

SEVERN BANCORP INC
Form 10-K
March 17, 2016

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

FORM 10-K

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

For the fiscal year ended December 31, 2015
or

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

For the transition period from _____ to _____ .

Commission File Number 0-49731

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

Maryland	52-1726127
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

200 Westgate Circle, Suite 200, Annapolis, Maryland	21401
(Address of principal executive offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
---------------------	---

Common Stock, par value \$.01 per share	Nasdaq Capital Market
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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ☐ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☐

Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	(Do not
	Smaller reporting company	check if a smaller reporting company)	

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

The aggregate market value of the 6,413,607 shares of common stock held by non-affiliates of the registrant, based on the closing sale price of the registrant's common stock on June 30, 2015 of \$4.81 per share was \$30,849,450.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

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

As of March 1, 2016, there were issued and outstanding 10,088,879 shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement for its 2016 Annual Meeting of Stockholders, which Definitive Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the registrant's fiscal year-ended December 31, 2015, are incorporated by reference into Part III of this Form 10-K; provided, however, that the Audit Committee Report and any other information in such proxy statement that is not required to be included in this Annual Report on Form 10-K, shall not be deemed to be incorporated herein by reference or filed as a part of this Annual Report on Form 10-K.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Severn Bancorp, Inc. (“Bancorp”) may from time to time make written or oral “forward-looking statements”, (as defined in the Securities Exchange Act of 1934, as amended, and the regulations thereunder) including statements contained in Bancorp’s filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits thereto), in its reports to stockholders and in other communications by Bancorp, pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements include, but are not limited to:

- Statements contained in “Item 1A. Risk Factors;”
- Statements contained in “Business” concerning strategy, competitive strengths, liquidity and business plans;

Statements contained in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the notes to Bancorp’s consolidated financial statements, such as statements concerning allowance for loan losses, liquidity, capital adequacy requirements, unrealized losses, guarantees, the Bank being well-capitalized, and impact of accounting pronouncements; and

- Statements as to trends or Bancorp’s or management’s beliefs, expectations and opinions.

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” “would,” “could,” “should,” “guidance,” “continue,” “project,” “forecast,” “confident,” and similar expressions are typically used to identify forward-looking statements. These statements are based on assumptions and assessments made by management in light of their experience and their perception of historical trends, current conditions, expected future developments and other factors they believe to be appropriate. Any forward-looking statements are not guarantees of Bancorp’s future performance and are subject to risks and uncertainties and may be affected by various factors that may cause actual results, developments and business decisions to differ materially from those in the forward-looking statements. Some of the factors that may cause actual results, developments and business decisions to differ materially from those contemplated by such forward-looking statements include the risk factors discussed under “Item 1A. Risk Factors” and the following:

- Changes in general economic and political conditions and by governmental monetary and fiscal policies;
- Changes in the economic conditions of the geographic areas in which Bancorp conducts business;
- Changes in interest rates;
- A downturn in the real estate markets in which Bancorp conducts business;
- The high degree of risk exhibited by Bancorp’s loan portfolio;
- Environmental liabilities with respect to properties of which Bancorp has title;
- Changes in federal and state regulation, including recent changes in capital requirements;
- Bancorp’s ability to estimate loan losses;
- Competition;

- Breaches in security or interruptions in Bancorp's information systems, including cyber security risks;
- Bancorp's ability to timely develop and implement technology;
- Bancorp's ability to retain its management team;

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· Perception of Bancorp in the marketplace;

· Bancorp's ability to maintain effective internal controls over financial reporting and disclosure controls and procedures; and

· Terrorist attacks and threats or actual war.

Bancorp can give no assurance that any of the events anticipated by the forward-looking statements will occur or, if any of them does, what impact they will have on Bancorp's results of operations and financial condition. Bancorp disclaims any intent or obligation to publicly update or revise any forward-looking statements, regardless of whether new information becomes available, future developments occur or otherwise.

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PART I

Item 1. Business

General

Bancorp is a savings and loan holding company chartered as a corporation in the state of Maryland in 1990. It conducts business primarily through two subsidiaries, Severn Savings Bank, FSB (“Bank”) and SBI Mortgage Company (“SBI”). The Bank’s principal subsidiary Louis Hyatt, Inc. (“Hyatt Commercial”), conducts business as Hyatt Commercial, a commercial real estate brokerage and property management company. SBI holds mortgages that do not meet the underwriting criteria of the Bank, and is the parent company of Crownsville Development Corporation (“Crownsville”), which is doing business as Annapolis Equity Group, which acquires real estate for syndication and investment purposes.

The Bank has four branches in Anne Arundel County, Maryland, which offer a full range of deposit products, and originate mortgages in its primary market of Anne Arundel County, Maryland and, to a lesser extent, in other parts of Maryland, Delaware and Virginia.

On November 23, 2009, Bancorp and the Bank each entered into a supervisory agreement with the Office of Thrift Supervision (“OTS”). As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), effective as of July 21, 2011, the OTS was abolished and the regulatory oversight functions and authority of the OTS related to the Bank were transferred to the Office of the Comptroller of the Currency (“OCC”) and the regulatory oversight functions and authority of the OTS related to Bancorp were transferred to the Board of Governors of the Federal Reserve System (“Federal Reserve” or “FRB”). The Bank’s supervisory agreement was replaced by a formal agreement dated April 13, 2013 with the OCC. On October 15, 2015, the Bank was notified by the OCC that its agreement was terminated. Bancorp’s supervisory agreement was enforced by FRB. On January 21, 2016, Bancorp was notified by the FRB that its agreement was terminated.

On April 23, 2013, the Bank was notified by the OCC that the OCC established minimum capital ratios for the Bank requiring it to immediately maintain a Tier I Leverage Capital Ratio to Adjusted Total Assets of at least 10% and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least 15%. On October 15, 2015, the Bank was notified by the OCC that these additional minimum capital ratios were no longer required.

As of December 31, 2015, Bancorp had total assets of \$762,079,000, total deposits of \$523,771,000, and total stockholders’ equity of \$86,456,000. Bancorp’s net income for the year ended December 31, 2015 was \$4,535,000. For more information, see “Item 6. Selected Financial Data.”

Bancorp’s internet address is www.severnbank.com. Bancorp makes available free of charge on www.severnbank.com its annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after it electronically files such material with, or furnishes it to, the SEC.

In addition, we will provide, at no cost, paper or electronic copies of our reports and other filings made with the SEC. Requests should be directed to:

Thomas G. Bevivino
Executive Vice President
Severn Bancorp, Inc.
200 Westgate Circle, Suite 200
Annapolis, Maryland 21401

The information on the website listed above, is not and should not be considered part of this Annual Report on Form 10-K and is not incorporated by reference in this document. This website is and is only intended to be an inactive textual reference.

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Business of the Bank

The Bank was organized in 1946 in Baltimore, Maryland as Pompei Permanent Building and Loan Association. It relocated to Annapolis, Maryland in 1980 and its name was changed to Severn Savings Association. Subsequently, the Bank obtained a federal charter and changed its name to Severn Savings Bank, FSB. The Bank operates four full-service branch offices and one administrative office. The Bank operates as a federally chartered savings bank whose principal business is attracting deposits from the general public and investing those funds in mortgage and commercial loans. The Bank also uses advances, or loans, from the Federal Home Loan Bank of Atlanta, ("FHLB-Atlanta") to fund its lending activities. The Bank provides a wide range of personal and commercial banking services. Personal services include mortgage lending and various other lending services as well as checking, savings, money market, time deposit and individual retirement accounts. Commercial services include commercial secured and unsecured lending services as well as business internet banking, corporate cash management services and deposit services. The Bank also provides safe deposit boxes, ATMs, debit cards, and personal internet banking including on-line bill pay, mortgage lending, and telephone banking, among other products and services.

The Bank's revenues are derived principally from interest earned on mortgage, commercial and other loans, and fees charged in connection with the loans and banking services. The Bank's primary sources of funds are deposits, advances from the FHLB-Atlanta, proceeds from loans sold on the secondary market, and payments and principal prepayment of its loans. The principal executive offices of the Bank are maintained at 200 Westgate Circle, Suite 200, Annapolis Maryland, 21401. Its telephone number is 410-260-2000 and its e-mail address is mailman@severnbank.com.

The Thrift Industry

Thrift institutions are financial intermediaries which historically have accepted savings deposits from the general public and, to a lesser extent, borrowed funds from outside sources and invested those deposits and funds primarily in loans secured by first mortgage liens on residential and other types of real estate. Such institutions may also invest their funds in various types of short- and long-term securities. The deposits of bank and thrift institutions are insured by the Deposit Insurance Fund ("DIF") as administered by the Federal Deposit Insurance Corporation ("FDIC"), and these institutions are subject to extensive regulations. These regulations govern, among other things, the lending and other investment powers of thrift institutions, including the terms of mortgage instruments these institutions are permitted to utilize, the types of deposits they are permitted to accept, and reserve requirements.

The operations of thrift institutions, including those of the Bank, are significantly affected by general economic conditions and by related monetary and fiscal policies of the federal government and regulations and policies of financial institution regulatory authorities, including the Federal Reserve and the OCC into which the former OTS was merged. Lending activities are influenced by a number of factors including the demand for housing, conditions in the construction industry, and availability of funds. Sources of funds for lending activities include savings deposits, loan principal payments, proceeds from sales of loans, borrowings from the FHLB-Atlanta and other sources. Savings flows at thrift institutions such as the Bank are influenced by a number of factors including interest rates on competing investments and levels of personal income.

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Earnings

The Bank's earnings depend primarily on the difference between income from interest-earning assets such as loans and investments, and interest paid on interest-bearing liabilities such as deposits and borrowings. The Bank typically engages in long-term mortgage lending at fixed rates of interest, generally for periods of up to 30 years, while accepting deposits for considerably shorter periods. However, many of the Bank's long-term fixed-rate loans are sold in the secondary market, typically resulting in net gains on the sale of such loans by the Bank.

Generally, rapidly rising interest rates cause the cost of interest-bearing liabilities to increase more rapidly than yields on interest-earning assets, thereby adversely affecting the earnings of many thrift institutions. While the industry has received expanded lending and borrowing powers in recent years permitting different types of investments and mortgage loans, including those with floating or adjustable rates and those with shorter terms, earnings and operations are still highly influenced by levels of interest rates and financial market conditions and by substantial investments in long-term mortgage loans.

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. Many of the Bank's competitors have higher legal lending limits than the Bank. The Bank's 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 short-term money market funds and other corporate and government securities funds. The Bank also faces increased competition for deposits from other financial institutions such as brokerage firms, insurance companies and mutual funds. The Bank is a community-oriented financial institution serving its market area with a wide selection of mortgage loans. Management considers the Bank's reputation for financial strength and customer service as its major competitive advantage in attracting and retaining customers in its market area. The Bank also believes it benefits from its community orientation.

Net Interest Income

Net interest income increases during periods when the spread between Bancorp's weighted average rate at which new loans are originated and the weighted average cost of interest-bearing liabilities widens. Market factors such as interest rates, competition, consumer preferences, the supply of and demand for housing, and the availability of funds affect the Bank's ability to originate loans.

Bancorp has supplemented its interest income through purchases of investments when appropriate. This activity is intended to generate positive interest rate spreads on large principal balances with minimal administrative expense.

Interest Rate and Volume of Interest-Related Assets and Liabilities

Both changes in rate and changes in the composition of Bancorp's interest-earning assets and interest-bearing liabilities can have a significant effect on net interest income.

For information concerning the extent to which changes in interest rates and changes in volume of interest-related assets and liabilities have affected Bancorp's interest income and expense during the fiscal years ended December 31, 2015 and 2014, refer to Item 6, "Selected Financial Data - Rate Volume Table".

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Market Area

The Bank's market area is primarily Anne Arundel County, Maryland and nearby areas, due to its four branch locations, all being located in Anne Arundel County.

The Bank continues to expand its business relationship banking department by focusing on the needs of the business community in Anne Arundel County, Maryland. In addition, the Bank increased its offerings to businesses and consumers, including additional commercial lending products, business internet banking, and an expanded line of consumer deposit products. The Bank has traditionally focused its lending activities on first mortgage loans secured by real estate for the purpose of purchasing, refinancing, developing and constructing one-to-four family residences and commercial properties in and near Anne Arundel County, Maryland. The demand for first mortgage lending has increased in 2015, as the Bank continues to be a leading mortgage lender in its market area in 2015. The Bank participates in the secondary market and sells loans it originates either with mortgage servicing rights released or retained.

Supervisory and Formal Agreements

On November 23, 2009, Bancorp and the Bank each entered into a supervisory agreement with the OTS.

Bancorp's agreement generally prohibited Bancorp from paying dividends or distributions, or incurring debt, without the prior approval of the FRB. As a result of the Dodd-Frank Act, Bancorp's supervisory agreement was enforced by the FRB. However, on January 21, 2016, Bancorp was notified by the FRB that its supervisory agreement was terminated.

The Bank's supervisory agreement was replaced by a formal agreement dated April 23, 2013 with the OCC. The formal agreement primarily addressed issues identified in the OCC's report and examination of the Bank's operations and financial condition in 2012 and prescribed certain corrective actions that the Bank must take. Additionally, on April 23, 2013, the Bank was notified by the OCC that the OCC established certain individual minimum capital ratios for the Bank. However, on October 15, 2015, the Bank was notified by the OCC that its formal agreement was terminated and that the additional minimum capital ratios were no longer required.

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The following table sets forth the composition of Bancorp's loan portfolios by type of loan at the dates indicated. The table includes a reconciliation of total net loans receivable, including loans held for sale, after consideration of undisbursed portion of loans, deferred loan fees and discounts, and allowances for losses on loans as of December 31:

	2015		2014		2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(dollars in thousands)									
Residential mortgage	\$285,930	45.00 %	\$309,461	44.91 %	\$258,919	39.56 %	\$269,405	38.60 %	\$295,876	39.78 %
Construction, land acquisition and development	77,478	12.19 %	84,325	12.24 %	75,539	11.54 %	71,523	10.25 %	99,122	13.32 %
Land	28,677	4.51 %	30,426	4.42 %	34,429	5.26 %	50,900	7.29 %	59,649	8.02 %
Lines of credit	20,188	3.18 %	19,251	2.79 %	21,598	3.30 %	31,428	4.50 %	34,278	4.61 %
Commercial real estate	174,912	27.53 %	198,539	28.81 %	220,160	33.64 %	222,038	31.81 %	203,010	27.29 %
Commercial non-real estate	9,296	1.46 %	10,167	1.47 %	8,583	1.31 %	6,120	0.88 %	5,599	0.75 %
Home equity	24,529	3.86 %	28,750	4.17 %	30,339	4.64 %	34,609	4.96 %	41,309	5.56 %
Consumer	1,224	0.19 %	1,040	0.15 %	1,185	0.18 %	858	0.12 %	897	0.12 %
Loans held for sale	13,203	2.08 %	7,165	1.04 %	3,726	0.57 %	11,116	1.59 %	4,128	0.55 %
Total gross loans	635,437	100.00 %	689,124	100.00 %	654,478	100.00 %	697,997	100.00 %	743,868	100.00 %
Deferred loan origination fees and costs, net	(2,719)		(2,480)		(2,131)		(2,047)		(2,485)	
Loans in process	(21,101)		(36,162)		(34,069)		(15,647)		(18,014)	
Allowance for loan losses	(8,758)		(9,435)		(11,739)		(17,478)		(25,938)	
Total loans net	\$602,859		\$641,047		\$606,539		\$662,825		\$697,431	

Table of ContentsLending ActivitiesGeneral

The Bank originates mortgage loans of all types, including residential, residential-construction, commercial-construction, commercial, land and residential lot loans. The Bank also originates non-mortgage loans, which include consumer, business and commercial loans. These loans constitute a small part of the Bank's portfolio.

The Bank originated and funded \$282,828,000 and \$232,781,000 of loans for the years ended December 31, 2015 and 2014, respectively.

Loan Origination Procedures

The following table contains information on the activity of the Bank's loans held for sale and its loans held for investment in its portfolio:

	For the Years Ended December 31,		
	2015	2014	2013
	(dollars in thousands)		
Held for Sale:			
Beginning balance	\$7,165	\$3,726	\$11,116
Originations	163,347	93,999	116,788
Net sales	(157,309)	(90,560)	(124,178)
Ending balance	\$13,203	\$7,165	\$3,726
Held for investment:			
Beginning balance	\$681,959	\$650,752	\$686,881
Originations and purchases	119,481	138,782	132,245
Transfers to foreclosed real estate	(2,234)	(847)	(10,341)
Repayments/payoffs	(176,972)	(106,728)	(109,381)
Bulk loan sales	-	-	(48,652)
Ending balance	\$622,234	\$681,959	\$650,752

The Bank originates residential mortgage loans that are to be held in the Bank's loan portfolio as well as loans that are intended for sale in the secondary market. Loans sold in the secondary market are primarily sold to investors with which the Bank maintains a correspondent relationship. These loans are made in conformity with standard underwriting criteria to assure maximum eligibility for possible resale in the secondary market, and are approved either by the Bank's underwriter or the correspondent's underwriter. Loans considered for the Bank's portfolio with borrowers that have lending relationships less than \$500,000 are approved by any of the Bank's Officers, which includes the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer, the Chief Credit Officer and the Chief Lending Officer. Loans considered for the Bank's portfolio with borrowers that have lending relationships of \$500,000 or greater are approved by the Bank's Directors Loan Committee. Meetings of the Directors Loan Committee are open to attendance by any member of the Bank's Board of Directors who wishes to attend. The loan committee reports to and consults with the Board of Directors in interpreting and applying the Bank's lending policy. Single loans greater than \$2,000,000, or loans to one borrower aggregating more than \$4,000,000, up to \$16,944,000 (the maximum amount of loans to one borrower as of December 31, 2015), must also have Board of Directors' approval.

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Loans that are sold are typically long-term (15 or more years) loans with fixed interest rates eligible for resale in the secondary market. Loans retained for Bancorp's portfolio typically include construction loans, commercial loans and loans that periodically reprice or mature prior to the end of an amortized term. Loans are sold with either servicing released or retained by the Bank. As of December 31, 2015, the Bank was servicing \$20,454,000 in loans for Federal Home Loan Mortgage Corporation ("FHLMC"), \$44,366,000 in loans for Federal National Mortgage Association ("FNMA") and \$11,640,000 in loans for other investors.

The following table contains information, as of December 31, 2015, on the percentage of fixed-rate single-family loans serviced for others by the Bank, by interest rate category.

Interest rate range	Percentage of Portfolio
Less than 5.00%	92.4%
5.00 – 6.00%	7.4%
6.01 – 7.00%	0.1%
7.01 – 8.00%	0.0%
Over 8.00%	0.1%
	100.0%

The Bank's mortgage loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. The authority of the Directors Loan Committee to approve loans is established by the Board of Directors and currently is commensurate with the Bank's limitation on loans to one borrower. The Bank's maximum amount of loans to one borrower currently is equal to 15% of the Bank's unimpaired capital, or \$16,944,000 as of December 31, 2015. Loans greater than this amount require participation by one or more additional lenders. Letters of credit are subject to the same limitations as direct loans. The Bank utilizes independent qualified appraisers approved by the Board of Directors to appraise the properties securing its loans and requires title insurance or title opinions so as to insure that the Bank has a valid lien on the mortgaged real estate. The Bank requires borrowers to maintain fire and casualty insurance on its secured properties.

The procedure for approval of construction loans is the same for residential mortgage loans, except that the appraiser evaluates the building plans, construction specifications, and estimates of construction costs. The Bank also evaluates the feasibility of the proposed construction project and the experience and track record of the developer. In addition, all construction loans generally require a commitment from a third-party lender or from the Bank for a permanent long-term loan to replace the construction loan upon completion of construction.

Residential Mortgage Loans

At December 31, 2015, Bancorp's residential mortgage loan portfolio totaled \$285,930,000, or 45.0% of Bancorp's loan portfolio. All of Bancorp's residential mortgage loans are secured by one to four family residential properties.

Commercial Real Estate Loans

At December 31, 2015, Bancorp's commercial real estate loan portfolio totaled \$174,912,000, or 27.5% of Bancorp's loan portfolio. All of Bancorp's commercial real estate loans are secured by improved property such as office buildings, retail strip shopping centers, industrial condominium units and other small businesses, most of which are located in the Bank's primary lending area. The largest commercial real estate loan outstanding at December 31, 2015 was a \$7,945,000 loan secured by a commercial property in Edgewater, Maryland. This loan has consistently performed in accordance with the terms of the debt instrument.

Loans secured by commercial real estate properties generally involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the real estate market or the economy.

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Construction and Land Acquisition and Development Loans

The Bank originates loans to finance the construction of one-to-four family dwellings, and to a lesser extent, commercial real estate. It also originates loans for the acquisition and development of unimproved property to be used for residential and/or commercial purposes in cases where the Bank is to provide the construction funds to improve the properties. As of December 31, 2015, Bancorp had 90 construction loans outstanding in the gross aggregate amount of \$77,478,000, representing 12.2% of its loan portfolio. Included in that total were commitments to advance an additional \$21,101,000.

Construction loan amounts are based on the appraised value of the property and, for builder loans, a feasibility study as to the potential marketability and profitability of the project. Construction loans generally have terms of up to one year, with reasonable extensions as needed, and typically have interest rates that float monthly at margins ranging from the prime rate to 2 percent above the prime rate. In addition to builders' projects, the Bank finances the construction of single family, owner-occupied houses where qualified contractors are involved and on the basis of strict written underwriting and construction loan guidelines. Construction loans are structured either to be converted to permanent loans with the Bank upon the expiration of the construction phase or to be paid off by financing from another financial institution.

Construction loans afford the Bank the opportunity to increase the interest rate sensitivity of its loan portfolio and to receive yields higher than those obtainable on loans secured by existing residential properties. These higher yields correspond to the higher risks associated with construction lending. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of the project under construction that is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs as well as the market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to value accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the ultimate success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank is forced to foreclose on a project prior to or at completion, due to a default, there can be no assurance that the Bank will be able to recover all of the unpaid balance of the loan as well as related foreclosure and holding costs. In addition, the Bank may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time. The Bank has attempted to address these risks through its underwriting procedures and its limited amount of construction lending on multi-family and commercial real estate properties.

It is the policy of the Bank to conduct physical inspections of each property secured by a construction or rehabilitation loan for the purpose of reporting upon the progress of the construction of improvements. These inspections, referred to as "construction draw inspections," are to be performed at the time of a request for an advance of construction funds. If no construction advance has been requested, a construction inspector or senior officer of the institution makes an inspection of the subject property at least quarterly.

Land and Residential Building Lots

Land loans include loans to developers for the development of residential subdivisions and loans on unimproved lots primarily to individuals. At December 31, 2015, Bancorp had outstanding land and residential building lot loans totaling \$28,677,000, or 4.5% of the total loan portfolio. The largest of these loans is for \$4,800,000, is secured by residential lots in Severn, Maryland, and has performed in accordance with the terms of the debt instrument. Land development loans typically are short-term loans; the duration of these loans is typically not greater than three years. The interest rate on land loans is generally at least 1% or 2% over the prime rate. The loan-to-value ratio generally does not exceed 75% at the time of loan origination. Land and residential building lot loans typically are made to customers of the Bank and developers and contractors with whom the Bank has had previous lending experience. In addition to the customary requirements for these types of loans, the Bank may also require a satisfactory Phase I

environmental study and feasibility study to determine the profit potential of the development.

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The Bank also offers other business and commercial loans. These are loans to businesses are typically lines of credit or other loans that are not secured by real estate, although equipment, securities, or other collateral may secure them. They typically are offered to customers with long-standing relationships with the Bank. At December 31, 2015, \$29,484,000, or 4.6%, of the loan portfolio consisted of lines of credit and other commercial loans.

Home Equity and Other Consumer Loans

The Bank also offers other loans to consumers, including home equity loans, home equity lines of credit and other consumer loans. At December 31, 2015, \$25,753,000, or 4.1% of the loan portfolio consisted of these loans.

Loan Portfolio Cash Flows

The following table sets forth the estimated maturity of Bancorp's loan portfolios by type of loan at December 31, 2015. The estimated maturity reflects contractual terms at December 31, 2015. Contractual principal repayments of loans do not necessarily reflect the actual life of the Bank's loan portfolios. The average life of mortgage loans is substantially less than their contractual terms because of loan prepayments and because of enforcement of "due on sale" clauses. The average life of mortgage loans tends to increase, however, when current mortgage loan rates substantially exceed rates on existing mortgage loans.

	Due Within one year or less	Due after 1 through 5 years	Due after 5 years	Total
	(dollars in thousands)			
Residential mortgage*	\$23,140	\$27,994	\$247,999	\$299,133*
Construction, land acquisition and development	63,921	13,557	-	77,478
Land	12,810	5,715	10,152	28,677
Lines of credit	12,563	7,476	149	20,188
Commercial real estate	13,984	46,897	114,031	174,912
Commercial, non-real estate	160	2,550	6,586	9,296
Home equity	-	-	24,529	24,529
Consumer	29	986	209	1,224
Total	\$126,607	\$105,175	\$403,655	\$635,437

*Includes loans categorized as held for sale.

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The following table contains certain information as of December 31, 2015 relating to the loan portfolio of Bancorp with the dollar amounts of loans due after one year that have fixed and floating rates. All loans are shown maturing based upon contractual maturities and include scheduled payments but not possible prepayments.

	Fixed	Floating	Total
	(dollars in thousands)		
Residential mortgage*	\$121,240	\$154,753	\$275,993*
Construction, land acquisition and development	6,492	7,065	13,557
Land	4,868	10,999	15,867
Lines of credit	-	7,625	7,625
Commercial real estate	61,989	98,939	160,928
Commercial, non-real estate	5,730	3,406	9,136
Home equity	-	24,529	24,529
Consumer	1,195	-	1,195
Total	\$201,514	\$307,316	\$508,830

*Includes loans categorized as held for sale.

Loans to One Borrower

Under regulatory guidelines, the aggregate amount of loans that the Bank may make to one borrower was \$16,944,000 at December 31, 2015, which is 15% of the Bank's unimpaired capital and unimpaired surplus. The Bank's three largest loans at December 31, 2015 were a \$7,945,000 loan secured by a commercial property located in Edgewater, Maryland, a \$5,092,000 loan secured by commercial property in Columbia, Maryland and a \$4,800,000 loan secured by residential property located in Severn, Maryland. All three loans are performing as agreed.

Origination and Purchase and Sale of Loans

The Bank originates residential loans in conformity with standard underwriting criteria to assure maximum eligibility for possible resale in the secondary market. Although the Bank has authority to lend anywhere in the United States, it has confined its loan origination activities primarily to the states of Maryland, Virginia and Delaware.

Loan originations are developed from a number of sources, primarily from referrals from real estate brokers, internet leads, builders, and existing and walk in customers.

