SEVERN BANCORP INC
Form 10-Q
August 08, 2007

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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

0-49731
(Commission File No.)

SEVERN BANCORP, INC.
(Exact Name of registrant as Specified in Its Charter)

Maryland	**52-1726127**
(State of incorporation)	(IRS employer identification number)
200 Westgate Circle, Suite 200, Annapolis, Maryland	**21401**
(Address of principal executive offices)	(Zip Code)

410-260-2000
(Registrant's telephone number)

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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer:_________ Accelerated filer: X Non- accelerated filer:________

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The registrant had 10,066,679 shares of Common Stock, par value $0.01 per share, outstanding at August 7, 2007.

SEVERN BANCORP, INC. AND SUBSIDIARIES
Table of Contents

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)

		June 30, 2007		December 31, 2006
ASSETS				
Cash and due from banks	$	9,186	$	16,982
Interest bearing deposits in other banks		621		709
Federal funds sold		7,850		1,024
Cash and cash equivalents		17,657		18,715
Investment securities held to maturity		5,105		7,271
Loans held for sale		519		2,970
Loans receivable, net of allowance for loan losses of $9,948 and $9,026, respectively		851,246		832,507
Premises and equipment, net		31,112		30,411
Federal Home Loan Bank of Atlanta stock at cost		9,047		9,468
Accrued interest receivable and other assets		11,143		10,574
Total assets	$	925,829	$	911,916
LIABILITIES AND STOCKHOLDERS' EQUITY				
Liabilities				
Deposits	$	642,587	$	626,524
Short-term borrowings		15,000		18,000
Long-term borrowings		150,000		155,000
Subordinated debentures		20,619		20,619
Accrued interest payable and other liabilities		5,933		5,331
Total liabilities		834,139		825,474
Stockholders' Equity				
Common stock, $0.01 par value, 20,000,000 shares authorized; 10,066,679 and 9,150,850 issued and outstanding, respectively		101		92
Additional paid-in capital		46,704		28,270
Retained earnings		44,885		58,080
Total stockholders' equity		91,690		86,442
Total liabilities and stockholders' equity	$	925,829	$	911,916

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

1

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

	For Three Months Ended June 30, 2007	For Three Months Ended June 30, 2006	For Six Months Ended June 30, 2007	For Six Months Ended June 30, 2006
Interest Income				
Loans	$ 17,619	$ 17,148	$ 35,195	$ 33,005
Securities, taxable	55	68	119	139
Other	313	329	686	656
Total interest income	17,987	17,545	36,000	33,800
Interest Expense				
Deposits	7,372	5,788	14,241	10,614
Short-term borrowings	115	159	224	245
Long-term borrowings	1,962	1,818	3,940	3,750
Total interest expense	9,449	7,765	18,405	14,609
Net interest income	8,538	9,780	17,595	19,191
Provision for loan losses	537	375	962	757
Net interest income after provision for loan losses	8,001	9,405	16,633	18,434
Other Income				
Real estate commissions	697	1,003	1,604	1,069
Real estate management fees	158	138	320	247
Mortgage banking activities	181	245	368	444
Other	256	5	689	231
Total other income	1,292	1,391	2,981	1,991
Non-Interest Expenses				
Compensation and related expenses	2,981	3,066	5,999	5,333
Occupancy, net	425	182	857	371
Other	943	757	1,879	1,340
Total non-interest expenses	4,349	4,005	8,735	7,044
Income before income tax provision	4,944	6,791	10,879	13,381
Income tax provision	2,053	2,704	4,498	5,312
Net income	$ 2,891	$ 4,087	$ 6,381	$ 8,069
Basic earnings per share	$ .29	$ .41	$ .63	$ .80
Diluted earnings per share	$ .29	$ .41	$ .63	$ .80
Common stock dividends declared per share	$ .06	$ .05	$ .12	$ .11

