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**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, 2019**
- 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**  
(State or other jurisdiction of incorporation or organization)

**52-1726127**  
(I.R.S. Employer Identification Number)

**200 Westgate Circle, Suite 200**  
**Annapolis, Maryland**  
(Address of principal executive offices)

**21401**  
(Zip Code)

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

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

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

<b>Title of each class:</b>	<b>Trading Symbol</b>	<b>Name of each exchange on which registered:</b>
Common Stock, par value \$0.01 per share	SVBI	The NASDAQ Stock Market, LLC

**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

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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 9,029,838 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, 2019 of \$8.69 per share was \$78,469,292.

(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 13, 2020, there were issued and outstanding 12,812,976 shares of the registrant's common stock.

**Documents incorporated by reference:**

Portions of the registrant's Definitive Proxy Statement for its 2020 Annual Meeting of Stockholders to be held on May 7, 2020 are incorporated by reference into Part III of this Form 10-K.

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### Caution Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K, as well as other periodic reports filed with the Securities and Exchange Commission (“SEC”), and written or oral communications made from time to time by or on behalf of Severn Bancorp and its subsidiaries (the “Company”), may contain statements relating to future events or future results of the Company that are considered “forward-looking statements” under the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by the use of words such as “believe,” “expect,” “anticipate,” “plan,” “estimate,” “intend,” and “potential,” or words of similar meaning, or future or conditional verbs such as “should,” “could,” or “may.” Forward-looking statements include statements of our goals, intentions and expectations; statements regarding our business plans, prospects, growth, and operating strategies; statements regarding the quality of our loan and investment portfolios; and estimates of our risks and future costs and benefits.

Forward-looking statements reflect our expectation or prediction of future conditions, events, or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risks and uncertainties include, but are not limited to, the risks identified in Item 1A of this Annual Report on Form 10-K and the following:

- general business and economic conditions nationally or in the markets that the Company serves could adversely affect, among other things, real estate prices, unemployment levels, and consumer and business confidence, which could lead to decreases in the demand for loans, deposits, and other financial services that we provide and increases in loan delinquencies and defaults;
- changes or volatility in the capital markets and interest rates may adversely impact the value of securities, loans, deposits, and other financial instruments and the interest rate sensitivity of our balance sheet as well as our liquidity;
- our liquidity requirements could be adversely affected by changes in our assets and liabilities;
- our investment securities portfolio is subject to credit risk, market risk, and liquidity risk as well as changes in the estimates we use to value certain of the securities in our portfolio;
- the effect of legislative or regulatory developments including changes in laws concerning taxes, banking, securities, insurance, and other aspects of the financial services industry;
- competitive factors among financial services companies, including product and pricing pressures, and our ability to attract, develop, and retain qualified banking professionals;
- the effect of fiscal and governmental policies of the United States (“U.S.”) federal government;
- the effect of any mergers, acquisitions, or other transactions to which we or our subsidiary may from time to time be a party;
- costs and potential disruption or interruption of operations due to cyber-security incidents;
- the effect of any change in federal government enforcement of federal laws affecting the medical-use cannabis industry;
- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the SEC, the Public Company Accounting Oversight Board, and other regulatory agencies; and
- geopolitical conditions, including acts or threats of terrorism, actions taken by the U.S. or other governments in response to acts or threats of terrorism, and/or military conflicts, which could impact business and economic conditions in the U.S. and abroad.

Forward-looking statements speak only as of the date of this report. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date of this report or to reflect the occurrence of unanticipated events except as required by federal securities laws.

## **PART I**

### **ITEM 1 BUSINESS**

#### **General**

Severn Bancorp and Subsidiaries (the “Company,” “we,” “our,” or “us”) is a savings and loan holding company incorporated in the state of Maryland in 1990. The Company conducts business primarily through four subsidiaries, Severn Savings Bank, FSB (the “Bank”), Mid-Maryland Title Company, Inc. (“the Title Company”), SBI Mortgage Company (“SBI”), and the Bank’s principal subsidiary Louis Hyatt, Inc. (“Hyatt Commercial”), which conducts business as Hyatt Commercial. SBI is the parent company of Crownsville Development Corporation (“Crownsville”), which does business as Annapolis Equity Group. Hyatt Commercial is a real estate brokerage company specializing in commercial real estate sales, leasing, and property management.

SBI engages in the origination of mortgages that do not meet the underwriting criteria of the Bank. It also owns subsidiary companies that purchase real estate for investment purposes. As of December 31, 2019, SBI had \$1.3 million in outstanding mortgage loans and it had \$671,000 invested in subsidiaries, which funds were held in cash, pending potential acquisition of investment real estate.

Crownsville, doing business as Annapolis Equity Group, is engaged in the business of acquiring real estate for investment and syndication purposes.

HS West, LLC (“HS”) is a subsidiary of the Bank which constructed a building in Annapolis, Maryland that serves as the Company’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 the Company and the Bank is a partner.

The Title Company engages in title work related to real estate transactions.

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 the Bank.

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

As of December 31, 2019, we had consolidated total assets of \$826.9 million, total loans of \$645.7 million, total deposits of \$661.0 million, and total stockholders’ equity of \$105.5 million. Net income for the year ended December 31, 2019 was \$8.4 million. At December 31, 2019, we had approximately 174 full-time equivalent employees.

#### **Availability of Information**

The Company makes available through the Investor Relations area of the Company website, at [www.severnbank.com](http://www.severnbank.com), annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (“Exchange Act”). Access to these reports is provided by means of a link to a third-party vendor that maintains a database of such filings. In general, the Company intends that these reports be available as soon as practicable after they are filed with or furnished to the Securities and Exchange Commission (“SEC”). Technical and other operational obstacles or delays caused by the vendor may delay their availability. The SEC maintains a website ([www.sec.gov](http://www.sec.gov)) where these filings also are available through the SEC’s EDGAR system. There is no charge for access to these filings through either the Company’s site or the SEC’s site. 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.

## **Business of the Bank**

The Bank was organized in 1946 in Baltimore, Maryland as Pompeii 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 seven full-service branch offices and one administrative office, all in Anne Arundel County, Maryland. The Bank operates as a federally chartered savings bank whose principal business is attracting deposits from the general public and investing those funds in residential mortgage and commercial loans. The Bank also uses advances, or loans, from the Federal Home Loan Bank of Atlanta, (“FHLB”) 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, in addition to Internet and mobile banking. Commercial services include commercial secured and unsecured lending services as well as business Internet banking, corporate cash management services, and deposit services to commercial customers, including those in the medical-use cannabis industry. The Bank also provides safe deposit boxes, ATMs, debit cards, credit cards, personal Internet banking including on-line bill pay and telephone banking, among other products and services.

Revenues are derived principally from interest earned on residential 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, proceeds from loans sold on the secondary market, sales and maturities of securities, and repayments and principal prepayment of loans. The principal executive offices of the Bank are maintained at 200 Westgate Circle, Suite 200, Annapolis Maryland, 21401 and the telephone number is 410-260-2000.

### ***Medical-Use Cannabis Related Business***

In 2017, we began providing banking services to customers that are licensed by the state of Maryland to do business in the medical-use cannabis industry as growers, processors, and dispensaries. Medical-use cannabis businesses are legal in the State of Maryland. We maintain stringent written policies and procedures related to the on-boarding of such businesses and to the monitoring and maintenance of such business accounts.

We do a deep upfront due diligence review of a medical-use cannabis business before the business is on-boarded, including a site visit and confirmation that the business is properly licensed by the state of Maryland. Throughout the relationship, we continue monitoring the business, including site visits, to ensure that the medical-use cannabis business continues to meet our stringent requirements, including maintenance of required licenses. We perform periodic financial reviews of the business and monitor the business in accordance with Bank Secrecy Act (“BSA”) and State Commission requirements.

Following is a summary of the level of business activities with our medical-use cannabis customers:

- Deposit and loan balances at December 31, 2019 were approximately \$22.8 million, or 3.4% of total deposits, and \$14.0 million, or 2.2% of total loans, respectively. Deposit and loan balances at December 31, 2018 were approximately \$17.0 million, or 2.2% of total deposits, and \$14.1 million, or 2.1% of total loans, respectively.
- Interest and noninterest income for the year ended December 31, 2019 were approximately \$773,000 and \$2.0 million, respectively. Interest and noninterest income for the year ended December 31, 2018 were approximately \$720,000 and \$1.4 million, respectively.
- The volume of deposits accepted from medical-use cannabis licensed (“licensed”) customers in 2019 was approximately \$267.6 million. The volume of deposits accepted from licensed customers in 2018 was approximately \$138.9 million.

### ***Our Business Strategy***

We are currently focused on growing assets and earnings by capitalizing on the network of Bank branches, mortgage offices, and ATMs that we have established.

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To continue asset growth and profitability, our business strategy is targeted to:

- capitalize on our personal relationship approach that we believe differentiates us from our larger competitors;
- provide our customers with access to local executives who make key credit and other decisions;
- pursue commercial lending opportunities with small to mid-sized businesses that are underserved by our larger competitors;
- develop innovative financial products and services to generate additional sources of revenue;
- cross-sell our products and services to our existing customers to leverage relationships and enhance our profitability;
- expand our closely monitored medical-use cannabis customer base in our market area; and
- adhere to rigorous credit standards to maintain good quality assets as we implement our growth strategy.

### ***Our Lending Activities***

We originate loans of all types, including residential mortgage, commercial, commercial mortgage, home equity, residential construction, commercial construction, land, residential lot, and consumer loans.

We originate residential mortgage loans that are to be held in our 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 government-sponsored enterprise (“GSE”) underwriting criteria required by the investors 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 our portfolio in the amounts of \$500,000 or less can be approved by the Chief Lending Officer, the Chief Credit Officer, or the Chief Executive Officer (“CEO”). Loans between \$500,000 and \$1.0 million must be approved by: (a) the Chief Credit Officer and the Chief Lending Officer or (b) the Chief Credit Officer and the CEO. Loans with balances between \$1.0 million and \$3.0 million must be approved by the Officers’ Loan Committee. Loans with balances between \$3.0 million and \$4.0 million must be approved by the Director’s Loan Committee. Loans between \$4.0 million and \$18.7 million (the maximum amount of loans to one borrower as of December 31, 2019), must be approved by the Board of Directors. Meetings of the Officers and Directors Loan Committees are open to attendance by any member of the Bank’s Board of Directors who wishes to attend. The loan committees report to and consult with the Board of Directors in interpreting and applying our lending policy.

Loans that are sold into the secondary market are typically residential long-term loans (15 or more years), generally with fixed rates of interest. Loans retained for our portfolio typically include construction loans, commercial loans, and loans that periodically reprice or mature prior to the end of an amortized term. Generally, loans are sold with servicing released, however for loans sold to the Federal National Mortgage Association (“FNMA”) or the Federal Home Loan Mortgage Corporation (“FHLMC”), the servicing rights have been retained. As of December 31, 2019, the Bank was servicing \$25.9 million in loans for FNMA and \$13.0 million in loans for FHLMC.

Our lending activities are subject to written policies approved by our Board of Directors to ensure proper management of credit risk. We make loans that are subject to a well-defined credit process that includes credit evaluation of borrowers, risk-rating of credits, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances, as well as procedures for on-going identification and management of credit deterioration. We conduct regular portfolio reviews to identify potential under-performing credits, estimate loss exposure, geographic and industry concentrations, and to ascertain compliance with our policies. For significant problem loans, we review and evaluate the financial strengths of our borrower and the guarantor, the related collateral and the effects of economic conditions.

We generally do not make loans to be held in our loan portfolio outside our market area unless the borrower has an established relationship with us and conducts its principal business operations within our market area. Consequently, we and our borrowers are affected by the economic conditions prevailing in our market area.

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### *Loan Approval Process*

Our 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 collateral 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 limitation on loans to one borrower. Our maximum amount of loans to one borrower is equal to 15% of the Bank's unimpaired capital, or \$18.7 million as of December 31, 2019. 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. For real estate collateral, we utilize independent qualified appraisers approved by management to appraise the collateral securing the loan and require title insurance or title opinions so as to ensure that we have a valid lien on the collateral. We require borrowers to maintain fire and casualty insurance on secured real estate.

The procedure for approval of construction loans is the same as above, except that the appraiser evaluates the building plans, construction specifications, and estimates of construction costs as well. The Bank also evaluates the feasibility of the proposed construction project and the experience and track record of the developer.

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.

### *Residential Mortgage Loans*

At December 31, 2019, our residential mortgage loan portfolio totaled \$268.2 million, or 41.5% of our loan portfolio. All of our residential mortgage loans are secured by one-to-four family residential properties and are primarily located in the Bank's market area.

### *Commercial Loans*

The Bank offers other business and commercial loans. These are loans to businesses and are typically lines of credit or other loans that, in general, are not secured by real estate. If not secured by real estate, they are usually secured by business assets, including accounts receivable, inventory, equipment, securities, or other collateral. At December 31, 2019, \$43.1 million, or 6.7% of our loan portfolio, consisted of commercial loans.