The Bank's mortgage loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. Loans considered for the Bank's portfolio with borrowers that have lending relationships less than \$500,000 are approved by any of the Bank's Officers, which includes the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer, the Chief Credit Officer and the Chief Lending Officer. Loans considered for the Bank's portfolio with borrowers that have lending relationships of \$500,000 or greater are approved by the Bank's Directors Loan Committee. Meetings of the Directors' Loan Committee are open to attendance by any member of the Bank's Board of Directors who wishes to attend. The loan committee reports to and consults with the Board of Directors in interpreting and applying the Bank's lending policy. Single loans greater than \$2,000,000, or loans to one borrower aggregating more than \$4,000,000, up to \$16,944,000 (the maximum amount of loans to one borrower as of December 31, 2015), must also have Board of Directors' approval. The Bank utilizes independent qualified appraisers approved by the Board of Directors to appraise the properties securing its loans and requires title insurance or title opinions so as to insure that the Bank has a valid lien on the mortgaged real estate. The Bank requires borrowers to maintain fire and casualty insurance on its secured properties.

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The procedure for approval of construction loans is the same as for residential mortgage loans, except that the appraiser evaluates the building plans, construction specifications, and estimates of construction costs. The Bank also evaluates the feasibility of the proposed construction project and the experience and track record of the developer. In addition, all construction loans generally require a commitment from a third-party lender or from the Bank for a permanent long-term loan to replace the construction loan upon completion of construction.

Consumer loans are underwritten on the basis of the borrower's credit history and an analysis of the borrower's income and expenses, ability to repay the loan, and the value of the collateral, if any.

Currently, it is the Bank's policy to originate both fixed-rate and adjustable-rate loans. The Bank is currently active in the secondary market and sells a portion of its fixed-rate loans.

Interest Rates, Points and Fees

The Bank realizes interest, point, and fee income from its lending activities. The Bank also realizes income from commitment fees for making commitments to originate loans, and from prepayment and late charges, loan fees, application fees, and fees for other miscellaneous services.

The Bank accounts for loan origination fees in accordance with standards set on the accounting for deferred costs and fees. These standards prohibit the immediate recognition of loan origination fees as revenues and require that such income (net of certain direct loan origination costs) for each loan be amortized, generally by the interest method, over the estimated life of the loan as an adjustment of yield. The Bank also realizes income from gains on sales of loans, and servicing released fees for loans sold with servicing released.

Delinquencies and Classified Assets and Allowance for Loan Losses

Delinquencies

The Board of Directors reviews delinquencies on all loans monthly. The Bancorp's collection procedures include sending a past due notice to the borrower on the 17th day of nonpayment, making telephone contact with the borrower between 20 and 30 days after nonpayment, and sending a letter after the 30th day of nonpayment. A notice of intent to foreclose is generally sent between 60 and 90 days after delinquency. When the borrower is contacted, Bancorp attempts to obtain full payment of the past due amount. However, Bancorp generally will seek to reach agreement with the borrower on a payment plan to avoid foreclosure.

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.

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For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information and 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 has not been finalized, but management determines that it is likely that the value is lower than the carrying value of that loan. Once the net collateral value has been determined, a charge-off is taken for the difference between the net collateral value and the carrying value of the loan. 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.

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

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

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

A loan is considered a troubled debt restructuring, sometimes referred to as a TDR, 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 a TDR.

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.

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The Bank discontinues the accrual of interest on loans 90 days or more past due, at which time all previously accrued but uncollected interest is deducted from income. \$585,000 in interest income would have been recorded for the year ended December 31, 2015 if the loans had been current in accordance with their original terms and had been outstanding throughout the year ended December 31, 2015 or since their origination (if held for only part of the fiscal year). For the year ended December 31, 2015, \$455,000 in interest income on such loans was actually included in net income. The following table sets forth information as to non-accrual loans and other non-performing assets.

	At December 31,									
	2015		2014		2013		2012		2011	
	(dollars in thousands)									
Loans accounted for on a non-accrual basis:										
Residential mortgage	\$3,191		\$6,052		\$6,802		\$14,436		\$8,912	
Construction, land acquisition and development	244		115		814		8,564		10,997	
Land	277		847		183		4,688		6,813	
Lines of credit	483		388		304		1,877		2,019	
Commercial real estate	2,681		652		1,155		5,793		2,140	
Commercial non-real estate	-		1,775		-		111		5	
Home Equity	2,098		3,016		1,777		2,000		343	
Consumer	-		-		-		26		203	
Total non-accrual loans	\$8,974		\$12,845		\$11,035		\$37,495		\$31,432	
Accruing loans greater than 90 days past due	\$-		\$-		\$-		\$-		\$-	
Foreclosed real-estate	\$1,744		\$1,947		\$8,972		\$11,441		\$19,932	
Total non-performing assets	\$10,718		\$14,792		\$20,007		\$48,936		\$51,364	
Nonaccrual troubled debt restructurings (included above)	\$1,329		\$2,641		\$2,091		\$5,635		\$19,351	
Accruing troubled debt restructurings	\$24,386		\$27,724		\$34,827		\$56,448		\$40,424	
Total non-accrual loans to net loans	1.5	%	2.0	%	1.8	%	5.8	%	4.5	%
Allowance for loan losses to total non-performing loans, including loans contractually past due 90 days or more	97.6	%	73.5	%	106.4	%	46.6	%	82.5	%
Total non-accrual and accruing loans greater than 90 days past due to total assets	1.2	%	1.7	%	1.4	%	4.4	%	3.5	%
Total non-performing assets to total assets	1.4	%	1.9	%	2.5	%	5.7	%	5.7	%

Included in non-accrual residential mortgage loans at December 31, 2015, were seventeen loans totaling \$2,891,000 to consumers and two loans totaling \$300,000 to builders. Included in non-accrual land loans at December 31, 2015 were three loans totaling \$277,000.

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Classified Assets

Federal regulations provide for the classification of loans and other assets, such as debt and equity securities, considered by the OCC to be of lesser quality, as “substandard,” “doubtful” or “loss assets.” An asset is considered substandard if the paying capacity and net worth of the obligor or the collateral pledged, if any, inadequately protects it. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values. Assets classified as loss assets are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not currently expose the insured institution to a sufficient degree of risk to warrant classification in one of these categories but possess credit deficiencies or potential weakness are required to be designated special mention by management.

When an insured institution classifies problem assets as either substandard or doubtful, it is required to establish general allowances for losses in an amount deemed prudent by management. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss assets, it is to charge-off such amount. An institution’s determination as to the classification of its assets is subject to scrutiny by the OCC, which can require the establishment of additional general or specific loss allowances. The Bank reviews monthly the assets in its portfolio to determine whether any assets require classification in accordance with applicable regulations.

Total classified loans decreased \$13,988,000 to \$13,873,000 at December 31, 2015 from \$27,861,000 at December 31, 2014 primarily due to an improving economy. All of these loans were classified as substandard. The allowance for loan losses as of December 31, 2015 was \$8,758,000, which was 1.4% of gross loans receivable and 97.6% of total non-performing loans.

[see table on following page]

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The following table summarizes the allocation of the allowance for loan losses by loan type and the percent of loans in each category compared to total loans (excluding loans held for sale) as of December 31,

	2015			2014			2013			2012			2011		
	Percentage of Loans			Percentage of Loans			Percentage of Loans			Percentage of Loans			Percentage of Loans		
	Allowance	Amount	Category	Allowance	Amount	Category	Allowance	Amount	Category	Allowance	Amount	Category	Allowance	Amount	Category
	to	Total	Loans	to	Total	Loans	to	Total	Loans	to	Total	Loans	to	Total	Loans
	(dollars in thousands)														
Residential mortgage	\$4,188	45.95 %		\$4,664	45.38 %		\$6,291	39.79 %		\$8,418	39.22 %		\$12,303	40.00 %	
Construction, land acquisition and development	446	12.45 %		362	12.37 %		414	11.61 %		2,120	10.41 %		3,916	13.40 %	
Land	510	4.61 %		646	4.46 %		1,346	5.29 %		2,245	7.41 %		2,405	8.06 %	
Lines of credit	57	3.24 %		12	2.82 %		36	3.32 %		87	4.57 %		725	4.63 %	
Commercial real estate	2,792	28.11 %		2,504	29.11 %		2,512	33.83 %		3,295	32.33 %		4,157	27.44 %	
Commercial non-real estate	234	1.50 %		280	1.49 %		135	1.32 %		46	0.89 %		169	0.76 %	
Home equity	528	3.94 %		963	4.22 %		1,003	4.66 %		1,254	5.04 %		2,257	5.58 %	
Consumer	3	0.20 %		4	0.15 %		2	0.18 %		13	0.13 %		6	0.13 %	
Total	\$8,758	100.00 %		\$9,435	100.00 %		\$11,739	100.00 %		\$17,478	100.00 %		\$25,938	100.00 %	

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The following table contains information with respect to Bancorp's allowance for loan losses for the periods indicated:

	At of or for the Year Ended December 31									
	2015		2014		2013		2012		2011	
	(dollars in thousands)									
Average loans outstanding, net*	\$618,309		\$622,935		\$648,959		\$692,831		\$753,926	
Total gross loans outstanding at end of period*	\$635,437		\$689,124		\$654,478		\$697,997		\$743,868	
Total net loans outstanding at end of period*	\$602,859		\$641,047		\$606,539		\$662,825		\$697,431	
Allowance balance at beginning of period*	\$9,435		\$11,739		\$17,478		\$25,938		\$29,871	
Provision for loan losses	(280)		831		16,520		765		4,612	
Actual charge-offs										
Residential real estate	454		844		7,919		4,299		4,421	
Construction, land acquisition and development	-		63		2,439		1,395		1,503	
Land	-		-		4,529		1,624		1,054	
Lines of credit	-		1,324		521		182		-	
Commercial real estate	80		92		8,343		416		811	
Commercial non-real estate	154		1,410		687		20		-	
Home Equity	834		261		809		1,407		39	
Consumer	-		-		46		10		717	
Total charge-offs	1,522		3,994		25,293		9,353		8,545	
Recoveries										
Residential real estate	629		306		1,034		18		-	
Construction, land acquisition and development	-		-		66		-		-	
Land	49		349		1,773		-		-	
Lines of credit	235		15		60		-		-	
Commercial real estate	-		25		54		-		-	
Commercial non-real estate	49		159		8		110		-	
Home Equity	163		-		15		-		-	
Consumer	-		5		24		-		-	
Total recoveries	1,125		859		3,034		128		-	
Net charge offs	397		3,135		22,259		9,225		8,545	
Allowance balance at end of period	\$8,758		\$9,435		\$11,739		\$17,478		\$25,938	
Net charge-offs as a percent of average loans*	0.06	%	0.50	%	3.43	%	1.33	%	1.13	%
Allowance for loan losses to total gross loans at end of period*	1.38	%	1.37	%	1.79	%	2.50	%	3.49	%
Allowance for loan losses to net loans at end of period*	1.45	%	1.47	%	1.94	%	2.64	%	3.72	%

*Includes held for sale loans.

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Federal thrift institutions, such as the Bank, have authority to invest in various types of liquid assets, including United States Treasury obligations and securities of various federal agencies, certificates of deposit at insured banks, bankers' acceptances and federal funds. As a member of the FHLB System, the Bank must maintain minimum levels of liquid assets specified by the OCC, which vary from time to time. Subject to various regulatory restrictions, federal thrift institutions may also invest a portion of their assets in certain commercial paper, corporate debt securities and mutual funds whose assets conform to the investments that a federal thrift institution is authorized to make directly.

The amortized cost of the Bank's investment securities held to maturity as of the dates indicated, are presented in the following table:

	At December 31,		
	2015	2014	2013
	(dollars in thousands)		
US Treasury securities	\$21,057	\$27,140	\$31,235
US Agency securities	20,011	17,044	11,123
US Government sponsored mortgage-backed securities	35,065	15,432	2,303
Total Investment Securities Held to Maturity	\$76,133	\$59,616	\$44,661

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Investment Scheduled Maturity Table

As of December 31, 2015

	One Year or Less		More than One to Five Years		More than Five to Ten Years		More than Ten Years		Total Investment Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Fair Value
	(dollars in thousands)										
US Treasury securities	\$9,047	1.65 %	\$12,010	1.77 %	\$-	-	\$-	-	\$21,057	1.72 %	\$21,325
US Agency securities	2,013	0.87 %	16,043	1.39 %	1,955	3.15 %	-	-	20,011	1.51 %	20,074
US Government sponsored mortgage-backed securities*	44	0.54 %	20,716	1.86 %	14,305	2.25 %	-	-	35,065	2.02 %	34,911
Total securities	\$11,104	1.50 %	\$48,769	1.68 %	\$16,260	2.36 %	-	-	\$76,133	1.80 %	\$76,310

* The amortized cost of mortgage-backed securities as of December 31, 2015, by contractual maturity, is shown above. Expected maturities may differ from contractual maturities because the securities may be called or prepaid with or without prepayment penalties.

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Deposits are attracted principally from within the Bank's primary market areas through the offering of a variety of deposit instruments, including passbook and statement accounts and certificates of deposit ranging in terms from three months to five years. Deposit account terms vary, principally on the basis of the minimum balance required; the time periods the funds must remain on deposit and the interest rate. The Bank also offers individual retirement accounts.

The Bank's policies are designed primarily to attract deposits from local residents rather than to solicit deposits from areas outside the Bank's primary markets. Interest rates paid, maturity terms, service fees and withdrawal penalties are established by the Bank on a periodic basis. Determination of rates and terms are predicated upon funds acquisition and liquidity requirements, rates paid by competitors, growth goals and federal regulations.

Deposits in the Bank as of December 31, 2015, 2014 and 2013 consisted of savings programs described below:

	2015	2014	2013
	(dollars in thousands)		
NOW accounts	\$56,096	\$54,827	\$40,067
Money market accounts	47,690	39,579	38,619
Passbooks	111,992	126,062	164,504
Certificates of deposit	277,778	298,489	301,355
Non-interest bearing accounts	30,215	24,857	26,704
Total deposits	\$523,771	\$543,814	\$571,249

The following table contains information pertaining to the certificates of deposit held by the Bank with a minimum denomination of \$100,000 as of December 31, 2015.

	Jumbo Certificates of Deposit (dollars in thousands)
Time Remaining Until Maturity	
Less than three months	\$ 21,635
3 months to 6 months	21,721
6 months to 12 months	39,510
Greater than 12 months	53,111
Total	\$ 135,977

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Liquidity and Asset/Liability Management

Two major objectives of asset and liability management are to maintain adequate liquidity and to control the interest sensitivity of the balance sheet.

Liquidity is the measure of a company's ability to maintain sufficient cash flow to fund operations and to meet financial obligations to depositors and borrowers. Liquidity is provided by the ability to attract and retain deposits and by principal and interest payments on loans and maturing securities in the investment portfolio. A strong core deposit base, supplemented by other deposits of varying maturities and rates, contributes to the Bank's liquidity.

Management believes that funds available through short-term borrowings and asset maturities are adequate to meet all anticipated needs for the next twelve months, and management is continually monitoring the Bank's liquidity position to meet projected needs.

Interest rate sensitivity is maintaining the ability to reprice interest earning assets and interest bearing liabilities in relationship to changes in the general level of interest rates. Management attributes interest rate sensitivity to a steady net interest margin through all phases of interest rate cycles. Management attempts to make the necessary adjustments to constrain adverse swings in net interest income resulting from interest rate movements through gap analysis and income simulation modeling techniques.

Borrowings

The Bank's credit availability under the FHLB of Atlanta's credit availability program was \$192,672,000 at December 31, 2015. The Bank's credit availability is based on the level of collateral pledged up to 25% of total assets. The Bank, from time to time, utilizes the line of credit when interest rates under the line are more favorable than obtaining deposits from the public. There were no short-term borrowings with the FHLB of Atlanta at December 31, 2015.

Employees

As of December 31, 2015, Bancorp and its subsidiaries had approximately 152 full-time equivalent employees. Bancorp's employees are not represented by any collective bargaining group.

Hyatt Commercial

Hyatt Commercial is a subsidiary of the bank and is a real estate brokerage company specializing in commercial real estate sales, leasing and property management.

SBI Mortgage Company

SBI Mortgage Company ("SBI") is a subsidiary of Bancorp that has engaged in the origination of mortgages not suitable for the Bank. It owns subsidiary companies that purchase real estate for investment purposes. As of December 31, 2015, SBI had \$1,444,000 in outstanding mortgage loans and it had \$479,000 invested in subsidiaries, which funds were held in cash, pending potential acquisition of investment real estate.

Crownsville Development Corporation

Crownsville Development Corporation, which is doing business as Annapolis Equity Group, is a subsidiary of SBI and is engaged in the business of acquiring real estate for investment and syndication purposes.

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HS West, LLC

HS West, LLC (“HS”) is a subsidiary of the Bank, and constructed a building in Annapolis, Maryland that serves as Bancorp’s and the Bank’s administrative headquarters. A branch office of the Bank is also located in the building. In addition, HS leases space to four unrelated companies and to a law firm of which the President of Bancorp and the Bank is a partner.

Severn Financial Services Corporation

Severn Financial Services Corporation is a subsidiary of the Bank that is part of a joint venture with a local insurance agency to provide various insurance products to customers of Bancorp.

Regulation

The financial services industry in the Bank’s market area is highly competitive, including competition from commercial banks, savings banks, credit unions, finance companies and non-bank providers of financial services. Several of the Bank’s competitors have legal lending limits that exceed that of the Bank’s, as well as funding sources in the capital markets that exceeds the Bank’s availability. The increased competition has resulted from a changing legal and regulatory climate, as well as from the economic climate.

General

Savings and loan holding companies and savings associations are extensively regulated under both federal and state law. This regulation is intended primarily to protect depositors and the Deposit Insurance Fund (“DIF”), and not the stockholders of Bancorp. The summary below describes briefly the regulation that is applicable to Bancorp and the Bank, does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

Regulatory Reform and Legislation

On July 21, 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act has significantly changed the bank regulatory structure and significantly impacted the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies have been given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and future impact of the Dodd-Frank Act may not be known for many months or years. The discussion below generally discusses the material provisions of the Dodd-Frank Act applicable to Bancorp and the Bank and is not complete or meant to be an exhaustive discussion.

Pursuant to the Dodd-Frank Act, effective July 21, 2011, the OTS, which was the primary federal regulator for Bancorp and the Bank, was abolished and replaced by the FRB with respect to savings and loan holding companies and their non-depository institution subsidiaries, including Bancorp, and was replaced by the OCC with respect to federal savings associations, including the Bank.

The Dodd-Frank Act required federal banking regulators to implement new capital requirements. See “Regulatory Capital Requirements” below.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to

prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Savings institutions with \$10 billion or less in assets, such as the Bank, continue to be examined for compliance with the consumer laws by their primary bank regulators.

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Effective July 21, 2011, the federal prohibitions on paying interest on demand deposits were eliminated, thus allowing businesses to have interest bearing checking accounts.

The Dodd-Frank Act weakened the federal preemption rules applicable to national banks and federal savings associations, allowing federal law to preempt state consumer protection law only where state law (i) would have a discriminatory effect on federal savings associations, (ii) would prevent or significantly interfere with the exercise by a federal savings association of its powers or (iii) is preempted by other federal law. The OCC has the authority to make preemption determinations and must make each determination on a case by case basis.

The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor.

The Dodd-Frank Act directed the FDIC to redefine the base for deposit insurance assessments paid by banks. Assessments will now be based on the average consolidated total assets less tangible equity of a financial institution. This change may proportionally shift deposit insurance funding away from banks that rely primarily on deposits for funding operations, like the Bank. The Dodd-Frank Act increased the minimum reserve ratio for the Deposit Insurance Fund from 1.15% to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of \$10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, leaving it, instead, to the discretion of the FDIC. The FDIC has recently exercised that discretion by establishing a long-range fund ratio of 2%.

The Dodd-Frank Act amended the Home Owners Loan Act (HOLA) to require that leverage capital requirements and risk based capital requirements applicable to depository and bank holding companies be extended to thrift holding companies. It also applied the Federal Reserve Board's "source of strength" doctrine, which has long applied to bank holding companies, to savings and loan holding companies. Pursuant to the doctrine, regulatory agencies must issue regulations requiring holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

The Dodd-Frank Act also included several provisions regarding executive compensation. Publicly traded companies must give stockholders a non-binding vote on executive compensation and so called "golden parachute" payments. Companies will be required to disclose the relationship between executive compensation and financial performance of the issuer in annual proxy materials.

Federal banking agencies adopted regulations implementing the provisions of the Dodd-Frank Act known as the "Volcker Rule." The Volcker Rule attempts to reduce risk and banking system instability by restricting U.S. banks and affiliated companies from investing in or engaging in proprietary trading and speculation and imposing a strict framework to justify exemptions for underwriting, market making and hedging activities. It also imposes limits on banking entities' investments in, and other relationships with, hedge funds and private equity funds. The regulations became effective on April 1, 2014 with full compliance being phased in through July 21, 2015, except that with respect to certain investments and relationships that were in place prior to December 31, 2013, the compliance period has been extended to July 21, 2016.

It is difficult to predict the exact impact the Dodd-Frank Act and the implementing rules and regulations will continue to have on savings and loan holding companies and banks. The Dodd-Frank Act and resulting rules and regulations may impact the profitability of our business or change certain of our business practices, including our ability to offer new products, make loans and achieve satisfactory interest spreads, and could expose us to additional costs, including increased regulatory compliance costs. The changes also may require us to invest significant management attention and resources to make any necessary changes to our operations in order to comply, and could materially adversely affect our business, results of operations and financial condition. The following provides a description of the current regulations that are applicable to Bancorp and the Bank and selected changes to be implemented pursuant to the

Dodd-Frank Act, all of which are subject to further change as additional provisions of the Dodd-Frank Act are implemented.

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Regulation of Bancorp

General. As previously noted the Dodd-Frank Act eliminated the OTS and transferred supervision of savings and loan holding companies to the FRB on July 21, 2011. As a unitary savings and loan holding company, Bancorp is now required to register and file reports with the FRB and is subject to regulation and examination by the FRB. In addition, the FRB has enforcement authority over Bancorp and its subsidiaries, which permits the FRB to restrict or prohibit activities determined to be a serious risk to the subsidiary savings association.

Activities Restriction Test. As a unitary savings and loan holding company, Bancorp generally is not subject to activity restrictions, provided the Bank satisfies the Qualified Thrift Lender (“QTL”) test (see “Qualified Thrift Lender Test” below). If the Bank failed to meet the QTL test, then Bancorp would become subject to the activities restrictions applicable to multiple savings and loan holding companies and, unless the Bank qualified as a QTL within one year thereafter, Bancorp would be required to register as, and would become subject to the restrictions applicable to, a bank holding company. Additionally, if Bancorp acquired control of another savings association, either through merger or other combination with the Bank, other than in a supervisory acquisition where the acquired association also met the QTL test, Bancorp would thereupon become a multiple savings and loan holding company and thereafter be subject to further restrictions on its activities. Bancorp presently intends to continue to operate as a unitary savings and loan holding company.

Regulatory Capital Requirements. Under amended capital regulations adopted pursuant to the Dodd-Frank Act, savings and loan holding companies became subject to the new regulatory capital requirements. However, in May 2015, amendments to the FRB’s small bank holding company policy statement (the “SBHC Policy”) became effective. The amendments made the SBHC Policy applicable to savings and loan holding companies, such as Bancorp, and increased the asset threshold to qualify to be subject to the provisions of the SBHC Policy from \$500 million to \$1.0 billion. Savings and loan holding companies that have total assets of \$1.0 billion or less are subject to the SBHC Policy and are not required to comply with the regulatory capital requirements described below provided that such holding company (i) is not engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) does not conduct significant off-balance sheet activities (including securitization and asset management or administration) either directly or through a nonbank subsidiary; and (iii) does not have a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the Securities and Exchange Commission. The FRB may in its discretion exclude any savings and loan holding company, regardless of asset size, from the SBHC Policy if such action is warranted for supervisory purposes. The exemption continues until Bancorp’s total assets exceed \$1.0 billion, does not meet the other requirements discussed above or the FRB deems it to be warranted for supervisory purposes.

Certain of the savings and loan holding company capital requirements promulgated by the FRB in 2013 became effective as of January 1, 2015. Those requirements establish the following four minimum capital ratios that savings and loan holding companies not subject to the SBHC Policy must comply with as of that date: (i) a common equity tier 1 capital to total risk-weighted assets ratio of 4.5%; (ii) a tier 1 capital to total risk-weighted assets ratio of 6.0% (up from 4%); (iii) a total capital to total risk-weighted assets ratio of 8%; and (iv) a tier 1 capital to total assets leverage ratio of 4%. For more information, see “Regulatory Capital Requirements” under “Regulation of the Bank” below.

Restrictions on Acquisitions. Except under limited circumstances, savings and loan holding companies, such as Bancorp, are prohibited from (i) acquiring, without approval of the FRB, control of a savings association or a savings and loan holding company or all or substantially all of the assets of any such association or holding company (ii) acquiring, without prior approval of the FRB, more than 5% of the voting shares of a savings association or a holding company which is not a subsidiary thereof or (iii) acquiring control of an uninsured institution, or retaining, for more than one year after the date of any savings association becomes uninsured, control of such association. In evaluating proposed acquisitions of savings institutions by holding companies, the FRB considers the financial and managerial

resources and future prospects of the holding company and the target institution, the effect of the acquisition on the risk to the DIF, the convenience and the needs of the community and competitive factors.

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No director or officer of a savings and loan holding company or person owning or controlling by proxy or otherwise more than 25% of such company's stock, may acquire control of any savings association, other than a subsidiary savings association, or of any other savings and loan holding company, without written approval of the FRB. Certain individuals, including Alan J. Hyatt, Louis Hyatt, and Melvin Hyatt, and their respective spouses ("Applicants"), filed an Application for Notice of Change In Control ("Notice") in April 2001 pursuant to 12 CFR Section 574.3(b). The Notice permitted the Applicants to acquire up to 32.32% of Bancorp's issued and outstanding shares of stock of Bancorp by April 16, 2002. The OTS approved requests by the Applicants to extend the time to consummate such acquisition of shares to December 16, 2011. The Applicants currently own approximately 29.86% of the total outstanding shares of Bancorp as of December 31, 2015.

The FRB is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies; and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Federal Securities Law. Bancorp's securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. As such, Bancorp is subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the Securities Exchange Act of 1934.

Financial Services Modernization Legislation. In November 1999, the Gramm-Leach-Bliley Act of 1999 ("GLBA") was enacted. The GLBA generally permits banks, other depository institutions, insurance companies and securities firms to enter into combinations that result in a single financial services organization to offer customers a wider array of financial services and products provided that they do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLBA resulted in increased competition for Bancorp and the Bank from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than Bancorp and the Bank.

