collectively evaluated for impairment	$8,679	$3,300	$607	$1,105	$37	$2,664	$179	$785	$2

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SEVERN BANCORP, INC. AND SUBSIDIARIES
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The accrual of interest on loans is discontinued at the time the loan is 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Bancorp's policy for recording payments received on non-accrual financing receivables is to record the payment towards principal and interest on a cash basis until such time as the loan is returned to accrual status.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The following tables summarize impaired loans at March 31, 2015 and December 31, 2014 (dollars in thousands):

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
March 31, 2015					
Residential mortgage	$13,626	$ 1,969	$ 15,254	$28,880	$29,765
Construction, acquisition and development	-	-	919	919	919
Land	353	49	1,595	1,948	2,065
Lines of credit	-	-	453	453	545
Commercial real estate	2,513	220	1,949	4,462	4,580
Commercial non-real estate	269	14	-	269	269
Home equity	-	-	3,147	3,147	4,109
Consumer	12	2	-	12	12
Total impaired loans	$16,773	$ 2,254	$ 23,317	$40,090	$40,264

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
December 31, 2014					
Residential mortgage	$14,094	$ 2,113	$ 14,441	$28,535	$29,487
Construction, acquisition and development	-	-	917	917	917
Land	355	53	1,684	2,039	2,157
Lines of credit	-	-	454	454	545
Commercial real estate	2,529	224	3,780	6,309	6,533
Commercial non-real estate	274	15	-	274	274
Home equity	1,472	370	2,079	3,551	4,274
Consumer	12	2	-	12	12
Total impaired loans	$18,736	$ 2,777	$ 23,355	$42,091	$44,199

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Note 10 - Loans Receivable - Continued

The following tables summarize average impaired loans for the three month periods ended March 31, 2015 and 2014 (dollars in thousands):

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance		Total Impaired Loans	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Three months ended March 31, 2015						
Residential mortgage	$13,648	$ 136	$15,343	$ 148	$28,991	$ 284
Construction, acquisition and development	-	-	1,157	9	1,157	9
Land	354	3	1,676	22	2,030	25
Lines of credit	-	-	454	13	454	13
Commercial real estate	2,518	31	1,953	40	4,471	71
Commercial non-real estate	270	2	-	13	270	15
Home equity	352	-	3,077	38	3,429	38
Consumer	12	-	-	-	12	-
Total impaired loans	17,154	$ 172	$23,660	$ 283	$40,814	$ 455

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance		Total Impaired Loans	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Three months ended March 31, 2014						
Residential mortgage	$15,076	$ 167	$18,702	$ 225	$33,778	$ 392
Construction, acquisition and development	-	-	2,735	19	2,735	19
Land	362	3	1,187	14	1,549	17
Lines of credit	-	-	1,937	20	1,937	20
Commercial real estate	2,083	29	4,157	68	6,240	97
Commercial non-real estate	-	-	530	7	530	7
Home equity	-	-	1,732	15	1,732	15
Consumer	-	-	-	-	-	-
Total impaired loans	17,521	$ 199	$30,980	$ 368	$48,501	$ 567

Note 10 - Loans Receivable - Continued

Bancorp recognized $455,000 and $567,000 of interest income on impaired loans using a cash-basis method of accounting for the three months ended March 31, 2015 and 2014, respectively. Bancorp did not record any interest income attributable to the change in present value due to the passage of time. Bancorp evaluates its impaired loans and assesses them based on either discounted cash flows or if it deems its loans to be collateral based, assesses impairment based on the net value of the underlying collateral.

Included in the above impaired loans amount at March 31, 2015 was $26,773,000 of loans that are not in non-accrual status. In addition, there was a total of $28,880,000 of residential real estate loans included in impaired loans at March 31, 2015, of which $24,040,000 were to consumers and $4,840,000 to builders. The collateral supporting impaired collateral dependent loans is individually reviewed by management to determine its estimated fair market value, less estimated disposal cost and a charge off is taken, if necessary, for the difference between the carrying amount of any loan and the estimated fair value of the collateral less estimated disposal cost.

Note 10 - Loans Receivable - Continued

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of March 31, 2015 and December 31, 2014. Included in the Pass column were $31,429,000 and $36,162,000 in unfunded commitments at March 31, 2015 and December 31, 2014, respectively (dollars in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
March 31, 2015					
Residential mortgage	$291,830	$2,825	$ 15,249	$ -	$309,904
Construction, acquisition and development	79,780	-	1,638	-	81,418
Land	29,903	-	140	-	30,043
Lines of credit	14,486	2,449	716	-	17,651
Commercial real estate	168,981	6,868	9,518	-	185,367
Commercial non-real estate	9,421	621	-	-	10,042
Home equity	23,404	-	2,829	-	26,233
Consumer	935	-	55	-	990
Total loans	$618,740	$12,763	$ 30,145	$ -	$661,648

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2014					
Residential mortgage	$295,589	$1,331	$ 12,541	$ -	$309,461
Construction, acquisition and development	82,778	-	1,547	-	84,325
Land	30,285	-	141	-	30,426
Lines of credit	16,112	2,479	660	-	19,251
Commercial real estate	181,686	7,172	9,681	-	198,539
Commercial non-real estate	9,275	637	255	-	10,167
Home equity	25,769	-	2,981	-	28,750
Consumer	985	-	55	-	1,040
Total loans	$642,479	$11,619	$ 27,861	$ -	$681,959

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Note 10 - Loans Receivable - Continued

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. Included in the Current column were $31,429,000 and $36,162,000 in unfunded commitments at March 31, 2015 and December 31, 2014, respectively. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of March 31, 2015 and December 31, 2014 (dollars in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Non-Accrual
March 31, 2015							
Residential mortgage	$1,737	$1,937	$1,951	$5,625	$304,279	$309,904	$7,085
Construction, acquisition and development	-	-	-	-	81,418	81,418	116
Land	-	101	6	107	29,936	30,043	820
Lines of credit	66	238	-	304	17,347	17,651	388
Commercial real estate	406	-	-	406	184,961	185,367	274
Commercial non-real estate	125	-	-	125	9,917	10,042	1,768
Home equity	-	188	1,769	1,957	24,276	26,233	2,866
Consumer	-	-	-	-	990	990	-
Total loans	$2,334	$2,464	$3,726	$8,524	$653,124	$661,648	$13,317

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Non-Accrual
December 31, 2014							
Residential mortgage	$2,549	$2,333	$3,095	$7,977	$301,484	$309,461	$6,052
Construction, acquisition and development	-	-	-	-	84,325	84,325	115
Land	-	-	6	6	30,420	30,426	847
Lines of credit	-	-	-	-	19,251	19,251	388
Commercial real estate	447	45	375	867	197,672	198,539	652
Commercial non-real estate	-	-	-	-	10,167	10,167	1,775
Home equity	174	242	2,417	2,833	25,917	28,750	3,016
Consumer	-	-	-	-	1,040	1,040	-
Total loans	$3,170	$2,620	$5,893	$11,683	$670,276	$681,959	$12,845

Bancorp does not have any greater than 90 days and still accruing loans as of the periods ended March 31, 2015 and December 31, 2014.