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

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

	For The Six Months Ended June 30,	
	2007	2006
Cash Flows from Operating Activities		
Net income	$ 6,381	$ 8,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan fees	(1,822)	(2,128)
Net amortization of premiums and discounts	3	15
Provision for loan losses	962	757
Provision for depreciation	624	200
Gain on sale of loans	(136)	(189)
Proceeds from loans sold to others	15,644	16,477
Loans originated for sale	(13,058)	(13,672)
Stock-based compensation expense	64	99
Increase in accrued interest receivable and other assets	(967)	(21)
Increase in accrued interest payable and other liabilities	602	2,300
Net cash provided by operating activities	8,297	11,907
Cash Flows from Investing Activities		
Proceeds from maturing investment securities	2,000	-
Principal collected on mortgage backed securities	163	364
Net increase in loans	(17,879)	(56,121)
Net proceeds from sale of foreclosed real estate	399	-
Investment in premises and equipment	(3,110)	(4,797)
Proceeds from sale of premises and equipment	1,785	-
(Purchase) redemption of Federal Home Loan Bank of Atlanta stock	421	(595)
Net cash used in investing activities	(16,221)	(61,149)

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

	For The Six Months Ended June 30, 2007	2006
Cash Flows from Financing Activities		
Net increase in deposits	16,063	38,563
Net decrease in short-term borrowings	(3,000)	(26,000)
Additional borrowed funds, long-term	-	40,000
Repayment of borrowed funds, long-term	(5,000)	(7,000)
Cash dividends and cash paid in lieu of fractional shares	(1,210)	(1,099)
Proceeds from exercise of options	13	-
Net cash provided by financing activities	6,866	44,464
Decrease in cash and cash equivalents	(1,058)	(4,778)
Cash and cash equivalents at beginning of year	18,715	24,995
Cash and cash equivalents at end of period	$ 17,657	$ 20,217
Supplemental disclosure of cash flows information:		
Cash paid during period for:		
Interest paid	$ 18,213	$ 14,577
Income taxes paid	$ 5,539	$ 5,645

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

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. (the "Company"), and its wholly owned subsidiaries, Louis Hyatt, Inc., 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, Homeowners Title and Escrow Corporation, Severn Financial Services Corporation, SSB Realty Holdings, LLC, SSB Realty Holdings II, LLC, and HS West, LLC ("HS West"). All intercompany accounts and transactions have been eliminated in the accompanying financial statements.

Note 2 - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America for complete 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 six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2007 or any other interim period. The unaudited consolidated financial statements for the three and six months ended June 30, 2007 should be read in conjunction with the audited consolidated financial statements and related notes, which are incorporated by reference in the Company's Annual Report on Form 10-K, for the fiscal year ended December 31, 2006.

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.

SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) Continued

Note 4 - Earnings Per Share and Stock Dividends

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for each period. Diluted earnings per share is computed by dividing net income by weighted average number of shares of common stock outstanding after consideration of the dilutive effect of the Company's outstanding stock options. Potential common shares related to stock options are determined using the treasury stock method. For the three and six month period ended June 30, 2007, all of the Company's outstanding stock options, which totaled 122,815, were included in the diluted earnings per share calculation. There were 124,630 outstanding stock options included in the diluted earnings per share calculation for the three and six month period ended June 30, 2006. The below amounts and cash dividends per share have been retroactively adjusted to give effect to a 10% stock dividend declared on February 21, 2007, effective for shares outstanding on March 15, 2007 and a 10% stock dividend declared on February 21, 2006, effective for shares outstanding March 28, 2006.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Common shares – weighted average (basic)	10,065,908	10,064,945	10,065,881	10,064,945
Common share equivalents – weighted average	14,500	11,106	18,612	3,312
Common shares – diluted	10,080,418	10,076,051	10,084,493	10,068,257

The accompanying Statements of Financial Condition reflect the issuance of 915,004 and 831,766 shares of common stock, and the transfer of $18,364,000 and $16,585,000 from retained earnings to common stock and additional paid-in capital, related to these 10% stock dividends during the first quarter of 2007 and 2006, respectively.

Note 5 - Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risks involved in issuing letters of credit are essentially the same as those that are involved in extending loan facilities to customers. The Company generally holds collateral supporting these commitments. The Company had $6,938,000 of standby letters of credit outstanding as of June 30, 2007. Management believes that the proceeds obtained through a liquidation of collateral would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of June 30, 2007 and December 31, 2006 for guarantees under standby letters of credit issued is not material.

SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) Continued

Note 6 - 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 the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and 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:

	Actual at June 30, 2007	Actual at December 31, 2006	To Be Well Capitalized Under Prompt Corrective Provisions
Tangible (1)	11.4%	11.0%	N/A
Tier I Capital (2)	13.5%	13.1%	6.0%
Core (1)	11.4%	11.0%	5.0%
Total Capital (2)	14.7%	14.3%	10.0%

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

Note 7 - Stock-Based Compensation

The Company currently has a stock-based compensation plan in place for directors, officers, and other key employees of the Company. Under the terms of the plan, the Company grants stock options for the purchase of the Company's common stock. The stock-based compensation is granted under terms and conditions determined by the Stock Option Committee of the Board of Directors. Stock options generally have a term of five years with 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 the Company vest immediately, and options granted to officers and employees vest over a five-year period, although the Stock Option Committee has the authority to provide for different vesting schedules.

Stock-based compensation expense for the six months ended June 30, 2007 and June 30, 2006 totaled $64,000 and $99,000, respectively. There were 825 and 0 options exercised during the six months ended June 30, 2007 and June 30, 2006, respectively.

SEVERN BANCORP, INC. AND SUBSIDIARIES
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) Continued

Note 8 - Commitments

HS West is finishing the construction of a building in Annapolis, Maryland that serves as the Company's and the Bank's administrative headquarters. A branch office of the Bank is included. As of June 30, 2007, HS West has incurred approximately $26.9 million of costs, which is included in premises and equipment in the Consolidated Statements of Financial Condition. The total cost is expected to be approximately $27.4 million, after completion of remaining tenant fit-out work, which is anticipated by the fall of 2007.

Note 9 - Recent Accounting Pronouncements

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. FASB Statement No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. Management is currently evaluating the potential impact, if any, of the adoption of FASB Statement No. 157 on the Company's financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company January 1, 2008. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

In March 2007, the FASB ratified EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based payment awards as an increase to additional paid-in capital. EITF 06-11 is effective for fiscal years beginning after September 15, 2007. The Company does not expect EITF 06-11 will have a material impact on its financial position, results of operations or cash flows.

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

The Company

The Company is a savings and loan holding company chartered in the state of Maryland. It conducts business through three subsidiaries: the Bank, which is the Company's principal subsidiary; Louis Hyatt, Inc., doing business as Hyatt Commercial, a commercial real estate brokerage and property management company; and SBI Mortgage Company, which holds mortgages that do not meet the underwriting criteria of the Bank, and is the parent company of Crownsville Development Corporation, 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. The Bank originates mortgages in its primary market of Anne Arundel County, Maryland and, to a lesser extent, in other parts of Maryland, Delaware and Northern Virginia. The Bank, through its subsidiary HS West, is finishing the construction of a building in Annapolis, Maryland that serves as the Company's and the Bank's administrative headquarters. A branch of the Bank is included. As of June 30, 2007, HS West had incurred approximately $26.9 million of costs, which is included in premises and equipment in the Consolidated Statements of Financial Condition. The total cost is expected to be approximately $27.4 million, after completion of remaining tenant fit-out work, which is expected by the fall of 2007. The Company's common stock trades under the symbol "SVBI" on the Nasdaq Stock Market.

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 management's determination of the amount of loan loss allowance; the effect of changes in interest rates; and changes in deposit insurance premiums. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "will," "would," "could," "should," "guidance," "potential," "continue," "confident," and similar expressions are typically used to identify forward-looking statements. The Company'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 the economy and interest rates both in the nation and Company's general market area, federal and state regulation, competition and other factors detailed from time to time in the Company's filings with the Securities and Exchange Commission (the "SEC"), including "Item 1A. Risk Factors" contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Critical Accounting Policies

The Company's significant accounting policies are set forth in note 1 of the audited consolidated financial statements as of December 31, 2006 which were included in the Company's annual report on Form 10-K. Of these significant accounting policies, the Company considers its policy regarding the allowance for loan losses to be its most critical accounting policy, because it requires management's most subjective and complex judgments. In addition, changes in economic conditions can have a significant impact on the allowance for loan losses and therefore the provision for loan losses and results of operations. The Company has developed policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Company'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.

9

Overview

The primary business of the Company is consumer oriented deposit products and residential and commercial mortgages. The real estate market has slowed from the second quarter of 2006, and the demand for construction lending and purchase money mortgage lending has slowed since then. New loan origination activity is down, and the interest rate spread between the Company's cost of funds and what it earns on loans has also decreased, as increases in interest rates paid on deposits and borrowings has outpaced interest earned on loans. Even though the Company has no exposure to the sub-prime lending market, it is experiencing an increase in non-accrual and delinquent loan activity in its loan portfolio, and expects that it may experience further deterioration in the coming months, until the residential market improves. In spite of the slower real estate market, the Company's loan portfolio has increased $18,739,000, or 2.3%, to $851,246,000 at June 30, 2007, compared to $832,507,000 at December 31, 2006.