Commercial loans generally involve a greater degree of risk than residential mortgage loans. Because payments on commercial loans secured by business assets or other collateral are often dependent on the successful operation or management of the commercial enterprise, repayment of these loans may be subject to a greater extent to adverse conditions in the economy.

### *Commercial Real Estate Loans*

At December 31, 2019, our commercial real estate loan portfolio totaled \$228.0 million, or 35.3% of our loan portfolio. All of our 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.

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.

### *Construction, Land Acquisition, and Development Loans ("ADC")*

We originate loans to finance the construction of one-to-four family dwellings, and to a lesser extent, commercial real estate. We also originate loans for the acquisition and development of unimproved property to be used for residential and/or commercial purposes, generally in cases where the Bank is to provide the construction funds to improve the

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properties. As of December 31, 2019, we had ADC loans outstanding in the amount of \$92.8 million, or 14.4% of our loan portfolio.

Construction loan amounts are based on the appraised value of the property. 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 200 basis points above the prime rate. In addition to builders' projects, we finance the construction of single-family, owner-occupied homes 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 the 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 ("LTV"). 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 we are forced to foreclose on a project prior to or at completion, due to a default, there can be no assurance that we will be able to recover all of the unpaid balance of the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time. We have attempted to address these risks through our underwriting procedures and our limited amount of construction lending on multi-family and commercial real estate properties.

It is our policy to obtain third-party physical inspections of each property secured by a construction or rehabilitation loan for the purpose of reporting upon the progress of the project. These inspections, referred to as "construction draw inspections," are to be performed at the time of a request for an advance of construction funds.

### *Home Equity and Other Consumer Loans*

We offer various consumer loans including home equity loans, home equity lines of credit, and other personal loans. At December 31, 2019, \$13.6 million, or 2.1% of our loan portfolio consisted of consumer loans. The majority of consumer loans are home equity lines of credit. Consumer loan repayments are dependent on the borrower's continuing financial stability and are more likely to be affected by unemployment, illness, and/or other personal economic factors.

### ***Our Deposit Activities***

Subject to the Company's Asset/Liability Committee ("ALCO") policies and current business plan, the Treasury function (see information on Treasury activities below) works closely with the Company's retail deposit operations to accomplish the objectives of maintaining deposit market share within the Company's primary markets and managing funding costs to preserve the net interest margin.

One of the Company's primary objectives as a community bank is to develop long-term, multi-product customer relationships from its comprehensive menu of financial products, which include both interest-bearing and noninterest-bearing checking accounts, savings accounts, money market accounts, and certificates of deposit ("CDs"). To that end, the lead product to develop such relationships is typically a deposit product. Additionally, we determine new locations for branches to enhance our deposit and market share growth and in 2019, we opened a new branch in Crofton, Maryland. The Company intends to rely on deposit growth to fund long-term loan growth.

Core deposits are deposits that provide stable funding sources and are generally not reactive to changes in the interest rate environment. We consider all deposits, except CDs of \$100,000 or more to be core deposits. Our experience has been that a substantial portion of CDs renew at time of maturity and remain on deposit with the Bank. Core deposits amounted to



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\$532.8 million, or 80.6% of total deposits, and \$635.8 million, or 81.6% of total deposits, at December 31, 2019 and 2018, respectively.

### ***Our Treasury Activities***

The Treasury function manages the wholesale segments of the balance sheet, including investments, purchased funds and long-term debt, and is responsible for all facets of interest rate risk management for the Company, which includes the pricing of deposits consistent with conservative interest rate risk and liquidity practices. Management's objective is to achieve the maximum level of consistent earnings over the long term, while minimizing interest rate risk, credit risk, and liquidity risk and optimizing capital utilization. In managing the investment portfolio under its stated objectives, we invest primarily in United States of America ("U.S.") Treasury and Agency securities and U.S Agency mortgage-backed securities ("MBS"). Treasury strategies and activities are overseen by the Risk Committee of the Board of Directors, ALCO and the Company's Investment Committee, which reviews all investment and funding transactions. The ALCO activities are summarized and reviewed quarterly with the Company's Board of Directors.

The primary objective of the investment portfolio is to provide the necessary liquidity consistent with anticipated levels of deposit funding and loan demand with a minimal level of risk. The overall average life of 3.9 years of the investment portfolio as of December 31, 2019, together with the types of investments, is intended to provide sufficient cash flows to support the Company's lending goals. Liquidity is also provided by lines of credit maintained with the FHLB, the Federal Reserve ("FRB"), and to a lesser extent, lines of credit from other banks.

### ***Our Borrowing Activities***

Management utilizes a variety of sources to raise borrowed funds at competitive rates, including federal funds purchased, FHLB borrowings, and retail repurchase agreements. FHLB borrowings typically carry rates at varying spreads from the LIBOR rate or treasury yield curve for the equivalent term because they may be secured with investments or high quality loans. Federal funds purchased, which are generally overnight borrowings, are typically purchased at the FRB target rate.

The Company's borrowing activities are achieved through the use of the previously mentioned lines of credit to address overnight and short-term funding needs, match-fund loan activity and, when opportunities are present, to lock in attractive rates due to market conditions.

### **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. Competition for loans comes primarily from savings and loan associations, savings banks, mortgage-banking companies, insurance companies, commercial banks, and Internet-based financial institutions. Many of our competitors have higher legal lending limits than we do. Our most direct competition for deposits has historically come from savings and loan associations, savings banks, commercial banks, and credit unions. We face additional competition for deposits from short-term money market funds and other corporate and government securities funds. We also face increased competition for deposits from other financial institutions such as brokerage firms, insurance companies, and mutual funds, as well as Internet-based financial institutions. We are a community-oriented financial institution serving our market area with a wide selection of mortgage loans and other consumer and commercial financial products and services. Management considers the Bank's reputation for financial strength and customer service as its major competitive advantage in attracting and retaining customers in our market area. We believe we also benefit from our community engagement activities.

### **Market Area**

Our market area is primarily Anne Arundel County, Maryland and nearby areas, and our seven branch locations are all located in Anne Arundel County. Anne Arundel county maintains a diverse set of economic drivers such as a large international airport, the defense industry, a large number of large private sector employers as well as telecommunications, retail, and distribution operations. The population of Anne Arundel County has been growing steadily since 2000 and is

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projected to continue such growth through 2020. The largest population demographic of Anne Arundel County is in the 20-44 age category.

We continue to expand our business relationship banking program by focusing on the needs of the business community in Anne Arundel County, Maryland. We focus our lending activities primarily 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. We strive to offer competitive deposit and loan products that fit the needs of the Anne Arundel County community. Our desire is to be a one-stop shop for all of the community's banking needs.

### **Supervision and Regulation**

The Company and its subsidiaries operate in an industry that is subject to laws and regulations that are enforced by a number of federal and state agencies. Changes in these laws and regulations, including interpretation and enforcement activities, could impact the cost of operating in the financial services industry, limit or expand permissible activities, or affect competition among banks and other financial institutions.

#### ***Regulation of the Company***

##### *General*

We are a unitary savings and loan holding company within the meaning of the Home Owners' Loan Act ("HOLA"). As such, we are registered with the FRB and are subject to regulations, examinations, supervision, and reporting requirements applicable to savings and loan holding companies. In addition, the FRB has enforcement authority over us and any nonsavings bank subsidiaries. Among other things, this authority permits the FRB to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution.

As a unitary savings and loan holding company, we generally are not subject to activity restrictions, provided the Bank satisfies the Qualified Thrift Lender ("QTL") test (see "*Qualified Thrift Lender Test*" under "*Regulation of the Bank*" below). If the Bank failed to meet the QTL test, then we would become subject to the activities restrictions applicable to multiple savings and loan holding companies and, unless the Bank qualifies as a QTL within one year thereafter, we would be required to register as, and would become subject to the restrictions applicable to, a bank holding company. Additionally, if we acquired control of another savings institution, other than in a supervisory acquisition where the acquired institution also met the QTL test, we would thereupon become a multiple savings and loan holding company and thereafter be subject to further restrictions on our activities. We currently intend to continue to operate as a unitary savings and loan holding company.

##### *Regulatory Capital Requirements*

Under capital regulations adopted pursuant to the Dodd-Frank Act, savings and loan holding companies became subject to additional 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 us and increased the asset threshold to qualify to be subject to the provisions of the SBHC Policy from \$500.0 million to \$1.0 billion. In August, 2018, the SBHC Policy was increased to \$3.0 billion in assets. Savings and loan holding companies that have total assets of \$3.0 billion or less are subject to the SBHC Policy and are not required to comply with the additional regulatory capital requirements 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 SEC. 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 our total assets exceed \$3.0 billion, we do not meet the other requirements discussed above, or the FRB deems it to be warranted for supervisory purposes.

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### *Restrictions on Acquisitions*

Except under limited circumstances, savings and loan holding companies, such as us, are prohibited from (i) acquiring, without approval of the FRB, control of a savings institution or a savings and loan holding company or all or substantially all of the assets of any such institution or holding company; (ii) acquiring, without prior approval of the FRB, more than 5% of the voting shares of a savings institution 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 institution becomes uninsured, control of such institution. 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 Federal Deposit Insurance Corporation (“FDIC”) fund, the convenience and the needs of the community, and competitive factors.

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 institution, other than a subsidiary savings institution, or of any other savings and loan holding company, without written approval of the FRB.

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*

The Company’s securities are registered with the SEC under the Exchange Act. As such, we are subject to the information, proxy solicitation, insider trading, and other requirements and restrictions of the Exchange Act.

### *Sarbanes-Oxley Act of 2002*

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) established a broad range of corporate governance and accounting measures intended to increase corporate responsibility and protect investors by improving the accuracy and reliability of disclosures under federal securities laws. The Company is subject to Sarbanes-Oxley because it is required to file periodic reports with the SEC under the Exchange Act. Among other things, Sarbanes-Oxley regulations and related NASDAQ Stock Market rules have established membership requirements and additional responsibilities for the Company’s audit committee, imposed restrictions on the relationship between the Company and its outside auditors (including restrictions on the types of nonaudit services the auditors may provide to the Company), imposed additional financial statement certification responsibilities for the Company’s CEO and Chief Financial Officer (“CFO”), expanded the disclosure requirements for corporate insiders, required management to evaluate the Company’s disclosure controls and procedures and its internal control over financial reporting, and required the Company’s auditors to issue a report on its internal control over financial reporting.

### *Financial Services Modernization Legislation*

In November 1999, the Gramm-Leach-Bliley Act of 1999 (“GLBA”) was enacted. 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 in general.

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

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### *Maryland Corporation Law*

We are incorporated under the laws of the State of Maryland, and are therefore subject to regulation by the State of Maryland. The rights of our stockholders are governed by the Maryland General Corporation Law.

### ***Regulation of the Bank***

#### *General*

As a federally chartered, FDIC insured savings institution, the Bank is subject to extensive regulation, primarily by the Office of the Comptroller of the Currency (“OCC”) and secondarily, by 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 regularly examines the Bank and prepares reports for the consideration of the Bank’s Board of Directors on 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.

#### *The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018*

On May 24, 2018, The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the “Regulatory Relief Act”) was enacted, which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. The Regulatory Relief Act’s provisions include, among other things: (i) exempting banks with less than \$10 billion in assets from the ability-to-repay requirements for certain qualified residential mortgage loans held in portfolio; (ii) not requiring appraisals for certain transactions valued at less than \$400,000 in rural areas; (iii) exempting banks that originate fewer than 500 open-end and 500 closed-end mortgages from the Home Mortgage Disclosure Act’s (“HMDA”) expanded data disclosures; (iv) clarifying that, subject to various conditions, reciprocal deposits of another depository institution obtained using a deposit broker through a deposit placement network for purposes of obtaining maximum deposit insurance would not be considered brokered deposits subject to the FDIC’s brokered-deposit regulations; (v) raising eligibility for the 18-month exam cycle from \$1 billion to banks with \$3 billion in assets; (vi) allowing qualifying federal savings banks to elect to operate with National Bank powers; and (vii) simplifying capital calculations by requiring regulators to establish for institutions under \$10 billion in assets a community bank leverage ratio at 9% that such institutions may elect to replace the general applicable risk-based capital requirements for determining well-capitalized status.

#### *Regulatory Capital Requirements*

Federal regulations require all FDIC insured depository institutions to meet several minimum capital standards: a common equity Tier 1 capital to total risk-based assets ratio of 4.5%; a Tier 1 capital to total risk-based assets ratio of 6.0%, a total capital to total risk-based assets ratio of 8%, a leverage ratio of 4%, and 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 gain/loss, 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 consists of 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. Cumulative preferred stock does not qualify as additional Tier 1 capital. Trust preferred securities and other nonqualifying capital instruments issued prior to May 19, 2010 by bank and savings and

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loan holding companies with less than \$15.0 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 mortgage loans, a risk weight of 100% is assigned to first-lien residential mortgage loans 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 (“MSRs”), and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

The regulations also 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, used for stock repurchases, or for the payment of discretionary bonuses to senior executive management. The capital conservation buffer requirement has been phased in over four years beginning on January 1, 2016 at 0.625% of risk-weighted assets, 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.

