

SEVERN BANCORP INC

Form 10-Q

May 12, 2011

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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, 2011

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 (I.R.S. employer identification no.)  
organization)

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.

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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, 2011: 10,066,679 shares.

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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,<br>2011 | December<br>31,<br>2010<br>(Audited) |
|--|-------------------|--------------------------------------|
| <b>ASSETS</b>  |                   |                                      |
| Cash and due from banks  | \$ 40,390         | \$ 33,339                            |
| Interest bearing deposits in other banks   | 40,222            | 20,149                               |
| Federal funds sold   | 25,433            | 17,467                               |
| Cash and cash equivalents  | 106,045           | 70,955                               |
| Investment securities held to maturity   | 31,248            | 27,311                               |
| Loans held for sale  | 342               | 3,426                                |
| Loans receivable, net of allowance for loan losses of<br>\$29,252 and \$29,871, respectively | 751,160           | 778,937                              |
| Premises and equipment, net  | 28,044            | 28,327                               |
| Foreclosed real estate   | 18,898            | 20,955                               |
| Federal Home Loan Bank stock at cost   | 7,692             | 7,692                                |
| Accrued interest receivable and other assets   | 24,307            | 24,940                               |
| <b>Total assets</b>  | <b>\$ 967,736</b> | <b>\$ 962,543</b>                    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                   |                                      |
| <b>Liabilities</b>   |                   |                                      |
| Deposits   | \$ 718,298        | \$ 714,776                           |
| Long-term borrowings   | 115,000           | 115,000                              |
| Subordinated debentures  | 24,119            | 24,119                               |
| Accrued interest payable and other liabilities   | 4,106             | 2,548                                |
| <b>Total liabilities</b>   | <b>861,523</b>    | <b>856,443</b>                       |
| <b>Stockholders' Equity</b>  |                   |                                      |
| Preferred stock, \$0.01 par value, 1,000,000 shares<br>authorized;                           |                   |                                      |
| Preferred stock series "A", 437,500 shares issued<br>and outstanding                         | 4                 | 4                                    |
| Preferred stock series "B", 23,393 shares issued<br>and outstanding                          | -                 | -                                    |
| Common stock, \$0.01 par value, 20,000,000 shares<br>authorized;                             |                   |                                      |
| 10,066,679 shares issued and outstanding   | 101               | 101                                  |

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|  |            |            |
|--|------------|------------|
| Additional paid-in capital                 | 74,448     | 74,352     |
| Retained earnings                          | 31,660     | 31,643     |
|  |            |            |
| Total stockholders' equity                 | 106,213    | 106,100    |
|  |            |            |
| Total liabilities and stockholders' equity | \$ 967,736 | \$ 962,543 |

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

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,  
2011                      2010

|   |           |           |
|---|-----------|-----------|
| <b>Interest Income</b>                              |           |           |
| Loans, including fees                               | \$ 11,529 | \$ 12,542 |
| Securities, taxable                                 | 122       | 40        |
| Other   | 47        | 14        |
| Total interest income                               | 11,698    | 12,596    |
| <b>Interest Expense</b>                             |           |           |
| Deposits  | 2,838     | 3,582     |
| Long-term borrowings and subordinated debentures    | 1,288     | 1,398     |
| Total interest expense                              | 4,126     | 4,980     |
| Net interest income                                 | 7,572     | 7,616     |
| Provision for loan losses                           | 634       | 2,544     |
| Net interest income after provision for loan losses | 6,938     | 5,072     |
| <b>Non-Interest Income</b>                          |           |           |
| Real estate commissions                             | 111       | 137       |
| Real estate management fees                         | 142       | 151       |
| Mortgage banking activities                         | 155       | 99        |
| Other   | 154       | 176       |
| Total non-interest income                           | 562       | 563       |
| <b>Non-Interest Expenses</b>                        |           |           |
| Compensation and related expenses                   | 2,614     | 2,452     |
| Occupancy   | 255       | 434       |
| Foreclosed real estate expenses, net                | 1,945     | 1,622     |
| Legal fees  | 184       | 268       |
| FDIC assessments and regulatory expense             | 560       | 561       |
| Other   | 1,151     | 1,127     |
| Total non-interest expenses                         | 6,709     | 6,464     |
| Income (loss) before income tax provision (benefit) | 791       | (829 )    |
| Income tax provision (benefit)                      | 344       | (301 )    |
| Net income (loss)                                   | \$ 447    | \$ (528 ) |
| Amortization of discount on preferred stock         | (68 )     | (68 )     |
| Dividends on preferred stock                        | (362 )    | (362 )    |
| Net income (loss) available to common stockholders  | \$ 17     | \$ (958 ) |

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|   |        |           |
|---|--------|-----------|
| Basic earnings (loss) per share           | \$ .00 | \$ (.10 ) |
| Diluted earnings (loss) per share         | \$ .00 | \$ (.10 ) |
| Common stock dividends declared per share | \$ -   | \$ -      |

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 Three Months Ended  
March 31,  
2011                      2010

|   |          |           |
|---|----------|-----------|
| <b>Cash Flows from Operating Activities</b>   |          |           |
| Net income (loss)   | \$ 447   | \$ (528 ) |
| Adjustments to reconcile net income (loss) to<br>net cash provided by operating activities: |          |           |
| Amortization of deferred loan fees  | (450 )   | (421 )    |
| Net amortization of premiums and<br>Discounts   | 37       | 2         |
| Provision for loan losses   | 634      | 2,544     |
| Provision for depreciation  | 314      | 302       |
| Gain on sale of loans   | (155 )   | (99 )     |
| Loss on sale of foreclosed real estate  | 521      | 194       |
| Provision for foreclosed real estate losses   | 1,059    | 934       |
| Proceeds from loans sold to others  | 8,813    | 8,810     |
| Loans originated for sale   | (5,574 ) | (6,090 )  |
| Stock-based compensation expense  | 28       | 33        |
| Decrease in net deferred tax asset  | 227      | 230       |
| Decrease in accrued interest receivable<br>and other assets                                 | 406      | 2,072     |
| Increase in accrued interest payable and other<br>Liabilities                               | 1,558    | 1,813     |
| Net cash provided by operating activities   | 7,865    | 9,796     |
| <b>Cash Flows from Investing Activities</b>   |          |           |
| Purchase of investment securities held to maturity  | (6,123 ) | (3,053 )  |
| Proceeds from maturing investment securities  | 2,000    | -         |
| Principal collected on mortgage-backed securities   | 149      | 7         |
| Net (increase) decrease in loans  | 23,685   | (2,884 )  |
| Proceeds from sale of foreclosed real estate  | 4,582    | 4,127     |
| Investment in foreclosed real estate  | (197 )   | (240 )    |
| Investment in premises and equipment  | (31 )    | -         |
| Net cash provided by (used in) investing activities   | 24,065   | (2,043 )  |



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

|  | For the Three Months Ended |           |
|--|----------------------------|-----------|
|  | March 31,                  |           |
|  | 2011                       | 2010      |
| <b>Cash Flows from Financing Activities</b>        |                            |           |
| Net increase in deposits                           | 3,522                      | 2,047     |
| Series "A" preferred stock dividend paid           | (70 )                      | (70 )     |
| Series "B" preferred stock dividend paid           | (292 )                     | (292 )    |
| Net cash provided by financing activities          | 3,160                      | 1,685     |
| Increase in cash and cash equivalents              | 35,090                     | 9,438     |
| Cash and cash equivalents at beginning of year     | 70,955                     | 51,401    |
| Cash and cash equivalents at end of period         | \$ 106,045                 | \$ 60,839 |
| Supplemental disclosure of cash flows information: |                            |           |
| Cash paid during period for:                       |                            |           |
| Interest   | \$ 4,142                   | \$ 4,993  |
| Income taxes                                       | \$ -                       | \$ -      |
| Transfer of loans to foreclosed real estate        | \$ 3,908                   | \$ 7,026  |

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. (“Bancorp”), and its 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, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2011 or any other interim period. The unaudited consolidated financial statements for the three months ended March 31, 2011 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, 2010. 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 (loss).