Maryland Corporation Law. Bancorp is incorporated under the laws of the State of Maryland, and is therefore subject to regulation by the state of Maryland. The rights of Bancorp's stockholders are governed by the Maryland General Corporation Law.

Regulation of the Bank

General. As noted above, the Dodd-Frank Act transferred supervision of savings associations like the Bank to the OCC, the agency that regulates national banks, on July 21, 2011. As a federally chartered, DIF-insured savings association, the Bank is subject to extensive regulation by the OCC and the FDIC. Lending activities and other investments of the Bank must comply with various statutory and regulatory requirements. The Bank is also subject to certain reserve requirements promulgated by the FRB. The OCC, in conjunction with the FDIC, regularly examines the Bank and prepares reports for the consideration of the Bank's Board of Directors on any deficiencies found in the operations of the Bank. The relationship between the Bank and depositors and borrowers is also regulated by federal and state laws, especially in such matters as the ownership of savings accounts and the form and content of mortgage documents utilized by the Bank.

The Bank must file reports with the OCC and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other financial institutions.

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Regulatory Capital Requirements. On July 9, 2013, the federal banking agencies approved amendments to their regulatory capital rules to conform U.S. regulatory capital rules with the international regulatory standards agreed to by the Basel Committee on Banking Supervision in the international accord referred to as “Basel III” and to implement certain provisions of the Dodd-Frank Act. The revisions established a new capital measure, “common equity tier 1 capital” as well as new higher capital ratio requirements, narrowed the definitions of capital, imposed new operating restrictions on banking organizations with insufficient capital buffers and increased the risk weighting of certain assets. The new requirements apply to all banks and savings associations and bank holding companies and savings and loan holding companies (other than bank or savings and loan holding companies that have less than \$1.0 billion in assets and otherwise qualify under the SBHB Policy). The rules became effective in January 2014 for institutions with assets over \$250 billion and internationally active institutions and became effective in January 2015 for all other institutions, including the Bank.

Under the amended regulations, the Bank is required to meet minimum levels of regulatory capital, including: (i) the new common equity tier 1 capital to total risk-weighted assets ratio of 4.5%; (ii) a tier 1 capital to total risk-weighted assets ratio of 6.0% (up from 4%); (iii) a total capital to total risk-weighted assets ratio of 8%; (iv) a tier 1 capital to total assets leverage ratio of 4%; and (v) a tangible capital, measured as core capital (tier 1 capital), to average total assets ratio of 1.5%.

Common equity tier 1 capital generally consists of common stock and related surplus, retained earnings, accumulated other comprehensive income and, subject to certain adjustments, minority common equity interests in subsidiaries, reduced by goodwill and other intangible assets (other than certain mortgage servicing assets), net of associated deferred tax liabilities.

Tier 1 Capital means the sum of common equity tier 1 capital and additional tier 1 capital. Additional tier 1 capital generally includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Under the amendments, cumulative preferred stock (other than cumulative preferred stock issued to the U.S. Treasury Department under the TARP Capital Purchase Program or the Small Business Lending Fund) no longer qualifies as additional tier 1 capital. Trust preferred securities and other non-qualifying capital instruments issued prior to May 19, 2010 by bank and savings and loan holding companies with less than \$15 billion in assets as of December 31, 2009 or by mutual holding companies may continue to be included in tier 1 capital but will be phased out over 10 years beginning in 2016 for all other banking organizations.

Total Capital includes tier 1 capital and tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock, and subordinated debt.

Tangible Capital means the amount of core capital (tier 1 capital), plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital.

Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, and residual interests) are multiplied by a risk weight factor assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien residential mortgages, a risk weight of 100% is assigned to first lien residential mortgages not qualifying under the prudently underwritten standards as well as commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans, a risk weight of 250% is assigned to certain mortgage serving rights, and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain

specified factors.

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In addition to higher capital requirements, the amended regulations provide that depository institutions and their holding companies are required to maintain a common equity tier 1 Capital conservation buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases or for the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement will be phased in over four years beginning on January 1, 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer requirement effectively raises the minimum required risk-based capital ratios to 7% common equity tier 1 capital, 8.5% tier 1 capital and 10.5% total capital on a fully phased-in basis.

The amendments also revise the prompt corrective action framework discussed below by incorporating the common equity tier 1 capital requirement and raising the capital requirements for certain capital categories. See “Prompt Corrective Action” below.

In addition to requiring institutions to meet the applicable capital standards for savings institutions, the OCC may require institutions to meet capital standards in excess of the prescribed standards as the OCC determines necessary or appropriate for such institution in light of the particular circumstances of the institution. Such circumstances would include a high degree of exposure to interest rate risk, concentration of credit risk and certain risks arising from non-traditional activity. The OCC may treat the failure of any savings institution to maintain capital at or above such level as an unsafe or unsound practice and may issue a directive requiring any savings institution which fails to maintain capital at or above the minimum level required by the OCC to submit and adhere to a plan for increasing capital.

As shown below, the Bank’s regulatory capital exceeded all minimum regulatory capital requirements applicable to it as of December 31, 2015 and 2014.

	Actual		Required For		Required To Be			
	Amount	%	Capital		Well			
			Adequacy		Capitalized			
			Purposes		Under Prompt			
					Corrective Action			
	Amount	%	Amount	%	Provisions			
	Amount	%	Amount	%	Amount	%		
	(dollars in thousands)							
<u>December 31, 2015</u>								
Tangible (1)	\$ 112,959	14.8 %	\$ 11,423	1.50 %	N/	A	N/	A
Tier 1 capital (2)	112,959	19.6 %	34,626	6.00 %	\$ 46,168	8.00	%	
Common Equity Tier 1(2))	112,959	19.6 %	25,970	4.50 %	37,512	6.50	%	
Leverage (1)	112,959	14.8 %	30,461	4.00 %	38,076	5.00	%	
Total (2)	120,193	20.8 %	46,168	8.00 %	57,710	10.00	%	
<u>December 31, 2014</u>								
Tangible (1)	\$ 106,916	13.8 %	\$ 11,590	1.50 %	N/	A	N/	A
Tier 1 capital (2)	106,916	19.4 %	N/	A	N/	A	\$ 33,081	6.00 %
Leverage (1)	106,916	13.8 %	30,906	4.00 %	38,633	5.00	%	
Total (2)	113,848	20.6 %	44,108	8.00 %	55,135	10.00	%	

(1) To adjusted total assets.

(2) To risk-weighted assets.

Enforcement. The OCC has primary enforcement responsibility over federal savings institutions and has the authority to bring enforcement action against the institution and all “institution-affiliated parties,” including stockholders, attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement actions by the OCC may range from issuance of a capital directive or cease and desist order, to removal of officers or directors of the institution and the appointment of a receiver or conservator. The FDIC also has the authority to terminate deposit insurance or recommend to the director of the OCC that enforcement action be taken with respect to a particular savings institution. If action is not taken by the director of the OCC, the FDIC has authority to take action under specific circumstances.

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Safety and Soundness Standards. Federal law requires each federal banking agency, including the OCC, to prescribe to certain standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines further provide that savings institutions should maintain safeguards to prevent the payment of compensation, fees and benefits that are excessive or that could lead to material financial loss, and should take into account factors such as comparable compensation practices at comparable institutions. If the OCC determines that a savings institution is not in compliance with the safety and soundness guidelines, it may require the institution to submit an acceptable plan to achieve compliance with the guidelines. A savings institution must submit an acceptable compliance plan to the OCC within 30 days of receipt of a request for such a plan. If the institution fails to submit an acceptable plan, the OCC must issue an order directing the institution to correct the deficiency. Failure to submit or implement a compliance plan may subject the institution to regulatory sanctions.

Prompt Corrective Action. Under the prompt corrective action regulations, the OCC is required and authorized to take supervisory actions against undercapitalized savings associations. The regulations were amended to incorporate the previously described amendments to regulatory capital standards that were effective January 1, 2015. For this purpose, a savings association is placed into one of the following five categories dependent on their respective capital ratios:

An institution is deemed to be “well capitalized” if it has a total risk-based capital ratio of 10.0% or greater, a tier 1 risk-based capital ratio of 8.0% or greater, a common equity tier 1 risk-based capital ratio of 6.5% or greater and a leverage ratio of 5.0% or greater.

An institution is “adequately capitalized” if it has a total risk-based capital ratio of 8.0% or greater, a tier 1 risk-based capital ratio of 6.0% or greater, a common equity tier 1 risk-based capital ratio of 4.5% or greater and a leverage ratio of 4.0% or greater.

An institution is “undercapitalized” if it has a total risk-based capital ratio of less than 8.0%, a tier 1 risk-based capital ratio of less than 6.0%, a common equity tier 1 risk-based capital ratio of less than 4.5% or a leverage ratio of less than 4.0%.

An institution is deemed to be “significantly undercapitalized” if it has a total risk-based capital ratio of less than 6.0%, a tier 1 risk-based capital ratio of less than 4.0%, a common equity tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%.

An institution is considered to be “critically undercapitalized” if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

Generally, the Federal Deposit Insurance Act requires the OCC to appoint a receiver or conservator for an institution within 90 days of that institution becoming “critically undercapitalized”. The regulation also provides that a capital restoration plan must be filed with the OCC within 45 days after an institution receives notice that it is “undercapitalized”, “significantly undercapitalized” or “critically undercapitalized”. In addition, numerous mandatory supervisory actions become immediately applicable to the institution, including, but not limited to, restrictions on growth, investment activities, payment of dividends and other capital distributions, and affiliate transactions. The OCC may also take any one of a number of discretionary supervisory actions against the undercapitalized institutions, including the issuance of a capital directive and, in the case of an institution that fails to file a required capital restoration plan, the replacement of senior executive officers and directors.

As of December 31, 2015, the Bank met the capital requirements of a “well capitalized” institution under applicable OCC regulations.

Premiums for Deposit Insurance. The Bank’s deposits are insured up to applicable limits by the DIF of the FDIC and are backed by the full faith and credit of the United States government.

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The FDIC regulations assess insurance premiums based on an institution's risk. Under this assessment system, the FDIC evaluates the risk of each financial institution based on its supervisory rating, financial ratios, and long-term debt issuer rating. In 2010, the assessment ranged from 7 to 77.5 basis points of an institution's deposits, depending on its risk category. On February 7, 2011, the FDIC issued final rules, effective April 1, 2011, implementing changes to the assessment rules as mandated by the Dodd-Frank Act. The final rules redefined the assessment base used for calculating deposit insurance assessments. Specifically, the rules base assessments on an institution's total assets less tangible capital, as opposed to total deposits. The base assessment rates range from 2.5 to 9 basis points for the least risky institutions to 30 to 45 basis points for the riskiest. The rate schedules will automatically adjust in the future as the DIF reaches certain milestones.

As discussed above, the Dodd-Frank Act made permanent the maximum deposit insurance amount of \$250,000 per depositor.

The FDIC is authorized to terminate a depository institution's deposit insurance upon a finding by the FDIC that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the Bank could have a material adverse effect on Bancorp's earnings.

All FDIC-insured depository institutions pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, commonly referred to as Financing Corporation ("FICO") bonds, were issued to capitalize the Federal Savings and Loan Insurance Corporation. For the quarter ended September 30, 2011, the annualized FICO assessment rate equaled 1.0 basis point for each \$100 in domestic deposits maintained at an institution. Beginning with the fourth quarter of 2011, the FICO assessment was based on total assets less tangible capital instead of deposits. The payment made in the fourth quarter of 2015 was based on a FICO assessment rate of 0.60 basis points and the first quarter of 2016 FICO assessment rate payment was 0.58 basis points. FICO assessments will continue until the bonds mature in 2017 through 2019.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operation of the Bank.

Privacy. The Bank is subject to the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records. The GLBA places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Pursuant to the GLBA and rules adopted thereunder financial institutions must provide:

- initial and annual notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates; and
- a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

Since the GLBA's enactment, a number of states have implemented their own versions of privacy laws. The Bank has implemented its privacy policies in accordance with applicable law.

Loans-to-One Borrower Limitations. With certain limited exceptions, the maximum amount that a savings association or a national bank may lend on an unsecured basis to any borrower (including certain related entities of the borrower) may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral.

At December 31, 2015, the Bank's loans-to-one-borrower limit was \$16,944,000 based upon the 15% of unimpaired capital and surplus measurement. At December 31, 2015, the Bank's three largest loans were a \$7,945,000 loan

secured by commercial property in Edgewater, Maryland, a \$5,092,000 loan secured by commercial property in Columbia, Maryland and a \$4,800,000 loan secured by residential property located in Severn, Maryland. These loans were performing in accordance with their terms.

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Qualified Thrift Lender Test. Savings associations must meet a QTL test, which may be met either by maintaining, on average, at least 65% of its portfolio assets in qualified thrift investments in at least nine of the most recent twelve month period, or meeting the definition of a “domestic building and loan association” as defined in the Code. “Portfolio Assets” generally means total assets of a savings institution, less the sum of (i) specified liquid assets up to 20% of total assets, (ii) goodwill and other intangible assets, and (iii) the value of property used in the conduct of the savings association’s business. Qualified thrift investments are primarily residential mortgages and related investments, including certain mortgage related securities. Associations that fail to meet the QTL test must either convert to a bank charter or operate under specified restrictions. As of December 31, 2015, the Bank was in compliance with its QTL requirement and met the definition of a domestic building and loan association.

Affiliate Transactions. Transactions between savings associations and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act as made applicable to savings associations by Section 11 of the Home Owners’ Loan Act (HOLA). A savings association affiliate includes any company or entity which controls the savings institution or that is controlled by a company that controls the savings association. For example, the holding company of a savings association and any companies which are controlled by such holding company, are affiliates of the savings association. Generally, Section 23A limits the extent to which the savings association or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such association’s capital stock and surplus, as well as contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to “covered transactions,” as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least as favorable, to the savings association as those provided to a non-affiliate. “Covered transaction” include the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a savings association to an affiliate. In addition to the restrictions imposed by Sections 23A and 23B, Section 11 of the Home Owners’ Loan Act prohibits a savings association from (i) making a loan or other extension of credit to an affiliate, except for any affiliate which engages only in certain activities which are permissible for bank holding companies, or (ii) purchasing or investing in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings association.

The Bank’s authority to extend credit to executive officers, directors, trustees and 10% stockholders, as well as entities under such person’s control, is currently governed by Section 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated by the FRB. Among other things, these regulations generally require such loans to be made on terms substantially similar to those offered to unaffiliated individuals, place limits on the amounts of the loans the Bank may make to such persons based, in part, on the Bank’s capital position, and require certain board of directors’ approval procedures to be followed.

Capital Distribution Limitations. OCC regulations impose limitations upon all capital distributions by savings associations, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger and other distributions charged against capital.

The OCC regulations require a savings association to file an application for approval of a capital distribution if:

- the association is not eligible for expedited treatment of its filings with the OCC;
- the total amount of all of capital distributions, including the proposed capital distribution, for the applicable calendar year exceeds its net income for that year to date plus retained net income for the preceding two years;
- the association would not be at least adequately capitalized, as determined under the capital requirements described above under “Prompt Corrective Action,” following the distribution; or
- the proposed capital distribution would violate any applicable statute, regulation, or regulatory agreement or condition.

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In addition, a savings association must give the OCC notice of a capital distribution if the savings association is not required to file an application, but:

- would not be well capitalized, as determined under the capital requirements described above under “Prompt Corrective Action,” following the distribution;
- the proposed capital distribution would reduce the amount of or retire any part of the savings association's common or preferred stock or retire any part of debt instruments such as notes or debentures included in capital, other than regular payments required under a debt instrument; or
- the savings association is a subsidiary of a savings and loan holding company, is filing a notice of the distribution with the FRB and is not otherwise required to file an application or notice regarding the proposed distribution with the OCC, in which case an information copy of the notice filed by the holding company with the FRB needs to be simultaneously provided to the OCC.

Further, any savings association subsidiary of a savings and loan holding company also must file a notice with the FRB of any proposed dividend or distribution.

The application or notice, as applicable, must be filed with the regulators at least 30 days before the proposed declaration of dividend or approval of the proposed capital distribution by its board of directors.

The OCC or FRB may prohibit a proposed dividend or capital distribution that would otherwise be permitted if it determines that:

- following the distribution, the savings association will be undercapitalized, significantly undercapitalized, or critically undercapitalized, as determined under the capital requirements described above under “Prompt Corrective Action;
- the proposed distribution raises safety or soundness concerns; or
- the proposed capital distribution would violate any applicable statute, regulation or regulatory agreement or condition.

In addition, as noted above, beginning in 2016, if the Bank does not have the required capital conservation buffer under the amended capital rules, its ability to pay dividends to Bancorp will be limited.

Branching. Under OCC branching regulations, the Bank is generally authorized to open branches in any state of the United States (i) if the Bank qualifies as a “domestic building and loan association” under the Code, which qualification requirements are similar to those for a Qualified Thrift Lender under the Home Owners’ Loan Act, or (ii) if the law of the state in which the branch is located, or is to be located, would permit establishment of the branch if the savings association were a state savings association chartered by such state. The OCC authority preempts any state law purporting to regulate branching by federal savings banks.

Community Reinvestment Act and the Fair Lending Laws. Savings associations have a responsibility under the Community Reinvestment Act and related regulations of the OCC to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in regulatory restrictions on its activities and the denial of applications. In addition, an institution's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in the OCC, other federal regulatory agencies as well as the Department of Justice taking enforcement actions. Based on an examination conducted June 30, 2015, the Bank received a satisfactory rating.

Federal Home Loan Bank System. The Bank is a member of the FHLB-Atlanta. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB.

Under the capital plan of the FHLB-Atlanta as of December 31, 2015, the Bank was required to own at least \$5,583,000 of the capital stock of the FHLB-Atlanta. As of such date, the Bank owned \$5,626,000 of the capital stock of the FHLB-Atlanta and was in compliance with the capital plan requirements.

Federal Reserve System. The FRB requires all depository institutions to maintain non interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and non personal time deposits. For transaction accounts in 2016, the first \$15.2 million, up from \$14.5 million in 2015, will be exempt from reserve requirements. A 3 percent reserve ratio will be assessed on transaction accounts over \$15.2 million up to and including \$110.2 million, up from \$103.6 million in 2015. A 10 percent reserve ratio will be assessed on transaction accounts in excess of \$110.2 million. At December 31, 2015, the Bank was in compliance with the reserve requirements.

Activities of Subsidiaries. A savings association seeking to establish a new subsidiary acquire control of an existing company or conduct a new activity through a subsidiary must provide 30 days prior notice to the FDIC and the FRB and conduct any activities of the subsidiary in compliance with regulations and orders of the FRB. The FRB has the power to require a savings association to divest any subsidiary or terminate any activity conducted by a subsidiary that the FRB determines to pose a serious threat to the financial safety, soundness or stability of the savings association or to be otherwise inconsistent with sound banking practices.

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Tying Arrangements. Federal savings associations are prohibited, subject to some exceptions, from extending credit to or offering any other services, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Other Regulations. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank's operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one-to four family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

In addition, the Consumer Financial Protection Bureau issues regulations and standards under these federal consumer protection laws that affect our consumer businesses. These include regulations setting "ability to repay" and "qualified mortgage" standards for residential mortgage loans and mortgage loan servicing and originator compensation standards. The Bank is evaluating recent regulations and proposals, and devotes significant compliance, legal and operational resources to compliance with consumer protection regulations and standards.

The operations of the Bank also are subject to the:

- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check; and
- The USA PATRIOT Act, which requires savings associations to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations.

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Item 1A. Risk Factors

Unless the context indicates otherwise, all references to “we,” “us,” “our” in this subsection “Risk Factors” refer to Bancorp and its subsidiaries. You should carefully consider the risks and uncertainties described below as well as elsewhere in this Annual Report on Form 10-K. If any of the risks or uncertainties actually occurs, our business, financial condition or results of future operations could be materially adversely affected. The risks and uncertainties described in this Form 10-K are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us. This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including the risks faced by us described below and elsewhere in this Annual Report on Form 10-K.

We may be adversely affected by changes in economic and political conditions and by governmental monetary and fiscal policies.

The thrift industry is affected, directly and indirectly, by local, domestic, and international economic and political conditions, and by governmental monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, tight money supply, real estate values, international conflicts and other factors beyond our control may adversely affect our potential profitability. Any future rises in interest rates, while increasing the income yield on our earning assets, may adversely affect loan demand and the cost of funds and, consequently, our profitability. Any future decreases in interest rates may adversely affect our profitability because such decreases may reduce the amounts that we may earn on our assets. Economic downturns have resulted and may continue to result in the delinquency of outstanding loans. We do not expect any one particular factor to materially affect our results of operations. However, downtrends in several areas, including real estate, construction and consumer spending, have had and may continue to have a material adverse impact on our ability to remain profitable. Further, there can be no assurance that the asset values of the loans included in our loan portfolio, the value of properties and other collateral securing such loans, or the value of foreclosed real estate will remain at current levels.

The changing economic environment poses significant challenges for Bancorp.

Negative developments in the financial services industry from 2008 into 2015 have resulted in uncertainty in the financial markets in general and a related general economic downturn globally. While we are beginning to experience modest improvement in performance, we may experience negative conditions in 2016. In addition, as a consequence of the recent United States recession, business activity across a wide range of industries face serious difficulties due to the decline in the housing market and lack of consumer spending. Although unemployment levels have fallen from the 2008-2009 recession, any downturn in the economy could cause unemployment rates to increase.

Although the U.S. economy has emerged from the severe recession that occurred in 2008 and 2009, economic growth has been slow and uneven. Recovery by many businesses has been impaired by lower consumer spending. A return to prolonged deteriorating economic conditions could significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. If the Federal Reserve Board continues to increase the federal funds rate, higher interest rates would likely result, which may reduce our loan originations, and housing markets and U.S. economic activity would be negatively affected. Further declines in real estate values and sales volumes and continued elevated unemployment levels may result in higher than expected loan delinquencies, increases in our nonperforming and criticized and classified assets and a decline in demand for our products and services. These events could then result in further increases in loan loss provisions, costs associated with monitoring delinquent loans and disposing of foreclosed property, which could negatively affect our financial condition and results of operations.

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We are operating in a challenging economic environment, including generally uncertain national and local market conditions. Negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. If the economy does not continue to improve, or worsens, declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including job losses and other factors, could have adverse effects on our borrowers, which could adversely affect our financial condition and results of operations. For instance, because payments on loans secured by commercial real estate properties are often dependent upon the successful operation of management of the properties, repayment of these loans are subject to adverse conditions in the economy. If consumer spending decreases, businesses located in commercial real estate property may close, reducing the rental income of the Bank's borrower. The reduction in rental income may result in the borrower being unable to make payments on the loan. Any deterioration in economic conditions could drive losses beyond that which is provided for in our allowance for loan losses and could result in the following:

- an increase in loan delinquencies, problem assets and foreclosures;
- a decline in demand for our products and services;
- a decrease in low cost or non-interest-bearing deposits; and
- a decline in the value of the collateral for our loans, which in turn may reduce customers' borrowing capacities, and reduce the value of assets and collateral supporting our existing loans.

During recent years, we experienced higher than normal levels of non-performing loans. No assurance can be given that these conditions will improve in the near term or will not worsen. Moreover, such conditions may result in a further increase in loan delinquencies, causing a decrease in our interest income, and may continue to have an adverse impact on our loan loss experience, possibly requiring us to add to our allowance for loan losses. Until conditions improve, we expect our business, financial condition and results of operations to be adversely affected.

Changes in interest rates could adversely affect our financial condition and results of operations.

The operations of financial institutions, such as ours, are dependent to a large degree on net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. Our net interest income is significantly affected by market rates of interest that in turn are affected by prevailing economic conditions, fiscal and monetary policies of the federal government and the policies of various regulatory agencies. Like all financial institutions, our balance sheet is affected by fluctuations in interest rates. Volatility in interest rates can also result in disintermediation, which is the flow of funds away from financial institutions into direct investments, such as U.S. Government bonds, corporate securities and other investment vehicles, including mutual funds, which, because of the absence of federal insurance premiums and reserve requirements, generally pay higher rates of return than those offered by financial institutions such as ours.

During the last few years, the Federal Reserve's involvement in the purchase of U.S. government debt securities, commonly known as "quantitative easing," has caused interest rates to be lower than they would have been without such involvement; however, quantitative easing ended in October 2014. Additionally, in December 2015, the FRB raised the target range for the federal funds rate for the first time since 2006 and indicated that further interest rate hikes may be undertaken. As a result of the end of quantitative easing and the FRB actions, interest rates could rise, which could disrupt domestic and world markets and could adversely affect the value of our investment portfolio or our liquidity and results of operations.

We expect to experience continual competition for deposit accounts which may make it difficult to reduce the interest paid on some deposits.

We believe that, in the current market environment, we have adequate policies and procedures for maintaining a conservative interest rate sensitive position. However, there is no assurance that this condition will continue. A sharp movement up or down in deposit rates, loan rates, investment fund rates and other interest-sensitive instruments on our balance sheet could have a significant, adverse impact on our net interest income and operating results.

Further downgrades of the U.S. credit rating, government spending cuts or another government shutdown could negatively impact our liquidity, financial conditions and earnings.

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Recent U.S. debt ceiling and budget deficit concerns have increased the possibility of additional credit-rating downgrades and economic slowdowns, or a recession in the United States. Although lawmakers passed legislation to raise the federal debt ceiling on multiple occasions, ratings agencies have lowered or threatened to lower the long-term sovereign credit rating on the United States. The impact of this or any further downgrades to the government's sovereign credit rating or its perceived creditworthiness could adversely affect the U.S. and global financial markets and economic conditions. Absent further quantitative easing by the Federal Reserve, these developments could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. In addition, disagreement over the federal budget has caused the U.S. federal government to shut down for periods of time. Continued adverse political and economic conditions could have a material adverse effect on our business, financial condition and results of operations.

Most of our loans are secured by real estate located in our market area. If there is a downturn in the real estate market, additional borrowers may default on their loans and we may not be able to fully recover our loans.

Although the real estate market has begun to rebound from the financial crisis of 2008-2009, it has not fully recovered and a downturn in the real estate market could adversely affect our business because most of our loans are secured by real estate. Substantially all of our real estate collateral is located in the states of Maryland, Virginia and Delaware. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature.

In addition to the risks generally present with respect to mortgage lending activities, our operations are affected by other factors affecting our borrowers, including:

- the ability of our mortgagors to make mortgage payments,
- the ability of our borrowers to attract and retain buyers or tenants, which may in turn be affected by local conditions such as an oversupply of space or a reduction in demand for rental space in the area, the attractiveness of properties to buyers and tenants, and competition from other available space, or by the ability of the owner to pay leasing commissions, provide adequate maintenance and insurance, pay tenant improvements costs and make other tenant concessions,
- interest rate levels and the availability of credit to refinance loans at or prior to maturity, and
- increased operating costs, including energy costs, real estate taxes and costs of compliance with environmental controls and regulations.