Notwithstanding the foregoing, pursuant to the Regulatory Relief Act (discussed above), the OCC finalized a rule that establishes a community bank leverage ratio (tier 1 capital to average total consolidated assets) at 9% for institutions under \$10 billion in assets that such institutions may elect to utilize in lieu of the general applicable risk-based capital requirements under Basel III. Such institutions that meet the community bank leverage ratio and certain other qualifying criteria will automatically be deemed to be well-capitalized. The new rule took effect on January 1, 2020.

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 nontraditional 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.

### *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 a cease and desist order, to removal of officers or directors of the institution and the appointment of a receiver or conservator. The

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FDIC also has the authority to terminate deposit insurance or recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If action is not taken by the OCC, the FDIC has authority to take action under specific circumstances.

### *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 institutions. For this purpose, a savings institution 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 FDIC Improvement Act (“FDICIA”) 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, 2019, the Bank met the capital requirements of a “well capitalized” institution under applicable OCC regulations.

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### *Premiums for Deposit Insurance*

The deposits of the Bank are insured up to the applicable limits by the Deposit Insurance Fund (“DIF”) of the FDIC, generally up to \$250,000 per insured depositor. The Bank pays deposit insurance premiums based on assessment rates established by the FDIC. Assessments for most institutions are based on financial measures and supervisory ratings derived from statistical modeling estimating the probability of failure within three years. In conjunction with the Deposit Insurance Fund reserve ratio achieving 1.15%, the assessment range (inclusive of possible adjustments) was reduced for most banks and savings associations to 1.5 basis points to 30 basis points.

Pursuant to the Dodd-Frank Act, the FDIC has backup enforcement authority over a depository institution holding company, such as us, if the conduct or threatened conduct of such holding company poses a risk to the DIF, although such authority may not be used if the holding company is generally in sound condition and does not pose a foreseeable and material risk to the DIF.

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. Additionally, the FDIC has authority to increase insurance assessments. The termination of deposit insurance for the Bank or an increase in the Bank’s insurance assessments could have a material adverse effect on our earnings.

### *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. Additionally, GLBA places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Pursuant to GLBA and rules adopted thereunder, financial institutions must provide an initial notice to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates.

Since 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 all applicable laws.

### *QTL Test*

Savings institutions 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 institution’s business. Qualified thrift investments are primarily residential mortgages and related investments, including certain mortgage-related securities. Institutions that fail to meet the QTL test are subject to OCC enforcement action for a violation of law. As of December 31, 2019, the Bank was in compliance with its QTL requirement and met the definition of a domestic building and loan institution.

### *Affiliate Transactions*

Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act (“FRA”) as made applicable to savings institutions by Section 11 of the HOLA. A savings institution affiliate includes any company or entity which controls the savings institution or that is controlled by a company that controls the savings institution. For example, the holding company of a savings institution and any companies which are controlled by such holding company, are affiliates of the savings institution. Generally, Section 23A limits the extent to which the savings institution or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such institution’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 institution as those provided to a nonaffiliate. “Covered transaction” include the making of loans to, purchase

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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 institution to an affiliate. In addition to the restrictions imposed by Sections 23A and 23B, Section 11 of HOLA prohibits a savings institution 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 institution.

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 FRA 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 institutions, 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 institution to file an application for approval of a capital distribution if:

- the institution 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 net income for that year to date plus retained net income for the preceding two years;
- the institution 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.

In addition, a savings institution must give the OCC notice of a capital distribution if the savings institution 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 institution'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 institution 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 institution subsidiary of a savings and loan holding company, such as the Bank, 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.



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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 institution 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, if the Bank does not have the required capital conservation buffer, if applicable, its ability to pay dividends to the Company may be limited. See “*Regulation of the Bank - Prompt Corrective Action*” above for additional information on the capital conservation buffer.

### *Branching*

Under OCC branching regulations, the Bank is generally authorized to open branches in any state of the U.S. (i) if the Bank qualifies as a “domestic building and loan association” under the Code, which qualification requirements are similar to those for a QTL under HOLA 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 institution were a state savings institution chartered by such state. The OCC authority preempts any state law purporting to regulate branching by federal savings banks.

### *Community Reinvestment Act (“CRA”) and the Fair Lending Laws*

Federal savings banks have a responsibility under the CRA 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 prohibits 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 CRA 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. We received a satisfactory rating from our most recent examination.

### *FHLB System*

The Bank is a member of the FHLB. 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, as of December 31, 2019, the Bank was required to own at least \$2.4 million of the capital stock of the FHLB. As of such date, we were in compliance with the capital plan requirements.

### *Federal Reserve System*

The FRB requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, NOW, and Super NOW checking accounts) and nonpersonal time deposits. For transaction accounts, the first \$16.3 million is exempt from reserve requirements. A 3% reserve ratio is assessed on transaction accounts over \$16.3 million up to and including \$124.2 million. Any transactions that exceed \$124.2 million are assessed \$3.2 million plus 10% of the amount over \$124.2 million. Nonpersonal time deposits have a 0% reserve. At December 31, 2019, we were in compliance with the reserve requirements.

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### *Activities of Subsidiaries*

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

### *Tying Arrangements*

Federal savings banks 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.

### *U.S. Patriot Act (“Patriot Act”)*

Anti-terrorism legislation enacted under the Patriot Act of 2001 expanded the scope of anti-money laundering laws and regulations and imposed significant new compliance obligations for financial institutions, including the Bank. The Patriot Act gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By way of amendments to the BSA, Title III of the Patriot Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, these regulations impose affirmative obligations on a wide range of financial institutions to maintain appropriate policies, procedures, and controls to detect, prevent, and report money laundering and terrorist financing.

### *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;
- HMDA, 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;
- 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;
- 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
- 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 loan transactions. These include regulations setting “ability to repay” and “qualified mortgage” standards for residential mortgage loans and mortgage loan servicing and originator compensation standards.

## ITEM 1A RISK FACTORS

### Risks Related to Our Business

***We provide banking services to customers who do business in the medical-use cannabis industry and the strict enforcement of federal laws regarding medical-use cannabis would likely result in our inability to continue to provide banking services to these customers and we could have legal action taken against us by the federal government.***

We have deposit and loan customers that are licensed by the state of Maryland to do business in the medical-use cannabis industry as growers, processors, and dispensaries. While medical-use cannabis is legal in the state of Maryland, it remains classified as a Schedule I controlled substance under the Federal Controlled Substances Act (“CSA”). As such, the cultivation, use, distribution and possession of marijuana is a violation of federal law that is punishable by imprisonment and fines. Moreover, the U.S. Supreme Court ruled in *USA v. Oakland Cannabis Buyers’ Coop.* that the federal government has the authority to regulate and criminalize cannabis, including medical marijuana.

In January 2018, the U.S. Department of Justice (“DOJ”) rescinded the “Cole Memo” and related memoranda which characterized the enforcement of the CSA against persons and entities complying with state regulatory systems permitting the use, manufacture and sale of medical marijuana as an inefficient use of their prosecutorial resources and discretion. The impact of the DOJ’s rescission of the Cole Memo and related memoranda is unclear, but may result in the DOJ increasing its enforcement actions against the regulated cannabis industry generally.

The U.S. Congress previously enacted an omnibus spending bill that includes a provision prohibiting the DOJ and the U.S. Drug Enforcement Administration from using funds appropriated by that bill to prevent states from implementing their medical-use cannabis laws. This provision, however, expires September 30, 2020. Further, the U.S. Court of Appeals for the Ninth Circuit held in *USA v. McIntosh* that this provision prohibits the DOJ from spending funds from relevant appropriations acts to prosecute individuals who engage in conduct permitted by state medical-use cannabis laws and who strictly comply with such laws. There is no guarantee that the U.S. Congress will extend this provision or that U.S. Federal courts located outside the Ninth Circuit will follow the ruling in *USA v. MacIntosh*.

Federal prosecutors have significant discretion and there can be no assurance that the federal prosecutor for the District of Maryland will not choose to strictly enforce the federal laws governing cannabis, including medical-use cannabis, or that the federal courts in Maryland will follow the Ninth Circuit’s ruling in *USA v. MacIntosh*. Any change in the federal government’s enforcement position, could cause us to immediately cease providing banking services to the medical-use cannabis industry in Maryland.

Additionally, as the possession and use of cannabis remains illegal under the CSA, we may be deemed to be aiding and abetting illegal activities through the services that we provide to these customers and could have legal action taken against us by the Federal government, including imprisonment and fines. Any change in position or potential action taken against us could result in significant financial damage to us and our stockholders.

The U.S. Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”) published guidelines in 2014 for financial institutions servicing state legal cannabis business. A financial institution that provides services to a medical-use cannabis related business can comply with BSA disclosure standards by following the FinCEN guidelines. Any adverse change in this FinCEN guidance, any new regulations or legislation, any change in existing regulations or oversight, whether a change in regulatory policy or a change in a regulator’s interpretation of a law or regulation, could have a negative impact on our interest income and noninterest income, as well as the cost of our operations, increasing our cost of regulatory compliance and of doing business, and/or otherwise affect us, which may materially affect our profitability.

***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.

Sharply rising interest rates 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.

During the first half of 2019, the interest rate environment remained stable as compared to the 2018 rate environment. However, in the third quarter of 2019, rates began dropping significantly. We do believe, however, that in the current market environment, we have adequate policies and procedures for maintaining a conservative interest rate sensitive position. 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.

***Reforms to and uncertainty regarding LIBOR may adversely affect our business.***

In 2017, a committee of private-market derivative participants and their regulators convened by the FRB, the ARRC, was created to identify an alternative reference interest rate to replace LIBOR. The ARRC announced SOFR, a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities, as its preferred alternative to LIBOR. The Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced its intention to stop persuading or compelling banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. Subsequently, the FRB announced final plans for the production of SOFR, which resulted in the commencement of its published rates by the Federal Reserve Bank of New York on April 2, 2018. Whether or not SOFR attains market traction as a LIBOR replacement tool remains in question and the future of LIBOR at this time is uncertain. The uncertainty as to the nature and effect of such reforms and actions and the political discontinuance of LIBOR may adversely affect the value of and return on our financial assets and liabilities that are based on or are linked to LIBOR, our results of operations or financial condition. In addition, these reforms may also require extensive changes to the contracts that govern these LIBOR based products, as well as our systems and processes.

***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 investment in such loans.***

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 customers to make loan 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

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- 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, 2019, approximately 93% 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 loans in default through the process of foreclosure and subsequent sale of the real estate collateral would then be diminished and we would be more likely to incur financial losses on such loans.

In addition, approximately 50% of the book value of our loans consisted of ADC and commercial real estate loans, which present additional risks described in “Item 1. Business – *“Lending Activities”*” of this Annual Report on 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.

At December 31, 2019 and 2018, our nonaccrual loans equaled \$4.2 million and \$4.7 million, respectively. For the years ended December 31, 2019 and 2018, we recognized \$(406,000) and \$289,000 in net loan (charge-offs) recoveries, respectively. At December 31, 2019, the total allowance for loan losses (“Allowance”) was \$7.1 million, which was 1.11% of total loans, compared with \$8.0 million, which was 1.18% of total loans, as of December 31, 2018.

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

In the course of our business, we may foreclose upon 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 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

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- 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. 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.

The Dodd-Frank Act, among other things, has changed and will continue to change the bank regulatory framework. The legislation has resulted in new regulations affecting the lending, funding, trading, and investment activities of banks and bank holding companies. An independent Consumer Financial Protection Bureau has assumed the consumer protection responsibilities of the various federal banking agencies and has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as the Bank, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. Banks and savings institutions with \$10.0 billion or less in assets will continue to be examined by their applicable bank regulators. The legislation also gives state attorneys general the ability to enforce applicable federal consumer protection laws. The Dodd-Frank Act also required the federal banking agencies to promulgate rules requiring mortgage lenders to retain a portion of the credit risk related to securitized loans. Bank regulatory agencies also have been responding aggressively to concerns and adverse trends identified in examinations. These measures are likely to increase our costs of doing business and increase our costs related to regulatory compliance, and may have a significant adverse effect on our lending activities, financial performance, and operating flexibility.

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.

***We are subject to more stringent capital requirements, which may adversely impact our return on equity, require us to raise additional capital, or constrain us from paying dividends or repurchasing shares.***

Effective January 1, 2015, the OCC implemented a new rule that substantially amended the regulatory risk-based capital rules applicable to the Bank. The rule implemented the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. On May 24, 2018, the Regulatory Relief Act was enacted which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. See details of the capital rules under "*Supervision and Regulation*" in Item 1 above.

The application of more stringent capital requirements for the Bank could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions such as the inability to pay dividends or repurchase shares if we were to be unable to comply with such requirements.