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 5 - Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares of common stock outstanding for each period. Diluted earnings (loss) 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 period ended March 31, 2011, because they were anti-dilutive, were 20,000 shares 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. For the three month period ended March 31, 2010, 210,715 shares of common stock issuable upon the 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 were not included in the diluted earnings per share calculation because they were anti-dilutive.

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2011                            | 2010       |
| Common shares – weighted average (basic)    | 10,066,679                      | 10,066,679 |
| Common share equivalents – weighted average | 3,245                           | -          |
| Common shares – diluted                     | 10,069,924                      | 10,066,679 |

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.

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

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. 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            |   | Actual               |   | To Be Well Capitalized Under Prompt Corrective Provisions |   |
|--------------------|-------------------|---|----------------------|---|---|---|
|                    | at March 31, 2011 |   | at December 31, 2010 |   |   |   |
| Tangible (1)       | 12.1              | % | 12.3                 | % | N/A   |   |
| Tier I Capital (2) | 15.9              | % | 15.6                 | % | 6.0   | % |
| Core (1)           | 12.1              | % | 12.3                 | % | 5.0   | % |
| Total Capital (2)  | 17.1              | % | 16.8                 | % | 10.0  | % |

(1) To adjusted total assets.

(2) To risk-weighted assets.

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.

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 8 - Stock-Based Compensation - continued

On March 16, 2010, Bancorp granted 100,000 options to certain officers and employees to purchase shares of Bancorp's stock at a price ranging from \$4.13 to \$4.54 per share. The options vest over a five year period from the date of grant.

The grant-date fair value of options granted was \$2.12. The fair value of the options awarded under the option plan is estimated on the date of grant using the Black-Scholes valuation model, which is dependent upon certain assumptions as presented below:

|                          |         |
|--------------------------|---------|
| Expected life (in years) | 5.00    |
| Risk-free interest rate  | 2.37 %  |
| Expected volatility      | 58.78 % |
| Expected dividend yield  | 0.00 %  |

The expected life of the options was estimated using the average vesting period of the options granted and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate is the U.S. Treasury rate commensurate with the expected life of the options on the grant date. Volatility of Bancorp's stock price was based on historical volatility. Dividend yield was based on management's projection of future dividends.

There were no options granted during the three months ended March 31, 2011.

Stock-based compensation expense for the three months ended March 31, 2011 and 2010 totaled \$28,000 and \$33,000, respectively. There were no options granted or exercised during the three months ended March 31, 2011 and 100,000 options granted and no options exercised during the three months ended March 31, 2010.

Information regarding Bancorp's stock-based compensation plan as of and for the three months ended March 31, 2011 is as follows:

|  | 2011      | Weighted<br>Average<br>Price |
|--|-----------|------------------------------|
|  | Shares    |                              |
| Options outstanding, December 31, 2010 | 190,750   | \$ 9.79                      |
| Options granted                        | -         | -                            |
| Options exercised                      | -         | -                            |
| Options forfeited                      | (90,750 ) | \$ 15.93                     |
| Options outstanding, March 31, 2011    | 100,000   | \$ 4.21                      |
| Options exercisable, March 31, 2011    | 20,834    | \$ 4.21                      |



The aggregate intrinsic value of the options outstanding as of March 31, 2011 and December 31, 2010 was \$25,600 and \$0, respectively.

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 8 - Stock-Based Compensation - continued

The following table summarizes the stock options outstanding and exercisable as of March 31, 2011.

| Range of Exercise Prices | Number Outstanding | Options Outstanding and Exercisable         |                                 |
|--------------------------|--------------------|---|---------------------------------|
|                          |                    | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
| \$4.13                   | 16,667             | 3.96  | \$4.13                          |
| \$4.54                   | 4,167              | 3.96  | \$4.54                          |
| \$4.13-\$4.54            | 20,834             | 3.96  | \$4.21                          |

As of March 31, 2011, there was \$168,000 of total unrecognized stock-based compensation expense related to non-vested stock options, which is expected to be recognized over a period of forty-eight months.

Note 9 - Investment Securities

The amortized cost and fair value of investment securities held to maturity are as follows:

|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|----------------|------------------------|-------------------------|------------|
| (dollars in thousands)                             |                |                        |                         |            |
| March 31, 2011:                                    |                |                        |                         |            |
| US Treasury securities                             | \$ 25,209      | \$ 207                 | \$ (49 )                | \$ 25,367  |
| US Agency securities                               | 5,217          | 5                      | (31 )                   | 5,191      |
| US government sponsored mortgage-backed securities | 822            | 47                     | -                       | 869        |
| Total  | \$ 31,248      | \$ 259                 | \$ (80 )                | \$ 31,427  |
| December 31, 2010:                                 |                |                        |                         |            |
| US Treasury securities                             | \$ 21,104      | \$ 223                 | \$ (2 )                 | \$ 21,325  |
| US Agency securities                               | 5,233          | -                      | (37 )                   | 5,196      |
| US Government sponsored Mortgage-backed securities | 974            | 61                     | -                       | 1,035      |
| Total  | \$ 27,311      | \$ 284                 | \$ (39 )                | \$ 27,556  |

The estimated fair value of debt securities at March 31, 2011, by contractual maturity are shown below. Expected maturities may differ from contractual maturities, because issuers may have the right to call or prepay obligations with

or without call or prepayment penalties.

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

## Note 9 - Investment Securities - continued

|   | Held to Maturity<br>(dollars in thousands) |                         |
|---|--|-------------------------|
|   | Amortized<br>Cost                          | Estimated<br>Fair Value |
| Due in one year or less                               | \$ 7,006                                   | \$ 7,023                |
| Due from one year to five years                       | 18,338                                     | 18,499                  |
| Due from five years to ten years                      | 5,082                                      | 5,036                   |
| US government sponsored<br>mortgage-backed securities | 822  | 869                     |
|   | \$ 31,248                                  | \$ 31,427               |

On March 31, 2011 and December 31, 2010, there were \$8,607,000 and \$8,760,000, respectively, in US Treasury securities and mortgage-backed securities pledged as collateral.

The following tables show 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 March 31, 2011 and December 31, 2010. Included in the table are six treasury securities and two agency securities in 2011 and one treasury security and five agency securities in 2010. Management believes that the unrealized losses are the result of interest rate levels differing from those existing at the time of purchase of the securities and actual and estimated prepayment speeds and are not necessarily related to the credit quality of the issuers of the securities. In addition, Bancorp 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. These unrealized losses are considered temporary as they reflect fair values on March 31, 2011 and December 31, 2010 and are subject to change daily as interest rates fluctuate.

|                        | Less than 12 months<br>Unrealized |        | 12 Months or More<br>Unrealized |        | Total<br>Unrealized |        |
|------------------------|-----------------------------------|--------|---------------------------------|--------|---------------------|--------|
|                        | Fair<br>Value                     | Losses | Fair<br>Value                   | Losses | Fair<br>Value       | Losses |
| March 31, 2011:        | (dollars in thousands)            |        |                                 |        |                     |        |
| US Treasury securities | \$6,065                           | (\$49) | \$-                             | \$(-)  | \$6,065             | (\$49) |
| US Agency securities   | 2,161                             | (31)   | -                               | (-)    | 2,161               | (31)   |
| Total                  | \$8,226                           | (\$80) | \$-                             | \$(-)  | \$8,226             | (\$80) |

December 31,  
2010:

|                        |         |        |     |       |         |        |
|------------------------|---------|--------|-----|-------|---------|--------|
| US Treasury securities | \$1,033 | \$(2)  | \$- | \$(-) | \$1,033 | \$(2)  |
| US Agency securities   | 5,196   | (37)   | -   | (-)   | 5,196   | (37)   |
| Total                  | \$6,229 | \$(39) | \$- | \$(-) | \$6,229 | \$(39) |

## SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

## Note 10 - Loans Receivable

| Loans receivable consist of the following:               | March 31<br>2011<br>(dollars in thousands) | December<br>31<br>2010 |
|--|--|------------------------|
| Residential mortgage, total                              | \$ 314,832                                 | \$ 326,255             |
| Individually evaluated for impairment                    | 56,964                                     | 59,189                 |
| Collectively evaluated for impairment                    | 257,868                                    | 267,066                |
| Construction, land acquisition and<br>development, total | 138,863                                    | 144,098                |
| Individually evaluated for impairment                    | 23,758                                     | 21,937                 |
| Collectively evaluated for impairment                    | 115,105                                    | 122,161                |
| Land, total  | 61,507                                     | 63,155                 |
| Individually evaluated for impairment                    | 10,769                                     | 10,196                 |
| Collectively evaluated for impairment                    | 50,738                                     | 52,959                 |
| Lines of credit, total                                   | 34,205                                     | 36,642                 |
| Individually evaluated for impairment                    | 3,484                                      | 4,564                  |
| Collectively evaluated for impairment                    | 30,721                                     | 32,078                 |
| Commercial real estate, total                            | 203,253                                    | 212,477                |
| Individually evaluated for impairment                    | 23,554                                     | 23,683                 |
| Collectively evaluated for impairment                    | 179,699                                    | 188,794                |
| Commercial non-real estate, total                        | 8,279                                      | 8,434                  |
| Individually evaluated for impairment                    | 305  | 305                    |
| Collectively evaluated for impairment                    | 7,974                                      | 8,129                  |
| Home equity, total                                       | 43,406                                     | 43,501                 |
| Individually evaluated for impairment                    | 1,673                                      | 975                    |
| Collectively evaluated for impairment                    | 41,733                                     | 42,526                 |
| Consumer, total  | 1,535                                      | 1,302                  |
| Individually evaluated for impairment                    | 63   | 61                     |
| Collectively evaluated for impairment                    | 1,472                                      | 1,241                  |
| Total Loans  | 805,880                                    | 835,864                |
| Individually evaluated for impairment                    | 120,570                                    | 120,910                |
| Collectively evaluated for impairment                    | 685,310                                    | 714,954                |
| Less   |  |                        |

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|   |            |            |
|---|------------|------------|
| Loans in process                              | (22,618 )  | (23,851 )  |
| Allowance for loan losses                     | (29,252 )  | (29,871 )  |
| Deferred loan origination fees and costs, net | (2,850 )   | (3,205 )   |
|   | \$ 751,160 | \$ 778,937 |

SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 – Loans Receivable - Continued

**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 generally accepted accounting principles. 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, as an integral part of their examination process, periodically review the Bank's allowance for losses on loans. 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.

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 agings 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; and
  - Effect of any changes in concentration of credit.





SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 – Loans Receivable - Continued

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 criticized 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 inherited 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 Bancorp for economic or legal reasons relating to the borrowers financial difficulties 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.

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The following is a summary of the allowance for loan losses at March 31, 2011 and December 31, 2010 and for the period ended March 31, 2011 and the year ended December 31, 2010 (dollars in thousands):

| March 2011  | Total     | Residential<br>Mortgage | Acquisition<br>and<br>Development | Land     | Lines of<br>Credit | Commercial<br>Real<br>Estate | Commercial<br>Non-Real<br>Estate | Home<br>Equity | Consumer |
|-------------|-----------|-------------------------|-----------------------------------|----------|--------------------|------------------------------|----------------------------------|----------------|----------|
| Beginning   |           |                         |                                   |          |                    |                              |                                  |                |          |
| Balance     | \$ 29,871 | \$ 16,339               | \$ 3,997                          | \$ 4,225 | \$ 458             | \$ 3,949                     | \$ 131                           | \$ 762         | \$ 10    |
| Provision   | 634       | (906 )                  | 1,845                             | (1,101 ) | (138 )             | 610                          | 48                               | 275            | 1        |
| Charge-offs | (1,253 )  | (668 )                  | (406 )                            | (166 )   | (- )               | (- )                         | (- )                             | (13 )          | (- )     |
| Recoveries  | -         | -                       | -                                 | -        | -                  | -                            | -                                | -              | -        |
| Ending      |           |                         |                                   |          |                    |                              |                                  |                |          |
| Balance     | \$ 29,252 | \$ 14,765               | \$ 5,436                          | \$ 2,958 | \$ 320             | \$ 4,559                     | \$ 179                           | \$ 1,024       | \$ 11    |

Ending  
balance  
related to:

|  |           |          |          |          |        |          |        |        |      |
|--|-----------|----------|----------|----------|--------|----------|--------|--------|------|
| Loans<br>individually<br>evaluated for<br>impairment | \$ 14,290 | \$ 7,803 | \$ 2,427 | \$ 1,803 | \$ 149 | \$ 1,488 | \$ -   | \$ 616 | \$ 4 |
| Loans<br>collectively<br>evaluated for<br>impairment | \$ 14,962 | \$ 6,962 | \$ 3,009 | \$ 1,155 | \$ 171 | \$ 3,071 | \$ 179 | \$ 408 | \$ 7 |

December  
2010

|             |           |           |          |          |        |          |        |          |       |
|-------------|-----------|-----------|----------|----------|--------|----------|--------|----------|-------|
| Beginning   |           |           |          |          |        |          |        |          |       |
| Balance     | \$ 34,693 | \$ 19,621 | \$ 1,492 | \$ 5,539 | \$ 20  | \$ 5,506 | \$ 82  | \$ 2,425 | \$ 8  |
| Provision   | 5,744     | 3,443     | 2,505    | 1,782    | 438    | (1,034 ) | 49     | (1,446 ) | 7     |
| Charge-offs | (10,666)  | (6,825 )  | (- )     | (3,096 ) | (- )   | (523 )   | (- )   | (217 )   | (5 )  |
| Recoveries  | 100       | 100       | -        | -        | -      | -        | -      | -        | -     |
| Ending      |           |           |          |          |        |          |        |          |       |
| Balance     | \$ 29,871 | \$ 16,339 | \$ 3,997 | \$ 4,225 | \$ 458 | \$ 3,949 | \$ 131 | \$ 762   | \$ 10 |

Ending  
b a l a n c e  
related to:

Loans  
individually  
evaluated for  
impairment

|           |          |          |          |        |        |      |        |      |
|-----------|----------|----------|----------|--------|--------|------|--------|------|
| \$ 14,540 | \$ 8,149 | \$ 2,645 | \$ 2,282 | \$ 264 | \$ 766 | \$ - | \$ 434 | \$ - |
|-----------|----------|----------|----------|--------|--------|------|--------|------|

Loans  
collectively  
evaluated for  
impairment

|           |          |          |          |        |          |        |        |       |
|-----------|----------|----------|----------|--------|----------|--------|--------|-------|
| \$ 15,331 | \$ 8,190 | \$ 1,352 | \$ 1,943 | \$ 194 | \$ 3,183 | \$ 131 | \$ 328 | \$ 10 |
|-----------|----------|----------|----------|--------|----------|--------|--------|-------|

## SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

## Note 10 - Loans Receivable - Continued

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 allowance was adequate as of March 31, 2011, changing economic and market conditions may require future adjustments to the allowance for loan losses.