Note 10 - Loans Receivable - Continued

Bancorp offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories:

- Rate Modification – A modification in which the interest rate is changed.
- Term Modification – A modification in which the maturity date, timing of payments or frequency of payments is changed.
- Interest Only Modification – A modification in which the loan is converted to interest only payments for a period of time.
- Payment Modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification above.
- Loan Balance Modification – A modification in which a portion of the outstanding loan balance is forgiven.
- Combination Modification – Any other type of modification, including the use of multiple categories above.

Bancorp has not purchased, sold or reclassified any loans to held for sale during the periods discussed. Only loans originated specifically for sale are recorded as held for sale at the period ended March 31, 2015 and December 31, 2014.

Bancorp considers a modification of a loan term a troubled debt restructuring or "TDR" if Bancorp for economic or legal reasons related to the borrower's financial difficulties grants a concession to the debtor that it would not otherwise consider. Prior to entering into a loan modification, Bancorp assesses the borrower's financial condition to determine if the borrower has the means to meet the terms of the modification. This includes obtaining a credit report on the borrower as well as the borrower's tax returns and financial statements.

There were 84 restructured loans at March 31, 2015 totaling $28,795,000, of which 75 loans totaling $26,175,000 were performing as agreed. Of those performing loans, 60 loans totaling $22,343,000 have not been late on a payment during the last 2 years.

There were 85 restructured loans at December 31, 2014 totaling $30,365,000, of which 76 loans totaling $27,724,000 were performing as agreed.

In the first quarter of 2015 and 2014 there were no TDR's that subsequently defaulted during the 12 month period ended March 31, 2015 and 2014.

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Note 10 - Loans Receivable - Continued

The following table presents loans that were restructured during the three months ended March 31, 2015 (dollars in thousands):

	Three months ended March 31, 2015					
	Rate Modification	Contracts	Combination Modifications	Contracts	Total	Total Contracts
Pre-Modification Outstanding Recorded Investment:						
Residential mortgage	-	-	$ 91	1	$ 91	1
Construction, acquisition and development	-	-	-	-	-	-
Land	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial non-real estate	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total loans	-	-	$ 91	1	$ 91	1

Post-Modification Outstanding Recorded Investment:						
Residential mortgage	-	-	$91	1	$91	1
Construction, acquisition and development	-	-	-	-	-	-
Land	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-
Commercial non-real estate	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total loans	-	-	$91	1	$91	1

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Note 10 - Loans Receivable - Continued

The following table presents restructured loans that occurred during the three months ended March 31, 2014 (dollars in thousands):

	Three months ended March 31, 2014					
	Rate Modification	Contracts	Combination Modifications	Contracts	Total	Total Contracts
Pre-Modification Outstanding Recorded Investment:						
Residential mortgage	-	-	$ 598	2	$598	2
Construction, acquisition and development	-	-	-	-	-	-
Land	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-
Commercial real estate	-	-	351	1	351	1
Commercial non-real estate	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total loans	-	-	$ 949	3	$949	3
Post-Modification Outstanding Recorded Investment:						
Residential mortgage	-	-	$446	2	$446	2
Construction, acquisition and development	-	-	-	-	-	-
Land	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-
Commercial real estate	-	-	345	1	345	1
Commercial non-real estate	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total loans	-	-	$791	3	$791	3

In addition, the TDR is evaluated for impairment. A determination is made as to whether an impaired TDR is cash flow or collateral dependent. If the TDR is cash flow dependent, an allowance for loan losses specific reserve is calculated based on the difference in net present value of future cash flows between the original and modified loan terms. If the TDR is collateral dependent, the collateral securing the TDR, which is always real estate, is evaluated for impairment based on either an appraisal or broker price opinion. If a TDR’s collateral valuation is less than its current loan balance, the TDR is written down for accounting purposes by the amount of the difference between the current loan balance and the collateral value. If the borrower performs under the terms of the modification, generally six consecutive months, and the ultimate collectability of all amounts contractually due under the modified terms is not in doubt, the loan is returned to accrual status. There are no loans that have been modified due to the financial difficulties of the borrower that are not considered a TDR. There were no TDR defaults during the quarters ended March 31, 2015 and 2014.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

Interest on TDRs was accounted for under the following methods as of March 31, 2015 and December 31, 2014 (dollars in thousands):

	Number of Contracts	Accrual Status	Number of Contracts	Non-Accrual Status	Total Number of Contracts	Total Modifications
March 31, 2015						
Residential mortgage	57	$21,730	5	$2,382	62	$ 24,112
Construction, acquisition and development	2	802	-	-	2	802
Land	5	973	1	6	6	979
Lines of credit	-	-	-	-	-	-
Commercial real estate	5	2,513	1	108	6	2,621
Commercial non-real estate	5	145	2	124	7	269
Home equity	-	-	-	-	-	-
Consumer	1	12	-	-	1	12
Total loans	75	$26,175	9	$2,620	84	$ 28,795
December 31, 2014						
Residential mortgage	57	$22,154	5	$2,402	62	$ 24,556
Construction, acquisition anddevelopment	2	803	-	-	2	803
Land	5	982	1	6	6	988
Lines of credit	-	-	-	-	-	-
Commercial real estate	6	3,623	1	109	7	3,732
Commercial non-real estate	5	150	2	124	7	274
Home equity	-	-	-	-	-	-
Consumer	1	12	-	-	1	12
Total loans	76	$27,724	9	$2,641	85	$ 30,365

Unless otherwise noted, the Bank requires collateral or other security to support financial instruments with off-balance-sheet credit risk (dollars in thousands).

Financial Instruments Whose Contract	Contract Amount At	
Amounts Represent Credit Risk	March 31, 2015	December 31, 2014
Standby letters of credit	$6,751	$ 7,357
Home equity lines of credit	8,310	8,571
Unadvanced construction commitments	31,429	36,162
Mortgage loan commitments	345	2,120
Lines of credit	24,570	23,844
Loans sold with limited repurchase provisions	41,022	38,247

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Note 10 - Loans Receivable - Continued

Standby letters of credit are conditional commitments issued by the Bank guaranteeing performance by a customer to various municipalities. These guarantees are issued primarily to support performance arrangements, limited to real estate transactions. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of March 31, 2015 and December 31, 2014 for guarantees under standby letters of credit issued was $115,000 and $314,000, respectively.

Home equity lines of credit are loan commitments to individuals as long as there is no violation of any condition established in the contract. Commitments under home equity lines expire ten years after the date the loan closes and are secured by real estate. The Bank evaluates each customer's credit worthiness on a case-by-case basis.

Unadvanced construction commitments are loan commitments made to borrowers for both residential and commercial projects that are either in process or are expected to begin construction shortly.

Mortgage loan commitments not reflected in the accompanying statements of financial condition at March 31, 2015 included $345,000 at a fixed range of 3.875% to 4.00% and none at floating interest rates and at December 31, 2014 included $2,120,000 at a fixed interest rate range of 3.750% to 4.50% and none at floating interest rates.

Lines of credit are loan commitments to individuals and companies as long as there is no violation of any condition established in the contract. Lines of credit have a fixed expiration date. The Bank evaluates each customer's credit worthiness on a case-by-case basis.