The Company expects to be challenged as it seeks to grow assets in the form of mortgage loans in a slower real estate environment. If interest rates increase, there may be less demand for mortgage loan refinancing. The Company will continue to manage loan and deposit pricing against the risks of rising costs of its deposits and borrowings.

The continued success and attraction of the markets in which the Company operates will also be important to the Company's ability to originate and grow its mortgage loans, as will the Company's continuing ability to maintain low overhead.

Results of Operations

Net income decreased by $1,196,000, or 29.3%, to $2,891,000 for the second quarter of 2007, compared to $4,087,000 for the second quarter of 2006. Basic and diluted earnings per share decreased by $.12, or 29.3%, to $.29 for the second quarter of 2007, compared to $.41 for the second quarter of 2006. Net income for the six months ended June 30, 2007 decreased by $1,688,000, or 20.9%, to $6,381,000, compared to $8,069,000 for the same period in 2006. The decrease in net income and basic and diluted earnings per share over last year was a result of decreased growth in the Company's mortgage portfolio from June 30, 2006 to June 30, 2007, and the Company's lower interest rate spread and increased operating expenses. The Company's interest rate spread decreased by .57%, to 3.75% for the six months ended June 30, 2007, compared to 4.32% for the same period in 2006.

Net interest income, which is interest earned net of interest expense, decreased by $1,242,000, or 12.7%, to $8,538,000 for the second quarter of 2007, compared to $9,780,000 for the second quarter of 2006. Net interest income for the six months ended June 30, 2007 decreased by $1,596,000, or 8.3%, to $17,595,000, compared to $19,191,000 for the same period in 2006. The primary reason for the decrease in net interest income was because the interest rates earned on the Company's loan portfolio have risen slower than the rise in interest rates paid on the Company's interest bearing liabilities. This increase was primarily the result of the growth of the Company's certificates of deposit portfolio. Net yield on interest earning assets for the six months ended June 30, 2007 was 4.07%, compared to 4.61% for the same period in 2006. This decrease in net yield may continue in the future.

The provision for loan losses increased by $162,000, or 43.2%, to $537,000 for the second quarter of 2007, compared to $375,000 for the second quarter of 2006. The provision for loan losses for the six months ended June 30, 2007 increased by $205,000, or 27.1%, to $962,000, compared to $757,000 for the same period in 2006. Even though the Company has no exposure to the sub-prime market, it has experienced an increase in non-accrual and delinquent loan activity in its loan portfolio, and expects that it may experience further deterioration in the coming months, until the residential market improves. The provision for loan losses and allowance for loan losses are based on management's judgment and evaluation of the loan portfolio. Management assesses the adequacy of the allowance for loan losses and the need for any addition thereto, by considering the nature and size of the loan portfolio, overall portfolio quality, review of specific problem loans, economic conditions that may affect the borrowers' ability to pay or the value of property securing loans, and other relevant factors. While management believes the current allowance for loan losses is adequate, changing economic and other conditions may require future adjustments to the allowance for loan losses.

Total other income decreased by $99,000, or 7.1%, to $1,292,000 for the second quarter of 2007, compared to $1,391,000 for the second quarter of 2006. The primary reason for the decrease is lower real estate commissions earned partially offset by higher real estate management fees earned by Hyatt Commercial. Total other income for the six months ended June 30, 2007 increased by $990,000, or 49.7%, to $2,981,000, compared to $1,991,000 for the same period in 2006. The primary reasons for the increase during the first six months of 2007, compared to the first six months of 2006 was an increase in real estate commissions earned and the gain realized on property sold by Hyatt Commercial during the first quarter of 2007 compared to the first quarter of 2006. Real estate commissions decreased $306,000, or 30.5%, to $697,000 for the second quarter of 2007, compared to $1,003,000 for the second quarter of 2006. Total real estate commissions for the six months ended June 30, 2007 increased $535,000, or 50.0%, to $1,604,000, compared to $1,069,000 for the same period in 2006. This increase was primarily the result of commissions earned during the first quarter of 2007 on the sale of two large commercial properties. Real estate management fees increased by $20,000, or 14.5%, to $158,000 for the second quarter of 2007, compared to $138,000 for the second quarter of 2006. Total real estate management fees for the six months ended June 30, 2007 increased $73,000, or 29.6%, to $320,000, compared to $247,000 for the same period in 2006. The primary reason for the increase was the increased management fees earned on the three commercial properties under management starting in the second quarter of 2006. Total other income for the six months ended June 30, 2007 increased $458,000, or 198.3%, to $689,000, compared to $231,000 for the same period in 2006. This increase was primarily the result of a $322,000 gain recognized in the first quarter of 2007 on the sale of property owned by Hyatt Commercial.