The following table presents Bancorp's non-performing assets as of March 31, 2011 and December 31, 2010 (dollars in thousands):

|   | March 31,<br>2011 | Number<br>of loans | December<br>31, 2010 | Number<br>of loans |
|---|-------------------|--------------------|----------------------|--------------------|
| Loans accounted for on a non-accrual basis:   |                   |                    |                      |                    |
| Residential mortgage  | \$ 18,342         | 47                 | \$ 18,778            | 46                 |
| Home equity   | 118               | 2                  | 118                  | 2                  |
| Lines of credit   | 2,259             | 4                  | 4,265                | 8                  |
| Commercial real estate  | 4,140             | 9                  | 1,927                | 6                  |
| Acquisition and development   | 15,216            | 15                 | 15,160               | 17                 |
| Land  | 4,881             | 18                 | 5,890                | 21                 |
| Commercial non-real estate  | -                 | -                  | -                    | -                  |
| Consumer  | 28                | 2                  | 26                   | 2                  |
| Total non-accrual loans   | \$ 44,984         | 97                 | \$ 46,164            | 102                |
| Accruing loans greater than 90 days past due  | \$ -              |                    | \$ -                 |                    |
| Foreclosed real-estate  | \$ 18,898         |                    | \$ 20,955            |                    |
| Total non-performing assets   | \$ 63,882         |                    | \$ 67,119            |                    |
| Total troubled debt restructurings  | \$ 58,243         | 106                | \$ 58,729            | 108                |
| Total non-accrual loans to net loans  | 6.0 %             |                    | 5.9 %                |                    |
| Allowance for loan losses   | \$ 29,252         |                    | \$ 29,871            |                    |
| Allowance to total loans  | 3.7 %             |                    | 3.7 %                |                    |
| Allowance for loan losses to total non-performing loans, including loans contractually past due 90 days or more | 65.0 %            |                    | 64.7 %               |                    |

Total non-accrual and  
accruing loans greater than

|                                     |     |   |     |   |
|-------------------------------------|-----|---|-----|---|
| 90 days past due to total<br>assets | 4.6 | % | 4.8 | % |
|-------------------------------------|-----|---|-----|---|

Total non-performing assets  
to total assets

|     |   |     |   |
|-----|---|-----|---|
| 6.6 | % | 7.0 | % |
|-----|---|-----|---|

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The following tables summarize impaired loans at March 31, 2011 and December 31, 2010 and the period ended March 31 2011 and the year ended December 31, 2010 (dollars in thousands):

|                             | Impaired Loans with<br>Specific Allowance |                      | Impaired<br>Loans with<br>No Specific<br>Allowance | Total Impaired Loans   |                                |
|-----------------------------|---|----------------------|--|------------------------|--------------------------------|
|                             | Recorded<br>Investment                    | Related<br>Allowance | Recorded<br>Investment                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance |
| <b>March 31, 2011</b>       |   |                      |  |                        |                                |
| Residential mortgage        | \$ 35,306                                 | \$ 7,803             | \$ 21,658  | \$ 56,964              | \$ 56,964                      |
| Home equity                 | 1,392                                     | 616                  | 281  | 1,673                  | 1,673                          |
| Lines of credit             | 717                                       | 149                  | 2,767  | 3,484                  | 3,484                          |
| Commercial real estate      | 5,724                                     | 1,488                | 17,830   | 23,554                 | 23,554                         |
| Acquisition and development | 14,467                                    | 2,427                | 9,291  | 23,758                 | 23,758                         |
| Land                        | 5,397                                     | 1,803                | 5,372  | 10,769                 | 10,769                         |
| Commercial non-real estate  | -   | -                    | 305  | 305                    | 305                            |
| Consumer                    | 4   | 4                    | 59   | 63                     | 63                             |
| Total impaired loans        | \$ 63,007                                 | \$ 14,290            | \$ 57,563  | \$ 120,570             | \$ 120,570                     |

|                          | Impaired Loans with<br>Specific Allowance |                      | Impaired<br>Loans with<br>No Specific<br>Allowance | Total Impaired Loans   |                                |
|--------------------------|---|----------------------|--|------------------------|--------------------------------|
|                          | Recorded<br>Investment                    | Related<br>Allowance | Recorded<br>Investment                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance |
| <b>December 30, 2010</b> |   |                      |  |                        |                                |
| Residential mortgage     | \$ 38,251                                 | \$ 8,149             | \$ 20,938  | \$ 59,189              | \$ 59,189                      |
| Home equity              | 568                                       | 434                  | 407  | 975                    | 975                            |
| Lines of credit          | 836                                       | 264                  | 3,728  | 4,564                  | 4,564                          |

|                             |           |           |           |            |            |
|-----------------------------|-----------|-----------|-----------|------------|------------|
| Commercial real estate      | 3,975     | 766       | 19,708    | 23,683     | 23,683     |
| Acquisition and development | 17,273    | 2,645     | 4,664     | 21,937     | 21,937     |
| Land                        | 6,567     | 2,282     | 3,629     | 10,196     | 10,196     |
| Commercial non-real estate  | -         | -         | 305       | 305        | 305        |
| Consumer                    | -         | -         | 61        | 61         | 61         |
| Total impaired loans        | \$ 67,470 | \$ 14,540 | \$ 53,440 | \$ 120,910 | \$ 120,910 |



SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The following tables summarize impaired loans at March 31, 2011 and December 31, 2010 and the period ended March 31 2011 and the year ended December 31, 2010 (dollars in thousands):

|                             | Impaired Loans with<br>Specific Allowance |                                  | Impaired Loans with No<br>Specific Allowance |                                  | Total Impaired Loans              |                                  |
|-----------------------------|---|----------------------------------|--|----------------------------------|-----------------------------------|----------------------------------|
|                             | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment            | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>March 31, 2011</b>       |   |                                  |  |                                  |                                   |                                  |
| Residential mortgage        | \$ 35,528                                 | \$ 303                           | \$ 21,608                                    | \$ 259                           | \$ 57,136                         | \$ 562                           |
| Home equity                 | 1,392                                     | 14                               | 281  | 2                                | 1,673                             | 16                               |
| Lines of credit             | 716                                       | 5                                | 2,767  | 22                               | 3,483                             | 27                               |
| Commercial real estate      | 5,732                                     | 71                               | 17,880                                       | 265                              | 23,612                            | 336                              |
| Acquisition and development | 14,622                                    | 228                              | 9,358  | 113                              | 23,980                            | 341                              |
| Land                        | 5,404                                     | 61                               | 5,373  | 47                               | 10,777                            | 108                              |
| Commercial non-real estate  | -   | 305                              | 7  | 305                              | 7                                 | -                                |
| Consumer                    | 4   | -                                | 59   | -                                | 63                                | -                                |
| Total impaired loans        | \$ 63,398                                 | \$ 682                           | \$ 57,631                                    | \$ 715                           | \$ 121,029                        | \$ 1,397                         |

|                          | Impaired Loans with<br>Specific Allowance |                                  | Impaired Loans with No<br>Specific Allowance |                                  | Total Impaired Loans              |                                  |
|--------------------------|---|----------------------------------|--|----------------------------------|-----------------------------------|----------------------------------|
|                          | Average<br>Recorded<br>Investment         | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment            | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <b>December 31, 2010</b> |   |                                  |  |                                  |                                   |                                  |
| Residential mortgage     | \$ 39,382                                 | \$ 1,508                         | \$ 21,611                                    | \$ 1,057                         | \$ 60,993                         | \$ 2,565                         |
| Home equity              | 568                                       | 21                               | 407  | 17                               | 975                               | 38                               |
| Lines of credit          | 985                                       | 167                              | 3,294  | 115                              | 4,279                             | 282                              |
| Commercial real estate   | 4,034                                     | 248                              | 19,838                                       | 1,420                            | 23,872                            | 1,668                            |
| Acquisition and          | 19,327                                    | 1,212                            | 5,307  | 303                              | 24,634                            | 1,515                            |

|                 |           |          |           |          |            |          |
|-----------------|-----------|----------|-----------|----------|------------|----------|
| development     |           |          |           |          |            |          |
| Land            | 6,572     | 288      | 3,772     | 492      | 10,344     | 780      |
| Commercial      |           |          |           |          |            |          |
| non-real estate | -         | -        | 900       | 45       | 900        | 45       |
| Consumer        | -         | -        | 61        | -        | 61         | -        |
| Total           |           |          |           |          |            |          |
| impaired loans  | \$ 70,868 | \$ 3,444 | \$ 55,190 | \$ 3,449 | \$ 126,058 | \$ 6,893 |

Changes in impaired loans during the three months ended March 31, 2011 is as follows (dollars in thousands):

|   |           |
|---|-----------|
| Impaired loans at December 31, 2010               | \$120,910 |
| Added to impaired loans                           | 8,206     |
| Gross loans transferred to foreclosed real estate | (4,700 )  |
| Paid off prior to foreclosure                     | (3,846 )  |
| Impaired loans at March 31, 2011                  | \$120,570 |

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

Included in the above impaired loans amount at March 31, 2011 is \$75,586,000 of loans that are not in non-accrual status. In addition, there was a total of \$56,964,000 of residential real estate loans included in impaired loans at March 31, 2011, of which \$44,972,000 were to consumers and \$11,992,000 to builders. The collateral supporting impaired loans is individually reviewed by management to determine its estimated fair market value, less estimated disposal cost and a specific allowance is established, if necessary, for the difference between the carrying amount of any loan and the estimated fair value of the collateral less estimated disposal cost.