The Bank has entered into several agreements to sell mortgage loans to third parties. The loans sold under these agreements for the three month period ended March 31, 2015 and year ended December 31, 2014 were $29,003,000 and $90,560,000, respectively. These agreements contain limited provisions that require the Bank to repurchase a loan if the loan becomes delinquent within the terms specified by the agreement. The credit risk involved in these financial instruments is essentially the same as that involved in extending loan facilities to customers.

Only loans originated specifically for sale are recorded as held for sale at the period ended March 31, 2015 and December 31, 2014.

No amount was recognized in the consolidated statement of financial condition at March 31, 2015 and December 31, 2014 as a liability for credit loss related to these loans.

Except for the liability recorded for standby letters of credit at March 31, 2015, liabilities for credit loss associated with these commitments were not material at March 31, 2015 and December 31, 2014.

Note 11 - Fair Values of Financial Instruments

A fair value hierarchy that prioritizes the inputs to valuation methods is used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair market hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following information should not be interpreted as an estimate of the fair value of Bancorp since a fair value calculation is only provided for a limited portion of Bancorp's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between Bancorp's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of Bancorp's financial instruments at March 31, 2015 and December 31, 2014.

Impaired Loans:
Impaired loans are carried at the lower of cost or the present value of expected future cash flows of the loan. If it is determined that the repayment of the loan will be provided solely by the underlying collateral, and there are no other available and reliable sources of repayment, the loan is considered collateral dependent. Impaired loans that are considered collateral dependent are carried at the lower of cost or the fair value of the underlying collateral. Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. The use of independent appraisals and management's best judgment are significant inputs in arriving at the fair value measure of the underlying collateral and impaired loans are therefore classified within level 3 of the fair value hierarchy.

For such loans that are classified as impaired, an allowance is established when the present value of the expected future cash flows of the impaired loan is lower than the carrying value of that loan. For such loans that are classified as collateral dependent impaired loans, an allowance is established when the current market value of the underlying collateral less its estimated disposal costs has not been finalized, but management determines that it is likely that the value is lower than the carrying value of that loan. Once the net collateral value has been determined, a charge-off is taken for the difference between the net collateral value and the carrying value of the loan.

Impaired loans are those for which Bancorp has measured impairment based on the present value of expected future cash flows or on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consisted of the loan balances of $16,773,000 and $18,736,000 at March 31, 2015 and December 31, 2014, respectively, less their valuation allowances of $2,254,000 and $2,777,000 at March 31, 2015 and December 31, 2014, respectively.

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Note 11 - Fair Values of Financial Instruments - Continued

Foreclosed Real Estate:
Real estate acquired through foreclosure is included in the following disclosure at the lower of carrying value or fair value less estimated disposal costs. Management periodically evaluates the recoverability of the carrying value of the real estate acquired through foreclosure using current estimates of fair value. In the event of a subsequent decline, management provides a specific allowance to reduce real estate acquired through foreclosure to fair value less estimated disposal cost. Expenses incurred on foreclosed real estate prior to disposition are charged to expense. Gains or losses on the sale of foreclosed real estate are recognized upon disposition of the property.

Foreclosed real estate totaled $2,211,000 and $1,947,000 as of March 31, 2015 and December 31, 2014, respectively. The carrying value of foreclosed residential real estate included within foreclosed real estate totaled $959,000 and $695,000 as of March 31, 2015 and December 31, 2014, respectively.

Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdiction totaled $3,943,000 as of March 31, 2015.

Note 11 - Fair Values of Financial Instruments - Continued

The following table sets forth financial assets that were accounted for at fair value on a nonrecurring and recurring basis by level within the fair value hierarchy as of March, 31, 2015 and December 31, 2014:

		March 31, 2015 Fair Value Measurement Using:		
	March 31, 2015	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(dollars in thousands)			
Nonrecurring fair value measurements				
Impaired loans	$14,519	$-	$ -	$ 14,519
Foreclosed real estate	2,211	-	-	2,211
Total nonrecurring fair value measurements	$16,730	$-	$ -	$ 16,730
Recurring fair value measurements				
Mortgage servicing rights	$619	$-	$ -	$ 619
Rate lock commitments	$7	$-	$ 7	$
Mandatory forward contracts	$(27)	$-	$ (27)	$
Total recurring fair value measurements	$599	$-	$ (20)	$ 619

		December 31, 2014 Fair Value Measurement Using:		
	December 31, 2014	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(dollars in thousands)			
Nonrecurring fair value measurements				
Impaired loans	$15,959	$-	$ -	$ 15,959
Foreclosed real estate	1,947	-	-	1,947

Total nonrecurring fair value measurements	$17,906	$-	$ -	$ 17,906
Recurring fair value measurements				
Mortgage servicing rights	$658	$-		$ 658
Rate lock commitments	$139	$-	$ 139	$
Mandatory forward contracts	$(59)	$-	$ (59)	$
Total recurring fair value measurements	$738	$-	$ 80	$ 658

There were no liabilities that were required to be re-measured on a nonrecurring basis at March 31, 2015 or December 31, 2014.

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Note 11 - Fair Values of Financial Instruments - Continued

The following table presents additional quantitative information about assets measured at fair value on a recurring basis and for which Bancorp has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
March 31, 2015					
Mortgage servicing rights	$619	Market approach	Weighted average prepayment speed	9.89	%
December 31, 2014					
Mortgage servicing rights	$658	Market approach	Weighted average prepayment speed	8.81	%

All appraisals are reviewed by the credit department; however, no modifications or adjustments are made to the appraisals received.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which Bancorp has utilized Level 3 inputs to determine fair value:

	Quantitative Information about Level 3 Fair Value Measurements				
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
March 31, 2015					
Impaired loans	$14,519	PV of future cash flows (1)	Discount rate	-6.00	%
	$-	Appraisal of collateral (2)	Liquidation expenses (3)	-6.00	%
Foreclosed real estate	$2,211	Appraisal of collateral (2),(4)	Appraisal adjustments (3)	-6.74% to -100% (-18.17%)	
December 31, 2014					
Impaired loans	$15,589	PV of future cash flows (1)	Discount rate	-6.00	%
	$370	Appraisal of collateral (2)	Liquidation expenses (3)	-6.00	%
Foreclosed real estate	$1,947	Appraisal of collateral (2),(4)	Appraisal adjustments (3)	-6.51% to -100% (-13.94%)	

(1) Cash flow which generally includes various level 3 inputs which are not identifiable.

(2) Fair value is generally determined through independent appraisals for the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(3) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

(4) Includes qualitative adjustments by management and estimated liquidation expenses.