Total non-interest expenses increased by $344,000, or 8.6%, to $4,349,000 for the second quarter of 2007, compared to $4,005,000 for the second quarter of 2006. Total non-interest expenses for the six months ended June 30, 2007 increased $1,691,000, or 24.0%, to $8,735,000, compared to $7,044,000 for the same period in 2006. Compensation and related expenses decreased by $85,000, or 2.8%, to $2,981,000 for the second quarter of 2007, compared to $3,066,000 for the same period in 2006. This decrease was due to lower commissions paid on new loan originations partially offset by higher salaries paid in 2007. Total compensation and related expenses for the six months ended June 30, 2007 increased by $666,000, or 12.5%, to $5,999,000, compared to $5,333,000 for the same period in 2006. This increase was primarily because of higher commissions paid by Hyatt Commercial to commercial real estate agents, consistent with the increase in real estate commissions earned as noted above, and higher salaries paid in 2007. Occupancy, net increased by $243,000, or 133.5%, to $425,000 for the second quarter of 2007, compared to $182,000 for the second quarter of 2006. Total Occupancy, net for the six months ended June 30, 2007 increased by $486,000, or 131.0%, to $857,000, compared to $371,000 for the same period in 2006. This increase was the result of costs and depreciation incurred on the Company’s new headquarters that were not offset by rents collected by outside tenants. Rental income from the new building began during the first quarter of 2007, with additional tenants expected to begin paying rent during the third quarter of 2007. Other non-interest expenses increased by $186,000, or 24.6%, to $943,000 for the second quarter of 2007, compared to $757,000 for the second quarter of 2006. Total other non-interest expense for the six months ended June 30, 2007 increased by $539,000, or 40.2%, to $1,879,000, compared to $1,340,000 for the same period in 2006. This increase was primarily due to additional legal fees incurred during 2007 relating to collection efforts on delinquent loans, higher professional fees and office expenses and printing costs incurred during 2007 associated with moving to the Company’s new headquarters.

Income Taxes

The income tax provision decreased by $651,000, or 24.1%, to $2,053,000 for the second quarter of 2007, compared to $2,704,000 for the second quarter of 2006. The income tax provision for the six months ended June 30, 2007 decreased by $814,000, or 15.3%, to $4,498,000, compared to $5,312,000 for the same period in 2006. The effective tax rate for the six months ended June 30, 2007 was 41.3% compared to 39.7% for the same period in 2006.

Analysis of Financial Condition

Total assets increased by $13,913,000, or 1.5%, to $925,829,000 at June 30, 2007, compared to $911,916,000 at December 31, 2006. Cash and cash equivalents decreased by $1,058,000, or 5.7%, to $17,657,000 at June 30, 2007, compared to $18,715,000 at December 31, 2006. This decrease was primarily due to decreased federal funds sold to satisfy loan growth. The loan portfolio increased during 2007, as net loans receivable increased $18,739,000, or 2.3%, to $851,246,000 at June 30, 2007, compared to $832,507,000 at December 31, 2006. This increase is the result of stronger loan demand during the second quarter of 2007. Prior to the second quarter of 2007, loan demand was down from June 30, 2006 levels. Loans held for sale decreased $2,451,000, or 82.5%, to $519,000 at June 30, 2007, compared to $2,970,000 at December 31, 2006. This decrease was primarily due to a slowdown in loans sold on the secondary market, and the timing of loans pending sale as of June 30, 2007. Total deposits increased $16,063,000, or 2.6%, to $642,587,000 at June 30, 2007 compared to $626,524,000 at December 31, 2006. This increase is primarily attributable to an ongoing campaign by the Company to attract money market deposit accounts and promotions to obtain shorter-term certificates of deposit. FHLB Atlanta borrowings decreased $8,000,000, or 4.6%, to $165,000,000 at June 30, 2007, compared to $173,000,000 as of December 31, 2006. This is a result of paying off short term FHLB Atlanta advances with deposit growth.