Of the impaired loans, \$63,007,000 and \$67,470,000 had a specific valuation allowance of \$14,290,000 and \$14,540,000 at March 31, 2011 and December 31, 2010, respectively. Impaired loans averaged \$121,029,000 and \$126,058,000 for the period ended March 31, 2011 and the year ended December 31, 2010, respectively.

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, 2011 and December 31, 2010 (dollars in thousands):

|                        | Pass       | Special<br>Mention | Substandard | Doubtful | Total      |
|------------------------|------------|--------------------|-------------|----------|------------|
| <b>March 31, 2011</b>  |            |                    |             |          |            |
| <b>Residential</b>     |            |                    |             |          |            |
| mortgage               | \$ 274,057 | \$ 8,391           | \$ 32,384   | \$ -     | \$ 314,832 |
| Home equity            | 40,294     | 1,439              | 1,673       | -        | 43,406     |
| Lines of credit        | 27,694     | 2,973              | 3,538       | -        | 34,205     |
| <b>Commercial real</b> |            |                    |             |          |            |
| estate                 | 186,544    | 3,419              | 13,290      | -        | 203,253    |
| Acquisition and        |            |                    |             |          |            |
| development            | 98,242     | 13,829             | 26,792      | -        | 138,863    |
| Land                   | 45,870     | 6,187              | 9,450       | -        | 61,507     |
| <b>Commercial</b>      |            |                    |             |          |            |
| non-real estate        | 8,241      | 38                 | -           | -        | 8,279      |
| Consumer               | 1,472      | -                  | 63          | -        | 1,535      |
| Total loans            | \$ 682,414 | \$ 36,276          | \$ 87,190   | \$ -     | \$ 805,880 |

|                          | Pass       | Special<br>Mention | Substandard | Doubtful | Total      |
|--------------------------|------------|--------------------|-------------|----------|------------|
| <b>December 31, 2010</b> |            |                    |             |          |            |
| <b>Residential</b>       |            |                    |             |          |            |
| mortgage                 | \$ 281,027 | \$ 9,999           | \$ 35,229   | \$ -     | \$ 326,255 |
| Home equity              | 41,030     | 1,497              | 974         | -        | 43,501     |

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|                             |            |           |           |      |            |
|-----------------------------|------------|-----------|-----------|------|------------|
| Lines of credit             | 28,979     | 2,796     | 4,867     | -    | 36,642     |
| Commercial real estate      | 197,031    | 3,667     | 11,779    | -    | 212,477    |
| Acquisition and development | 105,052    | 13,481    | 25,565    | -    | 144,098    |
| Land                        | 48,384     | 5,708     | 9,063     | -    | 63,155     |
| Commercial non-real estate  | 8,091      | 38        | 305       | -    | 8,434      |
| Consumer                    | 1,243      | -         | 59        | -    | 1,302      |
| Total loans                 | \$ 710,837 | \$ 37,186 | \$ 87,841 | \$ - | \$ 835,864 |

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

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. 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, 2011 and December 30, 2010 (dollars in thousands):

|                             | Current   | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | 90<br>Days+<br>Past Due | Total<br>Past Due | Non-<br>Accrual | Total Loans |
|-----------------------------|-----------|---------------------------|---------------------------|-------------------------|-------------------|-----------------|-------------|
| <b>March 31, 2011</b>       |           |                           |                           |                         |                   |                 |             |
| Residential mortgage        | \$288,965 | \$5,988                   | \$1,537                   | \$-                     | \$7,525           | \$18,342        | \$314,832   |
| Home equity                 | 42,614    | 674                       | -                         | -                       | 674               | 118             | 43,406      |
| Lines of credit             | 31,946    | -                         | -                         | -                       | -                 | 2,259           | 34,205      |
| Commercial real estate      | 194,307   | 1,571                     | 3,235                     | -                       | 4,806             | 4,140           | 203,253     |
| Acquisition and development | 121,305   | 1,870                     | 472                       | -                       | 2,342             | 15,216          | 138,863     |
| Land                        | 54,200    | 1,760                     | 666                       | -                       | 2,426             | 4,881           | 61,507      |
| Commercial non-real estate  | 8,279     | -                         | -                         | -                       | -                 | -               | 8,279       |
| Consumer                    | 1,507     | -                         | -                         | -                       | -                 | 28              | 1,535       |
| Total loans                 | \$743,123 | \$11,863                  | \$5,910                   | \$-                     | \$17,773          | \$44,984        | \$805,880   |
|                             | Current   | 30-59<br>Days Past<br>Due | 60-89<br>Days Past<br>Due | 90<br>Days+<br>Past Due | Total<br>Past Due | Non-<br>Accrual | Total Loans |
| <b>December 31, 2010</b>    |           |                           |                           |                         |                   |                 |             |
| Residential mortgage        | \$297,793 | \$5,028                   | \$4,656                   | \$-                     | \$9,684           | \$18,778        | \$326,255   |
| Home equity                 | 43,138    | 115                       | 130                       | -                       | 245               | 118             | 43,501      |
| Lines of credit             | 29,465    | 854                       | 2,058                     | -                       | 2,912             | 4,265           | 36,642      |
| Commercial real estate      | 206,434   | 3,058                     | 1,058                     | -                       | 4,116             | 1,927           | 212,477     |
| Acquisition and development | 122,858   | 1,950                     | 4,130                     | -                       | 6,080             | 15,160          | 144,098     |
| Land                        | 52,492    | 3,865                     | 908                       | -                       | 4,773             | 5,890           | 63,155      |
|                             | 8,434     | -                         | -                         | -                       | -                 | -               | 8,434       |

Commercial  
non-real estate

|             |           |          |          |     |          |          |           |
|-------------|-----------|----------|----------|-----|----------|----------|-----------|
| Consumer    | 1,272     | 4        | -        | -   | 4        | 26       | 1,302     |
| Total loans | \$761,886 | \$14,874 | \$12,940 | \$- | \$27,814 | \$46,164 | \$835,864 |

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 10 - Loans Receivable - Continued

The following tables summarize troubled debt restructurings at March 31, 2011 (dollars in thousands):

Modifications  
As of March 31, 2011

|                                     | Number of<br>Contracts | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding Recorded<br>Investment |
|-------------------------------------|------------------------|---|---|
| <b>Troubled Debt Restructurings</b> |                        |   |   |
| Residential mortgage                | 71                     | \$ 30,862   | \$ 30,791   |
| Home equity                         | -                      | -   | -   |
| Lines of credit                     | -                      | -   | -   |
| Commercial real estate              | 15                     | 13,537  | 13,344  |
| Acquisition and development         | 8                      | 10,011  | 9,782   |
| Land                                | 12                     | 4,503   | 4,326   |
| Commercial non-real estate          | -                      | -   | -   |
| Consumer                            | -                      | -   | -   |
| Total loans                         | 106                    | \$ 58,913   | \$ 58,243   |

|   | Number of<br>Contracts | Recorded<br>Investment |
|---|------------------------|------------------------|
| <b>Troubled Debt Restructurings That Subsequently<br/>Defaulted</b> |                        |                        |
| Residential mortgage  | 5                      | \$ 1,560               |
| Home equity   | 1                      | 100                    |
| Lines of credit   | -                      | -                      |
| Commercial real estate  | -                      | -                      |
| Acquisition and development   | 2                      | 2,310                  |
| Land  | -                      | -                      |
| Commercial non-real estate  | -                      | -                      |
| Consumer  | -                      | -                      |
| Total loans   | 8                      | \$ 3,970               |

Mortgage loans serviced for others not included in the accompanying consolidated statements of financial condition totaled \$83,380,000 and \$82,082,000 at March 31, 2011 and December 31, 2010, respectively.