***Income from mortgage-banking operations is volatile and we may incur losses with respect to our mortgage-banking operations that could negatively affect our earnings.***

A key component of our strategy is to sell on the secondary market the longer term, conforming fixed-rate residential mortgage loans that we originate, earning noninterest income in the form of gains on the sale of the loans. When interest

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rates rise, the demand for mortgage loans tend to fall and may reduce the number of loans we can originate for sale. Weak or deteriorating economic conditions also tend to reduce loan demand. Although we sell, and intend to continue selling, most loans in the secondary market with limited or no recourse, we are required, and will continue to be required, to give customary representations and warranties to the buyers relating to compliance with applicable law. If we breach those representations and warranties, the buyers will be able to require us to repurchase the loans and we may incur a loss on the repurchase.

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

The banking 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 could reduce the amounts earned 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 real estate acquired through foreclosure will remain at current levels.

***We have established an Allowance based on 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, 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 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.

In addition, bank regulatory agencies periodically review our Allowance 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, we may need additional provisions to increase the Allowance. Furthermore, growth in the loan portfolio would generally lead to an increase in the provision for loan losses.

Any increases in the Allowance 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 institutions, 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 we offer. In addition, over the last several years, the banking industry has undergone substantial consolidation and this trend is expected to continue.

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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.

***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 our 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.

***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 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 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.

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 ensure 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 CEO. 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. 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 Exchange Act. As a result, current and potential stockholders may lose confidence in our financial reporting and disclosure required under the Exchange Act, which could adversely affect our business and stock price and could subject us to regulatory scrutiny.***

Pursuant to Section 404 of Sarbanes-Oxley, 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 required to include an opinion of our independent registered public accounting firm as to our internal controls and, therefore, stockholders 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 we fail to complete this evaluation in a timely manner, or, 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 disclosures required under the Exchange Act, which could adversely affect our business and stock price.

***Terrorist attacks, threats or actual war, natural disasters, global climate change, pandemics, and other global conflicts may impact all aspects of our operations, revenues, costs, and stock price in unpredictable ways.***

Terrorist attacks in the U.S. 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 U.S. or its allies, or military or trade disruptions, may impact our operations. In addition, natural disasters, global climate change, pandemics, and other global conflicts may impact our operations as well. Any of these events could cause consumer confidence and savings to decrease or could result in increased volatility in the U.S. 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.

#### **Risks Related to the Investment in our Common Stock**

***Our stock price may be volatile due to limited trading volume.***

Our common stock is traded on the NASDAQ Stock Market. However, the average daily trading volume in the Company's common stock has been relatively small. As a result, trades involving a relatively small number of shares may have a significant effect on the market price of the common stock and it may be difficult for investors to acquire or dispose of large blocks of stock without significantly affecting the market price.

***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 the Company of its stock. Although we paid dividends in 2018 and 2019 and have declared a quarterly dividend payment for the first quarter of 2020, this dividend policy will continue to 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 2035 Debentures contain restrictions on our ability to declare and pay dividends on or repurchase our common stock.***

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

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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 of December 31, 2019, we were current on all interest due on the 2035 Debentures.

***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.

***“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% 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**

None.

**ITEM 2 PROPERTIES**

HS constructed a building in Annapolis, Maryland that serves as the Company’s and the Bank’s administrative headquarters. A branch office of the Bank is also included in the building. The Company 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 the Company and the Bank is a partner.

The Company has seven retail branch locations in Anne Arundel County, Maryland (shown below), a mortgage loan office in Frederick, Maryland, and also leases office space in Annapolis, Maryland from a third party. The leases are for various terms, with the longest ending in 2035.

<b>Headquarters Branch</b> <sup>(1)</sup> 200 Westgate Circle Annapolis, Maryland 21401	Full Service Branch
<b>Annapolis Branch</b> <sup>(1)</sup> 1917 West Street Annapolis, Maryland 21401	Full Service Branch with drive-thru
<b>Crofton Branch</b> <sup>(2)</sup> 2151 Defense Highway Crofton, Maryland 21114	Full Service Branch with drive-thru
<b>Edgewater Branch</b> <sup>(2)</sup> 3083 Solomon's Island Road	Full Service Branch with drive-thru

Edgewater, Maryland 21037	
<b>Glen Burnie Branch</b> <sup>(1)</sup>	Full Service Branch with drive-thru
413 Crain Highway, S.E. Glen Burnie, Maryland 21061	
<b>Lothian Branch</b> <sup>(2)</sup>	Full Service Branch with drive-thru
5401 Southern Maryland Boulevard Lothian, Maryland 20711	
<b>Severna Park Branch</b> <sup>(2)</sup>	Full Service Branch with drive-thru
598 Benfield Road Severna Park, Maryland 21146	
<b>Frederick Mortgage Office</b> <sup>(2)</sup>	Mortgage loan office
5291 Corporate Drive Ste. 202 Frederick, Maryland 21703	
(1) Branch is owned by Company	
(2) Branch/Office is leased by Company	

**ITEM 3 LEGAL PROCEEDINGS**

At December 31, 2019, we were party to legal actions that are routine and incidental to our business. In management’s opinion, the outcome of these matters, individually or in the aggregate, will not have a material effect on our results of operations or financial position.

**ITEM 4 MINE SAFETY DISCLOSURES**

Not applicable.

**PART II**

**ITEM 5 MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES**

The common stock of the Company is traded on the NASDAQ Stock Market under the symbol “SVBI.”

**Equity Compensation Plan**

The following table sets forth the securities authorized for issuance under the Company’s equity based compensation plans:

<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants, and rights</u>	<u>Weighted-average exercise price of outstanding options, warrants, and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans</u>
Equity compensation plan approved by security holders	234,173	\$ 6.60	500,000
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>234,173</b>	<b>\$ 6.60</b>	<b>500,000</b>

The plan under which options were granted under a previous plan expired in March 2018. A new plan with 500,000 shares set aside for grant was approved at the stockholders’ meeting in May 2019.

### **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.

Our main source of income is dividends from the Bank. As a result, any dividends paid to our common shareholders depend primarily upon regulatory approval and receipt of dividends from the Bank.

Under the terms of the Company's 2035 Debentures, if (i) there has occurred and is continuing an event of default; (ii) the Company is in default with respect to payment of any obligations under the related guarantee; or (iii) the Company 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 the Company 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 of December 31, 2019, the Company was current on all interest due on the 2035 Debentures.

Any dividend amount is established by the board of directors each quarter. In making its decision on dividends, the Board of Directors considers operating results, financial condition, capital adequacy, regulatory requirements, shareholder returns, and other factors. Shareholders received quarterly cash common stock dividends totaling \$1.8 million in 2019 and \$1.5 million in 2018. There were no dividends declared or paid in 2017, 2016, or 2015. There is no guarantee that dividends will be paid any time in the future.

The Company did not repurchase any shares of common stock during the fourth quarter of 2019.

**ITEM 6 SELECTED FINANCIAL DATA**

The following summary financial information as of and for the years ended December 31, 2019 and 2018 is derived from our audited consolidated financial statements included in this Annual Report on Form 10-K. The financial information for previous years is derived from our audited consolidated financial statements included in previously filed Annual Reports on Form 10-K. The information is a summary and should be read in conjunction with our audited consolidated financial statements and management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below.

	2019	2018	2017	2016	2015
<b>Consolidated Statement of Income Data:</b>					
	<i>(dollars in thousands, except per share data)</i>				
Net interest income	\$ 30,507	\$ 29,057	\$ 24,594	\$ 22,189	\$ 22,161
(Reversal of) provision for loan losses	(500)	(300)	(650)	(350)	(280)
Noninterest income	10,264	8,429	4,774	6,691	5,701
Noninterest expense	29,661	26,240	22,178	23,704	23,517
Income tax expense (benefit)	3,236	2,977	5,022	(10,014)	90
Net income	8,374	8,569	2,818	15,540	4,535
<b>Consolidated Statement of Financial Condition Data:</b>					
Total assets	\$ 826,919	\$ 974,233	\$ 804,787	\$ 787,485	\$ 762,079
Loans receivable, net of Allowance	638,547	674,305	660,096	601,309	589,656
Deposits	661,049	779,506	602,228	571,946	523,771
Long-term borrowings	35,000	73,500	88,500	103,500	115,000
Subordinated debentures	20,619	20,619	20,619	20,619	24,119
Stockholders' equity	105,472	98,453	91,100	87,930	86,456
<b>Average Balances:</b>					
Total assets	\$ 908,003	\$ 828,636	\$ 792,370	\$ 771,607	\$ 775,081
Loans receivable	676,622	675,418	617,838	604,356	624,087
Deposits	724,398	619,354	586,355	530,909	543,944
Stockholders' equity	102,617	95,211	87,842	93,554	84,156
<b>Per Share Data:</b>					
Number of shares of common stock outstanding at year end	12,810,926	12,759,576	12,233,424	12,123,179	10,088,879
Net income per common share:					
Basic	\$ 0.66	\$ 0.68	\$ 0.21	\$ 1.16	\$ 0.21
Diluted	0.65	0.67	0.21	1.15	0.21
Dividends declared per common share	0.14	0.12	—	—	—
<b>Performance and Capital Ratios:</b>					
Return on average assets	0.92 %	1.03 %	0.36 %	2.01 %	0.59 %
Return on average equity	8.16 %	9.00 %	3.21 %	16.61 %	5.39 %
Net interest margin	3.50 %	3.66 %	3.32 %	3.13 %	3.09 %
Average equity to average assets	11.30 %	11.49 %	11.09 %	12.12 %	10.86 %
Tier 1 leverage ratio (1)	13.4 %	13.5 %	13.5 %	12.9 %	14.8 %
Common equity Tier 1 capital ratio (1)	18.5 %	17.4 %	16.5 %	16.5 %	19.6 %
Tier 1 capital ratio (1)	18.5 %	17.4 %	16.5 %	16.5 %	19.6 %
Total capital ratio (1)	19.6 %	18.7 %	17.7 %	17.8 %	20.8 %
Dividend payout ratio	21.4 %	17.6 %	—	—	—
<b>Asset Quality Ratios:</b>					
Nonperforming assets to total assets	0.80 %	0.64 %	0.76 %	1.37 %	1.41 %
Allowance to:					
Total loans	1.11 %	1.18 %	1.21 %	1.47 %	1.46 %
Nonperforming loans	168.27 %	172.77 %	141.07 %	91.04 %	97.59 %
Net (charge-offs) recoveries to average total loans, net of unearned income	(0.06)%	0.04 %	(0.04)%	0.09 %	(0.06)%

(1) Bank only

## **ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### ***The Company***

The Company is a savings and loan holding company chartered as a corporation in the state of Maryland in 1990. It conducts business primarily through four subsidiaries, the Bank, SBI, the Title Company, and Hyatt Commercial. Hyatt Commercial conducts business as 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, which does business as Annapolis Equity Group and acquires real estate for syndication and investment purposes. The Title Company engages in title work related to real estate transactions. The Bank has seven 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.

### ***Overview***

The Company provides a wide range of personal and commercial banking services. Personal services include mortgage and consumer lending 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. The Company also provides ATMs, credit cards, debit cards, safe deposit boxes, and telephone banking, among other products and services.

We have experienced a decreased level of profitability in our operations in 2019, primarily due to loan runoff and increased noninterest expenses. Less fourth quarter interest income was generated from lower volumes of interest-earning assets, particularly from significantly lower medical-use cannabis related deposits that earned overnight interest income during the first half of 2019. Also, loan interest income decreased from lower loan volumes, which was slightly offset by a reduction in interest expense from less reliance on borrowings. Our income before income taxes amounted to \$11.6 million in 2019 and \$11.5 million in 2018. In 2019, the Mid-Atlantic region in which we operate continued to experience improved regional economic performance. The national economy improved as well throughout the year. Consumer confidence has been bolstered by certain positive economic trends such as lower unemployment and increased housing metrics. These positive trends have enabled us to maintain strong levels of liquidity, capital, and credit quality, despite decreased profitability.

The Company expects to experience similar stable market conditions during 2020. If interest rates increase, demand for borrowing may decrease and our interest rate spread could decrease. If interest rates decrease, demand for borrowing may increase, which could improve our interest rate spread, depending on other factors. We will continue to manage loan and deposit pricing against the risks of rising costs of our deposits and borrowings. Interest rates are outside of our control, so we must attempt to balance the pricing and duration of the loan portfolio against the risks of rising costs of our deposits and borrowings.

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

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

### ***Critical Accounting Policies***

Our accounting and financial reporting policies conform to accounting principles generally accepted in the U.S. ("GAAP") and general practice within the banking industry. Accordingly, preparation of the financial statements requires management to exercise significant judgment or discretion or make significant assumptions and estimates based on the information available that have, or could have, a material impact on the carrying value of certain assets or on income. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements

and the reported amounts of income and expenses during the periods presented. The accounting policies we view as critical are those relating to the Allowance, the valuation of securities, the valuation of real estate acquired through foreclosure, and the valuation of deferred tax assets and liabilities. Significant accounting policies are discussed in detail in “Notes to Consolidated Financial Statements - Note 1 - Summary of Significant Account Policies” in this Annual Report on Form 10-K.