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SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 11 - Fair Values of Financial Instruments – Continued

The estimated fair values of Bancorp's financial instruments as of March 31, 2015 and December 31, 2014 were as follows:

	Carrying Amount	Fair Value	Fair Value Measurement at March 31, 2015 Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets	(dollars in thousands)				
Cash and cash equivalents	$51,644	$51,644	$51,644	$ -	$ -
Investment securities (HTM)	57,919	58,860	-	58,860	-
Loans held for sale	13,059	13,225	-	13,225	-
Loans receivable, net	618,627	635,567	-	-	635,567
FHLB stock	5,583	5,583	-	5,583	-
Accrued interest receivable	2,315	2,315	-	2,315	-
Mortgage servicing rights	619	619	-	-	619
Rate lock commitments	7	7	-	7	-
Financial Liabilities					
Deposits	$546,535	$547,045	-	547,045	-
FHLB advances	115,000	108,743	-	108,743	-
Subordinated debentures	24,119	24,119	-	-	24,119
Accrued interest payable	2,343	2,343	-	2,343	-
Mandatory forward contracts	27	27	-	27	-
Off Balance Sheet Commitments	$-	$-	$-	$ -	$ -

	Carrying Amount	Fair Value	Fair Value Measurement At December 31, 2014 Quoted Prices in Active Markets For Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

			(Level 1)		
Financial Assets	(dollars in thousands)				
Cash and cash equivalents	$33,335	$33,335	$33,335	$ -	$ -
Investment securities (HTM)	59,616	60,123	-	60,123	-
Loans held for sale	7,165	7,211	-	7,211	-
Loans receivable, net	633,882	636,696	-	-	636,696
FHLB stock	5,936	5,936	-	5,936	-
Accrued interest receivable	2,297	2,297	-	2,297	-
Mortgage servicing rights	658	658	-	-	658
Rate lock commitments	139	139	-	139	-
Financial Liabilities					
Deposits	$543,814	$544,751	-	544,751	-
FHLB advances	115,000	108,859	-	108,859	-
Subordinated debentures	24,119	24,119	-	-	24,119
Accrued interest payable	2,136	2,136	-	2,136	-
Mandatory forward contracts	59	59	-	59	-
Off Balance Sheet Commitments	$-	$-	$-	$ -	$ -

Note 11 - Fair Values of Financial Instruments – Continued

The following methods and assumptions were used to measure the fair value of financial instruments recorded at cost on Bancorp's consolidated balance sheet:

Cash and cash equivalents:
The carrying amount reported in the consolidated statements of financial condition for cash and cash equivalents approximate those assets' fair values.

Investment Securities:
Bancorp utilizes a third party source to determine the fair value of its securities. The methodology consists of pricing models based on asset class and includes available trade, bid, other market information, broker quotes, proprietary models, various databases and trading desk quotes. All Bancorp's investments are considered Level 2.

Loans held for sale:
The fair value of loans held for sale is based primarily on investor quotes.

Loans receivable:
The fair values of loans receivable were estimated using discounted cash flow analyses, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. These rates were used for each aggregated category of loans as reported on the Office of the Comptroller of the Currency Quarterly Report.

FHLB stock:
The carrying amount of FHLB stock approximates fair value based on the redemption provisions of the FHLB. There have been no identified events or changes in circumstances that may have a significant adverse effect on the FHLB stock. Based on our evaluation, we have concluded that our FHLB stock was not impaired at March 31, 2015 and December 31, 2014.

Accrued interest receivable and payable:
The carrying amounts of accrued interest receivable and accrued interest payable approximates their fair values.

Derivative Instruments:
Mortgage banking derivatives used in the ordinary course of business primarily consist of mandatory forward sales contracts ("forward contract") and rate lock commitments. The fair value of Bancorp's derivative instruments is primarily measured by obtaining pricing from broker-dealers recognized to be market participants. The pricing is derived from market observable inputs that can generally be verified and do not typically involve significant judgment by Bancorp. Forward contracts and rate lock loan commitments are classified as Level 2 in the fair value hierarchy.

Mortgage servicing rights:
The fair value of mortgage servicing rights is determined using a valuation model administered by a third party that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, default rates, cost to service (including delinquency and foreclosure costs), escrow account earnings, contractual servicing fee income and other ancillary income such as late fees. Management reviews all significant assumptions on a monthly basis. Mortgage loan prepayment speed, a key assumption in the model, is the annual rate at which borrowers are forecasted to repay their mortgage loan principal. The discount rate used to determine the present value

of estimated future net servicing income, another key assumption in the model, is an estimate of the required rate of return investors in the market would require for an asset with similar risk. Both assumptions can, and generally will, change as market conditions and interest rates change.

Note 11 - Fair Values of Financial Instruments – Continued

Deposit liabilities:
The fair values disclosed for demand deposit accounts, savings accounts and money market deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

FHLB advances:
Fair values of long-term debt are estimated using discounted cash flow analysis, based on rates currently available for advances from the FHLB with similar terms and remaining maturities.

Subordinated debentures:
Current economic conditions have rendered the market for this liability inactive. As such, Bancorp is unable to determine a good estimate of fair value. Since the rate paid on the debentures held is lower than what would be required to secure an interest in the same debt at year end and we are unable to obtain a current fair value, Bancorp has disclosed that the carrying value approximates the fair value.

Off-balance sheet financial instruments:
Fair values for Bancorp's off-balance sheet financial instruments (lending commitments and letters of credit) are not significant and are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Note 12 - Recent Accounting Pronouncements

Under ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, a creditor will be considered to have physical possession of residential real estate property that is collateral for a residential mortgage loan and therefore should reclassify the loan to other real estate owned when either (a) the creditor obtains legal title to the property upon completion of a foreclosure, or (b) the borrower conveys all interest in the real estate property to the lender to satisfy that loan even though legal title may not have passed. The amendments are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. An entity can elect to adopt the amendments in this update using either a modified retrospective transition method or a prospective transition method. Bancorp has evaluated the effect of ASU 2014-04 and believes adoption will not have a material effect on the Consolidated Financial Statements.

Under ASU 2014-09, Revenue from Contracts with Customers, establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance. The revenue standard's core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. The new standard applies to all public entities for annual periods beginning after December 15, 2016. Early adoption is prohibited under U.S. GAAP. In April 2015, the FASB issued an exposure draft proposing a one-year delay of the effective date for this standard. The proposal is currently open for comment. Bancorp has evaluated the effect of ASU 2014-09 and believes adoption will not have a material effect on the Consolidated Financial Statements.

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

The Company

Bancorp is a savings and loan holding company chartered as a corporation in the state of Maryland in 1990. It conducts business primarily through two subsidiaries, Severn Savings Bank, FSB ("Bank") and SBI Mortgage Company ("SBI"). The Bank's principal subsidiary Louis Hyatt, Inc. ("Hyatt Commercial"), conducts business as Hyatt Commercial, a commercial real estate brokerage and property management company. SBI holds mortgages that do not meet the underwriting criteria of the Bank, and is the parent company of Crownsville Development Corporation ("Crownsville"), which is doing business as Annapolis Equity Group, which acquires real estate for syndication and investment purposes. The Bank has four branches in Anne Arundel County, Maryland, which offer a full range of deposit products, and originate mortgages in its primary market of Anne Arundel County, Maryland and, to a lesser extent, in other parts of Maryland, Delaware and Virginia.

Bank Competition

The Annapolis, Maryland area has a high density of financial institutions, many of which are significantly larger and have greater financial resources than the Bank, and all of which are competitors of the Bank to varying degrees. The Bank's competition for loans comes primarily from savings and loan associations, savings banks, mortgage banking companies, insurance companies and commercial banks. Its most direct competition for deposits has historically come from savings and loan associations, savings banks, commercial banks and credit unions. The Bank faces additional competition for deposits from money market mutual funds and corporate and government securities funds and investments. The Bank also faces increased competition for deposits from other financial institutions such as brokerage firms and insurance companies. The Bank is a community-oriented financial institution serving its market area with a wide selection of mortgage loan products. Management considers the Bank's reputation and customer service to be a major competitive advantage in attracting and retaining customers in its market area. The Bank also believes it benefits from its community orientation.