As of December 31, 2015, approximately 96% of the book value of our loan portfolio consisted of loans collateralized by various types of real estate. If real estate prices decline, the value of real estate collateral securing our loans will be reduced. Our ability to recover defaulted loans by foreclosing and selling the real estate collateral would then be diminished, and we would be more likely to incur financial losses on defaulted loans.

In addition, approximately 44% of the book value of our loans consisted of construction, land acquisition and development loans, commercial real estate loans and land loans, which present additional risks described in "Item 1. Business - Construction Loans" of this Form 10-K.

Our loan portfolio exhibits a high degree of risk.

We have a significant amount of nonresidential loans, as well as construction and land loans granted on a speculative basis. Although permanent single-family, owner-occupied loans currently represent the largest single component of assets and impaired loans, we have a significant level of nonresidential loans, construction loans, and land loans that have an above-average risk exposure. Our monitoring of higher risk loans and the internal asset review function may be inadequate in view of current real estate market weaknesses.

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At December 31, 2015 and December 31, 2014, our non-accrual loans (those loans 90 or more days in arrears) equaled \$8,974,000 and \$12,845,000, respectively. There were thirty-eight residential loans (including construction, land acquisition and development, land loans and home equity lines of credit) in non-accrual status totaling \$5,810,000 and seven commercial loans in non-accrual status totaling \$2,681,000 at December 31, 2015, compared to forty-eight residential loans in non-accrual status totaling \$10,030,000, and eight commercial loans in non-accrual status totaling \$2,427,000 at December 31, 2014. For the years ended December 31, 2015 and December 31, 2014, there were \$397,000 and \$3,135,000 of net loan charge-offs, respectively. At December 31, 2015, the total allowance for loan losses was \$8,758,000, which was 1.45% of total net loans, compared with \$9,435,000, which was 1.47% of total net loans, as of December 31, 2014.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and cash flows could be materially and adversely affected.

Our operations are located in Anne Arundel County, Maryland, which makes our business highly susceptible to local economic conditions. An economic downturn or recession in this area may adversely affect our ability to operate profitably.

Unlike larger banking organizations that are geographically diversified, our operations are concentrated in Anne Arundel County, Maryland. In addition, nearly all of our loans have been made to borrowers in the states of Maryland, Virginia and Delaware. As a result of this geographic concentration, our financial results depend largely upon economic conditions in our market area. A deterioration or recession in economic conditions in this market could result in one or more of the following:

- a decrease in deposits;
- an increase in loan delinquencies;
- an increase in problem assets and foreclosures;
- a decrease in the demand for our products and services; and
- a decrease in the value of collateral for loans, especially real estate, and reduction in customers' borrowing capacities.

Any of the foregoing factors may adversely affect our ability to operate profitably.

We are subject to federal and state regulation and the monetary policies of the FRB. Such regulation and policies can have a material adverse effect on our earnings and prospects.

Our operations are heavily regulated and will be affected by present and future legislation and by the policies established from time to time by various federal and state regulatory authorities. In particular, the monetary policies of the FRB have had a significant effect on the operating results of banks in the past, and are expected to continue to do so in the future. Among the instruments of monetary policy used by the FRB to implement its objectives are changes in the discount rate charged on bank borrowings and changes in the reserve requirements on bank deposits. In December 2015, the FRB raised the target range for the federal funds rate for the first time since 2006 and indicated that further interest rate hikes may be undertaken. It is not possible to predict what changes, if any, will be made to the

monetary policies of the FRB or to existing federal and state legislation or the effect that such changes may have on our future business and earnings prospects.

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If the Bank becomes “undercapitalized” as determined under the “prompt corrective action” initiatives of the federal bank regulators, such regulatory authorities will have the authority to require the Bank to, among other things, alter, reduce or terminate any activity that the regulator determines poses an excessive risk to the Bank. The Bank could further be directed to take any other action that the regulatory agency determines will better carry out the purpose of prompt corrective action. The Bank could be subject to these prompt corrective action restrictions if federal regulators determine that the Bank is in an unsafe or unsound condition or engaging in an unsafe or unsound practice. Some or all of the foregoing actions and restrictions could have a material adverse effect on our operations.

The Dodd-Frank Act may have a material impact on our operations.

The Dodd-Frank Act restructures the regulation of depository institutions. Under the Dodd-Frank Act, the OTS was merged into the OCC, which regulates national banks. Savings and loan holding companies are now regulated by the FRB. Also, included was the creation of a new federal agency to administer consumer protection and fair lending laws, a function that was previously performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions was reduced as well. The Dodd-Frank Act imposed consolidated capital requirements on savings and loan holding companies effective for us in 2015, which limits our ability to borrow at the holding company and invest the proceeds from such borrowings as capital in the Bank that could be leveraged to support additional growth. The Dodd-Frank Act contains various other provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. The full impact of the Dodd-Frank Act on our business and operations may not be known for years until all regulations implementing the statute are written, adopted and implemented. The Dodd-Frank Act may have a material impact on operations, particularly through increased regulatory burden and compliance costs.

Bancorp has become subject to more stringent capital requirements, which may have a material adverse effect on Bancorp’s operations.

In 2013, federal banking agencies adopted proposals that substantially amend the regulatory capital rules applicable to us and the Bank. The amendments implemented the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The amended rules establish new higher capital ratio requirements, narrow the definitions of capital, impose new operating restrictions on banking organizations with insufficient capital buffers and increase the risk weighting of certain assets. The amended rules became effective with respect to us and the Bank in January 2015, with certain requirements to be phased in beginning in 2016.

The application of more stringent capital requirements to us and the Bank could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could further limit our ability to make distributions, including paying out dividends or buying back shares,

We have established an allowance for loan losses based on our management's estimates. Actual losses could differ significantly from those estimates. If the allowance is not adequate, it could have a material adverse effect on our earnings and the price of our common stock.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents management's best estimate of probable incurred losses within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; industry concentrations and other unidentified losses inherent in the current loan portfolio. The determination of the

appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and judgment and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. Bancorp has seen a significant decrease in TDR balances compared to 2012, due in part to the bulk loan sales that we undertook in the third and fourth quarters of 2013. However, the TDR balances are still high compared to historical averages.

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In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to increase the allowance for loan losses. Furthermore, growth in the loan portfolio would generally lead to an increase in the provision for loan losses.

Any increases in the allowance for loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition, results of operations and cash flows.

We compete with a number of local, regional and national financial institutions for customers.

We face strong competition from savings and loan associations, banks, and other financial institutions that have branch offices or otherwise operate in our market area, as well as many other companies now offering a range of financial services. Many of these competitors have substantially greater financial resources and larger branch systems than us. In addition, many of our competitors have higher legal lending limits than us. Particularly intense competition exists for sources of funds including savings and retail time deposits as well as for loans and other services offered by us. In addition, over the last several years, the banking industry has undergone substantial consolidation, and this trend is expected to continue. Significant ongoing consolidation in the banking industry may result in one or more large competitors emerging in our primary target market. The financial resources, human capital and expertise of one or more large institutions could threaten our ability to maintain our competitiveness.

During the past several years, significant legislative attention has been focused on the regulation and deregulation of the financial services industry. Non-bank financial institutions, such as securities brokerage firms, insurance companies and mutual funds, have been permitted to engage in activities that compete directly with traditional bank business. Competition with various financial institutions could hinder our ability to maintain profitable operations and grow our business.

We face intense competitive pressure on customer pricing, which may materially and adversely affect revenues and profitability.

We generate net interest income, and charge our customers fees, based on prevailing market conditions for deposits, loans and other financial services. In order to increase deposit, loan and other service volumes, enter new market segments and expand our base of customers and the size of individual relationships, we must provide competitive pricing for such products and services. In order to stay competitive, we have had to intensify our efforts around attractively pricing our products and services. To the extent that we must continue to adjust our pricing to stay competitive, we will need to grow our volumes and balances in order to offset the effects of declining net interest income and fee-based margins. Increased pricing pressure also enhances the importance of cost containment and productivity initiatives, and we may not succeed in these efforts.

Our brand, reputation and relationship with our customers are key assets of our business and may be affected by how we are perceived in the marketplace.

Our brand and its attributes are key assets of our business. The ability to attract and retain customers to Bancorp's products and services is highly dependent upon the external perceptions of us and the industry in which we operate. Our business may be affected by actions taken by competitors, customers, third party providers, employees, regulators, suppliers or others that impact the perception of the brand, such as creditor practices that may be viewed as "predatory," customer service quality issues, and employee relations issues. Adverse developments with respect to our industry may also, by association, impair our reputation, or result in greater regulatory or legislative scrutiny.

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The operations of our business, including our interaction with customers, are increasingly done via electronic means, and this has increased our risks related to cyber-attacks.

We are exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. There has been an increased level of attention focused recently on cyber-attacks against large corporations that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating cash, other assets or sensitive information, corrupting data, or causing operational disruption. Cyber-attacks may also be carried out in a manner that does not require gaining unauthorized access, such as by causing denial-of-service attacks on websites. Cyber-attacks may be carried out by third parties or insiders using techniques that range from highly sophisticated efforts to electronically circumvent network security or overwhelm websites to more traditional intelligence gathering and social engineering aimed at obtaining information necessary to gain access. The objectives of cyber-attacks vary widely and can include theft of financial assets, intellectual property, or other sensitive information, including the information belonging to our banking customers. Cyber-attacks may also be directed at disrupting our operations.

While we have not incurred any losses related to cyber-attacks, nor are we aware of any specific or threatened cyber-incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; increased cybersecurity protection costs that may include organizational changes, deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

Our business is highly reliant on technology and our ability to manage the operational risks associated with technology.

We rely heavily on communications and information systems to conduct our business. Our business involves storing and processing sensitive customer data. Any failure, interruption or breach in security of these systems could result in theft of customer data or failures or disruptions in our customer relationship management, general ledger, deposit, loan, data storage, processing and other systems. Our inability to access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations. In addition, we operate a number of money transfer and related electronic, check and other payment connections that are vulnerable to individuals engaging in fraudulent activities that seek to compromise payments and related financial systems illegally. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, result in increased expense to contain the event and/or require that we provide credit monitoring services for affected customers or expose us to civil litigation and regulatory fines and sanctions, any of which could have a material adverse effect on our financial condition and results of operations.

Our business is highly reliant on third party vendors and our ability to manage the operational risks associated with outsourcing those services.

We rely on third parties to provide services that are integral to our operations. These vendors provide services that support our operations, including storage and processing of sensitive consumer data. A cyber security breach of a vendor's system may result in theft of our data or disruption of business processes. A material breach of customer data at a service provider's site may negatively impact our business reputation and cause a loss of customer business; result in increased expense to contain the event and/or require that we provide credit monitoring services for affected

customers, result in regulatory fines and sanctions and may result in litigation. In most cases, we will remain primarily liable to our customers for losses arising from a breach of a vendor's data security system. We rely on our outsourced service providers to implement and maintain prudent cyber security controls. We have procedures in place to assess a vendor's cyber security controls prior to establishing a contractual relationship and to periodically review assessments of those control systems; however, these procedures are not infallible and a vendor's system can be breached despite the procedures we employ.

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If our third party providers experience financial, operational or technological difficulties, or if there is any other disruption in our relationships with them, we may be required to locate alternative sources of such services, and we cannot assure you that we would be able to negotiate terms that are as favorable to us, or could obtain services with similar functionality as found in our existing systems without the need to expend substantial resources, if at all.

We continually encounter technological change, and, if we are unable to develop and implement efficient and customer friendly technology, we could lose business.

The financial services industry is continually undergoing rapid technological change, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to achieve additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Our success depends on our senior management team, and if we are not able to retain our senior management team, it could have a material adverse effect on us.

We are highly dependent upon the continued services and experience of our senior management team, including Alan J. Hyatt, our Chairman, President and Chief Executive Officer. We depend on the services of Mr. Hyatt and the other members of our senior management team to, among other things, continue the development and implementation of our strategies, and maintain and develop our customer relationships. We do not have an employment agreement with members of our senior management, nor do we maintain “key-man” life insurance on our senior management. If we are unable to retain Mr. Hyatt and other members of our senior management team, our business could be materially and adversely affected.

If we fail to maintain an effective system of internal control over financial reporting and disclosure controls and procedures, we may be unable to accurately report our financial results and comply with the reporting requirements under the Securities Exchange Act of 1934. As a result, current and potential stockholders may lose confidence in our financial reporting and disclosure required under the Securities Exchange Act of 1934, which could adversely affect our business and stock price and could subject us to regulatory scrutiny.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, referred to as Section 404, we are required to include in our Annual Reports on Form 10-K, our management’s report on internal control over financial reporting. We are currently not required to include an opinion of our independent registered public accounting firm as to our internal controls because we are a “smaller reporting company” under SEC rules and, therefore, stockholders do not have the benefit of such an independent review of our internal controls. Compliance with the requirements of Section 404 is expensive and time-consuming. If, in the future, we fail to complete this evaluation in a timely manner, or, if required, our independent registered public accounting firm cannot timely attest to our evaluation, we could be subject to regulatory scrutiny and a loss of public confidence in our internal control over financial reporting. In addition, any failure to maintain an effective system of disclosure controls and procedures could cause our current and potential stockholders and customers to lose confidence in our financial reporting and disclosure required under the Securities Exchange Act of 1934, which could adversely affect our business and stock price.

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Terrorist attacks and threats or actual war may impact all aspects of our operations, revenues, costs and stock price in unpredictable ways.

Terrorist attacks in the United States and abroad, as well as future events occurring in response to or in connection with them, including, without limitation, future terrorist attacks against U.S. targets, rumors or threats of war, actual conflicts involving the United States or its allies or military or trade disruptions, may impact our operations. Any of these events could cause consumer confidence and savings to decrease or could result in increased volatility in the United States and worldwide financial markets and economy. Any of these occurrences could have an adverse impact on our operating results, revenues and costs and may result in the volatility of the market price for our common stock and on the future price of our common stock.

There can be no assurance that we will pay dividends in the future.

Bank regulations govern and limit the payment of dividends and capital distributions to stockholders and purchases or redemption by Bancorp of its stock. In addition, Bancorp suspended its common stock dividend in the fourth quarter of 2009 to preserve its capital. Although we expect to be able to resume our policy of quarterly dividend payments, this dividend policy will be reviewed in light of future earnings, bank regulations and other considerations. No assurance can be given, therefore, that cash dividends on our common stock will be paid in the future.

Our Series A preferred stock, Series B preferred stock and 2035 Debentures contain restrictions on our ability to declare and pay dividends on, or repurchase our common stock.

Our ability to declare dividends on our common stock is limited by the terms of our (i) 8.0% Non-Cumulative Convertible Preferred Stock, referred to as Series A preferred stock, and (ii) our Fixed Rate Cumulative Perpetual Preferred Stock, Series B, par value \$0.01 per share and liquidation preference \$1,000 per share, referred to as Series B preferred stock. We 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 our 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, we may not declare or pay any dividend or distribution on our common stock, and we may not purchase, redeem or otherwise acquire for consideration any of our common stock, unless all accrued and unpaid dividends for all past dividend periods, including the latest completed dividend period, on all outstanding shares of Series B preferred stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside), subject to certain minor exceptions. Dividends on the Series A preferred stock and Series B preferred stock have not been declared since the first quarter of 2012 because Bancorp did not receive approval from the FRB to pay such dividends. As of December 31, 2015, the cumulative amount of dividends of the Series B preferred stock in arrears not declared, including interest on unpaid dividends at 9% per year was \$7,033,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the dividend arrearages on its Series B preferred stock have been paid in full and until Bancorp declares and pays a dividend on its Series A preferred stock.

Further, under the terms of our Junior Subordinated Debt Securities due 2035, referred to as the 2035 Debentures, if (i) there has occurred and is continuing an event of default, (ii) we are in default with respect to payment of any obligations under the related guarantee or (iii) we have given notice of our election to defer payments of interest on the 2035 Debentures by extending the interest distribution period as provided in the indenture governing the 2035 Debentures and such period, or any extension thereof, has commenced and is continuing, then we may not, among other things, declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of our capital stock, including our common stock. As permitted under the terms of the 2035 Debenture, as of December 31, 2015, Bancorp has deferred the payment of fifteen quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was \$1,863,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the interest deferrals on the 2035 Debentures

have been paid in full.

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An investment in our securities is not insured against loss.

Investments in our common stock are not deposits insured against loss by the FDIC or any other entity. As a result, an investor may lose some or all of his, her or its investment.

Conversion of our Series A preferred stock or exercise of the warrant issued to the Treasury Department will dilute the ownership interest of existing stockholders.

In two private placements conducted in November 2008, we issued Series A preferred stock convertible into 437,500 shares of our common stock, subject to adjustment, and a warrant to purchase 556,976 shares of our common stock, subject to adjustment. The conversion of some or all of the Series A preferred stock or the exercise of the warrant will dilute the ownership interest of existing stockholders. Any sales in the public market of the common stock issuable upon such conversion or exercise could adversely affect prevailing market prices of our common stock. In addition, the existence of the Series A preferred stock or warrant may encourage short selling by market participants because the conversion of the Series A preferred stock or exercise of the warrant could depress the price of our common stock.

“Anti-takeover” provisions will make it more difficult for a third party to acquire control of us, even if the change in control would be beneficial to our equity holders.

Our charter presently contains certain provisions that may be deemed to be “anti-takeover” and “anti-greenmail” in nature in that such provisions may deter, discourage or make more difficult the assumption of control of us by another corporation or person through a tender offer, merger, proxy contest or similar transaction or series of transactions. For example, currently, our charter provides that our Board of Directors may amend the charter, without stockholder approval, to increase or decrease the aggregate number of shares of our stock or the number of shares of any class that we have authority to issue. In addition, our charter provides for a classified Board, with each Board member serving a staggered three-year term. Directors may be removed only for cause and only with the approval of the holders of at least 75 percent of our common stock. The overall effects of the “anti-takeover” and “anti-greenmail” provisions may be to discourage, make more costly or more difficult, or prevent a future takeover offer, prevent stockholders from receiving a premium for their securities in a takeover offer, and enhance the possibility that a future bidder for control of us will be required to act through arms-length negotiation with our Board of Directors. These provisions may also have the effect of perpetuating incumbent management.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

HS constructed a building in Annapolis, Maryland that serves as Bancorp’s and the Bank’s administrative headquarters. A branch office of the Bank is also included in the building. Bancorp and the Bank lease their executive and administrative offices from HS. In addition, HS leases space to four unrelated companies and to a law firm in which the President of Bancorp and the Bank is a partner.

Bancorp has four retail branch locations in Anne Arundel County, Maryland, of which it owns three and leases the fourth from a third party. The current term of the lease expires in July 2020. There is no option to renew the lease for any additional terms. In addition, the Bank leases office space in Annapolis, Maryland from a third party. The lease expires January 2017, with the option to renew the lease for one additional five year term.

Item 3. Legal Proceedings

There are no material pending legal proceedings to which Bancorp, the Bank or any subsidiary is a party or to which any of their property is subject.

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Item 4. Mine Safety Disclosures

Not applicable.

Item 4.1. Executive Officers of the Registrant

James M. Anthony, age 44, joined Bancorp in August 2014 and currently serves as Executive Vice President and Chief Operating Officer. Mr. Anthony has over fifteen years of experience in the financial services industry, the last ten of which he spent at Chesapeake Bank & Trust where he served in key bank management positions including Chief Executive Officer, President, Senior Lending Officer, Head of Investment Services, and Chief Information Officer. Mr. Anthony holds an MBA from the University of Chicago and two degrees from the University of Maryland: a master's degree in systems engineering and a bachelor's degree in mechanical engineering. He is also a graduate of ABA Stonier Graduate School of Banking hosted by Georgetown University. Mr. Anthony currently serves on the board of directors of the Atlantic Community Bankers Bank.

Thomas G. Bevivino, age 60, a Certified Public Accountant, joined Bancorp in August 2004 and currently serves as Executive Vice President and Chief Financial Officer. Mr. Bevivino joined Bancorp as Controller, and served as the Executive Vice President and Chief Financial Officer of Bancorp and Bank from July, 2005 to February 2012, and was reappointed to the Chief Financial Officer position in September 2013. Effective December 2011, Mr. Bevivino became Chief Operating Officer of Bancorp and the Bank and served in such capacity until August 2014. Mr. Bevivino, was a financial consultant from 2002 until 2004, and served as Chief Financial Officer of Luminant Worldwide Corporation from 1999 until 2002.

Christopher A. Chick, age 48, joined Bancorp in 2015 as Executive Vice President and Chief Lending Officer. Mr. Chick has over 26 years in the banking industry. Prior to joining Bancorp, Mr. Chick held various management positions at Susquehanna Bank and was a Bank Examiner with the Office of Thrift Supervision. Mr. Chick is a graduate of the University of Baltimore where he received his Master of Finance. He is also a graduate of the Maryland Bankers Association, Executive School of Bank Management. Mr. Chick has been recognized within the industry with various awards including Next Leader in Banking, Maryland Bankers Association and Top Banker Award, Smart CEO.

Information concerning Alan J. Hyatt will be contained in the proxy statement for the 2016 Annual Meeting of Shareholders.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of Bancorp is traded on the Nasdaq Capital Market under the symbol "SVBI". As of March 10, 2016, there were 159 stockholders of record of Bancorp's common stock.

Computershare, 211 Quality Circle, Suite 210, College Station, Texas 77845-4470, serves as the Transfer Agent and Registrar for Bancorp.

The following table sets forth the high and low sales prices per share of Bancorp's common stock for the periods indicated, as reported on the Nasdaq Capital Market:

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Quarterly Stock Information

2015				2014			
Quarter	Stock Price		Per Share Dividend	Quarter	Stock Price		Per Share Dividend
	Low	High			Low	High	
1 st	\$4.25	\$4.95	\$ -	1 st	\$4.31	\$5.12	\$ -
2 nd	4.61	5.12	-	2 nd	4.41	4.93	-
3 rd	4.65	5.09	-	3 rd	4.26	4.90	-
4 th	4.66	5.88	-	4 th	4.30	4.85	-

Dividend Policy

Federal banking regulations limit the amount of dividends that banking institutions may pay and may require prior approval or non-objection from federal banking regulators before any dividends, capital distributions or share redemptions can be made.

Bancorp's main source of income is dividends from the Bank. As a result, Bancorp's dividends to its common shareholders depend primarily upon regulatory approval and receipt of dividends from the Bank.

Bancorp suspended its common stock dividend in the fourth quarter of 2009 to preserve its capital.

Bancorp's ability to declare a dividend on its common stock is also limited by the terms of Bancorp's Series A preferred stock and Series B preferred stock. Bancorp may not declare or pay any dividend on, make any distributions relating to, or redeem, purchase, acquire or make a liquidation payment relating to, or make any guarantee payment with respect to its common stock in any quarter until the dividend on the Series A preferred stock has been declared and paid for such quarter, subject to certain minor exceptions. Additionally, Bancorp may not declare or pay any dividend or distribution on its common stock, and Bancorp may not purchase, redeem or otherwise acquire for consideration any of its common stock, unless all accrued and unpaid dividends for all past dividend periods, including the latest completed dividend period, on all outstanding shares of Series B preferred stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside), subject to certain minor exceptions. Dividends on the Series A preferred stock and Series B preferred stock have not been declared since the first quarter of 2012 because Bancorp did not receive approval from the FRB to pay such dividends. As of December 31, 2015, the cumulative amount of dividends of the Series B preferred stock in arrears not declared, including interest on unpaid dividends was \$7,033,000. There is no requirement that Bancorp's board of directors declares any dividends on the Series A preferred stock and any unpaid dividends are not cumulative.

Additionally, under the terms of Bancorp's 2035 Debentures, if (i) there has occurred and is continuing an event of default, (ii) Bancorp is in default with respect to payment of any obligations under the related guarantee or (iii) Bancorp has given notice of its election to defer payments of interest on the 2035 Debentures by extending the interest distribution period as provided in the indenture governing the 2035 Debentures and such period, or any extension thereof, has commenced and is continuing, then Bancorp may not, among other things, declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of its capital stock, including common stock. As permitted under the terms of the 2035 Debenture, as of December 31, 2015, Bancorp has deferred the payment of fifteen quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was \$1,863,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the interest deferrals on the 2035 Debentures have been paid in full.

Table of ContentsItem 6. Selected Financial Data

The following summary financial information is derived from the audited financial statements of Bancorp, except as noted below. The information is a summary and should be read in conjunction with Bancorp's audited financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Summary Financial and Other Data

	At December 31,				
	2015	2014	2013	2012	2011
	(dollars in thousands, except per share information)				
Balance Sheet Data					
Total assets	\$762,079	\$776,328	\$799,603	\$852,118	\$901,163
Total loans, net	589,656	633,882	602,813	651,709	693,303
Investment securities held to maturity	76,133	59,616	44,661	34,066	40,357
Non-performing loans	8,974	12,845	11,035	37,495	31,432
Total non-performing assets	10,718	14,792	20,007	48,936	51,364
Deposits	523,771	543,814	571,249	599,394	652,757
Long-term debt	115,000	115,000	115,000	115,000	115,000
Total liabilities	675,623	692,518	716,834	743,122	794,698
Stockholders' equity	86,456	83,810	82,769	108,996	106,465
Book value per common share	\$5.93	\$5.68	\$5.57	\$8.18	\$7.93
Common shares outstanding	10,088,879	10,067,379	10,066,679	10,066,679	10,066,679
Other Data:					
Number of:					
Full service retail banking facilities	4	4	4	4	4
Full-time equivalent employees	152	150	160	142	127

Table of ContentsSummary of Operations

	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(dollars in thousands, except per share information)				
Interest income	\$31,153	\$31,816	\$33,792	\$39,057	\$44,501
Interest expense	8,992	8,634	9,184	12,502	15,587
Net interest income	22,161	23,182	24,608	26,555	28,914
Provision for loan losses	(280)	831	16,520	765	4,612
Net interest income after provision for loan losses	22,441	22,351	8,088	25,790	24,302
Non-interest income	6,110	4,325	5,529	4,123	2,510
Non-interest expense	23,926	23,736	30,072	23,527	24,050
Income (loss) before income tax provision	4,625	2,940	(16,455)	6,386	2,762
Provision for income taxes	90	31	8,710	2,658	1,210
Net income (loss)	\$4,535	\$2,909	\$(25,165)	\$3,728	\$1,552
Per Common Share Data:					
Basic earnings (loss) per common share	\$0.21	\$0.06	\$(2.64)	\$0.22	\$(0.02)
Diluted earnings (loss) per common share	\$0.21	\$0.06	\$(2.64)	\$0.22	\$(0.02)
Cash dividends declared per common share	\$-	\$-	\$-	\$-	\$-
Weighted number of common shares outstanding basic	10,083,942	10,067,379	10,066,679	10,066,679	10,066,679
Weighted number of common shares outstanding diluted	10,112,653	10,096,387	10,066,679	10,066,679	10,066,679

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	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
Performance Ratios:					
Return on average assets	0.59 %	0.37 %	(3.00 %)	0.42 %	0.17 %
Return on average equity	5.45 %	3.55 %	(24.45 %)	3.50 %	1.47 %
Dividend payout ratio	- %	- %	- %	- %	- %
Net interest margin	3.18 %	3.26 %	3.28 %	3.33 %	3.39 %
Interest rate spread	3.14 %	3.24 %	3.24 %	3.27 %	3.34 %
Non-interest expense to average assets	3.09 %	3.07 %	3.64 %	2.69 %	2.56 %
Efficiency ratio*	83.82 %	86.25 %	79.73 %	66.00 %	59.32 %
Asset Quality Ratios:					
Average equity to average assets	10.75 %	10.42 %	12.28 %	12.11 %	11.27 %
Nonperforming assets to total assets at end of period	1.41 %	1.91 %	2.50 %	5.74 %	5.70 %
Nonperforming loans to total gross loans at end of period**	1.41 %	1.86 %	1.69 %	5.37 %	4.23 %
Allowance for loan losses to net loans at end of period**	1.45 %	1.47 %	1.95 %	2.68 %	3.74 %
Allowance for loan losses to nonperforming loans at end of period**	97.59 %	73.45 %	106.38 %	46.61 %	82.52 %

* The efficiency ratio is non-interest expenses less foreclosure costs as a percentage of net interest income plus non-interest income.