## **Results of Operations**

### *Net Income*

Net income decreased by \$195,000, or 2.3%, to \$8.4 million for 2019, compared to \$8.6 million for 2018. Basic and diluted income per share decreased to \$0.66 and \$0.65, respectively, for 2019, compared to \$0.68 and \$0.67, respectively, for 2018. We recognized an increase in net interest income and noninterest income compared to 2018. Noninterest expenses increased in 2019 compared to 2018 and we recorded a larger reversal of the provision for loan losses in 2019 compared to 2018.

### *Net Interest Income*

Net interest income, which is interest earned net of interest expense, increased by \$1.5 million, or 5.0%, to \$30.5 million for 2019, compared to \$29.1 million for 2018. The increase in net interest income was primarily due to an increase in the average balance of interest-earning assets, along with a decrease in the average volume of borrowings. Our net interest margin decreased from 3.66% in 2018 to 3.50% in 2019 and our net interest spread decreased from 3.29% in 2018 to 3.17% in 2019.

### *Interest Income*

Interest income increased by \$2.2 million, or 5.7%, to \$39.8 million for 2019, compared to \$37.7 million for 2018. Average interest-earning assets increased from \$793.8 million in 2018 to \$871.5 million in 2019. The yield on average assets decreased from 4.74% for 2018 to 4.57% in 2019 primarily as a result of decreasing interest rates in the latter part of 2019, mostly affecting interest on our other interest-earning assets by decreasing the average yield from 2.88% in 2018 to 1.87% in 2019.

Average loans outstanding increased by \$1.2 million in 2019 compared to 2018 due to increased originations, primarily in the commercial segment. Total loan originations, however, were significantly offset by loan runoff in 2019, which resulted in a lesser increase in average loans than would have occurred without the runoff. Average held-to-maturity (“HTM”) securities decreased by \$14.3 million in 2019 compared to 2018 due to maturities of securities and repayments from MBS. Average other interest-earning assets increased from \$46.5 million in 2018 to \$133.9 million in 2019. The increase was primarily due to increased short-term medical-use cannabis related funds that account holders relocated to investment opportunities outside of the Bank during the latter part of 2019.

### *Interest Expense*

Interest expense increased by \$700,000, or 8.1%, to \$9.3 million for 2019, compared to \$8.6 million for 2018. The increase was primarily due to the increased average rate paid on our deposit accounts due to an increased interest rate environment in the first half of 2019. The average rate paid on deposits increased from 1.19% in 2018 to 1.25% in 2019. The average rate paid on CDs increased from 1.74% in 2018 to 2.38% in 2019. The increase in interest expense related to deposit accounts was slightly offset by a decrease in interest expense related to borrowings. Average borrowings decreased \$36.8 million in 2019 compared to 2018. We paid off \$38.5 million in long-term FHLB advances and commercial loans in 2019.



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The following table sets forth, for the years indicated, information regarding the average balances of interest-earning assets and interest-bearing liabilities and the resulting yields on average interest-earning assets and rates paid on average interest-bearing liabilities. Average balances are also provided for noninterest-earning assets and noninterest-bearing liabilities.

	2019			2018			2017		
	Average Balance	Interest (2)	Yield/Rate	Average Balance	Interest (2)	Yield/Rate	Average Balance	Interest (2)	Yield/Rate
<i>(dollars in thousands)</i>									
<b>ASSETS</b>									
Loans (1)	\$ 676,622	\$ 35,639	5.27 %	\$ 675,418	\$ 34,643	5.13 %	\$ 617,838	\$ 30,142	4.88 %
Loans held for sale ("LHFS")	10,962	562	5.13 %	5,598	234	4.18 %	3,550	152	4.28 %
Available-for-sale ("AFS") securities	11,392	202	1.77 %	11,795	208	1.76 %	5,164	92	1.78 %
HTM securities	35,584	728	2.05 %	49,867	988	1.98 %	61,514	1,141	1.85 %
Other interest-earning assets (3)	133,935	2,499	1.87 %	46,470	1,338	2.88 %	48,276	472	0.98 %
Restricted stock investments, at cost	3,038	180	5.92 %	4,612	249	5.40 %	4,750	225	4.74 %
Total interest-earning assets	871,533	39,810	4.57 %	793,760	37,660	4.74 %	741,092	32,224	4.35 %
Allowance	(8,042)			(8,179)			(8,589)		
Cash and other noninterest-earning assets	44,512			43,055			59,867		
<b>Total assets</b>	<b>\$908,003</b>	<b>39,810</b>		<b>\$828,636</b>	<b>37,660</b>		<b>\$792,370</b>	<b>32,224</b>	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest-bearing deposits:									
Checking and savings	\$ 386,206	2,517	0.65 %	\$ 255,665	1,794	0.70 %	\$ 286,738	713	0.25 %
CDs	203,165	4,833	2.38 %	224,222	3,894	1.74 %	215,924	3,324	1.54 %
Total interest-bearing deposits	589,371	7,350	1.25 %	479,887	5,688	1.19 %	502,662	4,037	0.80 %
Borrowings	74,949	1,953	2.61 %	111,788	2,915	2.61 %	115,574	3,593	3.11 %
Total interest-bearing liabilities	664,320	9,303	1.40 %	591,675	8,603	1.45 %	618,236	7,630	1.23 %
Noninterest-bearing deposits	135,027			139,467			83,693		
Other noninterest-bearing liabilities	6,039			2,283			2,599		
Stockholders' equity	102,617			95,211			87,842		
<b>Total liabilities and stockholders' equity</b>	<b>\$908,003</b>	<b>9,303</b>		<b>\$828,636</b>	<b>8,603</b>		<b>\$792,370</b>	<b>7,630</b>	
<b>Net interest income/net interest spread</b>		<b>\$ 30,507</b>	<b>3.17 %</b>		<b>\$ 29,057</b>	<b>3.29 %</b>		<b>\$ 24,594</b>	<b>3.12 %</b>
<b>Net interest margin</b>			<b>3.50 %</b>			<b>3.66 %</b>			<b>3.32 %</b>

(1) Nonaccrual loans are included in average loans.

(2) There are no tax equivalency adjustments.

(3) Other interest-earning assets include interest-earning deposits, federal funds sold, and certificates of deposit held for investment.

The "Rate/Volume Analysis" below indicates the changes in our net interest income as a result of changes in volume and rates. We maintain an asset and liability management policy designed to provide a proper balance between rate-sensitive assets and rate-sensitive liabilities to attempt to optimize interest margins while providing adequate liquidity for our

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anticipated needs. Changes in interest income and interest expense that result from variances in both volume and rates have been allocated to rate and volume changes in proportion to the absolute dollar amounts of the change in each.

	2019 vs. 2018			2018 vs. 2017		
	Due to Variances in			Due to Variances in		
	Rate	Volume	Total	Rate	Volume	Total
<b>Interest earned on:</b>	<i>(dollars in thousands)</i>					
Loans	\$ 934	\$ 62	\$ 996	\$ 1,599	\$ 2,902	\$ 4,501
LHFS	63	265	328	(4)	86	82
AFS securities	—	(6)	(6)	(1)	117	116
HTM Securities	32	(292)	(260)	74	(227)	(153)
Other interest-earning assets	(611)	1,772	1,161	884	(18)	866
Restricted stock investments, at cost	23	(92)	(69)	31	(7)	24
<b>Total interest income</b>	<b>441</b>	<b>1,709</b>	<b>2,150</b>	<b>2,583</b>	<b>2,853</b>	<b>5,436</b>
<b>Interest paid on:</b>						
Interest-bearing deposits:						
Checking and savings	(136)	859	723	1,152	(71)	1,081
CDs	1,332	(393)	939	438	132	570
Total interest-bearing deposits	1,196	466	1,662	1,590	61	1,651
Borrowings	(2)	(960)	(962)	(563)	(115)	(678)
<b>Total interest expense</b>	<b>1,194</b>	<b>(494)</b>	<b>700</b>	<b>1,027</b>	<b>(54)</b>	<b>973</b>
<b>Net interest income</b>	<b>\$ (753)</b>	<b>\$ 2,203</b>	<b>\$ 1,450</b>	<b>\$ 1,556</b>	<b>\$ 2,907</b>	<b>\$ 4,463</b>

*Provision for Loan Losses*

Our loan portfolio is subject to varying degrees of credit risk and an Allowance is maintained to absorb losses inherent in our loan portfolio. Credit risk includes, but is not limited to, the potential for borrower default and the failure of collateral to be worth what we determined it was worth at the time of the origination of the loan. We monitor loan delinquencies at least monthly. All loans that are delinquent and all loans within the various categories of our portfolio as a group are evaluated. Management, with the advice and recommendation of the Company's Board of Directors, estimates an Allowance to be set aside for loan losses. Included in determining the calculation are such factors as historical losses for each loan portfolio, current market value of the loan's underlying collateral, inherent risk contained within the portfolio after considering the state of the general economy, economic trends, consideration of particular risks inherent in different kinds of lending, and consideration of known information that may affect loan collectability. As a result of our Allowance analysis, for the years ended December 31, 2019 and 2018, we determined that provision reversals of \$500,000 and \$300,000, respectively, were appropriate.

See additional information about the provision for loan losses under "Credit Risk Management and the Allowance" later in this Item.

*Noninterest Income*

Total noninterest income increased by \$1.8 million, or 21.8%, to \$10.3 million for 2019 compared to \$8.4 million for 2018, primarily due to increased mortgage-banking revenue, increased real estate commissions, increased deposit service charges, and increased title company revenue. Mortgage-banking revenue increased \$1.2 million, or 46.3%, to \$3.7 million for 2019 compared to \$2.6 million for 2018. This increase was the result of an increase in mortgage-banking activity in 2019, with an increase of originations from \$100.8 million in 2018 to \$171.8 million in 2019. Real estate commissions by Hyatt Commercial increased by \$127,000, or 7.4%, to \$1.8 million for 2019 compared to \$1.7 million for 2018. The increase was due to an increase in commercial sales activity in 2019.

Deposit service charges increased \$637,000, or 41.0%, to \$2.2 million in 2019, compared to \$1.6 million in 2018 due primarily to on-boarding and monthly service fees charged to medical-use cannabis customers. Title company revenue increased \$81,000 from \$1.0 million in 2018 to \$1.1 million in 2019 due to increased loan closings.

### *Noninterest Expense*

Total noninterest expense increased \$3.4 million, or 13.0%, to \$29.7 million for 2019, compared to \$26.2 million for 2018, primarily due to increases in compensation and related expenses, occupancy costs, professional fees, and data processing and licensing and software costs. Compensation and related expenses increased by \$1.9 million, or 10.8%, to \$19.7 million for 2019, compared to \$17.8 million for 2018. This increase was primarily due to annual salary increases, increased commissions, and bonuses. Net occupancy costs increased by \$148,000, or 9.5%, to \$1.7 million for 2019 compared to \$1.6 million for 2018, primarily due to additional properties. We opened our Crofton branch in 2019. Professional fees increased by \$649,000, or 130.3%, to \$1.1 million in 2019 compared to \$498,000 in 2018, primarily due to increased external audit fees and additional consulting fees. Data processing fees and licensing and software expense increased \$410,000 and \$350,000, respectively, in 2019 compared to 2018 due to additional efficiency and security enhancements to our core and related systems, as well as the implementation of a new customer relationship management (“CRM”) system.

### *Income Tax Provision*

We recognized a \$3.2 million provision for income taxes on income before income taxes of \$11.6 million for an effective tax rate of 27.9% during 2019 compared to a provision for income taxes of \$3.0 million on income before taxes of \$11.5 million for an effective tax rate of 25.8% in 2018. The increase in the effective tax rate from 2018 to 2019 was a function of changes in our permanent differences between recorded tax expense and taxes payable.

### *Financial Condition*

Total assets decreased \$147.3 million, or 15.1%, to \$826.9 million at December 31, 2019 compared to \$974.2 million at December 31, 2018. Cash and cash equivalents decreased by \$100.1 million, or 53.2%, to \$88.2 million at December 31, 2019 compared to \$188.3 million at December 31, 2018, primarily due to the decrease in deposits noted below. LHFS increased \$1.2 million, or 12.6%, to \$10.9 million at December 31, 2019 compared to \$9.7 million at December 31, 2018. This increase was due to an increased volume of originations from \$100.8 million in 2018 to \$171.8 million in 2019. Loans decreased \$36.7 million, or 5.4%, to \$645.7 million at December 31, 2019 compared to \$682.3 million at December 31, 2018 due to significant loan runoff, which offset increased origination activity in 2019. Real estate acquired through foreclosure increased \$850,000, or 55.3%, to \$2.4 million at December 31, 2019 compared to \$1.5 million at December 31, 2018. This increase was due to the addition of four properties. Total securities decreased \$12.0 million, or 23.6%, due to maturities and MBS repayments. Total deposits decreased \$118.5 million, or 15.2%, to \$661.0 million at December 31, 2019 compared to \$779.5 million at December 31, 2018. Long-term borrowings decreased by \$38.5 million, or 52.4%, to \$35.0 million at December 31, 2019 compared to \$73.5 million at December 31, 2018 as we paid off FHLB advances and a commercial note payable.