Forward Looking Statements

In addition to the historical information contained herein, the discussion in this report contains forward-looking statements that involve risks and uncertainties and may be affected by various factors that may cause actual results to differ materially from those in the forward-looking statements. The forward-looking statements contained herein include, but are not limited to, those with respect to the Bank's strategy; management's determination of the amount of the loan loss allowance; the effect of changes in interest rates; changes in deposit insurance premiums; ability to meet obligations; and legal proceedings. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "will," "
"could," "should," "guidance," "potential," "continue," "project," "forecast," "confident," and similar expressions are typically
identify forward-looking statements. Bancorp's operations and actual results could differ significantly from those discussed in the forward-looking statements. Some of the factors that could cause or contribute to such differences include, but are not limited to: changes in general economic conditions and political conditions and by governmental monetary and fiscal policies; changes in the economic conditions of the geographic areas in which Bancorp conducts business; changes in interest rates; a downturn in the real estate markets in which Bancorp conducts business; the high degree of risk exhibited by Bancorp's loan portfolio; environmental liabilities with respect to properties Bancorp has title; changes in federal and state regulation; the effects of the supervisory agreements entered into by each of Bancorp and the Bank; Bancorp's ability to estimate loan losses; competition; breaches in security or interruptions in Bancorp's information systems; Bancorp's ability to timely develop and implement technology; Bancorp's ability to retain its management team; perception of Bancorp in the market place; Bancorp's ability to maintain effective internal controls over financial reporting and disclosure controls and procedures; and terrorist attacks and threat of actual war; and other factors detailed from time to time in Bancorp's filings with the Securities and Exchange Commission (the "SEC"), including "Item 1A. Risk Factors" contained in Bancorp's Annual Report on Form 10-K for the fiscal year ended

December 31, 2014.

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Critical Accounting Policies

Bancorp’s significant accounting policies are set forth in Note 1 of the audited consolidated financial statements as of December 31, 2014 which were included in Bancorp’s Annual Report on Form 10-K. Of these significant accounting policies, Bancorp considers its policies regarding the allowance for loan losses, the valuation of foreclosed real estate, the evaluation of other than temporary impairment of investment securities and the valuation of the deferred tax asset to be its most critical accounting policies, giving the uncertainty in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio and the material effect that such judgements can have on the results of operations and future taxable income. In addition, changes in economic conditions can have a significant impact on real estate values of underlying collateral affecting the allowance for loan losses and therefore the provision for loan losses and results of operations as well as the valuation of foreclosed real estate. Bancorp has developed policies and procedures for assessing the adequacy of the allowance for loan losses and the fair value of foreclosed real estate, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. Bancorp’s assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations, and the discovery of information with respect to borrowers that is not known to management at the time of the issuance of the consolidated financial statements.

Overview

Bancorp provides a wide range of personal and commercial banking services. Personal services include various lending services as well as checking, individual retirement accounts, money market, savings and time deposit accounts. Commercial services include commercial secured and unsecured lending services as well as business internet banking, corporate cash management services and deposit services. Bancorp also provides ATMs, debit cards, internet banking including on-line bill pay, mortgage lending, safe deposit boxes, and telephone banking, among other products and services.

Bancorp had net income of $865,000 for the three months ended March 31, 2015, compared to $867,000 for the three months ended March 31, 2014, primarily due to a decrease in net interest margin and non-interest income offset by a decrease in the provision for loan losses and non-interest expenses for the first quarter of 2015. Bancorp has experienced stronger loan demand and lower loan delinquencies from the levels experienced during the recent economic downturn. However, Bancorp continues to experience strong competition among financial institutions for loans and deposits. While the housing market has improved, it is still significantly below levels experienced in prior economic recoveries.

If interest rates increase, demand for borrowing may decrease and Bancorp’s interest rate spread could decrease. Bancorp will continue to manage loan and deposit pricing against the risks of rising costs of its deposits and borrowings. Interest rates are outside the control of Bancorp, so it must attempt to balance its pricing and duration of its loan portfolio against the risks of rising costs of its deposits and borrowings.

The continued success and attraction of Anne Arundel County, Maryland, and vicinity, will also be important to Bancorp’s ability to originate and grow mortgage loans and deposits, as will Bancorp’s continued focus on maintaining a low overhead.

If the volatility in the market and the economy continues or worsens, our business, financial condition, results of operations, access to funds and the price of our stock could be materially and adversely impacted.

Results of Operations

Net income decreased by $2,000 to $865,000 for the first quarter of 2015, compared to $867,000 for the first quarter of 2014. Basic and diluted income per share remained constant at $0.03 for the first quarter of 2015 compared to

$0.03 for the first quarter of 2014.

Net interest income, which is interest earned net of interest expense, decreased by $148,000, or 2.5%, to $5,659,000 for the first quarter of 2015, compared to $5,807,000 for the first quarter of 2014. The primary reason for the decrease in net interest income was a greater increase in the yield on interest-bearing liabilities than the increase in yield on interest-bearing assets during the first quarter of 2015, compared to the first quarter of 2014.

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Bancorp's loan portfolio is subject to varying degrees of credit risk and an allowance for loan losses is maintained to absorb losses inherent in its loan portfolio. Credit risk includes, but is not limited to, the potential for borrower default and the failure of collateral to be worth what Bancorp determined it was worth at the time of the granting of the loan. Bancorp monitors its loan delinquencies at least monthly. All loans that are delinquent and all loans within the various categories of Bancorp's portfolio as a group are evaluated. Bancorp's Board, with the advice and recommendation of Bancorp's management, estimates an allowance to be set aside for loan losses. Included in determining the calculation are such factors as historical losses for each loan portfolio, current market value of the loan's underlying collateral, inherent risk contained within the portfolio after considering the state of the general economy, economic trends, consideration of particular risks inherent in different kinds of lending and consideration of known information that may affect loan collectability.

The provision for loan losses decreased by $100,000, or 50.0%, to $100,000 for the first quarter of 2015, compared to $200,000 for the first quarter of 2014. This was primarily due to a lower loan portfolio and lower loan delinquencies at March 31, 2015 compared to March 31, 2014.

Total non-interest income decreased by $76,000, or 7.8%, to $900,000 for the first quarter of 2015, compared to $976,000 for the first quarter of 2014. The primary reason for the decrease in non-interest income was a decrease in real estate commissions, real estate management fees and other income, partially offset by an increase in mortgage banking activities. Mortgage banking activities increased $269,000, or 133.8%, to $470,000 for the first quarter of 2015, compared to $201,000 for the first quarter of 2014. This increase in activity was the result of an increase in residential loan originations due to the continued low interest rate environment, and management's decision to sell most of the longer term fixed rate mortgages. Real estate commissions by Hyatt Commercial decreased by $153,000, or 58.8%, to $107,000 for the first quarter of 2015, compared to $260,000 for the first quarter of 2014. Real estate management fees decreased by $96,000, or 37.8%, to $158,000 for the first quarter of 2015, compared to $254,000 for the first quarter of 2014. These decreases were primarily due to a lower level of commercial property sales and leasing during the first quarter of 2015 compared to the first quarter of 2014. Other non-interest income decreased $96,000, or 36.8%, to $165,000 for the first quarter of 2015, compared to $261,000 for the first quarter 2014. The primary reason for the decrease was due to a net loss of $260,000 recorded during the first quarter of 2015 for the change in the fair value of interest rate lock commitments and mandatory contracts entered into by the Bank. There was no entry recorded for the fair value of interest rate lock commitment and mandatory contracts during the first quarter of 2014.