**Includes held for sale loans.

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The following table contains for the periods indicated information regarding the total dollar amounts of interest income from interest-earning assets and the resulting average yields, the total dollar amount of interest expense on interest-bearing liabilities and the resulting average costs, net interest income, and the net yield on interest-earning assets.

	Year Ended December 31, 2015				2014				2013			
	Average Volume	Interest	Yield/Cost		Average Volume	Interest	Yield/Cost		Average Volume	Interest	Yield/Cost	
	(dollars in thousands)											
ASSETS												
Loans (1)	\$618,309	\$29,734	4.81	%	\$622,935	\$30,574	4.91	%	\$648,959	\$32,838	5.06	%
Investments (2)	43,254	709	1.64	%	44,468	746	1.68	%	33,797	601	1.78	%
Mortgage-backed securities	25,227	395	1.57	%	9,518	205	2.15	%	1,269	35	2.76	%
Other interest-earning assets (3)	10,806	315	2.92	%	33,560	291	0.87	%	65,436	318	0.49	%
Total interest-earning assets	697,596	31,153	4.47	%	710,481	31,816	4.48	%	749,461	33,792	4.51	%
Non-interest earning assets	75,505				75,125				88,431			
Total Assets	\$773,101				\$785,606				\$837,892			
LIABILITIES AND STOCKHOLDERS' EQUITY												
Savings and checking deposits	\$244,810	635	0.26	%	\$261,513	417	0.16	%	\$273,750	768	0.28	%
Certificates of deposits	293,174	3,415	1.16	%	293,682	3,511	1.20	%	311,654	3,938	1.26	%
Borrowings	139,124	4,942	3.55	%	139,122	4,706	3.38	%	139,119	4,478	3.22	%
Total interest-bearing liabilities	677,108	8,992	1.33	%	694,317	8,634	1.24	%	724,523	9,184	1.27	%
Non-interest bearing liabilities	12,857				9,457				10,450			
Stockholders' equity	83,136				81,832				102,919			
Total liabilities and stockholders' equity	\$773,101				\$785,606				\$837,892			
Net interest income and Interest rate spread		\$22,161	3.14	%		\$23,182	3.24	%		\$24,608	3.24	%
Net interest margin			3.18	%			3.26	%			3.28	%
Average interest-earning assets to average			103.03	%			102.33	%			103.44	%

interest-bearing
liabilities

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

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	Year ended December 31, 2015			Year ended December 31, 2014		
	vs.			vs.		
	Year ended December 31, 2014			Year ended December 31, 2013		
	Changes Due			Changes Due		
Total	to	VolumeRate	Total	to	VolumeRate	Total
Change	(1)	(1)	Change	(1)	(1)	Change
(dollars in thousands)						
Interest-earning assets						
Loans	\$(840)	\$(223)	\$(617)	\$(2,264)	\$(1,277)	\$(987)
Investments	(37)	(20)	(17)	145	179	(34)
Mortgage-backed securities	190	246	(56)	170	178	(8)
Other interest-earning assets	24	(663)	687	(27)	(277)	250
Total interest income	(663)	(660)	(3)	(1,976)	(1,197)	(779)
Interest-bearing liabilities						
Savings and checking deposits	218	(43)	261	(351)	(20)	(331)
Certificates of deposits	(96)	(6)	(90)	(427)	(215)	(212)
Borrowings	236	-	236	228	-	228
Total interest expense	358	(49)	407	(550)	(235)	(315)
Net change in net interest income	\$(1,021)	\$(611)	\$(410)	\$(1,426)	\$(962)	\$(464)

(1) Changes in interest income/expense not arising from volume or rate variances are allocated proportionately to rate and volume.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of OperationsOverview

Bancorp provides a wide range of personal and commercial banking services. Personal services include mortgage lending and various other lending services as well as deposit products such as personal internet banking and online bill pay, checking accounts, individual retirement accounts, money market accounts, and 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, mortgage lending, safe deposit boxes, and telephone banking, among other products and services.

Bancorp has experienced an improved level of profitability in 2015, as well as increased loan originations and expanded local economic activity. In addition, Bancorp's levels of non-performing assets, foreclosed real estate and provision for loan losses have improved in 2015. Management believes that, while conditions continue to improve, and real estate values in Bancorp's market area continue to stabilize and, in some cases improve, including job losses and other factors, still exist for some customers. The interest rate spread between Bancorp's cost of funds and what it earns on loans has decreased from 2014 levels and competition for new loans and deposits remains strong.

Bancorp's total loan portfolio has decreased from 2014 primarily due to management's decision to sell a larger portion of newly originated residential loans on the secondary market. Bancorp has experienced a decrease in loan

delinquencies in part due to an improved economy. The allowance for loan losses decreased from levels needed in 2014 primarily due to an improvement in the level of problem assets at December 31, 2015 compared to the level at December 31, 2014 and management's assessment of the collectability of the loans in Bancorp's portfolio. In addition, Bancorp has seen a decrease in foreclosed real estate in 2015 as compared to 2014. This is due to an improved economy resulting in a lower level of loan foreclosures in 2015 compared to 2014.

Bancorp expects to experience similar market conditions in 2016 as 2015, as the national and local economies continue to improve and as the employment environment in its market improves. However, the Federal Reserve Board has ended its quantitative easing program and recently raised the federal funds interest rate, and if interest rates increase, demand for borrowing may decrease and Bancorp's interest rate spread could decrease. Bancorp will continue to manage loan and deposit pricing against the risks of rising costs of its deposits and borrowings. Interest rates are outside the control of Bancorp, so it must attempt to balance its pricing and duration of its loan portfolio against the risks of rising costs of its deposits and borrowings.

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The continued success and attraction of Anne Arundel County, Maryland, and vicinity, will also be important to Bancorp's ability to originate and grow its 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, Bancorp's business, financial condition, results of operations, access to funds and the price of its stock could be materially and adversely impacted.

On November 23, 2009, Bancorp and the Bank each entered into a supervisory agreement with the OTS. The Bank's supervisory agreement was replaced by a formal agreement dated April 23, 2013 with the OCC. On October 15, 2015, the Bank was notified by the OCC that its agreement was terminated. Bancorp's supervisory agreement was enforced by the FRB. On January 21, 2016, Bancorp was notified by FRB that its agreement was terminated. See "Supervisory and Formal Agreements" for more information.

Critical Accounting Policies and Recent Accounting Pronouncements

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

Recent Accounting Pronouncements – Under ASU 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*, a creditor will be considered to have physical possession of residential real estate property that is collateral for a residential mortgage loan and therefore should reclassify the loan to other real estate owned when either (a) the creditor obtains legal title to the property upon completion of a foreclosure, or (b) the borrower conveys all interest in the real estate property to the lender to satisfy that loan even though legal title may not have passed. The amendments are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Bancorp adopted this guidance on January 1, 2015 using a prospective transition method; it did not have material impact on the consolidated financial statements. The guidance requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. Bancorp has included these disclosures in Note 16 Fair Values of Financial Instruments.

Under ASU 2014-09, *Revenue from Contracts with Customers*, establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance. The revenue standard's core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. The new standard applies to all public entities for annual periods beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016 including interim periods within that year. Bancorp has evaluated the effect of ASU 2014-09 and believes adoption will not have a material effect on the Consolidated

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Under ASU 2016-01, Amendment to the Recognition and Measurement Guidance for Financial Instruments, an entity is required to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in Other Comprehensive Income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of Available For Sale debt securities in combination with other deferred tax assets. The Amendment provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Amendment also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The new standard takes effect in 2018 for public companies. Early adoption is only permitted for the provision related to instrument-specific credit risk and the fair value disclosure exemption provided to nonpublic entities. Bancorp has evaluated the effect of ASU 2016-01 and believes adoption will not have a material effect on the Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, "Leases." The new standard establishes a right-to-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact this update will have on its consolidated financial position and results of operations.

Financial Condition

Total assets decreased by \$14,249,000, or 1.8% to \$762,079,000 at December 31, 2015, compared to the \$776,328,000 at December 31, 2014. The following discusses the material changes between the December 31, 2015 and 2014 statements of financial condition.

Cash

Cash and cash equivalents increased by \$10,256,000, or 30.8%, to \$43,591,000 at December 31, 2015, compared to \$33,335,000 at December 31, 2014. This increase was primarily due to proceeds received in 2015 from loan payoffs and higher proceeds from a larger portion of newly originated residential loans sold on the secondary market, partially offset by cash used in 2015 to purchase additional securities for the investment portfolio.

Investments

Investment securities held to maturity increased by \$16,517,000, or 27.7%, to \$76,133,000 at December 31, 2015, compared to \$59,616,000 at December 31, 2014. This increase was primarily due to management's decision to purchase additional securities to gain higher yields than cash held in federal funds sold since loan demand was low.

Loans

Loans Held For Sale. Loans held for sale increased by \$6,038,000, or 84.3%, to \$13,203,000 at December 31, 2015, compared to \$7,165,000 at December 31, 2014. This increase was primarily due to an increase in residential loans originated for sale on the secondary market and the timing of loans pending sale as of December 31, 2015 compared to December 31, 2014.

Loans Receivable. Total loans receivable, net decreased by \$44,226,000, or 7.0%, to \$589,656,000 at December 31, 2015, compared to \$633,882,000 at December 31, 2014. This decrease was primarily due to a decrease in portfolio loan demand and higher loan payoffs than expected in 2015. In addition, the allowance for loan losses decreased by \$677,000, or 7.2%, at December 31, 2015 to \$8,758,000, compared to \$9,435,000 at December 31, 2014. This decrease in the allowance was primarily due to a decreased loan portfolio, and an improvement in the level of problem loans at December 31, 2015 compared to the level at December 31, 2014 and management's assessment of the collectability of the loans in Bancorp's portfolio.

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Foreclosed Real Estate

Foreclosed real estate decreased by \$203,000, or 10.4%, to \$1,744,000 at December 31, 2015, compared to \$1,947,000 at December 31, 2014. This decrease was primarily due to an increase in the number of foreclosed properties sold in 2015 that were included in the balance as of December 31, 2014, and the lower level of loans foreclosed on in 2015 compared to 2014.

Premises and Equipment

Premises and equipment decreased by \$869,000, or 3.5%, to \$24,290,000 at December 31, 2015, compared to \$25,159,000 at December 31, 2014. This decrease was primarily due to the annual depreciation taken on premises and equipment in 2015, partially offset by new fixed assets acquired in 2015.

Accrued Interest Receivable and Other Assets

Accrued interest receivable and other assets decreased by \$1,452,000, or 15.6%, to \$7,836,000 at December 31, 2015, compared to \$9,288,000 at December 31, 2014. This decrease is primarily due to a reimbursement of a security deposit in 2015.

Liabilities

Deposits. Total deposits decreased by \$20,043,000, or 3.7%, to \$523,771,000 at December 31, 2015, compared to \$543,814,000 at December 31, 2014. This decrease was primarily the result of management's decision to not renew higher priced certificates of deposit given the higher amount of cash received from loan payoffs and proceeds received from loans sold on the secondary market.

FHLB-Atlanta Advances. FHLB-Atlanta advances at December 31, 2015 were \$115,000,000, which was unchanged from December 31, 2014. There were no contractual advance payoffs scheduled during 2015 and no additional advances were needed.

Subordinated Debentures. As of December 31, 2015, Bancorp had outstanding approximately \$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 3-month LIBOR (0.32% December 31, 2015) plus 200 basis points, and mature on January 7, 2035. Payments of principal, interest, premium and other amounts under the 2035 Debentures are subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of Bancorp, as defined in the 2035 Indenture. The 2035 Debentures became redeemable, in whole or in part, by Bancorp on January 7, 2010.

The 2035 Debentures were issued and sold to Severn Capital Trust I (the "Trust"), of which 100% of the common equity is owned by Bancorp. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities ("Capital Securities") to third-party investors and using the proceeds from the sale of such Capital Securities to purchase the 2035 Debentures. The 2035 Debentures held by the Trust are the sole assets of the Trust. Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the 2035 Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the 2035 Debentures. Bancorp has entered into an agreement which, taken collectively, fully and unconditionally guarantees the Capital Securities subject to the terms of the guarantee.

Under the terms of the 2035 Debenture, Bancorp is permitted to defer the payment of interest on the 2035 Debentures for up to 20 consecutive quarterly periods, provided that no event of default has occurred and is continuing. As of December 31, 2015, Bancorp has deferred the payment of fifteen quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was \$1,863,000.

Subordinated Notes and Series A Preferred Stock. 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 \$7,000,000. Each unit consists of 6,250 shares of Bancorp's Series A 8.0% Non-Cumulative Convertible Preferred Stock and Bancorp's Subordinated Notes ("Subordinated Notes") in the original principal amount of \$50,000. 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. 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 are not cumulative.

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Dividends on the Series A Preferred Stock have not been paid since the first quarter of 2012 because Bancorp has not received approval from the Federal Reserve to pay such dividends.

Series B Preferred Stock. 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. On September 25, 2013, the Treasury sold all of its 23,393 shares of Series B Preferred Stock to outside investors as part of their ongoing efforts to wind down and recover its remaining investments under the Troubled Asset Relief Program (“TARP”). The terms of the Series B Preferred Stock remain the same. The Treasury continues to hold the Warrant.

The Series B Preferred Stock qualifies as Tier 1 capital and pays cumulative compounding dividends at the rate of 9% per annum. The Series B Preferred Stock may be redeemed by Bancorp. The Series B Preferred Stock has no maturity date and ranks pari passu with Bancorp’s existing Series A Preferred Stock, in terms of dividend payments and distributions upon liquidation, dissolution and winding up of Bancorp.

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

Dividends on the Series B Preferred Stock have not been paid since the first quarter of 2012 because Bancorp has not received approval from the Federal Reserve to pay such dividends. As of December 31, 2015, Bancorp had cumulative dividends and interest in arrears on the Series B Preferred Stock of \$7,033,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the dividends in arrearage on its Series B Preferred Stock has been paid in full and until Bancorp declares and pays a dividend on its Series A preferred stock.

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.

Off-Balance Sheet Arrangements. Bancorp has certain outstanding commitments and obligations that could impact Bancorp’s financial condition, liquidity, revenues or expenses. These commitments and obligations include standby letters of credit, home equity lines of credit, loan commitments, lines of credit, and loans sold and serviced with limited repurchase provisions.

Standby letters of credit, which are conditional commitments of Bancorp to guarantee performance of customers to various municipalities, decreased \$1,420,000, or 19.3%, as of December 31, 2015 to \$5,937,000, compared to \$7,357,000 as of December 31, 2014. Bancorp continues to experience a decrease in demand from its customers for letter of credit requirements. Bancorp requires collateral supporting these letters of credit as deemed necessary, and 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 for guarantees under standby letters of credit issued as of December 31, 2015 and 2014 was \$115,000 and \$314,000, respectively.

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Unadvanced construction commitments decreased \$15,061,000, or 41.6%, as of December 31, 2015 to \$21,101,000, compared to \$36,162,000 as of December 31, 2014. This decrease was primarily the result of decreased construction activity in 2015 and the resulting lower level of new construction loan originations.

Home equity lines of credit decreased \$1,104,000, or 12.9%, as of December 31, 2015 to \$7,467,000, compared to \$8,571,000 as of December 31, 2014. This decrease was primarily due to management's decision to not aggressively seek new lines of credit and lower customer demand for home equity loans in 2015 because of lower home values in the marketplace. Home equity lines of credit allow the borrowers to draw funds up to a specified loan amount, from time to time. Bancorp's management believes it has sufficient liquidity resources to have the funding available as these borrowers draw on these loans.

Mortgage loan commitments increased \$1,113,000, or 52.5%, as of December 31, 2015 to \$3,233,000, compared to \$2,120,000 as of December 31, 2014. This increase was primarily due to the timing of loan commitments at year end. Loan commitments are obligations of Bancorp to provide loans, and such commitments are made in the usual course of business, however, these obligations can and do fluctuate based on the timing of when new loans are entered into.

Lines of credit, which are obligations of Bancorp to fund loans made to certain borrowers, increased \$3,345,000, or 14.0%, to \$27,189,000 as of December 31, 2015, compared to \$23,844,000 as of December 31, 2014. The increase was a result of slightly higher demand for this type of loan product during 2015. Bancorp's management believes it has sufficient liquidity resources to have the funding available as these borrowers draw on these loans.

Loans sold and serviced with limited repurchase provisions increased \$26,860,000, or 70.2%, to \$65,107,000 as of December 31, 2015, compared to \$38,247,000 as of December 31, 2014. This increase was primarily due to an increase in demand for new residential loan originated for sale on the secondary market in 2015 and management's decision to sell a larger portion of the new loan originations with servicing retained by Bancorp. Management typically retains servicing on those loans that are originated in Bancorp's primary market area.

Bancorp uses the same credit policies in making commitments and conditional obligations as it does for its on-balance sheet instruments. Except for the liability recorded for standby letters of credit at December 31, 2015, liabilities for credit losses associated with these commitments were not material at December 31, 2015 and 2014.

Comparison of Results of Operations for the Years Ended December 31, 2015 and 2014.

General. Net income increased \$1,626,000, or 55.9%, to \$4,535,000 for the year ended December 31, 2015 compared to \$2,909,000 for the year ended December 31, 2014. Earnings per common share, after the effect of dividends declared on preferred stock and amortization of discount on preferred stock, increased to \$0.21 per common share for the year ended December 31, 2015 compared to \$0.06 per common share for the year ended December 31, 2014. This increase in net income was primarily due to higher non-interest income and a lower provision for loan losses, partially offset by lower net interest income in 2015 compared to 2014.

Net Interest Income. Net interest income (interest earned net of interest charges) decreased \$1,021,000, or 4.4%, to \$22,161,000 for the year ended December 31, 2015, compared to \$23,182,000 for the year ended December 31, 2014. This decrease was primarily due to a decrease in Bancorp's loan portfolio and from higher interest expense on deposits and borrowings. Bancorp's interest rate spread declined 10 basis points to 3.14% for the year ended December 31, 2015, compared to 3.24% for the year ended December 31, 2014.

Provision for Loan Losses. 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 collectibility.

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During the year ended December 31, 2015, the provision for loan losses was (\$280,000) compared to \$831,000 for the year ended December 31, 2014. This decrease of \$1,111,000 was primarily due to lower total loans and improved asset quality at December 31, 2015 compared to December 31, 2014 and lower net charge-offs taken in 2015 compared to 2014.

The total allowance for loan losses decreased \$677,000, or 7.2% to \$8,758,000 as of December 31, 2015, compared to \$9,435,000 as of December 31, 2014. This decrease in the allowance was primarily due to a decreased loan portfolio, and an improvement in the level of criticized loans at December 31, 2015 compared to the level at December 31, 2014 and management's assessment of the collectability of the loans in Bancorp's portfolio.

Non-Interest Income. Total non-interest income increased \$1,785,000, or 41.3%, to \$6,110,000 for the year ended December 31, 2015 compared to \$4,325,000 for the year ended December 31, 2014.

Revenues from mortgage banking activities increased \$1,328,000, or 83.0%, to \$2,928,000 for the year ended December 31, 2015, compared to \$1,600,000 for the year ended December 31, 2014. This increase was primarily a result of higher residential loan originations sold on the secondary market in 2015, compared to 2014.

Real estate commissions increased \$285,000, or 27.6%, to \$1,319,000 for the year ended December 31, 2015, compared to \$1,034,000 for the year ended December 31, 2014. This increase was primarily the result of an improvement in general business conditions in Bancorp's market and a resulting increase in commercial sales and leasing in 2015 compared to 2014.

Real estate management fees decreased \$84,000, or 11.3%, to \$658,000 for the year ended December 31, 2015, compared to \$742,000 for the year ended December 31, 2014. This decrease was primarily due to a decrease in properties managed in 2015 compared to 2014.

Other non-interest income increased \$256,000, or 27.0%, to \$1,205,000 for the year ended December 31, 2015, compared to \$949,000 for the year ended December 31, 2014. This increase was primarily due to an approximate \$88,000 gain recorded for the sale of collateral from a subsidiary investment, and higher fees collected for credit reports and appraisals, partially offset by lower income recorded for the fair value of interest rate lock commitments and mandatory contracts in 2015, compared to 2014.

Non-Interest Expenses. Total non-interest expense increased \$190,000, or 0.8%, to \$23,926,000 for the year ended December 31, 2015 compared to \$23,736,000 for the year ended December 31, 2014.

Compensation and related expenses increased \$976,000, or 6.7%, to \$15,630,000 for the year ended December 31, 2015, compared to \$14,654,000 for the year ended December 31, 2014. This increase was primarily the result of hiring certain higher level employees in 2015, including senior management and credit department personnel, and an increase in commissions on real estate loan sales. As of December 31, 2015, Bancorp had 152 full-time equivalent employees compared to 150 at December 31, 2014.

Occupancy expense decreased \$56,000, or 3.2%, to \$1,676,000 for the year ended December 31, 2015, compared to \$1,732,000 for the year ended December 31, 2014. This decrease was primarily due to lower maintenance costs and utilities expenses in 2015.

Foreclosed real estate expenses, net increased \$220,000, or 2,200.0%, to \$230,000 for the year ended December 31, 2015, compared to \$10,000 for the year ended December 31, 2014. This increase was primarily due to higher expenses and writedowns associated with the properties and lower gains from sales compared to 2014. Included in expenses for 2015 were writedowns of approximately \$58,000 and other expenses of approximately \$221,000, partially offset by net gains on sale of REO of approximately \$49,000.

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Legal fees increased \$38,000, or 12.0%, to \$354,000 for the year ended December 31, 2015, compared to \$316,000 the year ended December 31, 2014. This increase was primarily due to additional law firms used in 2015 for customer loans compared to 2014.

The FDIC assessment decreased \$97,000, or 7.3%, to \$1,234,000 for the year ended December 31, 2015, compared to \$1,331,000 for the year ended December 31, 2014. This decrease was primarily the result of a decreased level of net assets in 2015 used by the FDIC to calculate assessment charge.

Professional fees decreased \$34,000, or 3.7%, to \$887,000 for the year ended December 31, 2015, compared to \$921,000 for the year ended December 31, 2014. This decrease was primarily the result of a decrease in accounting fees, partially offset by an increase in consulting fees for loan reviews, marketing and loan workouts in 2015 compared to 2014.

Advertising fees increased \$73,000, or 10.6%, to \$760,000 for the year ended December 31, 2015, compared to \$687,000 for the year ended December 31, 2014. This increase was primarily due a marketing campaign in 2015 for new online banking products offered by Bancorp.

Online charges decreased \$43,000, or 4.7%, to \$864,000 for the year ended December 31, 2015, compared to \$907,000 for the year ended December 31, 2014. This decrease was due to cost savings realized by a newly negotiated contract for core processing in late 2014.

Credit report and appraisal fees decreased \$117,000, or 13.1%, to \$773,000 for the year ended December 31, 2015, compared to \$890,000 for the year ended December 31, 2014. This decrease was due to a lower level of appraisals ordered for fewer problem assets in 2015.

Other non-interest expense decreased \$770,000, or 33.7%, to \$1,518,000 for the year ended December 31, 2015, compared to \$2,288,000 for the year ended December 31, 2014. This decrease was primarily the result of a lower reserve required on the improved quality of standby letters of credit in 2015 and the increased fair value of interest rate lock commitments and mandatory forward contracts in 2015, compared to 2014.

Income Taxes. Income taxes increased \$59,000, or 190.3%, to \$90,000 for the year ended December 31, 2015, compared to \$31,000 for the year ended December 31, 2014. This increase in the income tax provision in 2015 was due to higher net income and a higher provision calculated based on an alternative minimum tax calculation.

Liquidity and Capital Resources

In 2015, Bancorp's sources of liquidity were loan repayments, maturing investments, deposits, borrowed funds, and proceeds from loans sold on the secondary market. Bancorp considers core deposits stable funding sources and includes all deposits, except time deposits of \$100,000 or more. The Bank's experience has been that a substantial portion of certificates of deposit renew at time of maturity and remain on deposit with the Bank. Additionally, loan payments, maturities, deposit growth and earnings contributed to Bancorp's flow of funds.

In addition to its ability to generate deposits, Bancorp has external sources of funds, which may be drawn upon when desired. The primary source of external liquidity is an available line of credit with the FHLB-Atlanta. The Bank's credit availability under the FHLB of Atlanta's credit availability program was \$192,672,000 at December 31, 2015, of which \$115,000,000 was outstanding. The Bank's credit availability is based on the level of collateral pledged up to 25% of total assets.

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The maturities of these long-term advances at December 31, 2015 were as follows (dollars in thousands):

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

As of December 31, 2015, Bancorp had outstanding an aggregate of \$24,119,000 principal amount of subordinated debt, consisting of the 2035 Debentures and the Subordinated Notes. The 2035 Debentures total \$20,619,000 in principal amount pay interest quarterly at a floating rate of interest of 3-month LIBOR (0.32% December 31, 2015) plus 200 basis points, and mature on January 7, 2035. The Subordinated Notes total \$3,500,000 and pay 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.

As of December 31, 2015, Bancorp had \$3,233,000 outstanding in mortgage loan commitments, and unadvanced construction commitments of \$21,101,000 which Bancorp expects to fund from the sources of liquidity described above. These amounts do not include undisbursed lines of credit, home equity lines of credit and standby letters of credit, in the aggregate amount of \$40,593,000 at December 31, 2015, which Bancorp anticipates it will be able to fund, if required, from these liquidity sources in the regular course of business.