### *Securities*

We utilize the securities portfolio as part of our overall asset/liability management practices to enhance interest revenue while providing necessary liquidity for the funding of loan growth or deposit withdrawals. We continually monitor the credit risk associated with investments and diversify the risk in the securities portfolios. We held \$12.9 million and \$12.0 million in securities classified as AFS as of December 31, 2019 and 2018, respectively. We held \$26.0 million and \$38.9 million in securities classified as HTM as of December 31, 2019 and 2018, respectively.

Changes in current market conditions, such as interest rates and the economic uncertainties in the mortgage, housing, and banking industries impact the securities market. Quarterly, we review each security in our AFS portfolio to determine the nature of any decline in value and evaluate if any impairment should be classified as other-than-temporary impairment (“OTTI”). Such evaluations resulted in the determination that no OTTI charges were required during 2019 or 2018.

All of the AFS and HTM securities that were impaired as of December 31, 2019 were so due to declines in fair values resulting from changes in interest rates or increased credit/liquidity spreads compared to the time they were purchased. We have the intent to hold these securities to maturity and it is more likely than not that we will not be required to sell the securities before recovery of value. As such, management considers the impairments to be temporary.

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Our securities portfolio composition is as follows at December 31:

	AFS			HTM		
	2019	2018	2017	2019	2018	2017
	<i>(dollars in thousands)</i>					
U.S. Treasury securities	\$ —	\$ 1,981	\$ —	\$ 994	\$ 1,991	\$ 4,994
U.S. government agency notes	5,019	9,997	10,119	4,986	11,992	19,004
MBS	7,887	—	—	19,980	24,929	30,305
	<b>\$ 12,906</b>	<b>\$ 11,978</b>	<b>\$ 10,119</b>	<b>\$ 25,960</b>	<b>\$ 38,912</b>	<b>\$ 54,303</b>

The amortized cost, estimated fair values, and weighted average yields of debt securities at December 31, 2019, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations.

	Amortized Cost	Unrealized		Estimated Fair Value	Weighted Average Yield
		Gains	Losses		
<i>(dollars in thousands)</i>					
<b>AFS Securities:</b>					
U.S. government agency notes:					
Due within one year	\$ 5,017	\$ 2	\$ —	\$ 5,019	2.23 %
MBS:					
Due after ten years	7,951	—	64	7,887	2.90 %
	<b>\$ 12,968</b>	<b>\$ 2</b>	<b>\$ 64</b>	<b>\$ 12,906</b>	2.64 %
<b>HTM Securities:</b>					
U.S. Treasury securities:					
Due within one year	\$ 994	\$ 14	\$ —	\$ 1,008	2.63 %
US government agency notes:					
Due within one year	3,007	—	5	3,002	1.80 %
Due after one to five years	1,979	100	—	2,079	2.81 %
MBS:					
Due after one to five years	1,430	10	2	1,438	2.15 %
Due after five to ten years	7,114	51	3	7,162	2.77 %
Due after ten years	11,436	53	20	11,469	2.86 %
	<b>\$ 25,960</b>	<b>\$ 228</b>	<b>\$ 30</b>	<b>\$ 26,158</b>	2.66 %

Weighted yields are based on amortized cost. MBS are assigned to maturity categories based on their final maturity.

We did not hold any securities with an aggregate book value and market value in excess of 10% of stockholders' equity.

**LHFS**

We originate residential mortgage loans for sale on the secondary market. At December 31, 2019 and 2018, such LHFS, which are carried at fair value, amounted to \$10.9 million and \$9.7 million, respectively, the majority of which are subject to purchase commitments from investors.

When we sell mortgage loans we make certain representations to the purchaser related to loan ownership, loan compliance and legality, and accurate documentation, among other things. If a loan is found to be out of compliance with any of the representations subsequent to the date of purchase, we may be required to repurchase the loan or indemnify the purchaser for losses related to the loan, depending on the agreement with the purchaser. In addition other factors may cause us to be required to repurchase or "make-whole" a loan previously sold.

The most common reason for a loan repurchase is due to a documentation error or disagreement with an investor, or on rare occasions for fraud. Repurchase requests are negotiated with each investor at the time we are notified of the demand and an appropriate reserve is taken at that time. We did not repurchase any loans during 2019 or 2018. We do not expect

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increases in repurchases or related losses to be a growing trend nor do we see it having a significant impact on our financial results.

*Loans*

Our loan portfolio is expected to produce higher yields than investment securities and other interest-earning assets; the absolute volume and mix of loans and the volume and mix of loans as a percentage of total interest-earning assets is an important determinant of our net interest margin.

The following table sets forth the composition of our loan portfolio net of unearned loan fees as of December 31:

	2019		2018		2017		2016		2015	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	<i>(dollars in thousands)</i>									
Residential Mortgage	\$268,152	41.5 %	\$274,759	40.3 %	\$285,819	42.8 %	\$257,659	42.2 %	\$283,211	47.4 %
Commercial	43,127	6.7 %	35,884	5.2 %	37,356	5.6 %	46,468	7.6 %	29,484	4.9 %
Commercial real estate	228,012	35.3 %	242,693	35.6 %	235,129	35.2 %	195,710	32.1 %	174,912	29.2 %
ADC	92,822	14.4 %	114,540	16.8 %	93,060	13.9 %	90,102	14.8 %	85,054	14.2 %
Home equity/2nds	12,031	1.9 %	13,386	2.0 %	15,703	2.3 %	19,129	3.1 %	24,529	4.1 %
Consumer	1,541	0.2 %	1,087	0.1 %	1,084	0.2 %	1,210	0.2 %	1,224	0.2 %
	<b>\$645,685</b>	<b>100.0 %</b>	<b>\$682,349</b>	<b>100.0 %</b>	<b>\$668,151</b>	<b>100.0 %</b>	<b>\$610,278</b>	<b>100.0 %</b>	<b>\$598,414</b>	<b>100.0 %</b>

Loans decreased by \$36.7 million, or 5.4%, to \$645.7 million at December 31, 2019 compared to \$682.3 million at December 31, 2018. This decrease was primarily due to decreased residential mortgage, commercial real estate, and ADC loan demand, as well as significant runoff in 2019 in those loan segments. Commercial loans increased 20.2% as we increased our focus on commercial lending in 2019.

Approximately 53% of our loans had adjustable rates as of December 31, 2019. Our variable-rate loans adjust to the current interest rate environment, whereas fixed rates do not allow this flexibility. If interest rates were to increase in the future, our interest earned on the variable-rate loans would improve, and if rates were to fall, the interest we earn on such loans would decline, thus impacting our interest income. Some variable-rate loans have rate floors and/or ceilings which may delay and/or limit changes in interest income in a period of changing rates. See our discussion in “*Interest Rate Sensitivity*” later in this Item for more information on interest rate fluctuations.

The following table sets forth the maturity distribution for our loan portfolio at December 31, 2019. Some of our loans may be renewed or repaid prior to maturity. Therefore, the following table should not be used as a forecast of our future cash collections.

	<b>Maturing</b>						<b>Total</b>
	<b>In one year or less</b>		<b>After 1 through 5 years</b>		<b>After 5 years</b>		
	<b>Fixed</b>	<b>Variable</b>	<b>Fixed</b>	<b>Variable</b>	<b>Fixed</b>	<b>Variable</b>	
	<i>(dollars in thousands)</i>						
Residential Mortgage	\$22,306	\$ 11,031	\$25,736	\$ 5,578	\$ 63,006	\$140,495	<b>\$268,152</b>
Commercial	3,490	16,661	8,097	2,812	5,616	6,451	<b>43,127</b>
Commercial real estate	9,005	12,766	52,116	7,709	71,230	75,186	<b>228,012</b>
ADC	34,889	19,569	5,480	17,376	1,398	14,110	<b>92,822</b>
Home equity/2nds	263	—	389	—	203	11,176	<b>12,031</b>
Consumer	—	—	672	23	846	—	<b>1,541</b>
	<b>\$69,953</b>	<b>\$ 60,027</b>	<b>\$92,490</b>	<b>\$ 33,498</b>	<b>\$142,299</b>	<b>\$247,418</b>	<b>\$645,685</b>
		<b>\$129,980</b>		<b>\$125,988</b>		<b>\$389,717</b>	

*Credit Risk Management and the Allowance*

Credit risk is the risk of loss arising from the inability of a borrower to meet his or her obligations and entails both general risks, which are inherent in the process of lending, and risks specific to individual borrowers. Our credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry, or collateral type.

We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, management recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions.

Management has an established methodology to determine the adequacy of the Allowance that assesses the risks and losses inherent in the loan portfolio. Our Allowance methodology employs management's assessment as to the level of future losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and/or lines of business. In determining our ability to collect certain loans, we also consider the fair value of any underlying collateral. In addition, we evaluate credit risk concentrations, including trends in large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors. Our risk management practices are designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may inherently exist within the loan portfolio. The assessment aspects involved in analyzing the quality of individual loans and assessing collateral values can also contribute to undetected, but probable, losses. For more detailed information about our Allowance methodology and risk rating system, see Note 3 to the Consolidated Financial Statements.

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The following table summarizes the activity in our Allowance by portfolio segment as of and for the years ended December 31:

	2019	2018	2017	2016	2015
	<i>(dollars in thousands)</i>				
<b>Allowance, beginning of year</b>	<b>\$ 8,044</b>	<b>\$ 8,055</b>	<b>\$ 8,969</b>	<b>\$ 8,758</b>	<b>\$ 9,435</b>
Charge-offs:					
Residential mortgage	(20)	(534)	(726)	(151)	(454)
Commercial	—	—	—	(17)	(154)
Commercial real estate	(537)	(38)	—	(178)	(80)
ADC	—	(34)	—	(72)	—
Home equity/2nds	—	—	(98)	(50)	(834)
Consumer	(14)	—	(2)	—	—
Total charge-offs	<u>(571)</u>	<u>(606)</u>	<u>(826)</u>	<u>(468)</u>	<u>(1,522)</u>
Recoveries:					
Residential mortgage	14	228	375	324	629
Commercial	—	—	—	54	284
Commercial real estate	130	424	157	23	—
ADC	5	—	—	157	49
Home equity/2nds	11	243	30	421	163
Consumer	5	—	—	50	—
Total recoveries	<u>165</u>	<u>895</u>	<u>562</u>	<u>1,029</u>	<u>1,125</u>
Net (charge-offs) recoveries	<u>(406)</u>	<u>289</u>	<u>(264)</u>	<u>561</u>	<u>(397)</u>
Reversal of provision for loan losses	<u>(500)</u>	<u>(300)</u>	<u>(650)</u>	<u>(350)</u>	<u>(280)</u>
<b>Allowance, end of year</b>	<b>\$ 7,138</b>	<b>\$ 8,044</b>	<b>\$ 8,055</b>	<b>\$ 8,969</b>	<b>\$ 8,758</b>
Loans:					
Year-end balance	\$ 645,685	\$ 682,349	\$ 668,151	\$ 610,278	\$ 598,414
Average balance during year	676,622	675,418	617,838	604,356	624,087
Allowance as a percentage of year-end loan balance	1.11 %	1.18 %	1.21 %	1.47 %	1.46 %
Percent of average loans:					
Reversal of provision for loan losses	0.07 %	0.04 %	0.11 %	0.06 %	0.04 %
Net (charge-offs) recoveries	(0.06)%	0.04 %	(0.04)%	0.09 %	(0.06)%

The following tables summarize our allocation of the Allowance by loan segment as of December 31:

	2019			2018			2017		
	Amount	Percent of Total	Percent of Loans to Total Loans	Amount	Percent of Total	Percent of Loans to Total Loans	Amount	Percent of Total	Percent of Loans to Total Loans
	<i>(dollars in thousands)</i>								
Residential mortgage	\$ 2,264	31.7 %	41.5 %	\$ 2,224	27.6 %	40.3 %	\$ 3,099	38.5 %	42.8 %
Commercial	1,421	19.9 %	6.7 %	2,736	34.0 %	5.2 %	527	6.5 %	5.6 %
Commercial real estate	984	13.8 %	35.3 %	457	5.7 %	35.6 %	2,805	34.8 %	35.2 %
ADC	2,286	32.0 %	14.4 %	2,239	27.8 %	16.8 %	1,236	15.4 %	13.9 %
Home equity/2nds	134	1.9 %	1.9 %	222	2.8 %	2.0 %	386	4.8 %	2.3 %
Consumer	—	— %	0.2 %	1	— %	0.1 %	2	— %	0.2 %
Unallocated	49	0.7 %	— %	165	2.1 %	— %	—	— %	— %
<b>Total</b>	<b>\$ 7,138</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>\$ 8,044</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>\$ 8,055</b>	<b>100.0 %</b>	<b>100.0 %</b>

	2016			2015		
	Amount	Percent of Total	Percent of Loans to Total Loans	Amount	Percent of Total	Percent of Loans to Total Loans
	<i>(dollars in thousands)</i>					
Residential mortgage	\$ 3,833	42.7 %	42.2 %	\$ 4,188	47.8 %	47.4 %
Commercial	478	5.3 %	7.6 %	291	3.3 %	4.9 %
Commercial real estate	2,535	28.3 %	32.1 %	2,792	31.9 %	29.2 %
ADC	1,390	15.5 %	14.8 %	956	10.9 %	14.2 %
Home equity/2nds	728	8.1 %	3.1 %	528	6.1 %	4.1 %
Consumer	5	0.1 %	0.2 %	3	— %	0.2 %
<b>Total</b>	<b>\$ 8,969</b>	<b>100.0 %</b>	<b>100.0 %</b>	<b>\$ 8,758</b>	<b>100.0 %</b>	<b>100.0 %</b>

Based upon management’s evaluation, provisions are made to maintain the Allowance as a best estimate of inherent losses within the portfolio. The Allowance totaled \$7.1 million at December 31, 2019 and \$8.0 million at December 31, 2018. Any changes in the Allowance from period to period reflect management’s ongoing application of its methodologies to establish the Allowance, which, for the year ended December 31, 2019, resulted in a reversal of the provision for loan losses of \$500,000, compared to a similar such reversal of \$300,000 for the year ended December 31, 2018.