The Bank 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 consolidated statement of financial condition. The contract amounts of these instruments express the extent of involvement the Bank has in each class of financial instruments.



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

Note 10 - Loans Receivable - Continued

The Bank'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 Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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

| Financial Instruments Whose<br>Contract          | Contract Amount At |                      |
|--|--------------------|----------------------|
| Amounts Represent Credit Risk                    | March 31,<br>2011  | December<br>31, 2010 |
| Standby letters of credit                        | \$ 17,481          | \$ 17,959            |
| Home equity lines of credit                      | 14,113             | 14,340               |
| Unadvanced construction<br>commitments           | 22,618             | 26,662               |
| Mortgage loan commitments                        | 568                | 5,827                |
| Lines of credit                                  | 29,727             | 25,833               |
| Loans sold with limited repurchase<br>provisions | 31,355             | 37,943               |

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, 2011 and December 31, 2010 for guarantees under standby letters of credit issued is not material.

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.



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

Note 10 - Loans Receivable - Continued

Mortgage loan commitments not reflected in the accompanying statements of financial condition at March 31, 2011 include \$320,000 at a fixed rate of 5.50% and \$248,000 at floating rates and at December 31, 2010 include \$5,669,000 at a fixed range of 3.625% to 6.25% and \$158,000 at floating 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 period ended March 31, 2011 and year ended December 31, 2010 were \$6,944,000 and \$59,113,000, 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. No amount was recognized in the consolidated statement of financial condition at March 31, 2011 and December 31, 2010 as a liability for credit loss related to these loans. The Bank has never had to repurchase a loan under these agreements.

Note 11 - Fair Values of Financial Instruments

FASB ASC 820, "Fair Value Measurements and Disclosures", establishes a fair value hierarchy that prioritizes the inputs to valuation methods 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 under FASB ASC 820 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 table summarizes the valuation of assets re-measured at fair value on a nonrecurring basis, by the above FASB ASC 820 pricing methodology as of March 31, 2011 and December 31, 2010 (dollars in thousands):



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

Note 11 - Fair Values of Financial Instruments - Continued

|                        | Fair Value Measurement at March 31, 2011 Using |         |         |           |
|------------------------|--|---------|---------|-----------|
|                        | Total  | Level 1 | Level 2 | Level 3   |
| Impaired loans         | \$ 48,717                                      | -       | -       | \$ 48,717 |
| Foreclosed real estate | 18,898   | -       | -       | 18,898    |

|                        | Fair Value Measurement at December 31, 2010 Using |         |         |           |
|------------------------|---|---------|---------|-----------|
|                        | Total   | Level 1 | Level 2 | Level 3   |
| Impaired loans         | \$ 52,930   | -       | -       | \$ 52,930 |
| Foreclosed real estate | 20,955  | -       | -       | 20,955    |

There were no liabilities that were required to be re-measured on a nonrecurring basis at March 31, 2011 or December 31, 2010.

The following information should not be interpreted as an estimate of the fair value of the entire 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 assets and liabilities at March 31, 2011 and December 31, 2010.

**Cash and cash equivalents:**

The carrying amount reported in the consolidated statement 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 fixed income 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.

**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, 2011 and December 31, 2010.

**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 and using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

SEVERN BANCORP, INC. AND SUBSIDIARIES  
Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 11 - Fair Values of Financial Instruments - Continued

These rates were used for each aggregated category of loans as reported on the Office of Thrift Supervision Quarterly Report.

Impaired loans are those that are accounted for under FASB ASC 310-10-35, in which Bancorp has measured impairment generally based 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 \$63,007,000 and \$67,470,000 at March 31, 2011 and December 31, 2010, respectively, less their valuation allowances of \$14,290,000 and \$14,540,000 at March 31, 2011 and December 31, 2010, respectively, as determined under FASB ASC 310-10-35.

Foreclosed Real Estate:

Real estate acquired through or in the process of foreclosure is recorded and included in the above disclosure at 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 an allowance to reduce real estate acquired through foreclosure to fair value less estimated disposal cost. The fair value consisted of the foreclosed real estate balances of \$18,898,000 and \$20,955,000 at March 31, 2011 and December 31, 2010, respectively, less their write downs of \$3,083,000 and \$2,839,000 at March 31, 2011 and December 31, 2010, respectively, as determined under FASB ASC 310-10-35. 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.

Accrued interest receivable and payable:

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

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.





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

Note 11 - Fair Values of Financial Instruments - Continued

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.

The following table summarizes the roll forward of level 3 assets for the three months ended March 31, 2011 and 2010 (dollars in thousands):

|                                    | Impaired<br>Loans | Foreclosed<br>Real Estate |
|------------------------------------|-------------------|---------------------------|
| Balance at December 31, 2010       | \$ 52,930         | \$ 20,955                 |
| Transfer to foreclosed real estate | (3,266 )          | 3,908                     |
| Additions                          | 8,718             | 197                       |
| Additional allowances              | 249               | (1,059 )                  |
| Paid off/sold                      | (9,914 )          | (5,103 )                  |
| Balance at March 31, 2011          | \$ 48,717         | \$ 18,898                 |

  

|                                    | Impaired<br>Loans | Foreclosed<br>Real Estate |
|------------------------------------|-------------------|---------------------------|
| Balance at December 31, 2009       | \$ 50,403         | \$ 21,574                 |
| Transfer to foreclosed real estate | (6,660 )          | 7,026                     |
| Additions                          | 19,903            | 240                       |
| Additional allowances              | (577 )            | (934 )                    |
| Paid off/sold                      | (10,889 )         | (4,321 )                  |
| Balance at March 31, 2010          | \$ 52,180         | \$ 23,585                 |

The \$249,000 in reduced allowances recorded against impaired loans was included in the provision for loan losses on the statement of operations for the three months ended March 31, 2011. The \$1,059,000 of additional reserves recorded against foreclosed real estate was included in non-interest expenses on the statement of operations for the three months ended March 31, 2011. Included in the \$3,908,000 of loans transferred to foreclosed real estate were three loans totaling \$1,305,000 that were not considered impaired per FASB ASC 310-10-35.

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, 2011 and December 31, 2010 were as follows:

|                              | March 31, 2011     |               | December 31, 2010  |               |
|------------------------------|--------------------|---------------|--------------------|---------------|
|                              | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| (dollars in thousands)       |                    |               |                    |               |
| <b>Financial Assets</b>      |                    |               |                    |               |
| Cash and cash equivalents    | \$ 106,045         | \$ 106,045    | \$ 70,955          | \$ 70,955     |
| Investment securities        | 31,248             | 31,427        | 27,311             | 27,556        |
| FHLB stock                   | 7,692              | 7,692         | 7,692              | 7,692         |
| Loans held for sale          | 342                | 342           | 3,426              | 3,426         |
| Loans receivable, net        | 751,160            | 782,036       | 778,937            | 819,864       |
| Accrued interest receivable  | 3,713              | 3,713         | 3,918              | 3,918         |
| <b>Financial Liabilities</b> |                    |               |                    |               |
| Deposits                     | \$ 718,298         | \$ 722,292    | \$ 714,776         | \$ 719,142    |
| FHLB advances                | 115,000            | 106,811       | 115,000            | 105,546       |
| Subordinated debentures      | 24,119             | 24,119        | 24,119             | 24,119        |
| Accrued interest payable     | 678                | 678           | 694                | 694           |
| <b>Off Balance Sheet</b>     |                    |               |                    |               |
| Commitments                  | \$ -               | \$ -          | \$ -               | \$ -          |

Note 12 - Recent Accounting Pronouncements

In January 2010, the FASB has issued Accounting Standard Update “ASU” 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB’s objective is to improve these disclosures and, thus increase the transparency in financial reporting. Specifically, ASU 2010-6 amends Codification Subtopic 820-10 to now require:

- A reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and
- In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements.