Total non-interest expenses decreased $113,000, or 2.0%, to $5,593,000 for the first quarter of 2015, compared to $5,706,000 for the first quarter of 2014. Compensation and related expenses increased by $173,000, or 4.8%, to $3,810,000 for the first quarter of 2015, compared to $3,637,000 for the first quarter of 2014. This increase was primarily due to higher commissions paid due to higher mortgage banking activities during the first quarter of 2015 compared to the first quarter of 2014. Net occupancy costs decreased by $8,000, or 1.8%, to $425,000 for the first quarter of 2015, compared to $433,000 for the first quarter of 2014. The primary reason for the decrease was lower rental expenses. The net gain on foreclosed real estate expense increased by $12,000, or 22.6%, to ($65,000) for the first quarter of 2015 compared to ($53,000) for the first quarter of 2014. This decrease was primarily due to a higher gain realized on properties sold during the first quarter of 2015, compared to the first quarter of 2014. Legal fees decreased by $42,000, or 40.4%, to $62,000 for the first quarter of 2015, compared to $104,000 for the first quarter of 2014. This decrease was primarily due to a lower level of loan delinquencies and related attorney fees associated with collections during the first quarter of 2015 compared to the first quarter of 2014. FDIC assessments and regulatory expense decreased by $34,000, or 9.7% to $318,000 for the first quarter of 2015, compared to $352,000 for the first quarter of 2014. This decrease was primarily due to a decrease in the risk-based assessment charged by the FDIC. Professional fees increased by $75,000, or 39.3%, to $266,000 for the first quarter of 2015, compared to $191,000 for the first quarter of 2014. This increase was primarily due to an increase in fees incurred for loan reviews and credit administration projects. Office supplies decreased $36,000, or 38.7%, to $57,000 for the first quarter of 2015, compared to $93,000 for the first quarter of 2014. The decrease is due to a lower usage of supplies during the first quarter of 2015, compared to the first quarter of 2014. Online charges decreased $14,000, or 6.3%, to $209,000 for the first quarter of 2015, compared to $223,000 for the first quarter of 2014. This decrease was primarily due to a general decrease in processing charges. Credit report and appraisal fees decreased $43,000, or 24.9%, to $130,000 for the first quarter of 2015, compared to $173,000 for the first quarter of 2014. This decrease was primarily due to fewer appraisals needed for loans in foreclosure during the first quarter of 2015, compared to the first quarter of 2014. Other non-interest expenses decreased by $172,000, or 31.1%, to $381,000 for the first quarter of 2014 compared to $553,000 for the first quarter of 2014. This decrease was primarily due to a $200,000 decrease in a prior reserve taken for contingent liabilities related to standby letters of credit during the first quarter of 2015.

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Income Taxes

Income tax expense decreased by $9,000 to $1,000 for the first quarter of 2015 compared to $10,000 for the first quarter of 2014. The effective tax rate for the first quarter of 2015 was 0.1% compared to 1.1% for the first quarter of 2014. The low effective tax rates for 2015 and 2014 was primarily due to the utilization of Bancorp's Federal and State net operating loss carryforwards during the quarter ended March 31, 2015.

Analysis of Financial Condition

Total assets increased $5,300,000 to $781,628,000 at March 31, 2015, compared to $776,328,000 at December 31, 2014. Cash and cash equivalents increased by $18,309,000, or 54.9%, to $51,644,000 at March 31, 2015, compared to $33,335,000 at December 31, 2014. This increase was primarily due to management's decision to increase cash balances to preserve liquidity at March 31, 2015, compared to December 31, 2014. Net loans receivable decreased $15,255,000, or 2.4%, to $618,627,000 at March 31, 2015, compared to $633,882,000 at December 31, 2014. This decrease is due to lower loan sales volume during the first quarter of 2015 and management's decision to sell most of new fixed rate residential loans. Loans held for sale increased $5,894,000, or 82.3%, to $13,059,000 at March 31, 2015, compared to $7,165,000 at December 31, 2014. This increase was primarily due to the timing of loans pending sale as of March 31, 2015. Foreclosed real estate increased $264,000, or 13.6%, to $2,211,000 at March 31, 2015 compared to $1,947,000 at December 31, 2014. This increase was the result of new loan foreclosures outpacing properties sold during the first quarter of 2015. Total deposits increased $2,721,000, or 0.5%, to $546,535,000 at March 31, 2015 compared to $543,814,000 at December 31, 2014. The increase was primarily the result of new deposit promotions during the first quarter of 2015 and new accounts opened in the first quarter of 2015. Long-term borrowings remained at $115,000,000 at March 31, 2015 and December 31, 2014. These borrowings do not mature until 2016 or later and would incur prepayment penalties if paid earlier.

Stockholders' Equity

Total stockholders' equity increased $465,000 to $84,275,000 at March 31, 2014 compared to $83,810,000 as of December 31, 2014. This increase was primarily a result of net income for the first three months of 2015 partially offset by the dividends declared to Bancorp's preferred stockholders.

Liquidity

Bancorp's liquidity is determined by its ability to raise funds through several sources including borrowed funds, capital, deposits, loan repayments, maturing investments and the sale of loans.

In assessing its liquidity, the management of Bancorp considers operating requirements, anticipated deposit flows, expected funding of loans, deposit maturities and borrowing availability, so that sufficient funds may be available on short notice to meet obligations as they arise or to permit Bancorp to take advantage of business opportunities.

Management believes Bancorp has sufficient cash flow and liquidity to meet its current commitments through the next 12 months. Certificates of deposit, which are scheduled to mature in less than one year, totaled $197,708,000 at March 31, 2015. Based on past experience, management believes that a significant portion of such deposits will remain with Bancorp. At March 31, 2015, Bancorp had commitments to originate mortgage loans of $345,000, unadvanced home equity lines of credit of $8,310,000, unadvanced construction commitments of $31,429,000, unused lines of credit of $24,570,000 and commitments under standby letters of credit of $6,751,000. Bancorp has the ability to reduce its commitments for new loan originations, adjust other cash outflows, and borrow from FHLB Atlanta should the need arise. As of March 31, 2015, outstanding FHLB Atlanta borrowings totaled $115,000,000, and Bancorp had available to it an additional $39,610,000 in borrowing availability from FHLB Atlanta.

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Net cash used in operating activities increased $1,762,000 to ($1,644,000) for the three months ended March 31, 2015, compared to net cash provided by operating activities of $118,000 for the same period in 2014. This increase was primarily the result of an increase in loans originated for sale in 2015. Net cash provided by investing activities increased $13,428,000 to $17,139,000 for the three months ended March 31, 2015, compared to $3,711,000 provided by investing activities for the same period in 2014. This increase was primarily due to loans decreasing in the first quarter of 2015 compared to increasing in the first quarter of 2014. Net cash provided by financing activities increased $11,099,000 to $2,814,000 for the three months ended March 31, 2015, compared to $8,285,000 used in financing activities for the same period in 2014. This increase was primarily due to a net increase in deposits in 2015 compared to the decrease in deposits during the same period in 2014.