Stockholders' Equity

Total stockholders' equity increased $5,248,000, or 6.1%, to $91,690,000 at June 30, 2007 compared to $86,442,000 as of December 31, 2006. This increase was primarily a result of net earnings, offset by dividends declared.

Asset Quality

Non-accrual loans (those loans 120 or more days in arrears) decreased $638,000, or 10.8%, to $5,289,000 as of June 30, 2007, compared to $5,927,000 as of December 31, 2006. There were fifteen residential loans in non-accrual status totaling $5,219,000 and four consumer loans in non-accrual status totaling $70,000 at June 30, 2007, compared to sixteen residential loans in non-accrual status totaling $5,829,000 and one commercial loan in non-accrual status totaling $98,000 at December 31, 2006. There was $40,000 in charge offs in the six months ended June 30, 2007, and $0 in charge offs in the six months ended June 20, 2006. At June 30, 2007, the total allowance for loan losses was $9,948,000, which was 1.17% of total net loans, compared with $9,026,000, which was 1.08% of total net loans as of December 31, 2006. The allowance for loan losses is based on management's judgment and evaluation of the loan portfolio. Management assesses the adequacy of the allowance for loan losses and the need for any addition thereto, by considering the nature and size of the loan portfolio, overall portfolio quality, review of specific problem loans, economic conditions that may affect the borrowers' ability to pay or the value of property securing loans, and other relevant factors. While management believes the current allowance is adequate, changing economic and other conditions may require future adjustments to the allowance for loan losses. As of June 30, 2007, the Company had foreclosed real estate comprised of three residential properties with a book value of $571,000 and an appraised value of $718,000. The ratio of non-performing loans plus foreclosed assets to total assets was 0.63% at June 30, 2007 and 0.76% at December 31, 2006.

Liquidity

The Company's liquidity is determined by its ability to raise funds through loan payments, maturing investments, deposits, borrowed funds, capital, and the sale of loans. Based on the internal and external sources available, the Company's liquidity position exceeded anticipated short-term and long-term needs at June 30, 2007. Additionally, loan payments, maturities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements.

In assessing its liquidity, the management of the Company 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 so that the Company may take advantage of business opportunities.

Management believes it has sufficient cash flow and liquidity to meet its current commitments. Certificates of deposit, which are scheduled to mature in less than one year, totaled $451,026,000 at June 30, 2007. Based on past experience, management believes that a significant portion of such deposits will remain with the Company. At June 30, 2007, the Company had commitments to originate loans of $32,575,000, unused lines of credit of $36,693,000, and commitments under standby letters of credit of $6,938,000. In addition, the Company expects to incur additional tenant fit-out costs totaling approximately $550,000, associated with its new headquarters. The Company 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 June 30, 2007, outstanding FHLB Atlanta borrowings totaled $165,000,000, and the Company had available to it an additional $109,560,000 in borrowing availability from FHLB Atlanta.

Net cash provided by operating activities decreased $3,610,000 to $8,297,000 for the six months ended June 30, 2007, compared to $11,907,000 for the same period in 2006. This decrease was primarily the result of lower net income and lower proceeds from loans sold to others in 2007. Net cash used in investing activities decreased $44,928,000 to $16,221,000 for the six months ended June 30, 2007, compared to $61,149,000 for the same period in 2006. This decrease was primarily due to less funding of new loan originations in 2007. Net cash from financing activities decreased by $37,598,000 to $6,866,000 for the six months ended June 30, 2007, compared to $44,464,000 for the same period in 2006. This decrease was primarily due to a decrease in deposit growth and decreased net borrowings from FHLB Atlanta.

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 most 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.

Average Balance Sheet

The following table presents the Company's distribution of the average consolidated balance sheets and net interest analysis for the six months ended June 30, 2007 and June 30, 2006.