At December 31, 2018, due to a reevaluation of its qualitative factors, the Company changed its estimates of the Allowance relative to historical loss experience within specific loan portfolio segments in order to better align its qualitative factors with historical losses experienced over a longer period of time, relative to those specific loan segments. The result of this change in estimate did not result in a material increase in the Allowance compared to the year ended December 31, 2017, however there were material changes to the Allowance between loan segments. Due to the change in accounting estimate, Allowance allocated to commercial loans and ADC loans increased approximately \$2.2 and \$1.1 million, respectively, while Allowance allocated to residential mortgage loans and commercial real estate loans decreased \$600,000 and \$2.7 million, respectively, as of December 31, 2018. This change in accounting estimate had no impact on earnings or diluted earnings per share. This change in estimate did not have any impact on the current period provision for loan losses, rather, it resulted in re-allocation of existing Allowances between loan classifications.

During 2019 we recorded net charge-offs of \$406,000 compared to net recoveries of \$289,000 during 2018. During 2019, net charge-offs as compared to average loans outstanding amounted to 0.06% compared to net recoveries as compared to average loans outstanding of 0.04% during 2018. The Allowance as a percentage of outstanding loans decreased from 1.18% as of December 31, 2018 to 1.11% as of December 31, 2019, reflecting the improvement in our overall asset quality.

Although management uses available information to establish the appropriate level of the Allowance, future additions or reductions to the Allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. As a result, our Allowance may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our Allowance and related methodology. Such agencies may require us to recognize adjustments to the Allowance based on their judgments about information available to them at the time of their examination. Management believes the Allowance is adequate as of December 31, 2019 and is sufficient to address the credit losses inherent in the current loan portfolio.

#### Nonperforming Assets (“NPAs”)

Given the volatility of the real estate market, it is very important for us to have current appraisals on our NPAs. In general, we obtain appraisals on NPAs on an annual basis. As part of our asset monitoring activities, we maintain a Loss Mitigation Committee that meets once a month. During these Loss Mitigation Committee meetings, all NPAs and loan delinquencies are reviewed. We also produce an NPA report which is distributed monthly to senior management and is also discussed and reviewed at the Loss Mitigation Committee meetings. This report contains all relevant data on the NPAs, including the latest appraised value and valuation date. Accordingly, these reports identify which assets will require an updated appraisal. As a result, we have not experienced any internal delays in identifying which loans/credits require appraisals.



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With respect to the ordering process of the appraisals, we have not experienced any delays in turnaround time nor has this been an issue over the past three years. Furthermore, we have not had any delays in turnaround time or variances thereof in our specific loan operating markets.

NPAs, expressed as a percentage of total assets, totaled 0.8% at December 31, 2019 and 0.6% at December 31, 2018. The ratio of the Allowance to nonperforming loans was 168.3% at December 31, 2019 and 172.8% at December 31, 2018. The decrease in this ratio from December 31, 2018 to December 31, 2019 was primarily a reflection of the decrease in the Allowance. The ratio of nonperforming loans to total loans was 0.7% at both December 31, 2019 and 2018.

The distribution of our NPAs is illustrated in the following table as of December 31:

	2019	2018	2017	2016	2015
<b>Nonaccrual Loans:</b>	<i>(dollars in thousands)</i>				
Residential mortgage	\$ 3,766	\$ 2,580	\$ 3,891	\$ 3,580	\$ 3,191
Commercial	—	430	78	151	483
Commercial real estate	237	660	159	2,938	2,681
ADC	89	558	314	269	521
Home equity/2nds	150	428	1,268	2,914	2,098
	<u>4,242</u>	<u>4,656</u>	<u>5,710</u>	<u>9,852</u>	<u>8,974</u>
<b>Real Estate Acquired Through Foreclosure:</b>					
Residential mortgage	1,377	1,366	—	206	1,381
Commercial	—	—	—	—	37
Commercial real estate	452	—	187	528	—
ADC	558	171	216	239	326
	<u>2,387</u>	<u>1,537</u>	<u>403</u>	<u>973</u>	<u>1,744</u>
<b>Total Nonperforming Assets</b>	<u>\$ 6,629</u>	<u>\$ 6,193</u>	<u>\$ 6,113</u>	<u>\$ 10,825</u>	<u>\$ 10,718</u>

Nonaccrual loans amounted to \$4.2 million at December 31, 2019 and \$4.7 million at December 31, 2018. Significant activity in nonaccrual loans during 2019 included additions of \$2.3 million, transfers to real estate acquired through foreclosure of \$1.3 million, returns to accrual status of \$172,000, and pay-offs/sales of \$1.1 million.

Real estate acquired through foreclosure increased \$850,000 to \$2.4 million at December 31, 2019 compared to \$1.5 million at December 31, 2018, due to the addition of four properties.

The activity in our real estate acquired through foreclosure was as follows as of and for the years ended December 31:

	2019	2018	2017	2016	2015
	<i>(dollars in thousands)</i>				
<b>Balance at beginning of year</b>	<b>\$ 1,537</b>	<b>\$ 403</b>	<b>\$ 973</b>	<b>\$ 1,744</b>	<b>\$ 1,947</b>
Real estate acquired in satisfaction of loans	1,342	1,366	703	1,575	2,234
Write-downs and losses on real estate acquired through foreclosure	(259)	(61)	(103)	(176)	(9)
Proceeds from sales of real estate acquired through foreclosure	(233)	(171)	(1,170)	(2,170)	(2,428)
<b>Balance at end of year</b>	<u><b>\$ 2,387</b></u>	<u><b>\$ 1,537</b></u>	<u><b>\$ 403</b></u>	<u><b>\$ 973</b></u>	<u><b>\$ 1,744</b></u>

There were no loans greater than 90 days past due and still accruing at December 31, 2019, 2018, 2017, 2016, or 2015.

**Troubled Debt Restructured Loans (“TDRs”)**

In situations where, for economic or legal reasons related to a borrower’s financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a TDR.

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The composition of our TDRs is illustrated in the following table as of December 31:

	2019	2018	2017	2016	2015
Residential mortgage:	<i>(dollars in thousands)</i>				
Nonaccrual	\$ 85	\$ 446	\$ 736	\$ 2,137	\$ 1,071
<90 days past due/current	7,675	9,469	11,631	15,648	20,831
Commercial:					
Nonaccrual	—	—	—	—	—
<90 days past due/current	—	—	—	—	103
Commercial real estate:					
Nonaccrual	—	—	78	249	252
<90 days past due/current	984	1,019	1,862	1,914	2,464
ADC:					
Nonaccrual	—	—	6	6	6
<90 days past due/current	130	134	137	170	978
Home equity/2nds:					
Nonaccrual	—	—	—	—	—
<90 days past due/current	—	—	—	238	—
Consumer:					
Nonaccrual	—	—	—	—	—
<90 days past due/current	69	76	84	96	10
<b>Totals:</b>					
Nonaccrual	85	446	820	2,392	1,329
<90 days past due/current	8,858	10,698	13,714	18,066	24,386
	<u>\$ 8,943</u>	<u>\$ 11,144</u>	<u>\$ 14,534</u>	<u>\$ 20,458</u>	<u>\$ 25,715</u>

See additional information on TDRs in Note 3 to the Consolidated Financial Statements.

*Deposits*

Deposits were \$661.0 million at December 31, 2019 and \$779.5 million at December 31, 2018. During the year ended December 31, 2019, we experienced decreases in all categories of deposit accounts due primarily to competition. In 2019 we saw runoff of short-term medical-use cannabis related funds (funds that have not actually been used in the medical-use cannabis industry yet) that account holders relocated to investment opportunities outside of the Bank. Management was aware of the short-term nature of certain medical-use cannabis related deposits and offset those funds by maintaining short-term liquidity to meet any deposit outflows.

The deposit breakdown is as follows as of December 31:

	2019	2018	2017	2016	2015
	<i>(dollars in thousands)</i>				
NOW	\$ 83,612	\$ 106,508	\$ 63,616	\$ 63,137	\$ 56,096
Money market	162,621	203,351	103,649	66,356	47,690
Savings	61,514	75,692	98,717	110,492	111,992
CDs	230,401	247,351	263,413	273,816	277,778
Total interest-bearing deposits	538,148	632,902	529,395	513,801	493,556
Noninterest-bearing deposits	122,901	146,604	72,833	58,145	30,215
<b>Total deposits</b>	<u>\$ 661,049</u>	<u>\$ 779,506</u>	<u>\$ 602,228</u>	<u>\$ 571,946</u>	<u>\$ 523,771</u>

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The following table provides the maturities of CDs in amounts of \$100,000 or more at December 31:

	<b>2019</b>	<b>2018</b>
Maturing in:	<i>(dollars in thousands)</i>	
3 months or less	\$ 13,137	\$ 26,910
Over 3 months through 6 months	21,019	23,330
Over 6 months through 12 months	37,331	27,160
Over 12 months	56,805	66,352
	<b><u>\$ 128,292</u></b>	<b><u>\$ 143,752</u></b>

*Borrowings*

Our borrowings consist of advances from the FHLB and a term loan from a commercial bank.

The FHLB advances are available under a specific collateral pledge and security agreement, which requires that we maintain collateral for all of our borrowings equal to 30% of total assets. Our advances from the FHLB may be in the form of short-term or long-term obligations. Short-term advances have maturities for one year or less and may contain prepayment penalties. Long-term borrowings through the FHLB have original maturities up to 20 years and generally contain prepayment penalties.

At December 31, 2019, our total available credit line with the FHLB was \$246.7 million. The Bank, from time to time, utilizes the line of credit when interest rates are more favorable than obtaining deposits from the public. Our outstanding FHLB advance balance at December 31, 2019 and December 31, 2018 was \$35.0 million and \$70.0 million, respectively.

On September 30, 2016, we entered into a loan agreement with a commercial bank whereby we borrowed \$3.5 million for a term of 8 years. The unsecured note bore interest at a fixed rate of 4.25% for the first 36 months then converted to a floating rate of the Wall Street Journal Prime plus 50 basis points for the remaining five years. Repayment terms were monthly interest only payments for the first 36 months, then quarterly principal payments of \$175,000 plus interest. During the fourth quarter of 2019, we repaid the loan without penalty.

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Certain information regarding our borrowings is as follows as of December 31:

	2019	2018	2017
<b>Amount outstanding at year-end:</b>		<i>(dollars in thousands)</i>	
FHLB advances	\$ 35,000	\$ 70,000	\$ 85,000
Commercial note payable	—	3,500	3,500
<b>Weighted-average interest rate at year-end:</b>			
FHLB advances	1.92 %	2.27 %	2.40 %
Commercial note payable	— %	4.25 %	4.25 %
<b>Maximum outstanding at any month-end:</b>			
FHLB advances	\$ 70,000	\$ 96,000	\$ 169,950
Commercial note payable	3,500	3,500	3,500
<b>Average outstanding:</b>			
FHLB advances	\$ 50,897	\$ 87,669	\$ 91,456
Commercial note payable	3,433	3,500	3,500
<b>Weighted-average interest rate during the year:</b>			
FHLB advances	1.74 %	2.17 %	3.03 %
Commercial note payable	4.20 %	5.04 %	5.04 %

The following table sets forth information concerning the interest rates and maturity dates of the advances from the FHLB as of December 31, 2019:

Principal Amount <i>(in thousands)</i>	Rate	Maturity
\$ 25,000	1.75% to 1.92%	2020
10,000	2.19%	2022
<b>\$ 35,000</b>		

*Subordinated Debentures*

As of December 31, 2019 and 2018, the Company had outstanding \$20.6 million in principal amount of Junior Subordinated Debt Securities, due in 2035 (the “2035 Debentures”). The 2035 Debentures were issued pursuant to an Indenture dated as of December 17, 2004 (the “2035 Indenture”) between the Company and Wells Fargo Bank, National Association as Trustee. The 2035 Debentures pay interest quarterly at a floating rate of interest of 3-month LIBOR 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 the Company, as defined in the 2035 Indenture. The 2035 Debentures became redeemable, in whole or in part, by the Company 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 the Company. 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. We have 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 Debentures, we are 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, 2019, we were current on all interest due on the 2035 Debentures.