In addition to the foregoing, the payment of dividends is a use of cash, but is not expected to have a material effect on liquidity. As of December 31, 2015, Bancorp had no material commitments for capital expenditures.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary, actions by the regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Management believes, as of December 31, 2015, that the Bank meets all capital adequacy requirements to which it is subject.

In 2013, the federal banking agencies have adopted proposals that substantially amended the regulatory capital rules applicable to us and the Bank. The amended rules established new higher capital ratio requirements, narrowed the definitions of capital, imposed new operating restrictions on banking organizations with insufficient capital buffers and increased the risk weighting of certain assets. The amended rules became effective with respect to us and the Bank in January 2015, with certain requirements to be phased in beginning in 2016. Management believes that the current capital levels of Bancorp and the Bank are sufficient to comply with the standards under the new rules.

We anticipate that our primary sources of liquidity in fiscal 2016 will be from loan repayments, maturing investments, deposits, borrowed funds, and proceeds from loans sold on the secondary market. We believe that these sources of liquidity will be sufficient for Bancorp to meet its liquidity needs over the next twelve months. Cash generated from these liquidity sources may be affected by a number of factors. See "Risk Factors" for a discussion of the factors that can negatively impact the amount of cash we could receive.

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The following table contains, for the periods indicated, information regarding the financial obligations owing by Bancorp under contractual obligations.

	Payments due by period (dollars in thousands)				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Long-term borrowings	\$115,000	\$15,000	\$85,000	\$15,000	\$-
Subordinated debentures	24,119	-	3,500	-	20,619
Operating lease obligations	666	152	286	228	-
Certificates of Deposit	277,778	169,298	78,234	30,246	-
Total	\$417,563	\$184,450	\$167,020	\$45,474	\$20,619

Qualitative Information About Market Risk. The principal objective of Bancorp's interest rate risk management is to evaluate the interest rate risk included in balance sheet accounts, determine the level of risks appropriate given Bancorp's business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with Bancorp's interest rate risk management policy. Through this management, Bancorp seeks to reduce the vulnerability of its operations to changes in interest rates. The Board of Directors of Bancorp is responsible for reviewing assets/liability policies and interest rate risk position. The Board of Directors reviews the interest rate risk position on a quarterly basis and, in connection with this review, evaluates Bancorp's business activities and strategies, the effect of those strategies on Bancorp's net interest margin and the effect that changes in interest rates will have on Bancorp's loan portfolio. While continuous movement of interest rates is certain, the extent and timing of these movements is not always predictable. Any movement in interest rates has an effect on Bancorp's profitability. Bancorp faces the risk that rising interest rates could cause the cost of interest bearing liabilities, such as deposits and borrowings, to rise faster than the yield on interest earning assets, such as loans and investments. Bancorp's interest rate spread and interest rate margin also may be negatively impacted in a declining interest rate environment even though Bancorp generally borrows at short-term interest rates and lends at longer-term interest rates. This is because loans and other interest earning assets may be prepaid and replaced with lower yielding assets before the supporting interest bearing liabilities reprice downward. Bancorp's interest rate margin may also be negatively impacted in a flat or inverse-yield curve environment. Mortgage origination activity tends to increase when interest rates trend lower and decrease when interest rates rise.

Bancorp's primary strategy to control interest rate risk is to sell substantially all long-term fixed-rate loans in the secondary market. Bancorp did retain a higher amount of certain loans, including residential mortgages with floating rates, but these loans typically have interest rates that reset after a period of three to seven years. To further control interest rate risk related to its loan portfolio, Bancorp originates construction loans that typically have terms of one year or less. The turnover in construction loan portfolio assists Bancorp in maintaining a reasonable level of interest rate risk.

Quantitative Information About Market Risk. The primary market risk facing Bancorp is interest rate risk. From an enterprise prospective, Bancorp manages this risk by striving to balance its loan origination activities with the interest rate market. Bancorp attempts to maintain a substantial portion of its loan portfolio in short-term loans such as

construction loans. This has proven to be an effective hedge against rapid increases in interest rates as the construction loan portfolio reprices rapidly.

The matching of maturity or repricing of interest earning assets and interest bearing liabilities may be analyzed by examining the extent to which these assets and liabilities are interest rate sensitive and by monitoring the Bank's interest rate sensitivity gap. An interest earning asset or interest bearing liability is interest rate sensitive within a specific time period if it will mature or reprice within that time period. The difference between rate sensitive assets and rate sensitive liabilities represents the Bank's interest sensitivity gap.

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Exposure to interest rate risk is actively monitored by Bancorp's management. Its objective is to maintain a consistent level of profitability within acceptable risk tolerances across a broad range of potential interest rate environments. Bancorp uses the BankersGPS model to monitor its exposure to interest rate risk, which calculates changes in the economic value of equity ("EVE"). The following table represents Bancorp's EVE at December 31, 2015. The EVE was calculated based upon information provided to the OCC.

ECONOMIC VALUE OF EQUITY (EVE)

Change In Rates	\$ Amount	Economic Value of Equity	
		\$ Change	% Change
+400bp	91,143	(18,573)	(16.9)%
+300bp	94,472	(15,244)	(13.9)%
+200bp	98,602	(11,114)	(10.1)%
+100bp	103,703	(4,013)	(5.5)%
0bp	109,716		
-100bp	116,642	6,926	6.3%
-200bp	124,258	14,542	13.3%
-300bp	133,183	23,467	21.4%
-400bp	143,482	33,766	30.8%

The above table suggests that if interest rates rise 100 basis points, Bancorp's market value of equity would decrease in value by \$4,013,000.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

Financial statements and supplementary data are included herein at pages F-1 through F-56, and incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and ProceduresDisclosure Controls and Procedures.

Under the supervision and with the participation of Bancorp's management, including its Chief Executive Officer and Chief Financial Officer, Bancorp has evaluated the effectiveness of its disclosure controls and procedures as of December 31, 2015. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the period covered by this report, Bancorp's disclosure controls and procedures were effective 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 Securities Exchange Act of 1934 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 Securities Exchange Act of 1934 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.

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

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

Management's Report on Internal Control over Financial Reporting

Bancorp is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with accounting principles generally accepted in the United States of America, and as such, include some amounts that are based on management's best estimates and judgments.

Bancorp's management is responsible for establishing and maintaining effective internal control over financial reporting. The system of internal control over financial reporting, as it relates to the consolidated financial statements, is evaluated for effectiveness by management and tested for reliability through a program of internal audits and management testing and review. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management assessed the effectiveness of Bancorp's internal control over financial reporting as of December 31, 2015. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework 2013. Based on its assessment, management concluded that as of December 31, 2013, Bancorp's internal control over financial reporting is effective and meets the criteria of the Internal Control – Integrated Framework.

This Annual Report does not include an attestation report of Bancorp's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by Bancorp's registered public accounting firm pursuant to a provision of the Dodd-Frank Act which eliminates such requirement for "smaller reporting companies", as defined in SEC regulations.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information contained in Item 4.1, "Executive Officers of the Registrant," of this Form 10-K is incorporated herein by reference.

The additional information required by this item will be included in Bancorp's definitive Proxy Statement relating to the 2016 Annual Stockholders Meeting ("Proxy Statement"), which Bancorp intends to file with the Securities and Exchange Commission within 120 days after December 31, 2015, and is incorporated herein by reference.

Bancorp has adopted a code of ethics that applies to its employees, including its chief executive officer, chief financial officer, and persons performing similar functions and directors. A copy of the code of ethics is filed as an exhibit to Bancorp's Form 10-K for the year ended December 31, 2003, which was filed with the Securities and Exchange Commission on March 25, 2004. Bancorp intends to satisfy the disclosure requirement under Item 10 of Form 8-K regarding any future amendments to a provision of its code of ethics by posting such information on Bancorp's website: www.severnbank.com.

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Item 11. Executive Compensation

The information required by this item will be included in Bancorp's Proxy Statement, which Bancorp intends to file with the Securities and Exchange Commission within 120 days after December 31, 2015, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table provides certain information as of December 31, 2015 with respect to Bancorp's equity based compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plan approved by security holders	339,800	\$4.83	250,501
Equity compensation plans not approved by security holders	-	-	-
Total	339,800	\$4.83	250,501

The additional information required by this item will be included in Bancorp's Proxy Statement, which Bancorp intends to file with the Securities and Exchange Commission within 120 days after December 31, 2015, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item will be included in Bancorp's Proxy Statement, which Bancorp intends to file with the Securities and Exchange Commission with 120 days after December 31, 2015, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item will be included in Bancorp's Proxy Statement, which Bancorp intends to file with the Securities and Exchange Commission with 120 days after December 31, 2015, and is incorporated herein by reference.

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PART IV

Item 15. Exhibits. Financial Statement Schedules

(a) The following consolidated financial statements of Bancorp and its wholly owned sub-sidiaries are filed as part of this report:

1. Financial Statements

Report of BDO USA, LLP, independent registered public accounting firm.

Consolidated statements of financial condition at December 31, 2015 and December 31, 2014

Consolidated statements of operations for the years ended December 31, 2015 and 2014,

Consolidated statements of stockholders' equity for the years ended December 31, 2015 and 2014

Consolidated statements of cash flows for the years ended December 31, 2015 and 2014

Notes to consolidated financial
statements

2. Financial Statement Schedules

All financial statement schedules have been omitted, as required information is either inapplicable or included in the consolidated financial statements or related notes.

3. Exhibits

The following exhibits are filed as part of this report:

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
3.1	Articles of Incorporation of Severn Bancorp, Inc., as amended ⁽¹⁾
3.2	Bylaws of Severn Bancorp, Inc., as amended ⁽²⁾
4.1	Warrant for Purchase of Shares of Common Stock ⁽³⁾
10.1+	Stock Option Plan ⁽⁴⁾
10.2+	Employee Stock Ownership Plan ⁽⁵⁾
10.3+	Form of Common Stock Option Agreement ⁽⁶⁾
10.4+	2008 Equity Incentive Plan ⁽⁷⁾
10.5+	Form of Subscription Agreement ⁽⁸⁾
10.6	Form of Subordinated Note ⁽⁸⁾
10.7	Purchase Agreement, dated November 21, 2008, between Bancorp and the United States Department of the Treasury ⁽³⁾
10.8	Supervisory Agreement dated November 23, 2009 between Severn Savings Bank, FSB and the OTS ⁽⁹⁾
10.9	Supervisory Agreement dated November 23, 2009 between Severn Bancorp, Inc. and the OTS ⁽⁹⁾
10.10+	Form of Director Option Award ⁽¹⁰⁾
10.11+	Form of Employee Option Award ⁽¹⁰⁾
10.12	Formal Agreement between Severn Savings Bank, FSB and the Office of the Comptroller of the Currency, dated April 23, 2013. ⁽¹¹⁾
14.1	Code of Ethics ⁽¹²⁾
<u>21.1*</u>	Subsidiaries of Severn Bancorp, Inc.
<u>23.1*</u>	Consent of BDO USA, LLP
<u>31.1*</u>	Certification of CEO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
<u>31.2*</u>	Certification of CFO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
<u>32 *</u>	Certification of CEO and CFO pursuant to Section 906 of Sarbanes-Oxley Act of 2002
101*	

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

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+ Denotes management contract, compensatory plan or arrangement.

* Filed herewith.

(1) Incorporated by reference from Bancorp's Annual Report on Form 10-K for fiscal year ended December 31, 2008 and filed with the Securities and Exchange Commission on March 11, 2009.

(2) Incorporated by reference from Bancorp's Annual Report on Form 10-K for fiscal year ended December 31, 2007 and filed with Securities and Exchange Commission on March 12, 2008.

(3) Incorporated by reference from Bancorp's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 24, 2008.

(4) Incorporated by reference from Bancorp's Annual Report on Form 10-K filed for fiscal year ended December 31, 2004 and with the Securities and Exchange Commission on March 21, 2005.

(5) Incorporated by reference from Bancorp's Registration Statement on Form 10 filed with the Securities and Exchange Commission on June 7, 2002.

(6) Incorporated by reference from Bancorp's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 20, 2006.

(7) Incorporated by reference from Bancorp's 2008 Proxy Statement filed with Securities and Exchange Commission on March 12, 2008.

(8) Incorporated by reference from Bancorp's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 18, 2008.

(9) Incorporated by reference from Bancorp's Annual Report on Form 10-K for fiscal year ended December 31, 2009 and filed with the Securities and Exchange Commission on March 15, 2010.

(10) Incorporated by reference from Bancorp's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010 and filed with the Securities and Exchange Commission on August 13, 2010.

(11) Incorporated by reference from Bancorp's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 and filed with the Securities and Exchange Commission on May 8, 2013.

(12) Incorporated by reference from Bancorp's Annual Report on Form 10-K for fiscal year ended December 31, 2003 and filed with the Securities and Exchange Commission on March 25, 2004.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

March 17, 2016 /s/ Alan J. Hyatt

Alan J. Hyatt

Chairman of the Board, President,

Chief Executive Officer and Director

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

March 17, 2016 /s/ Alan J. Hyatt

Alan J. Hyatt
Chairman of the Board,
President, Chief Executive Officer
and Director

March 17, 2016 /s/ Thomas G. Bevivino

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

March 17, 2016 /s/ Konrad M. Wayson

Konrad M. Wayson, Director
Vice Chairman of the Board

March 17, 2016 /s/ Raymond S. Crosby

Raymond S. Crosby, Director

March 17, 2016 /s/ James H. Johnson, Jr.

James H. Johnson, Jr., Director

March 17, 2016 /s/ David S. Jones

David S. Jones, Director

March 17, 2016 /s/ Eric M. Keitz

Eric M. Keitz, Director

March 17, 2016 /s/ John A. Lamon III

John A. Lamon III, Director

March 17, 2016 /s/ Albert W. Shields

Albert W. Shields, Director

March 17, 2016 /s/ Mary Kathleen Sulick

Mary Kathleen Sulick, Director

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Severn Bancorp, Inc.

We have audited the accompanying consolidated statements of financial condition of Severn Bancorp, Inc. and Subsidiaries (the “Company”) as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders’ equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Severn Bancorp, Inc. and Subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/BDO USA, LLP

Harrisburg, Pennsylvania

March 17, 2016

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Table of ContentsSEVERN BANCORP, INC. AND SUBSIDIARIESAnnapolis, MarylandCONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in thousands, except per share data)

	December 31,	
	2015	2014
ASSETS		
Cash and due from banks	\$28,366	\$24,866
Interest bearing deposits in other banks	15,225	8,469
Cash and cash equivalents	43,591	33,335
Investment securities held to maturity (fair value: \$76,310 at December 31, 2015; \$60,123 at December 31, 2014)	76,133	59,616
Loans held for sale	13,203	7,165
Loans receivable, net of allowance for loan losses of \$8,758 and \$9,435 in 2015 and 2014, respectively	589,656	633,882
Premises and equipment, net	24,290	25,159
Foreclosed real estate	1,744	1,947
Federal Home Loan Bank stock, at cost	5,626	5,936
Accrued interest receivable and other assets	7,836	9,288
Total assets	\$762,079	\$776,328
LIABILITIES AND STOCKHOLDERS' EQUITY		
<u>Liabilities</u>		
Deposits	\$523,771	\$543,814
Long-term borrowings	115,000	115,000
Subordinated debentures	24,119	24,119
Accrued interest payable and other liabilities	12,733	9,585
Total Liabilities	675,623	692,518
<u>Stockholders' Equity</u>		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized:		
Preferred stock series "A", 437,500 shares issued and outstanding; \$3,500 liquidation preference at December 31, 2015 and December 31, 2014	4	4
Preferred stock series "B", 23,393 shares issued and outstanding; \$23,393 liquidation preference at December 31, 2015 and December 31, 2014	-	-
Common stock, \$0.01 par value, 20,000,000 shares authorized; 10,088,879 and 10,067,379 shares issued and outstanding, respectively	101	101
Additional paid-in capital	76,335	75,848
Retained earnings	10,016	7,857
Total stockholders' equity	86,456	83,810
Total liabilities and stockholders' equity	\$762,079	\$776,328

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

Table of ContentsSEVERN BANCORP, INC. AND SUBSIDIARIESAnnapolis, MarylandCONSOLIDATED STATEMENTS OF OPERATIONS

(dollars in thousands, except per share data)

	Years Ended December 31,	
	2015	2014
<u>Interest Income</u>		
Loans, including fees	\$29,734	\$30,574
Securities, taxable	1,104	951
Other	315	291
Total interest income	31,153	31,816
<u>Interest Expense</u>		
Deposits	4,050	3,928
Long-term borrowings and subordinated debentures	4,942	4,706
Total interest expense	8,992	8,634
Net interest income	22,161	23,182
Provision for loan losses	(280)	831
Net interest income after provision for loan losses	22,441	22,351
<u>Non-Interest Income</u>		
Mortgage banking activities	2,928	1,600
Real estate commissions	1,319	1,034
Real estate management fees	658	742
Other	1,205	949
Total non-interest income	6,110	4,325
<u>Non-Interest Expenses</u>		
Compensation and related expenses	15,630	14,654
Occupancy	1,676	1,732
Foreclosed real estate expenses, net	230	10
Legal	354	316
FDIC assessments and regulatory expense	1,234	1,331
Professional fees	887	921
Advertising	760	687
Online charges	864	907
Credit reports and appraisal fees	773	890
Other	1,518	2,288
Total non-interest expenses	23,926	23,736
Income before income tax provision	4,625	2,940
Income tax provision	90	31
Net income	4,535	2,909
Amortization of discount on preferred stock	271	270
Dividends on preferred stock	2,105	2,072
Net income available to common stockholders	\$2,159	\$567

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Basic income per common share	\$0.21	\$0.06
Diluted income per common share	\$0.21	\$0.06

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

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Table of ContentsSEVERN BANCORP, INC. AND SUBSIDIARIESAnnapolis, MarylandCONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITYYears Ended December 31, 2015 and 2014

(dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Total Stockholders' Equity
Balance - December 31, 2013	\$ 4	\$ 101	\$ 75,374	\$ 7,290	\$ 82,769
Net Income	-	-	-	2,909	2,909
Stock-based compensation	-	-	201	-	201
Dividend declared on Series B preferred stock	-	-	-	(2,072)	(2,072)
Amortization of discount on Series B preferred stock	-	-	270	(270)	-
Exercised Options (700 shares)	-	-	3	-	3
Balance - December 31, 2014	4	101	75,848	7,857	83,810
Net Income	-	-	-	4,535	4,535
Stock-based compensation	-	-	120	-	120
Dividend declared on Series B preferred stock	-	-	-	(2,105)	(2,105)
Amortization of discount on Series B preferred stock	-	-	271	(271)	-
Exercised Options (21,500 shares)	-	-	96	-	96
Balance - December 31, 2015	\$ 4	\$ 101	\$ 76,335	\$ 10,016	\$ 86,456

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

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Table of ContentsSEVERN BANCORP, INC. AND SUBSIDIARIESAnnapolis, MarylandCONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

	Years Ended December 31,	
	2015	2014
<u>Cash Flows from Operating Activities</u>		
Net income	\$4,535	\$2,909
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred loan fees	(1,283)	(995)
Net amortization of premiums and discounts	458	239
Provision for loan losses	(280)	831
Provision for depreciation	1,137	1,110
Provision for foreclosed real estate	58	-
Gain on sale of loans	(2,927)	(2,207)
Gain on sale of foreclosed real estate	(49)	(302)
Proceeds from loans sold to others	160,236	92,767
Loans originated for sale	(163,347)	(93,999)
Stock-based compensation expense	120	201
Decrease (increase) in accrued interest receivable and other assets	1,452	(261)
Increase in accrued interest payable and other liabilities	1,043	1,047
Net cash provided by operating activities	1,153	1,340
<u>Cash Flows from Investing Activities</u>		
Purchase of investment securities held to maturity	(27,830)	(21,549)
Proceeds from maturing investment securities held to maturity	7,000	5,000
Principal collected on mortgage-backed securities held to maturity	3,855	1,355
Net decrease (increase) in loans	43,555	(31,752)
Proceeds from sale of foreclosed real estate	2,428	8,174
Investment in premises and equipment	(268)	(431)
Redemption of FHLB stock	310	254
Net cash provided by (used in) investing activities	29,050	(38,949)

Table of ContentsSEVERN BANCORP, INC. AND SUBSIDIARIESAnnapolis, MarylandCONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(dollars in thousands)

	Years Ended December 31,	
	2015	2014
<u>Cash Flows from Financing Activities</u>		
Net decrease in deposits	\$(20,043)	\$(27,435)
Proceeds from exercise of options	96	3
Net cash used in financing activities	(19,947)	(27,432)
Increase (decrease) in cash and cash equivalents	10,256	(65,041)
Cash and cash equivalents at beginning of year	33,335	98,376
Cash and cash equivalents at end of year	\$43,591	\$33,335

Supplemental disclosure of cash flows information:

Cash (received) paid during year for:

Interest	\$7,991	\$7,874
Income taxes	\$(273)	\$9
Transfer of net loans to foreclosed real estate	\$2,234	\$847

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

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include the accounts of Severn Bancorp, Inc. ("Bancorp"), and its wholly-owned subsidiaries, SBI Mortgage Company and SBI Mortgage Company's subsidiary, Crownsville Development Corporation, and its subsidiary, Crownsville Holdings I, LLC, and Severn A. 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.

B. Business - The Bank's primary business activity is the acceptance of deposits from the general public and the use of the proceeds for investments and loan originations. The Bank is subject to competition from other financial institutions. In addition, the Bank is subject to the regulations of certain federal agencies and undergoes periodic examinations by those regulatory authorities.

Bancorp has no reportable segments. Management does not separately allocate expenses, including the cost of funding loan demand, between the retail and real estate operations of Bancorp. As such, discrete financial information is not available and segment reporting would not be meaningful.

C. Estimates - The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of financial condition and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, the fair value of foreclosed real estate, the evaluation of other than temporary impairment of investment securities and the valuation allowance of deferred tax assets.

D. Investment Securities Held to Maturity – Investment securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. Declines in the fair value of held to maturity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer and (3) determines if the Bank does not intend to sell the security before recovery of its amortized cost.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies - Continued

Federal Home Loan Bank Stock – Federal Home Loan Bank of Atlanta (the “FHLB”) stock is an equity interest in the FHLB, which does not have a readily determinable fair value for purposes of generally accepted accounting principles, because its ownership is restricted and it lacks a market. FHLB stock can be sold back only at par value of \$100 per share and only to the FHLB or another member institution. As of December 31, 2015 and 2014, the Bank owned shares totaling \$5,626,000 and \$5,936,000, respectively.

The Bank evaluated the FHLB stock for impairment in accordance with generally accepted accounting principles. The Bank’s determination of whether this investment is impaired is based on an assessment of the ultimate recoverability of its cost rather than by recognizing temporary declines in value. The determination of whether a decline in value affects the ultimate recoverability of its cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and accordingly on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management has evaluated the FHLB stock for impairment and believes that no impairment charge is necessary as of December 31, 2015.

F. Loans Held for Sale - Loans held for sale are carried at lower of cost or market value in the aggregate based on investor quotes. Net unrealized losses are recognized through a valuation allowance by charges to income.

Derivative Financial Instruments – The Bank enters into commitments to fund residential loans with intentions of selling them in the secondary market. The Bank also enters into forward sales agreements for certain funded loans and loan commitments. The Bank records unfunded commitments intended for loans held for sale and forward sale agreements at fair value with changes in fair value recorded as a component of other income. Loans originated and intended for sale in the secondary market are carried at lower of cost or fair value based on those sales commitments. For pipeline loans which are not pre-sold to an investor, the Bank manages the interest rate risk on rate lock commitments by entering into forward sales contracts of mortgage backed securities, whereby the Bank obtains the right to deliver securities to investors in the future at a specific price. Such contracts are accounted for as derivatives and are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in other income.

H. Loan Servicing - Mortgage loans held for sale are sold either with the mortgage servicing rights released or retained by the Bank. Gains and losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying values of the loan servicing rights, if retained, and related mortgage loans sold. Mortgage servicing rights totaled \$623,000 and \$658,000 at December 31, 2015 and 2014, respectively.

Loans serviced for others not included in the accompanying consolidated statements of financial condition totaled \$76,460,000 and \$93,332,000 at December 31, 2015 and 2014, respectively. As of December 31, 2015, the Bank was servicing \$20,454,000 in loans for Federal Home Loan Mortgage Corporation (“FHLMC”), \$44,366,000 in loans for Federal National Mortgage Association (“FNMA”) and \$11,640,000 in loans for other investors.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies - Continued

- I. Loans - Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. The Bank categorizes the loans into eight classifications: residential mortgage; construction; land acquisition and development; land; lines of credit; commercial real estate; commercial non-real estate; home equity; and consumer. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Residential lending is generally considered to involve less risk than other forms of lending, although payment experience on these loans is dependent to some extent on economic and market conditions in the Bank's lending area. Multifamily residential, commercial, construction and other loan repayments are generally dependent on the operations of the related properties or the financial condition of its borrower or guarantor. Accordingly, repayment of such loans can be more susceptible to adverse conditions in the real estate market and the regional economy.

A substantial portion of the Bank's loans receivable is mortgage loans secured by residential and commercial real estate properties located in the State of Maryland. Loans are extended only after evaluation by management of customers' creditworthiness and other relevant factors on a case-by-case basis. The Bank generally does not lend more than 80% of the appraised value of a property and requires private mortgage insurance on residential mortgages with loan-to-value ratios in excess of 80%.

In addition, the Bank generally obtains personal guarantees of repayment from borrowers and/or others for construction, commercial and multifamily residential loans and disburses the proceeds of construction and similar loans only as work progresses on the related projects.

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

All interest accrued in the current year, but not collected for loans that are placed on non-accrual or charged-off, is reversed against interest income. Any interest accrued in prior years for loans that are placed on non-accrual or charged-off is charged against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – 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 J. 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 aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

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

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – Continued

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

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

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

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.

Foreclosed Real Estate - Real estate acquired through or in the process of foreclosure is recorded at fair value less estimated disposal costs. Management periodically evaluates the recoverability of the carrying value of the real estate acquired through foreclosure using estimates as described under the caption "Allowance for Loan Losses". In the event of a subsequent decline, management provides a specific reserve to reduce real estate acquired through K. foreclosure to fair value less estimated disposal cost. Expenses on foreclosed real estate incurred prior to the disposition of the property, such as maintenance, insurance and taxes, and physical security, are charged to expense. Material expenses that improve the property to its best use are capitalized to the property. Gains or losses on the sale of foreclosed real estate are recognized upon disposition of the property.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – Continued

L. Transfers of Financial Assets – Transfers of financial assets, including loan and loan participation sales, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from Bancorp, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) Bancorp does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return the specific assets.