In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

- For purposes of reporting fair value measurements for each class of assets and liabilities, a reporting entity need to use judgment in determining the appropriate classes of assets and liabilities; and

- A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

In January 2011, the FASB issued ASU 2011-1, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No.2010-20 (ASU 2011-1). The FASB determined that certain provisions relating to troubled debt restructurings (TDRs) should be deferred until additional guidance and clarification on the definition of TDRs is issued.

In April 2011, the FASB issued ASU No. 2011-2, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt restructuring (ASU 2011-2). ASU 2011-2 amends ASC Topic 310 – Receivables, by clarifying guidance for creditors in determining whether a concession has been granted and whether a debtor is experiencing financial difficulties. The amendments are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. ASU 2011-2 also makes disclosure requirements deferred under ASU 2011-1 effective for interim and annual periods beginning on or after June 15, 2011. Bancorp has evaluated the effect of ASU 2011-2 and believes adoption will not have a material effect on the consolidated financial statements.

## 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, and is headquartered in Annapolis, Maryland. It conducts business primarily through three subsidiaries: the Bank, a federal savings bank, which is Bancorp's principal subsidiary; Louis Hyatt, Inc., a subsidiary of the Bank, 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 loans in its primary market of Anne Arundel County, Maryland and, to a lesser extent, in other parts of Maryland, Delaware and Virginia. Bancorp's common stock trades under the symbol "SVBI" on the Nasdaq Capital Market.

### 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," and similar expressions are typically used to 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 on 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 with the Office of Thrift Supervision; 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, 2010.

## Critical Accounting Policies

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.

Bancorp's significant accounting policies are set forth in Note 1 of the audited consolidated financial statements as of December 31, 2010 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 and the fair value of foreclosed real estate to be its most critical, because they require 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 the fair value of foreclosed real estate and therefore on the provision for loan losses and the provision for losses on foreclosed real estate and, ultimately, on results of operations. 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 and estimated value of foreclosed real estate. 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 continues to experience improved earnings from those experienced during the second half of 2008 and all of 2009 as it sees some improvement in the national and local economic environment. While current earnings are better than the same quarter of 2010, Bancorp may continue to experience the challenges it and many other financial institutions faced in 2008 and 2009 as a result of the economic recession. Those challenges, including increased loan delinquencies and a decrease in the demand for certain loan products including construction, development, and land acquisition loans, continue to show signs of improvement from 2008 and 2009. However, continued declines in real estate values, home sales volumes and financial stress on borrowers as a result of the recession, including job losses and other factors, have continued to affect Bancorp's borrowers. Management believes that this economic deterioration has stabilized which has caused loan delinquencies and impaired loans to decrease from 2009 levels. The interest rate spread between Bancorp's cost of funds and what it earns on loans has increased from 2009 and 2010 levels. The increase in interest rate spread was caused by a decrease in non-accrual loans in which interest income was not recorded, and decreases in interest rates paid on deposits and other borrowings outpacing the decreases in interest earned on loans.

If interest rates increase, demand for borrowing may remain low 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 increased by \$975,000 to a net income of \$447,000 for the first quarter of 2011, compared to a net loss of \$528,000 for the first quarter of 2010. Basic and diluted earnings (loss) per share increased by \$.10, to \$.00 for the first quarter of 2011 compared to \$(.10) for the first quarter of 2010. The increase in net income and basic and diluted earnings (loss) per share over last year was primarily the result of improvement in Bancorp's loan portfolio which required less provisioning for potential loan losses.

Net interest income, which is interest earned net of interest expense, decreased by \$44,000, or 0.6%, to \$7,572,000 for the first quarter of 2011, compared to \$7,616,000 for the first quarter of 2010. The primary reason for the decrease in net interest income was a decrease in Bancorp's loan portfolio and a decrease in the net interest margin. Net interest margin for the three months ended March 31, 2011 was 3.46%, compared to 3.49% for the same period in 2010.





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 the Bank determined it was worth at the time of the granting of the loan. The Bank monitors its loan portfolio loan delinquencies at least as often as monthly. All loans that are delinquent and all loans within the various categories of the Bank's portfolio as a group are evaluated. The Bank's Board, with the advice and recommendation of the Bank's loss mitigation committee, 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 \$1,910,000, or 75.1%, to \$634,000 for the first quarter of 2011, compared to \$2,544,000 for the first quarter of 2010. This decrease was a result of management's determination that less of a provision for loan losses was needed for the level of inherent risk in its portfolio for the quarter ended March 31, 2011 as compared to the quarter ended March 31, 2010. Bancorp's total loan portfolio has decreased from 2010. In addition, Bancorp has experienced a modest decrease in loan delinquencies, which contributed to the decision to reduce the provision for loan losses from first quarter of 2010 levels. Management believes that Bancorp will continue to experience improvement in the challenges faced by many financial institutions resulting from the slowdown in the economy and real estate markets.

Total non-interest income decreased by \$1,000, or 0.2%, to \$562,000 for the first quarter of 2011, compared to \$563,000 for the first quarter of 2010. The primary reason for the decrease in non-interest income was a decrease in real estate commissions and management fees by Hyatt Commercial, partially offset by increased mortgage banking activities. Real estate commissions decreased \$26,000, or 19.0%, to \$111,000 for the first quarter of 2011, compared to \$137,000 for the first quarter of 2010. This decrease was due to lower sales and leasing activity in 2011 compared to 2010. Real estate management fees decreased \$9,000, or 6.0%, to \$142,000 for the first quarter of 2011, compared to \$151,000 for the first quarter of 2010. This decrease was partially offset by an increase in mortgage banking activity of \$56,000, or 56.6%, to \$155,000 for the first quarter of 2011, compared to \$99,000 for the first quarter of 2010. This increase was due to higher loan refinancing activity in the first quarter of 2011 compared to the first quarter of 2010.

Total non-interest expenses increased by \$245,000, or 3.8%, to \$6,709,000 for the first quarter of 2011, compared to \$6,464,000 for the first quarter of 2010. Compensation and related expenses increased by \$162,000, or 6.6%, to \$2,614,000 for the first quarter of 2011, compared to \$2,452,000 for the first quarter of 2010. This increase was primarily because of salary increases that went into effect January 1, 2011 and an increase in salary expense and health insurance from newly hired employees. Net occupancy costs decreased by \$179,000, or 41.2%, to \$255,000 for the first quarter of 2011, compared to \$434,000 for the first quarter of 2010. This decrease was the result of increased rents collected on a previously unoccupied space which helped offset occupancy costs. Foreclosed real estate expenses, net increased by \$323,000, or 19.9%, to \$1,945,000 for the first quarter of 2011, compared to \$1,622,000 for the first quarter of 2010. This increase was the result of additional foreclosure expenses incurred due to the economic environment and the increase in loan foreclosures experienced by Bancorp. Legal fees decreased by \$84,000, or 31.3%, to \$184,000 for the first quarter of 2010, compared to \$268,000 for the first quarter of 2010. This decrease was the result of the timing of services provided by outside legal firms. FDIC assessments and regulatory expense remained constant at \$560,000 for the first quarter of 2011, compared to \$561,000 for the first quarter of 2010. Other non-interest expenses increased by \$24,000, or 2.1%, to \$1,151,000 for the first quarter of 2011 compared to \$1,127,000 for the first quarter of 2010. There were no material variances in the increase.



## Income Taxes

Income tax expense increased by \$645,000 to \$344,000 for the first quarter of 2011 compared to an income tax benefit of \$301,000 for the first quarter of 2010. The increase was consistent with the increase in pretax income. The effective tax rate for the first quarter of 2011 was 43.5% compared to 36.3% for the first quarter of 2010. The change in the effective tax rate was primarily due to a valuation allowance placed on a portion of the deferred tax asset resulting from current state operating loss carryforwards.