Federal Home Loan Bank of Atlanta Line of Credit

The Bank has an available line of credit, secured by various loans in its portfolio, in the amount of twenty percent of its total assets, with the FHLB Atlanta. As of March 31, 2015, the total available line of credit with the FHLB Atlanta was approximately $154,610,000, of which $115,000,000 was outstanding in the form of long-term borrowings. The Bank, from time to time, utilizes the line of credit when interest rates are more favorable than obtaining deposits from the public.

The following table sets forth information concerning the interest rates and maturity dates of the advances from the FHLB Atlanta as of March 31, 2015 (dollars in thousands):

Principal Amount	Rate	Maturity
$15,000	1.81% to 1.83%	2016
70,000	2.43% to 4.05%	2017
15,000	2.58% to 3.43%	2018
15,000	4.00 %	2019
$115,000		

Subordinated Debentures

As of March 31, 2015, Bancorp had outstanding $20,619,000 principal amount of Junior Subordinated Debt Securities Due 2035 (the “2035 Debentures”). The 2035 Debentures were issued pursuant to an Indenture dated as of December 17, 2004 (the “2035 Indenture”) between Bancorp and Wells Fargo Bank, National Association, as Trustee. The 2035 Debentures pay interest quarterly at a floating rate of interest of LIBOR (0.28% as of March 31, 2015) plus 200 basis points, and mature on January 7, 2035. Payments of principal, interest, premium and other amounts under the 2035 Debentures are subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of Bancorp, as defined in the 2035 Indenture. The 2035 Debentures became redeemable, in whole or in part, by Bancorp on January 7, 2010.

The 2035 Debentures were issued and sold to Severn Capital Trust I (the “Trust”), of which 100% of the common equity is owned by Bancorp. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities (“Capital Securities”) to third-party investors and using the proceeds from the sale of such Capital Securities to purchase the 2035 Debentures. The 2035 Debentures held by the Trust are the sole assets of the Trust.

Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the 2035 Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the 2035 Debentures. Bancorp has entered into an agreement which, taken collectively, fully and unconditionally guarantees the Capital Securities subject to the terms of the guarantee. Under the terms of the 2035 Indenture, Bancorp is permitted to defer the payment of interest on the 2035 Debentures for up to 20 consecutive quarterly periods provided that no event of default has occurred and is continuing. As of March 31, 2015, Bancorp has deferred the payment of twelve quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was $1,474,000.

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Under the terms of Bancorp’s 2035 Indenture, if Bancorp has deferred payments of interest on the 2035 Debentures, the Bancorp may not, among other things, declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of its capital stock, including common stock until all such deferred interest has been paid. Accordingly, Bancorp will not be able to pay dividends on its common stock until the deferred interest on the 2035 Debentures has been paid in full.

On November 15, 2008, Bancorp completed a private placement offering consisting of a total of 70 units, at an offering price of $100,000 per unit, for gross proceeds of $7.0 million. Each unit consists of 6,250 shares of Bancorp's Series A 8.0% Non-Cumulative Convertible Preferred Stock and Bancorp's Subordinated Note in the original principal amount of $50,000.

The aggregate principal amount of Subordinated Notes outstanding at March 31, 2015 was $3,500,000. The Subordinated Notes earn interest at an annual rate of 8.0%, payable quarterly in arrears on the last day of March, June, September and December commencing December 31, 2008. The Subordinated Notes are redeemable in whole or in part at the option of Bancorp at any time beginning on December 31, 2009 until maturity, which is December 31, 2018. Debt issuance costs totaled $245,000 and are being amortized over 10 years. Interest payments on the Subordinated Notes are current as of March 31, 2015.

Preferred Stock

Bancorp issued a total of 437,500 shares of its Series A 8.0% Non-Cumulative Convertible Preferred Stock (“Series A Preferred Stock”) as part of the private placement offering completed on November 15, 2008. The liquidation preference is $8.00 per share. Each share of Series A Preferred Stock is convertible at the option of the holder into one share of Bancorp’s common stock, subject to adjustment upon certain corporate events. The initial conversion rate is equivalent to an initial conversion price of $8.00 per share of Bancorp’s common stock. At the option of Bancorp, on and after December 31, 2014, at any time and from time to time, some or all of the Series A Preferred Stock may be converted into shares of Bancorp’s common stock at the then-applicable conversion rate. Costs related to the issuance of the preferred stock totaled $247,000 and were netted against the proceeds.

If declared by Bancorp's board of directors, cash dividends at an annual rate of 8.0% will be paid quarterly in arrears on the last day of March, June, September and December commencing December 31, 2008. Dividends will not be paid on Bancorp’s common stock in any quarter until the dividend on the Series A Preferred Stock has been paid for such quarter; however, there is no requirement that Bancorp's board of directors declare any dividends on the Series A Preferred Stock and any unpaid dividends shall not be cumulative. Dividends on the Series A Preferred Stock have not been declared since the first quarter of 2012.

On November 21, 2008, Bancorp entered into an agreement with the United States Department of the Treasury (“Treasury”), pursuant to which Bancorp issued and sold (i) 23,393 shares of its Series B Fixed Rate Cumulative Perpetual Preferred Stock, par value $0.01 per share and liquidation preference $1,000 per share, (the “Series B Preferred Stock”) and (ii) a warrant (the “Warrant”) to purchase 556,976 shares of Bancorp’s common stock, par value $0.01 per share, for an aggregate purchase price of $23,393,000. Costs related to the issuance of the preferred stock and warrants totaled $45,000 and were netted against the proceeds. On September 25, 2013, the Treasury sold all of its 23,393 shares of Series B Preferred Stock to outside investors as part of their ongoing efforts to wind down and recover its remaining investments under the Troubled Asset Relief Program (“TARP”). The terms of the Series B Preferred Stock remain the same. The Treasury continues to hold a warrant to purchase 556,976 shares of Bancorp’s common stock.

The Series B Preferred Stock qualifies as Tier 1 capital and pays cumulative compounding dividends at a rate of 5% per annum for the first five years, and 9% per annum effective November 21, 2013. The Series B Preferred Stock may be redeemed by Bancorp.

The Series B Preferred Stock has no maturity date and ranks pari passu with Bancorp’s existing Series A Preferred Stock, in terms of dividend payments and distributions upon liquidation, dissolution and winding up of Bancorp.

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The Series B Preferred Stock is non-voting, other than class voting rights on certain matters that could adversely affect the Series B Preferred Stock. If dividends on the Series B Preferred Stock have not been paid for an aggregate of six quarterly dividend periods or more, whether consecutive or not, Bancorp's authorized number of directors will be automatically increased by two and the holders of the Series B Preferred Stock, voting together with holders of any then outstanding voting parity stock, will have the right to elect those directors at Bancorp's next annual meeting of stockholders or at a special meeting of stockholders called for that purpose. These preferred share directors will be elected annually and serve until all accrued and unpaid dividends on the Series B Preferred Stock have been paid. In connection with the sale by the Treasury of the Series B Preferred Stock, the Federal Reserve obtained waivers from the outside investors who purchased the Series B Preferred Stock in which such investors agreed not to exercise their right to elect directors, and certain other voting or control rights, without the prior approval of the Federal Reserve.