M. Premises and Equipment - Premises and equipment are carried at cost less accumulated depreciation. Depreciation and amortization of premises and equipment is accumulated by the use of the straight-line method over the estimated useful lives of the assets. Additions and improvements are capitalized, and charges for repairs and maintenance are expensed when incurred. The related cost and accumulated depreciation are eliminated from the accounts when an asset is sold or retired and the resultant gain or loss is credited or charged to income.

N. Statement of Cash Flows - In the statement of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal Home Loan Bank of Atlanta overnight deposits, and federal funds sold. Generally, federal funds are sold for one day periods.

O. Income Taxes - Deferred income taxes are recognized for temporary differences between the financial reporting basis and income tax basis of assets and liabilities based on enacted tax rates expected to be in effect when such amounts are realized or settled. Deferred tax assets are recognized only to the extent that it is more likely than not that such amount will be realized based on consideration of available evidence.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. To the extent that current available evidence about the future raises doubt about the likelihood of a deferred tax asset being realized, a valuation allowance is established. Bancorp recognizes a tax position as a benefit only if it “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The judgment about the level of future taxable income is inherently subjective and is reviewed on a continual basis as regulatory and business factors change.

Bancorp recognizes interest and penalties on income taxes as a component of income tax expense.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – Continued

Earnings Per Common Share - Basic earnings per share of common stock for the years ended December 31, 2015 and 2014 is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding for each year. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by Bancorp relate to outstanding stock options, warrants, and convertible preferred stock, and are determined using the treasury stock method.

Not included in the diluted earnings per share calculation for the years ended December 31, 2015 and 2014, because they were anti-dilutive, were shares of common stock issuable upon exercise of outstanding stock options totaling 151,500 and 172,000, respectively, 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.

	Year Ended December 31,	
	2015	2014
Common shares – weighted average (basic)	10,083,942	10,067,379
Common share equivalents – weighted average	28,711	29,008
Common shares – weighted average (diluted)	10,112,653	10,096,387

Advertising Cost - Advertising cost is expensed as incurred and totaled \$760,000, and \$687,000 for the years ended December 31, 2015, and 2014, respectively.

Troubled Debt Restructuring – Loans are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring may be modified by means of extending the maturity date of the loan, reducing the interest rate on the loan to a rate below market, a combination of rate adjustments and maturity extensions, or by other means including covenant modifications, forbearances or other concessions. All troubled debt restructurings, or TDRs, are considered impaired.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – Continued

Significant Group Concentrations of Credit Risk – Most of Bancorp’s activities are with customers located in Anne Arundel County, Maryland and nearby areas. Note 2, of the Notes to Consolidated Financial Statements discusses S. the types of securities that Bancorp currently invests in. Note 3 discusses the types of lending that Bancorp engages in. Although Bancorp intends to have a diversified loan portfolio, its debtors’ ability to honor their contracts will be influenced by the region’s economy. Bancorp does not have any significant concentrations to any one customer.

Bancorp’s investment portfolio consists principally of obligations of the United States and its agencies. In the opinion of management, there is no concentration of credit risk in its investment portfolio. Bancorp places deposits in correspondent accounts and, on occasion, sells Federal funds to qualified financial institutions. Management believes credit risk associated with correspondent accounts and with Federal funds sold is not significant. Therefore, management believes that these particular practices do not subject Bancorp to unusual credit risk.

Off-Balance Sheet Financial Instruments – In the ordinary course of business, Bancorp has entered into off-balance T.sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated balance sheet when they are funded.

Recent Accounting Pronouncements – Under ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure, a creditor will be considered to have physical possession of residential real estate property that is collateral for a residential mortgage loan and therefore should reclassify the loan to other real estate owned when either (a) the creditor obtains legal title to the property upon completion of a foreclosure, or (b) the borrower conveys all interest in the real estate property to the lender to U. satisfy that loan even though legal title may not have passed. The amendments are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Bancorp adopted this guidance on January 1, 2015 using a prospective transition method; it did not have material impact on the consolidated financial statements. The guidance requires disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. Bancorp has included these disclosures in Note 16 Fair Values of Financial Instruments.

Under ASU 2014-09, Revenue from Contracts with Customers, establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance. The revenue standard’s core principal is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. The new standard applies to all public entities for annual periods beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year. Bancorp has evaluated the effect of ASU 2014-09 and believes adoption will not have a material effect on the Consolidated Financial Statements.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies – Continued

Financial Statements.

Under ASU 2016-01, Amendment to the Recognition and Measurement Guidance for Financial Instruments, an entity is required to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in Other Comprehensive Income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of Available For Sale debt securities in combination with other deferred tax assets. The Amendment provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Amendment also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. The new standard takes effect in 2018 for public companies. Early adoption is only permitted for the provision related to instrument-specific credit risk and the fair value disclosure exemption provided to nonpublic entities. Bancorp has evaluated the effect of ASU 2016-01 and believes adoption will not have a material effect on the Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, “Leases.” The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact this update will have on its consolidated financial position and results of operations.

- V. Subsequent Events – Bancorp has evaluated events and transactions occurring subsequent to December 31, 2015, the date of the consolidated statements of financial condition, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Concentration of Credit Risk – From time to time, the Bank will maintain balances with its correspondent bank that W.exceed the \$250,000 federally insured deposit limit. Management routinely evaluates the credit worthiness of the correspondent bank and does not feel they pose a significant risk to Bancorp.

- X. 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.

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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)				
<u>December 31, 2015:</u>				
US Treasury securities	\$21,057	\$ 276	\$ 8	\$21,325
US Agency securities	20,011	139	76	20,074
US Government sponsored mortgage-backed securities	35,065	41	195	34,911
Total	\$76,133	\$ 456	\$ 279	\$76,310
<u>December 31, 2014:</u>				
US Treasury securities	\$27,140	\$ 465	\$ 29	\$27,576
US Agency securities	17,044	130	57	17,117
US Government sponsored mortgage-backed securities	15,432	48	50	15,430
Total	\$59,616	\$ 643	\$ 136	\$60,123

As of December 31, 2015 and 2014, there were \$0 and \$4,244,000, respectively, of US Treasury securities or mortgage-backed securities pledged by Bancorp as collateral for borrowers' letters of credit with Anne Arundel County. Bancorp is no longer required to pledge collateral due to its improved financial condition.

The following table shows fair value and unrealized losses, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2015. Included in the table are four US Treasury securities, thirteen Agency securities and twelve Mortgage-backed securities in a gross unrealized loss position at December 31, 2015. There were seven US Treasury securities, ten Agency securities and five Mortgage-backed securities in a gross unrealized loss position at December 31, 2014. Management believes that the unrealized losses in 2015 and 2014 were the result of interest rate levels differing from those existing at the time of purchase of the securities and actual and estimated prepayment speeds. The Bank does not consider any of these securities to be other than temporarily impaired at December 31, 2015 or December 31, 2014, because the unrealized losses were related primarily to changes in market interest rates and widening of sector spreads and were not necessarily related to the credit quality of the issuers of the securities.

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	Less than 12 months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
<u>December 31, 2015:</u>						
US Treasury securities	\$3,992	\$ 8	\$ -	\$ -	\$3,992	\$ 8
US Agency securities	12,958	76	-	-	12,958	76
US Government sponsored mortgage-backed securities	31,091	195	-	-	31,091	195
Total	\$48,041	\$ 279	\$ -	\$ -	\$48,041	\$ 279

December 31, 2014:

US Treasury securities	\$6,953	\$ 29	\$ -	\$ -	\$6,953	\$ 29
US Agency securities	10,024	57	-	-	10,024	57
US Government sponsored mortgage-backed securities	13,405	50	-	-	13,405	50
Total	\$30,382	\$ 136	\$ -	\$ -	\$30,382	\$ 136

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

	Held to Maturity (dollars in thousands)	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$11,060	\$ 11,125
Due from one year to five years	28,053	28,211
Due from five years to ten years	1,955	2,063
US Government sponsored mortgage-backed securities	35,065	34,911
	\$76,133	\$ 76,310

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Loans receivable, including unfunded commitments consist of the following:

	December 31	
	2015	2014
	(dollars in thousands)	
Residential mortgage, total	\$285,930	\$309,461
Individually evaluated for impairment	26,087	28,535
Collectively evaluated for impairment	259,843	280,926
Construction, land acquisition and development, total	77,478	84,325
Individually evaluated for impairment	309	917
Collectively evaluated for impairment	77,169	83,408
Land, total	28,677	30,426
Individually evaluated for impairment	1,608	2,039
Collectively evaluated for impairment	27,069	28,387
Lines of credit, total	20,188	19,251
Individually evaluated for impairment	299	454
Collectively evaluated for impairment	19,889	18,797
Commercial real estate, total	174,912	198,539
Individually evaluated for impairment	6,321	6,309
Collectively evaluated for impairment	168,591	192,230
Commercial non-real estate, total	9,296	10,167
Individually evaluated for impairment	122	274
Collectively evaluated for impairment	9,174	9,893
Home equity, total	24,529	28,750
Individually evaluated for impairment	2,285	3,551
Collectively evaluated for impairment	22,244	25,199
Consumer, total	1,224	1,040
Individually evaluated for impairment	10	12
Collectively evaluated for impairment	1,214	1,028
Total Loans	622,234	681,959
<u>Less</u>		
Unfunded commitments included above	(21,101)	(36,162)
	601,133	645,797
Individually evaluated for impairment	37,041	42,091
Collectively evaluated for impairment	564,092	603,706

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	601,133	645,797
Allowance for loan losses	(8,758)	(9,435)
Deferred loan origination fees and costs, net	(2,719)	(2,480)
Net Loans	\$589,656	\$633,882

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 – Loans Receivable - Continued

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

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

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

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

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

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

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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 – Loans Receivable - Continued

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

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

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

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

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

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

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

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

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

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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Note 3 – Loans Receivable - Continued

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

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

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

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

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

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Note 3 – Loans Receivable – Continued

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

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

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The following is a summary of the allowance for loan losses for the years ended December 31, 2015 and December 31, 2014 (dollars in thousands):

2015	Total	Residential Mortgage	Acquisition and Development	Land	Lines of Credit	Commercial Real Estate	Commercial Non-Real Estate	Home Equity	Consumer
Beginning Balance	\$9,435	\$ 4,664	\$ 362	\$646	\$12	\$ 2,504	\$ 280	\$963	\$ 4
Provision	(280)	(651)	84	(185)	(190)	368	59	236	(1)
Charge-offs	(1,522)	(454)	-	-	-	(80)	(154)	(834)	-
Recoveries	1,125	629	-	49	235	-	49	163	-
Ending Balance	\$8,758	\$ 4,188	\$ 446	\$510	\$57	\$ 2,792	\$ 234	\$528	\$ 3

Allowance on loans
individually evaluated for
impairment

\$2,282	\$ 1,838	\$ -	\$78	\$30	\$ 328	\$ 5	\$2	\$ 1
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Allowance on loans
collectively evaluated for
impairment

\$6,476	\$ 2,350	\$ 446	\$432	\$27	\$ 2,464	\$ 229	\$526	\$ 2
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2014	Total	Residential Mortgage	Acquisition and Development	Land	Lines of Credit	Commercial Real Estate	Commercial Non-Real Estate	Home Equity	Consumer
Beginning Balance	\$11,739	\$ 6,291	\$ 414	\$1,346	\$36	\$ 2,512	\$ 135	\$1,003	\$ 2
Provision	831	(1,089)	11	(1,049)	1,285	59	1,396	221	(3)
Charge-offs	(3,994)	(844)	(63)	-	(1,324)	(92)	(1,410)	(261)	-
Recoveries	859	306	-	349	15	25	159	-	5
Ending Balance	\$9,435	\$ 4,664	\$ 362	\$646	\$12	\$ 2,504	\$ 280	\$963	\$ 4

Allowance on loans
individually evaluated
for impairment

\$2,777	\$ 2,113	\$ -	\$53	\$-	\$ 224	\$ 15	\$370	\$ 2
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Allowance on loans
collectively evaluated
for impairment

\$6,658	\$ 2,551	\$ 362	\$593	\$12	\$ 2,280	\$ 265	\$593	\$ 2
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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - 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 at December 31, 2015, changing economic and market conditions may require future adjustments to the allowance for loan losses.

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.

During the year ended December 31, 2015, the provision for loan losses was (\$280,000) compared to \$831,000 for the year ended December 31, 2014. This decrease of \$1,111,000 was primarily due to lower total loans and improved asset quality at December 31, 2015 compared to December 31, 2014 and lower net charge-offs taken in 2015 compared to 2014.

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

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	Unpaid Principal Balance
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	
December 31, 2015					
Residential mortgage	\$ 11,885	\$ 1,838	\$ 14,202	\$ 26,087	\$ 26,656
Construction, acquisition and development	-	-	309	309	309
Land	639	78	969	1,608	1,723
Lines of credit	299	30	-	299	299
Commercial real estate	3,214	328	3,107	6,321	6,469
Commercial non-real estate	103	5	19	122	123
Home equity	16	2	2,269	2,285	3,251
Consumer	10	1	-	10	10
Total Impaired loans	\$ 16,166	\$ 2,282	\$ 20,875	\$ 37,041	\$ 38,840

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

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The following tables summarize average impaired loans for the years ended December 31, 2015 and 2014 (dollars in thousands):

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance		Total Impaired Loans	
	Average	Interest	Average	Interest	Average	Interest
	Recorded	Income	Recorded	Income	Recorded	Income
	Investmen	Recognized	Investmen	Recognized	Investmen	Recognized
December 31, 2015						
Residential mortgage	\$ 12,645	\$ 540	\$ 13,886	\$ 564	\$ 26,531	\$ 1,104
Construction, acquisition and development	114	1	573	29	687	30
Land	822	21	1,035	72	1,857	93
Lines of credit	25	1	321	18	346	19
Commercial real estate	2,933	134	2,179	166	5,112	300
Commercial non-real estate	213	5	10	13	223	18
Home equity	337	8	2,520	115	2,857	123
Consumer	11	-	414	3	425	3
Total Impaired loans	\$ 17,100	\$ 710	\$ 20,938	\$ 980	\$ 38,038	1,690

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance		Total Impaired Loans	
	Average	Interest	Average	Interest	Average	Interest
	Recorded	Income	Recorded	Income	Recorded	Income
	Investmen	Recognized	Investmen	Recognized	Investmen	Recognized
December 31, 2014						
Residential mortgage	\$ 14,222	\$ 592	\$ 17,342	\$ 648	\$ 31,564	\$ 1,240
Construction, acquisition and development	-	-	1,831	54	1,831	54
Land	359	13	1,774	89	2,133	102
Lines of credit	599	15	616	41	1,215	56
Commercial real estate	2,556	120	4,515	230	7,071	350
Commercial non-real estate	258	5	406	23	664	28
Home equity	1,460	-	2,174	65	3,634	65
Consumer	13	-	-	-	13	-
Total Impaired loans	\$ 19,467	\$ 745	\$ 28,658	\$ 1,150	\$ 48,125	1,895

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Included in the above impaired loans amount at December 31, 2015 is \$28,067,000 of loans that are not in non-accrual status. In addition, there was a total of \$26,087,000 of residential real estate loans included in impaired loans at December 31, 2015, of which \$20,378,000 were to consumers and \$5,709,000 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 charge-off to the loan is made, if necessary, for the difference between the carrying amount of any loan and the estimated fair value of the collateral less estimated disposal cost. A specific allowance is established if the net collateral value has not been finalized, but management determines that it is likely that the net collateral value of the loan is lower than the carrying value of the loan.

The following tables present the classes of the loan portfolio, including unfunded commitments summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk rating system as of December 31, 2015 and 2014 (dollars in thousands):

	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2015					
Residential mortgage	\$268,583	\$12,457	\$ 4,890	\$ -	\$285,930
Construction acquisition and development	77,168	71	239	-	77,478
Land	26,845	1,268	564	-	28,677
Lines of credit	19,521	368	299	-	20,188
Commercial real estate	155,766	13,208	5,938	-	174,912
Commercial non-real estate	9,151	125	20	-	9,296
Home equity	22,018	588	1,923	-	24,529
Consumer	1,224	-	-	-	1,224
Total loans	\$580,276	\$28,085	\$ 13,873	\$ -	\$622,234

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

Included in the Pass column were \$21,101,000 and \$36,162,000 in unfunded commitments at December 31, 2015 and 2014, respectively.

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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. There were no loans past due greater than 90 days and still accruing as of December 31, 2015 and 2014. Included in the Current column were \$21,101,000 and \$36,162,000 in unfunded commitments at December 31, 2015 and 2014, respectively. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31, 2015 and 2014 (dollars in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	Non-Accrual
December 31, 2015							
Residential mortgage	\$ 1,593	\$ 65	\$ 2,461	\$ 4,119	\$ 281,811	\$ 285,930	\$ 3,191
Construction acquisition and development	-	-	-	-	77,478	77,478	244
Land	137	-	156	293	28,384	28,677	277
Lines of credit	149	-	-	149	20,039	20,188	483
Commercial real estate	253	-	292	545	174,367	174,912	2,681
Commercial non-real estate	-	-	-	-	9,296	9,296	-
Home equity	-	-	625	625	23,904	24,529	2,098
Consumer	3	-	-	3	1,221	1,224	-
Total loans	\$ 2,135	\$ 65	\$ 3,534	\$ 5,734	\$ 616,500	\$ 622,234	\$ 8,974
December 31, 2014							
Residential mortgage	\$ 2,549	\$ 2,333	\$ 3,095	\$ 7,977	\$ 301,484	\$ 309,461	\$ 6,052
Construction acquisition and development	-	-	-	-	84,325	84,325	115
Land	-	-	6	6	30,420	30,426	847
Lines of credit	-	-	-	-	19,251	19,251	388
Commercial real estate	447	45	375	867	197,672	198,539	652
Commercial non-real estate	-	-	-	-	10,167	10,167	1,775
Home equity	174	242	2,417	2,833	25,917	28,750	3,016
Consumer	-	-	-	-	1,040	1,040	-
Total loans	\$ 3,170	\$ 2,620	\$ 5,893	\$ 11,683	\$ 670,276	\$ 681,959	\$ 12,845

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

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 Contract Amounts Represent Credit Risk	Contract Amount	
	At December 31, 2015	2014
	(dollars in thousands)	
Standby letters of credit	\$5,937	\$7,357
Home equity lines of credit	7,467	8,571
Unadvanced construction commitments	21,101	36,162
Mortgage loan commitments	3,233	2,120
Lines of credit	27,189	23,844
Loans sold with limited repurchase provisions	65,107	38,247

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, except for certain standby letters of credit, 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 December 31, 2015 and 2014 for guarantees under standby letters of credit issued was \$115,000 and \$314,000, respectively.

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

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

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Note 3 - Loans Receivable – Continued

Mortgage loan commitments not reflected in the accompanying statements of financial condition at December 31, 2015 include seven loans at a fixed interest rate range of 3.75% to 8.00% totaling \$3,233,000 and two at floating interest rates totaling \$0, and at December 31, 2014 included \$2,120,000 at a fixed rate range of 3.75% to 4.50% and none at floating interest rates.

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

The Bank has entered into several agreements to sell mortgage loans to third parties. The loans sold under these agreements for the years ended December 31, 2015 and 2014 were \$163,150,000 and \$90,560,000, respectively. These agreements contain limited provisions that require the Bank to repurchase a loan if the loan becomes delinquent within a period ranging generally from 120 to 180 days after the sale date depending on the investor's agreement. The credit risk involved in these financial instruments is essentially the same as that involved in extending loan facilities to customers. No amount has been recognized in the consolidated statement of financial condition at December 31, 2015 and 2014 as a liability for credit loss related to these loans. The Bank repurchased no loans under these agreements in 2015 or 2014.

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

Except for the liability recorded for standby letters of credit of \$115,000 and \$314,000 at December 31, 2015 and 2014, respectively, liabilities for credit losses associated with these commitments were not material at December 31, 2015 and 2014.

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

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

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

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The following tables present newly restructured loans that occurred during the years ended December 31, 2015 and 2014 by the type of concession (dollars in thousands):

	Year ended December 31, 2015							
	Rate Modification	Contracts	Term Modifications	Contracts	Combination Modifications	Contracts	Total	Total Contracts
Pre-Modification Outstanding Recorded Investment:								
Residential mortgage	\$-	-	\$ 91	1	\$ -	1	\$91	2
Construction, acquisition and development	-	-	-	-	-	-	-	-
Land	-	-	-	-	61	1	61	1
Lines of credit	-	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-	-	-
Commercial non-real estate	-	-	-	-	-	-	-	-
Home equity	-	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-	-
Total loans	\$-	-	\$ 91	1	\$ 61	2	\$152	3
Post-Modification Outstanding Recorded Investment:								
Residential mortgage	\$-	-	\$ 91	1	\$ 109	1	\$200	2
Construction, acquisition and development	-	-	-	-	-	-	-	-
Land	-	-	-	-	31	1	31	1
Lines of credit	-	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	-	-	-	-
Commercial non-real estate	-	-	-	-	-	-	-	-
Home equity	-	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-	-
Total loans	\$-	-	\$ 91	1	\$ 140	2	\$231	3

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	Year ended December 31, 2014							
	Rate Modification	Contracts Modification	Term Modifications	Contracts	Combination Modifications	Contracts	Total	Total Contracts
Pre-Modification Outstanding Recorded Investment:								
Residential mortgage	-	-	-	-	\$ 447	2	\$447	2
Construction, acquisition and development	-	-	-	-	-	-	-	-
Land	-	-	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	541	3	541	3
Commercial non-real estate	-	-	-	-	-	-	-	-
Home equity	-	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-	-
Total loans	-	-	-	-	\$ 988	5	\$988	5
Post-Modification Outstanding Recorded Investment:								
Residential mortgage	-	-	-	-	\$ 447	2	\$447	2
Construction, acquisition and development	-	-	-	-	-	-	-	-
Land	-	-	-	-	-	-	-	-
Lines of credit	-	-	-	-	-	-	-	-
Commercial real estate	-	-	-	-	541	3	541	3
Commercial non-real estate	-	-	-	-	-	-	-	-
Home equity	-	-	-	-	-	-	-	-
Consumer	-	-	-	-	-	-	-	-
Total loans	-	-	-	-	\$ 988	5	\$988	5

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

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

	Number of Contracts	Accrual Status	Number of Contracts	Non- Accrual Status	Total Number of Contracts	Total Modifications
December 31, 2015						
Residential mortgage	55	\$20,831	3	\$ 1,071	58	\$ 21,902
Construction, acquisition and development	1	71	-	-	1	71
Land	6	907	1	6	7	913
Lines of credit	-	-	-	-	-	-
Commercial real estate	4	2,464	2	252	6	2,716
Commercial non-real estate	4	103	-	-	4	103
Home equity	-	-	-	-	-	-
Consumer	1	10	-	-	1	10
Total loans	71	\$24,386	6	\$ 1,329	77	\$ 25,715
December 31, 2014						
Residential mortgage	57	\$22,154	5	\$ 2,402	62	\$ 24,556
Construction, acquisition and development	2	803	-	-	2	803
Land	5	982	1	6	6	988
Lines of credit	-	-	-	-	-	-
Commercial real estate	6	3,623	1	109	7	3,732
Commercial non-real estate	5	150	2	124	7	274
Home equity	-	-	-	-	-	-
Consumer	1	12	-	-	1	12
Total loans	76	\$27,724	9	\$ 2,641	85	\$ 30,365

Management does not charge off a TDR, or a portion of a TDR, until one of the following conditions has been met:

The loan has been foreclosed on. Once the loan has been transferred from the loans receivable to foreclosed real estate, a charge off is recorded for the difference between the recorded amount of the loan and the net value of the underlying collateral.

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

Prior to either of the above conditions, a loan is assessed for impairment when a loan becomes a TDR. If, based on management's assessment of the underlying collateral of the loan, it is determined that the TDR's collateral valuation is less than its current loan balance, the TDR is written down for accounting purposes by the amount of the difference between the current loan balance and the collateral.

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Premises and equipment are summarized by major classification as follows:

	December 31,		Estimated
	2015	2014	Useful
	(dollars in thousands)		Lives
Land	\$1,537	\$1,537	-
Building	29,464	29,423	39 Years
Leasehold improvements	1,676	1,675	15-27.5 Years
Furniture, fixtures and equipment	2,385	2,985	3-10 Years
Construction in process	37	-	
Total at cost	35,099	35,620	
Accumulated depreciation	(10,809)	(10,461)	
	\$24,290	\$25,159	

Depreciation expense was \$1,137,000 and \$1,110,000 for the years ended December 31, 2015 and 2014, respectively.

Bancorp has four retail branch locations in Anne Arundel County, Maryland, of which it owns three and leases the fourth from a third party. The lease term expires July 2020. There is an option remaining to renew the lease for one additional five year term. In addition, the Bank leases office space in Annapolis, Maryland from a third party. The lease expires in January 2020.

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Note 4 - Premises and Equipment - Continued

The minimum future annual rental payments on leases are as follows:

Years	
Ended	
December	
31, (in	
thousands)	
2016	\$ 152
2017	152
2018	134
2019	134
2020	94

Total rent expense was \$131,000 and \$121,000 for the years ended December 31, 2015 and 2014, respectively.

The minimum future annual rental income on leases is as follows:

Years	
Ended	
December	
31, (in	
thousands)	
2016	\$ 974
2017	674
2018	455
2019	217

H.S. West, LLC, a subsidiary of the Bank, leases space to three unrelated companies and to a law firm of which the President of Bancorp and the Bank is a partner. Total gross rental income included in occupancy expense on the Consolidated Statements of Operations was \$970,000 and \$956,000 for the years ended December 31, 2015 and 2014, respectively.

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As of December 31, 2015, Bancorp had foreclosed real estate consisting of seven residential properties with a carrying value of \$1,419,000 and three land parcels with a carrying value of \$325,000. During the year ended December 31, 2015, Bancorp sold a total of twelve properties previously included in foreclosed real estate. The properties sold during 2015 had a combined net book value of \$2,379,000 after total write-downs taken subsequent to their transfer from loans to foreclosed real estate of \$1,023,000, and were sold at a combined net gain of \$49,000. In addition, Bancorp incurred \$1,526,000 in costs related to the sale of the properties. The following table summarizes the changes in foreclosed real estate for the years ended December 31, 2015 and 2014 (dollars in thousands):

Foreclosed real estate at December 31, 2013	\$8,972
Transferred from impaired loans, net of specific reserves of \$3,303	847
Property improvements	-
Additional write downs	-
Property sold, including loss on sale	(7,872)
Foreclosed real estate at December 31, 2014	\$1,947
Transferred from impaired loans, net of specific reserves of \$2,282	2,234
Property improvements	-
Additional write downs	(58)
Property sold, including loss on sale	(2,379)
Foreclosed real estate at December 31, 2015	\$1,744

Total foreclosed real estate expense for 2015 was \$230,000. Net gain on the property sales was \$49,000, property write downs totaled \$58,000 and operating expense was \$221,000. Total foreclosed real estate expense for 2014 was \$10,000. Net gain on the property sales was \$302,000, property write downs totaled \$0 and operating expense was \$312,000.

Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process according to local requirements of the applicable jurisdiction totaled \$1,487,000 as of December 31, 2015.

Note 6 - Investment in Federal Home Loan Bank of Atlanta Stock

The Bank is required to maintain an investment in the stock of the FHLB in an amount equal to at least 1% of the unpaid principal balances of the Bank's residential mortgage loans or 1/20 of its outstanding advances from the FHLB, whichever is greater. Purchases and sales of stock are made directly with the FHLB at par value.

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Deposits in the Bank as of December 31, 2015 and 2014 consisted of the following:

Category	December 31, 2015		December 31, 2014	
	Amount	Percent	Amount	Percent
	(dollars in thousands)			
NOW accounts	\$56,096	10.71 %	\$54,827	10.08 %
Money market accounts	47,690	9.11 %	39,579	7.28 %
Passbooks	111,992	21.38 %	126,062	23.18 %
Certificates of deposit	277,778	53.03 %	298,489	54.89 %
Non-interest bearing accounts	30,215	5.77 %	24,857	4.57 %
Total deposits	\$523,771	100.00%	\$543,814	100.00%

At December 31, 2015 scheduled maturities of certificates of deposit are as follows:

	Amount (dollars in thousands)
One year or less	\$ 169,298
More than 1 year to 2 years	56,335
More than 2 years to 3 years	21,899
More than 3 years to 4 years	5,936
More than 4 years to 5 years	24,310
	\$ 277,778

The aggregate amount of jumbo certificates of deposit with a minimum denomination of \$250,000 was \$25,713,000 and \$30,702,000 at December 31, 2015 and 2014, respectively.

Note 8 – Long Term Borrowings

The Bank's total credit availability under the FHLB's credit availability program was \$192,672,000 and \$153,070,000 at December 31, 2015 and 2014, respectively. The Bank's credit availability is based on the level of collateral pledged up to 25% of total assets. There were no short-term borrowings with the FHLB at December 31, 2015 and 2014. Long-term advances outstanding were \$115,000,000 at December 31, 2015 and 2014. The maturities of these long-term advances at December 31, 2015 are as follows (dollars in thousands):

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

The Bank's stock in the FHLB is pledged as security for the advances and under a blanket floating lien security agreement with the FHLB. The Bank is required to maintain as collateral for its advances, qualified loans in varying amounts depending on the loan type. Loans with an approximate fair value of \$274,783,000 are pledged as collateral at December 31, 2015.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Subordinated Debentures

As of December 31, 2015, Bancorp had outstanding approximately \$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 3-month LIBOR (0.32% December 31, 2015) plus 200 basis points, and mature on January 7, 2035. Payments of principal, interest, premium and other amounts under the 2035 Debentures are subordinated and junior in right of payment to the prior payment in full of all senior indebtedness of Bancorp, as defined in the 2035 Indenture. The 2035 Debentures became redeemable, in whole or in part, by Bancorp on January 7, 2010.

The 2035 Debentures were issued and sold to Severn Capital Trust I (the "Trust"), of which 100% of the common equity is owned by Bancorp. The Trust was formed for the purpose of issuing corporation-obligated mandatorily redeemable Capital Securities ("Capital Securities") to third-party investors and using the proceeds from the sale of such Capital Securities to purchase the 2035 Debentures. The 2035 Debentures held by the Trust are the sole assets of the Trust. Distributions on the Capital Securities issued by the Trust are payable quarterly at a rate per annum equal to the interest rate being earned by the Trust on the 2035 Debentures. The Capital Securities are subject to mandatory redemption, in whole or in part, upon repayment of the 2035 Debentures. Bancorp has entered into an agreement which, taken collectively, fully and unconditionally guarantees the Capital Securities subject to the terms of the guarantee. \$17,000,000 of the proceeds from Bancorp's issuance of the debentures was contributed to the Bank, and qualifies as Tier 1 capital for the Bank under Federal Reserve Board guidelines. Under the terms of the 2035 Indenture, Bancorp is permitted to defer the payment of interest on the 2035 Debentures for up to 20 consecutive quarterly periods provided that no event of default has occurred and is continuing. As of December 31, 2015, Bancorp has deferred the payment of fifteen quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was \$1,863,000. This amount is included in the accrued interest payable and other liabilities total on the balance sheet.

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

On November 15, 2008, Bancorp completed a private placement offering consisting of a total of 70 units, at an offering price of \$100,000 per unit, for gross proceeds of \$7.0 million. Each unit consisted of 6,250 shares of Bancorp's Series A preferred stock and Bancorp's Subordinated Note in the original principal amount of \$50,000.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 – Employee Benefit Plans

The Bank has a 401(k) Retirement Savings Plan. Employees may contribute a percentage of their salary up to the maximum amount allowed by law. The Bank is obligated to contribute 50% of the employee's contribution, not to exceed 6% of the employee's annual salary. All employees who have completed one year of service with the Bank are eligible to participate. The Bank's contributions to this plan were \$217,000, and \$198,000 for the years ended December 31, 2015 and 2014, respectively.

The Bank has an Employee Stock Ownership Plan ("ESOP") for the exclusive benefit of participating employees. The Bank recognized ESOP expense of \$140,000 for each of the years ended December 31, 2015 and 2014, and had unallocated shares to participants in the plan totaling 10,000 shares and 25,000 shares as of December 31, 2015 and 2014, respectively. The fair value of the unallocated shares at December 31, 2015 was approximately \$58,000.

Note 11 - Stockholders' Equity

As part of the private placement offering discussed in Note 9, Bancorp issued a total of 437,500 shares of its Series A 8.0% Non-Cumulative Convertible preferred stock ("Series A preferred stock"). The liquidation preference is \$8.00 per share. Holders of Series A preferred stock will not be entitled to any further liquidation distribution on the Series A preferred stock. Each share of Series A preferred stock is convertible at the option of the holder into one share of Bancorp 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 common stock. At the option of Bancorp, on and after December 31, 2015, at any time and from time to time, some or all of the Series A preferred stock may be converted into shares of Bancorp 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 common stock in any quarter until the dividend on the Series A preferred stock has been paid for such quarter; however, there is no requirement that Bancorp's board of directors declare any dividends on the Series A preferred stock and any unpaid dividends shall not be cumulative. Dividends on the Series A preferred stock have not been declared since the first quarter of 2012.

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

The Series B preferred stock qualifies as Tier 1 capital and pays cumulative compounding dividends at a rate of 9% per annum. The Series B preferred stock may be redeemed by Bancorp.

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

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Note 11 - Stockholders' Equity - Continued

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

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

Bancorp's ability to declare dividends on its common stock are limited by the terms of Bancorp's Series A preferred stock and Series B preferred stock. Bancorp may not declare or pay any dividend on, make any distributions relating to, or redeem, purchase, acquire or make a liquidation payment relating to, or make any guarantee payment with respect to its common stock in any quarter until the dividend on the Series A preferred stock has been declared and paid for such quarter, subject to certain minor exceptions. Additionally, Bancorp may not declare or pay dividend or distribution on its common stock, and Bancorp may not purchase, redeem or otherwise acquire for consideration any of its common stock, unless all accrued and unpaid dividends for all past dividend periods, including the latest completed dividend period, on all outstanding shares of Series B preferred stock have been or are contemporaneously declared and paid in full (or have been declared and a sum sufficient for the payment thereof has been set aside), subject to certain minor exceptions. As of December 31, 2015, the cumulative amount of dividends of the Series B preferred stock in arrears not declared, including interest on unpaid dividends was \$7,033,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the dividend arrearages on its Series B preferred stock have been paid in full and until Bancorp declares and pays a dividend on its Series A preferred stock.

Additionally, under the terms of Bancorp's 2035 Debentures, if (i) there has occurred and is continuing an event of default, (ii) Bancorp is in default with respect to payment of any obligations under the related guarantee or (iii) Bancorp has given notice of its election to defer payments of interest on the 2035 Debentures by extending the interest distribution period as provided in the indenture governing the 2035 Debentures and such period, or any extension thereof, has commenced and is continuing, then Bancorp may not, among other things, declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of its capital stock, including common stock. As permitted under the terms of the 2035 Debentures, as of December 31, 2015, Bancorp has deferred the payment of fifteen quarters of interest and the cumulative amount of interest in arrears not paid, including interest on unpaid interest, was \$1,863,000. Accordingly, Bancorp will not be able to pay dividends on its common stock until the interest deferrals on the 2035 Debentures have been paid in full.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12- 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 plan, Bancorp has the ability to grant various stock compensation incentives, including stock options, stock appreciation rights, and restricted stock. The number of shares available to grant under the plan was 260,501 at December 31, 2015. 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 (FASB ASC 718) 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. Stock-based compensation expense included in the consolidated statements of operations for the years ended December 31, 2015 and 2014 totaled \$120,000 and \$201,000, respectively. There was no income tax benefit recognized in the consolidated statements of operations for stock-based compensation for the years ended December 31, 2015 and 2014.

There were 111,500 options granted in 2015 and 50,000 options granted in 2014.

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Information regarding Bancorp's stock option plan as of and for the years ended December 31, 2015 and 2014 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Life	Aggregate Intrinsic Value
Options outstanding, December 31, 2013	319,000	\$4.23		
Options granted	50,000	4.67		
Options exercised	(700)	3.37		
Options forfeited	(40,100)	3.93		
Options outstanding, December 31, 2014	328,200	4.33		
Options granted	111,500	5.85		
Options exercised	(21,500)	4.48		
Options forfeited	(78,400)	4.29		
Options outstanding, December 31, 2015	339,800	4.83	3.48	\$322,714
Options exercisable, December 31, 2015	104,230	4.17	2.53	\$164,859
Option price range at December 31, 2015		\$3.37 to \$6.33		

The stock-based compensation expense amounts were derived using the Black-Scholes option-pricing model. The following weighted average assumptions were used to value options granted in current and prior periods presented.

	2015	2014
Expected life of options	5.5 years	5.5 years
Risk-free interest rate	1.71 %	1.76 %
Expected volatility	61.84 %	66.61 %
Expected dividend yield	0.00 %	0.00 %
Weighted average fair value of options granted	\$3.16	\$2.63

The expected life of options amount is based on the vesting period and the expiration date of the options granted. The Risk-free interest rate is based on the US Treasury's five year Treasury note rate at the time of the option grant. The expected volatility is based on the closing common stock price of Bancorp over a five year period. The expected dividend yield is based on Bancorp's current policy of not paying a common stock dividend. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

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

	Shares	Weighted Average Exercise Price
Nonvested options outstanding, December 31, 2014	198,505	\$ 4.44
Nonvested options granted	111,500	5.85
Nonvested options vested	(45,435)	4.31
Nonvested options forfeited	(29,000)	4.55
Nonvested options outstanding, December 31, 2015	235,570	\$ 5.13

As of December 31, 2015, there was approximately \$690,000 of total unrecognized stock-based compensation cost related to non-vested stock options, which is expected to be recognized over a period of fifty-eight months.

Note 13- Regulatory Matters

As of December 31, 2015, Bancorp's reservable liability was below the threshold established by the Federal Reserve Bank and therefore, Bancorp was not required to maintain reserves (in the form of deposits with the Federal Reserve Bank or a correspondent bank on behalf of the Federal Reserve Bank.)

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

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

As of December 31, 2015, the most recent notification from the regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios are also presented in the table.

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The following table presents the Bank's actual capital amounts and ratios at December 31, 2015 and 2014:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions			
	Amount	%	Amount	%	Amount	%		
	(dollars in thousands)							
December 31, 2015								
Tangible (1)	\$112,959	14.8%	\$11,423	1.50%	N/	A	N/	A
Tier 1 capital (2)	112,959	19.6%	34,626	6.00%	\$46,168		8.00	%
Common Equity Tier 1 (2)	112,959	19.6%	25,970	4.50%	\$37,512		6.50	%
Leverage (1)	112,959	14.8%	30,461	4.00%	38,076		5.00	%
Total (2)	120,193	20.8%	46,168	8.00%	57,710		10.00	%
December 31, 2014								
Tangible (1)	\$106,916	13.8%	\$11,590	1.50%	N/	A	N/	A
Tier 1 capital (2)	106,916	19.4%	N/	A	N/	A	\$33,081	6.00 %
Leverage (1)	106,916	13.8%	30,906	4.00%	38,633		5.00	%
Total (2)	113,848	20.6%	44,108	8.00%	55,135		10.00	%

(1) To adjusted total assets.

(2) To risk-weighted assets.

On November 23, 2009, Bancorp and the Bank each entered into a supervisory agreement with the Office of Thrift Supervision (“OTS”). As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), effective as of July 21, 2011, the OTS was abolished, and the regulatory oversight functions and authority of the OTS related to the Bank were transferred to the Office of the Comptroller of the Currency (“OCC”) and the regulatory oversight functions and authority of the OTS related to Bancorp were transferred to the Board of Governors of the Federal Reserve System (“Federal Reserve” or “FRB”). The Bank’s supervisory agreement was replaced by a formal agreement dated April 23, 2013 with the OCC. On October 15, 2015, the Bank was notified by the OCC that its agreement was terminated. Bancorp’s supervisory agreement was enforced by the FRB. On January 21, 2016, Bancorp was notified by FRB that its agreement was terminated.

On April 23, 2013, the Bank was notified by the OCC that the OCC established minimum capital ratios for the Bank requiring it to immediately maintain a Tier 1 Leverage Capital Ratio to Adjusted Total Assets of at least 10% and a Total Risk-Based Capital to Risk-Weighted Assets ratio of at least 15%. On October 15, 2015 the Bank was notified by the OCC that these additional minimum capital ratios were no longer required.

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The income tax provision consists of the following for the years ended December 31:

	2015	2014
<u>Current</u>		
Federal	\$83	\$12
State	7	19
	90	31
<u>Deferred</u>		
Federal	1,486	1,029
State	321	251
	1,807	1,280
Valuation allowance	(1,807)	(1,280)
Total income tax provision	\$90	\$31

The amount computed by applying the statutory federal income tax rate to income before taxes is less than the tax provision for the following reasons for the years ended December 31:

	2015		2014	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Statutory Federal income tax rate	\$1,572	34.0 %	\$1,000	34.0 %
State tax net of Federal income tax benefit	216	4.7 %	178	6.1 %
Valuation allowance change	(1,807)	(39.1)%	(1,280)	(43.5)%
Other adjustments	109	2.4 %	133	4.5 %
	\$90	2.0 %	\$31	1.1 %

Bancorp does not have a liability related to tax positions at December 31, 2015 or 2014.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2015 and 2014 are presented below:

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	2015	2014
	(dollars in thousands)	
Deferred Tax Assets:		
Allowance for loan losses	\$5,456	\$5,648
Loan charge-offs	-	-
Reserve on foreclosed real estate	552	565
Reserve for uncollected interest	143	263
Reserve for contingent liability	57	128
Federal net operating loss carryforwards	7,306	8,593
State net operating loss carryforwards	1,457	1,606
Charitable contribution carryforwards	319	319
Other	88	12
Total deferred tax assets	15,378	17,134
Valuation allowance	(12,485)	(14,292)
Total deferred tax assets, net of valuation allowance	2,893	2,842
Deferred Tax Liabilities:		
Federal Home Loan Bank stock dividends	(84)	(84)
Loan origination costs	(733)	(627)
Accelerated depreciation	(1,544)	(1,599)
Prepaid expenses	(278)	(265)
Mortgage servicing rights	(252)	(265)
Other	(2)	(2)
Total deferred tax liabilities	(2,893)	(2,842)
Net deferred tax assets	\$-	\$-

At December 31, 2015, federal net operating losses totaled \$20,875,000 and expire in 2033 and 2034. The state net operating losses totaled \$27,173,000 and expire at various times from 2023 through 2033.

In assessing the realizability of federal or state deferred tax assets at December 31, 2015, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and prudent, feasible and permissible as well as available tax planning strategies in making this assessment. Based on its review of all available evidence, and after consideration of the losses recorded on the loan sales in 2013, management determined it was more likely than not that the deferred tax assets will not be realized and accordingly determined that a valuation allowance should be recorded as of December 31, 2015 and 2014. The deferred tax asset valuation may, in accordance with the requirements of generally accepted accounting principles, be reversed in future periods, depending upon Bancorp's financial position and results of operations in the future, among other factors, and, in such event, may be available to increase future earnings.

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Note 14 - Income Taxes - Continued

Bancorp will continue to have the benefit of the net operating loss carryforward relating to the deferred tax asset, and will have the ability to utilize the carryforward against future federal and state income taxes.

The statute of limitations for Internal Revenue Service examination of Bancorp's federal consolidated tax returns remains open for tax years 2012 through 2015.

Note 15 - Related Party Transactions

During the years ended December 31, 2015 and 2014, the Bank engaged in the transactions described below with parties that are deemed affiliated.

During January 2007, a law firm, in which the President of Bancorp and the Bank is a partner, entered into a five year lease agreement with a subsidiary of Bancorp. The term of the lease is five years with the option to renew the lease for three additional five year terms. The first option to renew was exercised in January 2012. The total payments received by the subsidiary, which includes rent, common area maintenance and utilities were \$404,000 and \$385,000 for the years ended December 31, 2015 and 2014, respectively. In addition, the law firm represents Bancorp and the Bank in certain legal matters. The fees for services rendered by that firm were \$206,000, and \$324,000 for the years ended December 31, 2015 and 2014 respectively.

Members of the Board of Directors of Bancorp had loans outstanding totaling \$3,186,000 and \$3,340,000 at December 31, 2015 and 2014, respectively. The following table shows loan activity for the year ended December 31, 2015:

	2015
Beginning balance as of December 31, 2014	\$3,340,000
Loan funding	-
Loan pay off/payment	154,000
Ending balance as of December 31, 2015	\$3,186,000

Note 16 - Fair Value of Financial Instruments

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

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

Level 2: Significant other observable inputs other than level 1 such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, inputs that are observable or can be corroborated by observable market data.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Fair Value of Financial Instruments - Continued

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

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

Impaired Loans:

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

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

Impaired loans are those for which Bancorp has measured impairment based on the present value of expected future cash flows or on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consisted of the loan balances of \$16,166,000 and \$18,736,000 at December 31, 2015 and December 31, 2014, respectively, less their valuation allowances of \$2,282,000 and \$2,777,000 at December 31, 2015 and December 31, 2014, respectively. The fair value of seven impaired collateral-dependent loans that were partially charged off during the year ended December 31, 2015 totaled \$3,219,000 net of charge-offs of \$622,000. The fair value of nine impaired collateral-dependent loans that were partially charged off during the year ended December 31, 2014 totaled \$3,834,000 net of charge-offs of \$477,000.

Foreclosed Real Estate:

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

December 31, 2015
Fair Value Measurement
Using:
Quoted
Prices
in
Active Markets
for Identical
Assets
(Level 1)
(dollars in thousands)

Impaired loans	\$17,103	\$-	\$ -	\$ 17,103
Foreclosed real estate	543	-	-	543
Total nonrecurring fair value measurements	\$17,646	\$-	\$ -	\$ 17,646

Mortgage servicing rights	\$623	\$-	\$ -	\$ 623
Rate lock commitments	141	-	141	-
Mandatory forward contracts	111	-	111	-
Total recurring fair value measurements	\$875	\$-	\$ 252	\$ 623

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	December 31, 2014			
				Fair Value Measurement
				Using:
				Quoted
				Prices
				in
				Active
				Markets
				Other
				Observable
				Inputs
				(Level 2)
				Significant
				Unobservable
				Inputs
				(Level 3)
				Assets
				(Level
				1)
				(dollars in thousands)
<u>Nonrecurring fair value measurements</u>				
Impaired loans	\$15,959	\$-	\$ -	\$ 15,959
Foreclosed real estate	1,947	-	-	1,947
Total nonrecurring fair value measurements	\$17,906	\$-	\$ -	\$ 17,906
<u>Recurring fair value measurements</u>				
Mortgage servicing rights	\$658	\$-	\$ -	\$ 658
Rate lock commitments	139	-	139	-
Mandatory forward contracts	(59)	-	(59)	-
Total recurring fair value measurements	\$738	\$-	\$ 80	\$ 658

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

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

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

Quantitative Information about Level 3 Fair Value Measurements					
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
<u>December 31, 2015</u>					
Impaired loans	\$ 13,884	PV of future cash flows (1)	Discount Rate	-6.00	%
	\$ 3,219	Appraisal of collateral (2)	Liquidation expenses (3)	-6.00	%
Foreclosed real estate	\$ 543	Appraisal of collateral (2),(4)	Appraisal adjustments (3)	-6.12% to -7.31% (-6.24%)	
<u>December 31, 2014</u>					
Impaired loans	\$ 15,589	PV of future cash flows (1)	Discount Rate	-6.00	%
	\$ 370	Appraisal of collateral (2)	Liquidation expenses (3)	-6.00	%
Foreclosed real estate	\$ 1,947	Appraisal of collateral (2),(4)	Appraisal adjustments (3)	-6.51% to -100% (-13.94%)	

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

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

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

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

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

			Fair Value Measurement at December 31, 2015		
			Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value			
<u>Financial Assets</u>	(dollars in thousands)				
Cash and cash equivalents	\$43,591	\$43,591	\$43,591	\$ -	\$ -
Investment securities (HTM)	76,133	76,310	-	76,310	-
Loans held for sale	13,203	13,295	-	13,295	-
Loans receivable, net	589,656	593,742	-	-	593,742
FHLB stock	5,626	5,626	-	5,626	-
Accrued interest receivable	2,218	2,218	-	2,218	-
Mortgage servicing rights	623	623	-	-	623
Rate lock commitments	141	141	-	141	-
Mandatory forward contracts	111	111	-	111	-
<u>Financial Liabilities</u>					
Deposits	\$523,771	\$524,458	-	524,458	-
FHLB advances	115,000	110,759	-	110,759	-
Subordinated debentures	24,119	24,119	-	-	24,119
Accrued interest payable	3,137	3,137	-	3,137	-
<u>Off Balance Sheet Commitments</u>	\$-	\$-	\$-	\$ -	\$ -
			Fair Value Measurement at December 31, 2014		
			Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	Carrying Amount	Fair Value			
<u>Financial Assets</u>	(dollars in thousands)				

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Cash and cash equivalents	\$ 33,335	\$ 33,335	33,335	\$ -	\$ -
Investment securities (HTM)	59,616	60,123	-	60,123	-
Loans held for sale	7,165	7,211	-	7,211	-
Loans receivable, net	633,882	636,696	-	-	636,696
FHLB stock	5,936	5,936	-	5,936	-
Accrued interest receivable	2,297	2,297	-	2,297	-
Mortgage servicing rights	658	658	-	-	658
Rate lock commitments	139	139	-	139	-

Financial Liabilities

Deposits	\$ 543,814	\$ 544,751	-	544,751	-
FHLB advances	115,000	108,859	-	108,859	-
Subordinated debentures	24,119	24,119	-	-	24,119
Accrued interest payable	2,136	2,136	-	2,136	-
Mandatory forward contracts	59	59	-	59	-

<u>Off Balance Sheet Commitments</u>	\$ -	\$ -	-	\$ -	\$ -
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SEVERN BANCORP, INC. AND SUBSIDIARIES

Annapolis, Maryland

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Fair Value of Financial Instruments – Continued

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

Cash and cash equivalents:

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

Investment Securities:

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

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 December 31, 2015 and 2014.

Loans held for sale:

The fair value of loans held for sale is based primarily on mandatory contracts.

Loans receivable:

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

Accrued interest receivable and payable:

The carrying amounts of accrued interest receivable and accrued interest payable approximates its fair value.

Derivative Instruments:

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

Mortgage servicing rights:

The fair value of mortgage servicing rights is determined using a valuation model administered by a third party that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, default rates, cost to service (including delinquency and foreclosure costs), escrow account earnings, contractual

servicing fee income and other ancillary income such as late fees. Management reviews all significant assumptions on a monthly basis. Mortgage loan prepayment speed, a key assumption in the model, is the annual rate at which borrowers are forecasted to repay their mortgage loan principal. The discount rate used to determine the present value of estimated future net servicing income, another key assumption in the model, is an estimate of the required rate of return investors in the market would require for an asset with similar risk. Both assumptions can, and generally will, change as market conditions and interest rates change.

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SEVERN BANCORP, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Note 16 - Fair Values of Financial Instruments – Continued

Deposit liabilities:

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

FHLB advances:

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

Subordinated debentures:

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

Off-balance sheet financial instruments:

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

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Information as to the financial position of Severn Bancorp, Inc. as of December 31, 2015 and 2014 and results of operations and cash flows for each of the years ended December 31, 2015 and 2014 is summarized below.

	December 31,	
	2015	2014
	(dollars in thousands)	
Statements of Financial Condition		
Cash	\$993	\$1,316
Equity in net assets of subsidiaries:		
Bank	113,294	107,316
Non-Bank	3,881	3,758
Loans, net of allowance for loan losses	-	-
Other assets	912	920
Total assets	\$119,080	\$113,310
Subordinated debentures	\$24,119	\$24,119
Other liabilities	8,505	5,381
Total liabilities	32,624	29,500
Stockholders' equity	86,456	83,810
Total liabilities and stockholders' equity	\$119,080	\$113,310
	December 31,	
	2015	2014
Statements of Operations		
Interest income	\$-	\$34
Interest expense on subordinated debentures	1,322	1,086
Net interest expense	(1,322)	(1,052)
General and administrative expenses	243	242
Provision for loan losses	-	(19)
Loss before income taxes and equity in undistributed net income of subsidiaries	(1,565)	(1,275)
Income tax expense	-	(20)
Equity in undistributed net income of subsidiaries	6,100	4,204

Net income

\$4,535 \$2,909

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	For the Years Ended December 31, 2015 2014 (dollars in thousands)	
Statements of Cash Flows		
<u>Cash Flows from Operating Activities:</u>		
Net income	\$4,535	\$2,909
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in undistributed earnings of subsidiaries	(6,100)	(4,204)
Provision for loan losses	-	(19)
Decrease in other assets	8	559
Stock-based compensation expense	120	201
Increase in other liabilities	1,018	298
Cash used in operating activities	(419)	(256)
<u>Cash Flows from Investing Activities:</u>		
Net decrease in loans	-	350
Cash provided by investing activities	-	350
<u>Cash Flows from Financing Activities:</u>		
Proceeds from sale of foreclosed real estate	-	250
Proceeds from exercise of options	96	3
Cash provided by financing activities	96	253
(Decrease) increase in cash and cash equivalents	(323)	347
Cash and cash equivalents at beginning of year	1,316	969
Cash and cash equivalents at end of year	\$993	\$1,316