## Analysis of Financial Condition

Total assets increased \$5,193,000, or 0.5%, to \$967,736,000 at March 31, 2011, compared to \$962,543,000 at December 31, 2010. Cash and cash equivalents increased by \$35,090,000, or 49.5%, to \$106,045,000 at March 31, 2011, compared to \$70,955,000 at December 31, 2010. This increase was primarily in federal funds sold and correspondent bank balances. The loan portfolio decreased, as net loans receivable decreased \$27,777,000, or 3.6%, to \$751,160,000 at March 31, 2011, compared to \$778,937,000 at December 31, 2010. This decrease was the result of the continued general slowdown in loan demand during the first three months of 2011 and the transfer of \$3,908,000 of net loans to foreclosed real estate. Loans held for sale decreased \$3,084,000, or 90.0%, to \$342,000 at March 31, 2011, compared to \$3,426,000 at December 31, 2010. This decrease was primarily due to lower loan demand and the timing of loans pending sale as of March 31, 2011. Foreclosed real estate decreased \$2,057,000, or 9.8%, to \$18,898,000 at March 31, 2011 compared to \$20,955,000 at December 31, 2010. Total deposits increased \$3,532,000, or 0.5%, to \$718,298,000 at March 31, 2011 compared to \$714,776,000 at December 31, 2010. These changes are primarily the result of Bancorp's continued marketing of checking accounts and increased banking relationships. FHLB Atlanta borrowings remained at \$115,000,000 at March 31, 2011, compared to December 31, 2010.

## Stockholders' Equity

Total stockholders' equity increased \$113,000, or 0.1%, to \$106,213,000 at March 31, 2011 compared to \$106,100,000 as of December 31, 2010. This increase was primarily a result of the net income for the first quarter of 2011 partially offset by dividends paid to its 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 so that Bancorp may take advantage of business opportunities.

Management believes it 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 \$162,576,000 at March 31, 2011. Based on past experience, management believes that a significant portion of such deposits will remain with Bancorp. At March 31, 2011, Bancorp had commitments to originate mortgage loans of \$568,000, unadvanced home equity lines of credit of \$14,113,000, unadvanced construction commitments of \$22,618,000, unused lines of credit of \$29,727,000, and commitments under standby letters of credit of \$17,481,000. 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, 2011, outstanding FHLB Atlanta borrowings totaled \$115,000,000, and Bancorp had available

to it an additional \$76,700,000 in borrowing availability from FHLB Atlanta.

Net cash provided by operating activities decreased \$1,931,000 to \$7,865,000 for the three months ended March 31, 2011, compared to \$9,796,000 for the same period in 2010. This decrease was primarily the result of a decrease in the provision for loan losses and a smaller decrease in accrued interest receivable and other assets in 2011. Net cash provided by investing activities for the three months ended March 31, 2011 was \$24,065,000 compared to \$2,043,000 used in investing activities for the same period in 2010, an increase of \$26,108,000. This increase was primarily due to a net decrease in loans in 2011 compared to a net increase in 2010. Net cash provided by financing activities increased by \$1,475,000 to \$3,160,000 for the three months ended March 31, 2011, compared to \$1,685,000 for the same period in 2010. This increase was primarily due to an increase in deposits in 2011.

#### 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 (20%) of its total assets, with the FHLB Atlanta. As of March 31, 2011, the total available line of credit with the FHLB Atlanta was approximately \$191,700,000, of which \$115,000,000 was outstanding. 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, 2011 (dollars in thousands):

| Principal<br>Amount | Rate  | Maturity   |
|---------------------|-------|------------|
| \$ -                | - %   | 2011       |
| -                   | - %   | 2012       |
| -                   | - %   | 2013       |
|                     | 2.94% |            |
|                     | to    |            |
| 25,000              | 4.21% | 2014       |
|                     | 3.71% |            |
|                     | to    |            |
| 40,000              | 4.34% | 2015       |
|                     | 2.58% |            |
|                     | to    |            |
| 50,000              | 4.05% | Thereafter |
| \$ 115,000          |       |            |

#### Subordinated Debentures

As of March 31, 2011, 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 (0.30313% as of March 31, 2011) 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.

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, 2011 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.

#### 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, 2013, 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.

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. The Series B Preferred Stock qualifies as Tier 1 capital and will pay cumulative compounding dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter.

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.

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.





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, prior to November 21, 2011, unless Bancorp has redeemed the Series B preferred stock or the Treasury Department has transferred the Series B preferred stock to a third party, Bancorp may not, without the consent of the Treasury (1) declare or pay any dividend or make any distribution on its common stock (other than regular quarterly cash dividends of not more than \$0.06 per share) or (2) redeem, purchase or acquire any shares of our common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Letter Agreement with the Treasury Department.

On November 23, 2009, Bancorp and the Bank entered into supervisory agreements with its regulators. 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.

#### 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, 2011 and March 31, 2010:

|   | Three Months Ended March 31, 2011 |          |            |   | Three Months Ended March 31, 2010 |          |            |   |
|---|-----------------------------------|----------|------------|---|-----------------------------------|----------|------------|---|
|   | Average<br>Volume                 | Interest | Yield/Cost |   | Average<br>Volume                 | Interest | Yield/Cost |   |
| (dollars in thousands)  |                                   |          |            |   |                                   |          |            |   |
| ASSETS  |                                   |          |            |   |                                   |          |            |   |
| Loans (1)   | \$787,252                         | \$11,529 | 5.86       | % | \$836,985                         | \$12,542 | 5.99       | % |
| Held to maturity securities (2)   | 32,021                            | 122      | 1.52       | % | 9,317                             | 40       | 1.72       | % |
| Other interest-earning assets<br>(3)                                    | 55,391                            | 47       | 0.34       | % | 27,042                            | 14       | 0.21       | % |
| Total interest-earning assets   | 874,664                           | 11,698   | 5.35       | % | 873,344                           | 12,596   | 5.77       | % |
| Non-interest earning assets   | 86,884                            |          |            |   | 94,101                            |          |            |   |
| Total assets  | \$961,548                         |          |            |   | \$967,445                         |          |            |   |
| LIABILITIES AND STOCKHOLDERS' EQUITY                                    |                                   |          |            |   |                                   |          |            |   |
| Savings and checking deposits   | \$296,889                         | 694      | 0.94       | % | \$271,891                         | 1,058    | 1.56       | % |
| Certificates of deposit   | 415,284                           | 2,144    | 2.07       | % | 435,855                           | 2,524    | 2.32       | % |
| Long-term borrowings  | 139,119                           | 1,288    | 3.70       | % | 125,000                           | 1,398    | 4.47       | % |
| Total interest-bearing liabilities                                      | 851,292                           | 4,126    | 1.94       | % | 832,746                           | 4,980    | 2.39       | % |
| Non-interest bearing liabilities  | 3,446                             |          |            |   | 29,092                            |          |            |   |
| Stockholders' equity  | 106,810                           |          |            |   | 105,607                           |          |            |   |
| Total liabilities and stockholders' equity                              | \$961,548                         |          |            |   | \$967,445                         |          |            |   |
| Net interest income and interest rate spread                            |                                   | \$7,572  | 3.41       | % |                                   | \$7,616  | 3.38       | % |
| Net interest margin   |                                   |          | 3.46       | % |                                   |          | 3.49       | % |
| Average interest-earning assets to average interest-bearing liabilities |                                   |          | 102.75     | % |                                   |          | 104.88     | % |

(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 includes interest-bearing deposits in other banks, federal funds sold and FHLB stock investments.

#### 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, 2010, as reported in Bancorp's Form 10-K filed with the SEC on March 15, 2011.

#### Item 4. 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 defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2011. Based upon this evaluation, Bancorp's Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2011, Bancorp's disclosure controls and procedures were effective in reaching a reasonable level of assurance that (i) information required to be disclosed by Bancorp in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) information required to be disclosed by Bancorp in its reports that it files or submits under the Exchange Act 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 Bancorp'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 March 31, 2011 that have materially affected, or are reasonably likely to materially affect, Bancorp'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 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.

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, 2010 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, 2010.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

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 |

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, 2011

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

May 12, 2011

Thomas G. Bevivino  
Thomas G. Bevivino, Executive Vice President  
and Chief Financial Officer  
(Principal Financial Officer)

Exhibit Index

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