	Six Months Ended June 30, 2007			Six Months Ended June 30, 2006		
	Average Balance	Interest	Rate Annualized	Average Balance	Interest	Rate Annualized
	(dollars in thousands)					
ASSETS						
Loans (1)	$838,125	$35,195	8.40%	$804,120	$33,005	8.21%
Investments (2)	4,000	67	3.35%	5,000	76	3.04%
Mortgage-backed securities	2,179	52	4.77%	3,116	63	4.04%
Other interest-earning assets (3)	19,310	686	7.11%	20,728	656	6.33%
Total interest-earning assets	863,614	36,000	8.34%	832,964	33,800	8.12%
Non-interest earning assets	53,139			40,011		
Total assets	$916,753			$872,975		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Savings and checking deposits	$136,893	1,534	2.24%	$141,177	1,192	1.69%
Certificates of deposit	506,347	12,707	5.02%	473,942	9,422	3.98%
Short-term borrowings	8,333	224	5.38%	8,500	245	5.76%
Long-term borrowings	150,000	3,940	5.25%	145,833	3,750	5.14%
Total interest-bearing liabilities	801,573	18,405	4.59%	769,452	14,609	3.80%
Non-interest bearing liabilities	25,413			26,621		
Stockholders' equity	89,767			76,902		
Total liabilities and stockholders’ equity	$916,753			$872,975		
Net interest income and interest rate spread		$17,595	3.75%		$19,191	4.32%
Net interest margin			4.07%			4.61%
Average interest-earning assets to average interest-bearing liabilities			107.74%			108.25%

(1) Non-accrual loans are included in the average balances and in the computation of yields.

(2) The Company does not have any tax-exempt securities.

(3) Other interest-earning assets includes interest-bearing deposits in other banks, federal funds sold and FHLB stock investments.

Off-Balance Sheet Arrangements

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments express the extent of involvement the Company has in each class of financial instruments.

The Company's exposure to credit loss from non-performance by the other party to the above mentioned financial instruments is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The credit risk involved in these financial instruments is essentially the same as that involved in extending loan facilities to customers. No amount has been recognized in the statement of financial condition at June 30, 2007, as a liability for credit loss.

Off-balance sheet financial instruments whose contract amounts represent credit and interest rate risk are summarized as follows:

Financial Instruments Whose Contract Amounts Represent Credit Risk	Contract Amount At June 30, 2007 (dollars in thousands)
Standby letters of credit	$6,938
Home equity lines of credit	$23,897
Unadvanced construction commitments	$112,228
Loan commitments	$8,678
Lines of credit	$36,693
Loans sold with limited repurchase provisions	$4,150

Legal Proceedings

There are various claims pending involving the Company, 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 the Company's financial condition and results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in market risk since December 31, 2006, as reported in Company's Form 10-K filed with the SEC on or about March 13, 2007.

Item 4. Controls and Procedures

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of its disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of June 30, 2007. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2007, the Company's disclosure controls and procedures were effective in reaching a reasonable level of assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) is accumulated and communicated to its management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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 the Company 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.

Item 4T. Controls and Procedures

Not applicable.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

None other than ordinary routine litigation incidental to the Company's business.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risk factors in our Annual Report on Form 10-K have not materially changed. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. 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 operating results.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

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

The Company held its Annual Meeting of Shareholders on April 25, 2007, at which it (a) re-elected three individuals to serve additional three-year terms as directors and (b) ratified the appointment of Beard Miller Company LLP as the Company's independent auditors for the fiscal year ending December 31, 2007.

The names of the Directors who were re-elected at the Annual Meeting of Shareholders are as follows:

	Votes For	Votes Against	Votes Withheld
Melvin Hyatt	7,542,833	0	4,620
S. Scott Kirkley	7,540,393	0	7,060
Albert W. Shields	7,543,533	0	3,920

The names of the Directors whose terms of office continued after the Annual Meeting of Shareholders are as follows:

Louis DiPasquale, Jr.
Alan J. Hyatt
Melvin G. Meekins, Jr.
Ronald P. Pennington
T. Theodore Schultz
Keith Stock

The shareholders of the Company ratified the appointment of Beard Miller Company LLP as the Company's independent auditors for the fiscal year ending December 31, 2007

	Votes For	Votes Against	Votes Abstain
Appointment of Beard Miller Company LLP as independent auditors	7,421,108	126,345	0

Item 5. Other Information.

None

Item 6. Exhibits.

<u>Exhibit No.</u> <u>Description</u>

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

SIGNATURES

Under 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.

August 8, 2007	*Alan J. Hyatt* Alan J. Hyatt, Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
August 8, 2007	*Thomas G. Bevivino* Thomas G. Bevivino, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

20

Exhibit Index

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