The Warrant has a 10-year term and is immediately exercisable at an exercise price of $6.30 per share of Common Stock. The exercise price and number of shares subject to the Warrant are both subject to anti-dilution adjustments. Pursuant to the Purchase Agreement, Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

Bancorp's ability to declare dividends on its common stock are limited by the terms of Bancorp's Series A preferred stock and Series B preferred stock. Bancorp may not declare or pay any dividend on, make any distributions relating to, or redeem, purchase, acquire or make a liquidation payment relating to, or make any guarantee payment with respect to its common stock in any quarter until the dividend on the Series A Preferred Stock has been declared and paid for such quarter, subject to certain minor exceptions. Additionally Bancorp may not declare or pay any dividend or distribution on its common stock, and Bancorp may not purchase, redeem or otherwise acquire for consideration any of its common stock, unless all accrued and unpaid dividends for all past dividend periods, including the latest completed dividend period, on all outstanding shares of Series B Preferred Stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside), subject to certain minor exceptions.

Dividends on the Series A Preferred Stock and Series B Preferred Stock have not been paid since the first quarter of 2012 because Bancorp did not receive approval from the Federal Reserve Bank of Richmond to pay such dividends. As of March 31, 2015, Bancorp has unpaid cumulative dividends and interest in arrears on the Series B Preferred Stock of $5,068,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the dividend in arrearage on its Series B Preferred Stock has been paid in full.

On November 23, 2009, Bancorp and the Bank entered into supervisory agreements with their respective regulators. Bancorp is currently under its original agreement which is now enforced by the Federal Reserve Bank of Richmond. On April 23, 2013, the Bank entered into a new agreement with the OCC, which superseded and terminated the supervisory agreement entered into on November 23, 2009. The agreements require, among other things, that Bancorp and the Bank must obtain prior regulatory approval before any dividends or capital distributions can be made.

Effects of Inflation

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America and practices within the banking industry which require the measurement of financial condition and operating results in terms of historical dollars, without considering the changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

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Average Balance Sheet

The following table presents Bancorp's distribution of the average consolidated balance sheets and net interest analysis for the three months ended March 31, 2015 and March 31, 2014:

	Three Months Ended March 31, 2015				Three Months Ended March 31, 2014			
	Average Volume	Interest	Yield/Cost		Average Volume	Interest	Yield/Cost	
	(dollars in thousands)							
ASSETS								
Loans (1)	$636,172	$7,546	4.74	%	$614,203	$7,642	4.98	%
Held to maturity securities (2)	58,882	233	1.58	%	44,578	194	1.74	%
Other interest-earning assets (3)	7,450	81	4.33	%	60,364	86	0.57	%
Total interest-earning assets	702,504	7,860	4.48	%	719,145	7,922	4.41	%
Non-interest earning assets	69,334				79,522			
Total assets	$771,838				$798,667			
LIABILITIES AND STOCKHOLDERS' EQUITY								
Savings and checking deposits	$242,544	164	0.27	%	$270,370	99	0.15	%
Certificates of deposit	296,239	840	1.13	%	299,601	887	1.18	%
Borrowings	139,119	1,197	3.44	%	139,119	1,129	3.25	%
Total interest-bearing liabilities	677,902	2,201	1.30	%	709,090	2,115	1.19	%
Non-interest bearing liabilities	11,436				8,024			
Stockholders' equity	82,500				81,553			
Total liabilities and stockholders' equity	$771,838				$798,667			
Net interest income and interest rate spread		$5,659	3.18	%		$5,807	3.22	%
Net interest margin			3.22	%			3.23	%
Average interest-earning assets to average interest-bearing liabilities			103.63	%			101.42	%

(1) Non-accrual loans are included in the average balances and in the computation of yields.
(2) Bancorp does not have any tax-exempt securities.
(3) Other interest-earning assets include interest-bearing deposits in other banks, federal funds sold and FHLB stock investments.

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Recent Accounting Pronouncements

For information concerning recent accounting pronouncements, see Note 12 to the unaudited Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in market risk since December 31, 2014, as reported in Bancorp’s Form 10-K filed with the SEC on March 17, 2015.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of Bancorp's management, including its Chief Executive Officer and Chief Financial Officer, Bancorp has evaluated the effectiveness of its disclosure controls and procedures as of March 31, 2015. Disclosure controls and procedures are defined in Rule 13a-15(e) under the Securities Exchange Act as those controls and other procedures of an issuer that are designed to ensure that the information required to be disclosed by the issuer in the reports it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the period covered by this report, Bancorp’s disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

Bancorp’s management, with the participation of its Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of Bancorp’s internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), to determine whether any changes occurred during the quarter ended March 31, 2015, that have materially affected, or are reasonably likely to materially affect, Bancorp’s internal control over financial reporting. Based on that evaluation, there were no such changes during the quarter ended March 31, 2015.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Bancorp have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

There are various claims pending involving Bancorp, arising in the normal course of business. Management believes, based upon consultation with legal counsel, that liabilities arising from these proceedings, if any, will not be material to Bancorp’s consolidated financial condition and consolidated results of operations.

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Item 1A. Risk Factors

The risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 should be carefully considered by you. If any of the risks actually occur, Bancorp's business, financial condition or results of operations could be materially and adversely affected. The risks described in our Annual Report on Form 10-K are not the only risks facing Bancorp. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations. This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Bancorp's actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including the risks faced by Bancorp described in Bancorp's Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

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

None.

Item 3. Defaults Upon Senior Securities

As noted above, Bancorp and the Bank entered into formal agreements with the regulators that require, among other things, that Bancorp and Bank obtain prior regulatory approval before paying any dividends or distributions. During the first quarter of 2015, Bancorp did not receive approval from the Federal Reserve Bank of Richmond to pay dividends on the Series B Preferred Stock in the amount of $527,000 due on February 15, 2015 and Series A Preferred Stock in the amount of $70,000 due on March 31, 2015. As of March 31, 2015, Bancorp has unpaid cumulative dividends and interest in arrears on the Series B Preferred Stock of $5,068,000 and $0 on the Series A Preferred Stock.

Also as noted above, as permitted under the terms of the 2035 Indenture, as of March 31, 2015, Bancorp has deferred the payment of eleven quarters of interest on its 2035 Debentures and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was $1,474,000.

Bancorp and Bank continue to work with the regulators to obtain approval for dividends and interest payments.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101	The following financial statements from the Severn Bancorp, Inc. Quarterly Report on Form 10-Q as of March 31, 2015 and for the three months ended March 31, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) The Consolidated Statements of Financial Condition; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Stockholders' Equity; (iv) the Consolidated Statements of Cash Flows; and (v) the Notes to Consolidated Financial Statements.

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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.

SEVERN BANCORP, INC.

May 12, 2015 Alan J. Hyatt
Alan J. Hyatt,
Chairman of the Board, President and
Chief Executive Officer (Principal Executive Officer)

May 12, 2015 Thomas G. Bevivino
Thomas G. Bevivino,
Executive Vice President, Chief Financial Officer
(Principal Financial and Accounting Officer)

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Exhibit Index

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