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### *Capital Resources*

Total stockholders' equity increased \$7.0 million to \$105.5 million at December 31, 2019 compared to \$98.5 million at December 31, 2018. The increase was principally a result of 2019 net income, net of common stock dividends.

### Series A Preferred Stock

On November 15, 2008, the Company 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 the Company's Series A 8.0% Non-Cumulative Convertible Preferred Stock. On March 13, 2018, the Company notified holders of its Series A preferred stock that the Company had exercised its option to convert all 437,500 outstanding shares of Series A preferred stock for 437,500 shares of common stock. The Company converted the Series A preferred stock on April 2, 2018 and as of that date, the Series A preferred stock was no longer deemed outstanding and all rights with respect to such stock ceased and terminated.

### Capital Adequacy

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. As of both December 31, 2019 and 2018, the Bank exceeded all capital adequacy requirements to which it is subject and met the qualifications to be considered "well-capitalized." See details of our capital ratios in Note 10 to the Consolidated Financial Statements.

### ***Off-Balance Sheet Arrangements and Derivatives***

We enter into off-balance sheet arrangements in the normal course of business. These arrangements consist primarily of commitments to extend credit, lines of credit, and letters of credit. In addition, we have certain operating lease obligations.

#### *Credit Commitments*

Credit commitments are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Our exposure to credit loss in the event of nonperformance by the borrower is the contract amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. We are not aware of any accounting loss we would incur by funding our commitments.

See more detailed information on credit commitments below under "*Liquidity*."

#### *Derivatives*

We maintain and account for derivatives, in the form of interest-rate lock commitments ("IRLCs"), mandatory forward contracts, and best effort forward contracts, in accordance with the Financial Accounting Standards Board ("FASB") guidance on accounting for derivative instruments and hedging activities. We recognize gains and losses on IRLCs, mandatory forward contracts, and best effort forward contracts on the loan pipeline through mortgage-banking revenue in the Consolidated Statements of Income.

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IRLCs on mortgage loans that we intend to sell in the secondary market are considered derivatives. We are exposed to price risk from the time a mortgage loan closes until the time the loan is sold. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 14 days to 60 days. For these IRLCs, we attempt to protect the Bank from changes in interest rates through the use of best efforts and mandatory forward contracts.

Information pertaining to the carrying amounts of our derivative financial instruments follows as of December 31:

	2019		2018	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
	<i>(dollars in thousands)</i>			
Asset - IRLCs	\$ 7,645	\$ 179	\$ 3,710	\$ 100
Asset - mandatory forward contracts	7,645	23	—	—
Asset - best effort forward contracts	10,591	23	3,710	—
Liability - mandatory forward contracts	—	—	9,363	16

*Contractual Obligations*

We have certain obligations to make future payments under contract. At December 31, 2019, the aggregate contractual obligations and commitments were:

	Total	Less than one Year	After 1-3 Years	After 3-5 Years	After 5 Years
		<i>(dollars in thousands)</i>			
CDs	\$230,401	\$126,156	\$ 91,588	\$12,657	\$ —
Borrowings	35,000	25,000	10,000	—	—
Subordinated debentures	20,619	—	—	—	20,619
Annual rental commitments under noncancelable leases	3,170	357	694	547	1,572
	<b>\$289,190</b>	<b>\$151,513</b>	<b>\$102,282</b>	<b>\$13,204</b>	<b>\$22,191</b>

*Liquidity*

Liquidity describes our ability to meet financial obligations, including lending commitments and contingencies, which arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of our customers, to fund our mortgage-banking operations, as well as to meet current and planned expenditures. These cash requirements are met on a daily basis through the inflow of deposit funds, the maintenance of short-term overnight investments, maturities and calls in our securities portfolio, and available lines of credit with the FHLB, which requires pledged collateral. Fluctuations in deposit and short-term borrowing balances may be influenced by the interest rates paid, general consumer confidence, and the overall economic environment. There can be no assurances that deposit withdrawals and loan fundings will not exceed all available sources of liquidity on a short-term basis. Such a situation would have an adverse effect on our ability to originate new loans and maintain reasonable loan and deposit interest rates, which would negatively impact earnings.

Our principal sources of liquidity are loan repayments, maturing investments, sales of AFS securities, deposits, borrowed funds, and proceeds from loans sold on the secondary market. The levels of such sources are dependent on the Bank's operating, financing, and investing activities at any given time. We consider core deposits stable funding sources and include all deposits, except CDs of \$100,000 or more. The Bank's experience has been that a substantial portion of CDs renew at time of maturity and remain on deposit with the Bank. CDs scheduled to mature within one year amounted to \$126.2 million at December 31, 2019. Additionally, loan payments, maturities, deposit growth, and earnings contribute to our flow of funds.

In addition to our ability to generate deposits, we have 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. Our credit availability under the FHLB's credit availability program was \$246.7 million at December 31, 2019, of which \$35.0 million was outstanding.

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The borrowing requirements of customers include commitments to extend credit and the unused portion of lines of credit (collectively “commitments”), which totaled \$113.5 million at December 31, 2019. Historically, many of the commitments expire without being fully drawn; therefore, the total commitment amounts do not necessarily represent future cash requirements. As of December 31, 2019, we had \$16.9 million in unadvanced commitments for home equity lines of credit, \$701,000 outstanding in mortgage loan commitments, \$79.4 million outstanding in unadvanced construction commitments, and commitments under lines of credit for \$16.5 million, which we expect to fund from the sources of liquidity described above. Standby letters of credit amounted to \$3.3 million at December 31, 2019.

Customer withdrawals are also a principal use of liquidity, but are generally mitigated by growth in customer funding sources, such as deposits and short-term borrowings.

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, 2019, we had no material commitments for capital expenditures.

Our ability to acquire deposits or borrow could be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. At December 31, 2019, management considered the Company’s liquidity level to be sufficient for the purposes of meeting our cash flow requirements. We are not aware of any undisclosed known trends, demands, commitments, or uncertainties that are reasonably likely to result in material changes in our liquidity.

We anticipate that our primary sources of liquidity over the next twelve months will be from loan repayments, maturing investments, deposit growth, and borrowed funds. We believe that these sources of liquidity will be sufficient for us to meet our liquidity needs over the next twelve months.

### ***Interest Rate Sensitivity***

Interest rate sensitivity is an important factor in the management of the composition and maturity configurations of our interest-earning assets and our funding sources. The primary objective of our asset/liability management is to ensure the steady growth of our primary earnings component, net interest income. Our net interest income can fluctuate with significant interest rate movements. We may attempt to structure the statement of financial condition so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. However, imbalances in these repricing opportunities at any point in time may be appropriate to mitigate risks from fee income subject to interest rate risk, such as mortgage-banking activities.

The measurement of our interest rate sensitivity, or “gap,” is one of the techniques used in asset/liability management. Interest sensitive gap is the dollar difference between our assets and liabilities which are subject to interest rate pricing within a given time period, including both floating-rate or adjustable-rate instruments and instruments which are approaching maturity. More assets repricing or maturing than liabilities over a given time period is considered asset-sensitive and is reflected as a positive gap, and more liabilities repricing or maturing than assets over a given time period is considered liability-sensitive and is reflected as a negative gap. An asset-sensitive position (i.e., a positive gap) will generally enhance earnings in a rising interest rate environment and will negatively impact earnings in a falling interest rate environment, while a liability-sensitive position (i.e., a negative gap) will generally enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable.

Our management and our board of directors oversee the asset/liability management function and meet periodically to monitor and manage the statement of financial condition, control interest rate exposure, and evaluate pricing strategies. We evaluate the asset mix of the statement of financial condition continually in terms of several variables: yield, credit quality, funding sources, and liquidity. Our management of the liability mix of the statement of financial condition focuses on expanding our various funding sources and promotion of deposit products with desirable repricing or maturity characteristics.

In theory, we can diminish interest rate risk through maintaining a nominal level of interest rate sensitivity. In practice, this is made difficult by a number of factors including cyclical variation in loan demand, different impacts on our interest-

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sensitive assets and liabilities when interest rates change, and the availability of our funding sources. Accordingly, we strive to manage the interest rate sensitivity gap by adjusting the maturity of and establishing rates on the interest-earning asset portfolio and certain interest-bearing liabilities commensurate with our expectations relative to market interest rates. Additionally, we may employ the use of off-balance sheet instruments, such as interest rate swaps or caps, to manage our exposure to interest rate movements. Generally, we attempt to maintain a balance between rate-sensitive assets and liabilities that is appropriate to minimize our overall interest rate risk, not just our net interest margin.

Our interest rate sensitivity position as of December 31, 2019 is presented in the following table. Our assets and liabilities are scheduled based on maturity or repricing data except for core deposits which are based on internal core deposit analyses. These assumptions are validated periodically by management. The difference between our rate-sensitive assets and rate-sensitive liabilities, or the interest rate sensitivity gap, is shown at the bottom of the table. As of December 31, 2019, we had a one-year cumulative negative gap of \$111.4 million.

	180 days or less	181 days - one year	One-five years	> 5 years	Total
	<i>(dollars in thousands)</i>				
Interest-bearing deposits (1)	\$ 95,733	\$ —	\$ —	\$ —	\$ 95,733
Securities	6,570	3,562	7,570	21,164	38,866
Restricted stock investments	2,431	—	—	—	2,431
LHFS	10,910	—	—	—	10,910
Loans	149,497	73,720	304,576	110,754	638,547
	<b>\$265,141</b>	<b>\$ 77,282</b>	<b>\$312,146</b>	<b>\$ 131,918</b>	<b>\$ 786,487</b>
Savings	\$ 24,606	\$ 18,454	\$ 18,454	\$ —	\$ 61,514
NOWs	63,564	20,048	—	—	83,612
Money market	137,228	18,138	7,255	—	162,621
CDs	60,800	65,356	104,245	—	230,401
Borrowings	—	25,000	10,000	—	35,000
Subordinated debentures	20,619	—	—	—	20,619
	<b>\$306,817</b>	<b>\$ 146,996</b>	<b>\$139,954</b>	<b>\$ —</b>	<b>\$ 593,767</b>
<b>Period</b>	<b>\$ (41,676)</b>	<b>\$ (69,714)</b>	<b>\$172,192</b>	<b>\$ 131,918</b>	
<b>% of Assets</b>	<b>(5.04)%</b>	<b>(8.43)%</b>	<b>20.82 %</b>	<b>15.95 %</b>	
<b>Cumulative</b>	<b>\$ (41,676)</b>	<b>\$ (111,390)</b>	<b>\$ 60,802</b>	<b>\$ 192,720</b>	
<b>% of Assets</b>	<b>(5.04)%</b>	<b>(13.47)%</b>	<b>7.35 %</b>	<b>23.30 %</b>	
<b>Cumulative assets to liabilities</b>	<b>86.42 %</b>	<b>75.45 %</b>	<b>110.24 %</b>	<b>132.46 %</b>	

(1) Includes CDs held for investment

While we monitor interest rate sensitivity gap reports, we primarily test our interest rate sensitivity through the deployment of simulation analysis. We use earnings simulation models to estimate what effect specific interest rate changes would have on our net interest income. Simulation analysis provides us with a more rigorous and dynamic measure of interest sensitivity. Changes in prepayments have been included where changes in behavior patterns are assumed to be significant to the simulation, particularly mortgage-related assets. Call features on certain securities and borrowings are based on their call probability in view of the projected rate change, and pricing features such as interest rate floors are incorporated. We attempt to structure our asset and liability management strategies to mitigate the impact on net interest income by changes in market interest rates. However, there can be no assurance that we will be able to manage interest rate risk so as to avoid significant adverse effects on net interest income. We use the PROFITstar® model to monitor our exposure to interest rate risk, which calculates changes in the economic value of equity (“EVE”).



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At December 31, 2019, the simulation model provided the following interest-rate risk profile (changes in the EVE):

<b>Change in Rates</b>	<b>Amount</b>	<b>\$ Change</b>	<b>% Change</b>
	<i>(dollars in thousands)</i>		
+400 bp	\$ 145,951	\$ 648	0.45 %
+300 bp	149,554	4,251	2.93 %
+200 bp	152,214	6,911	4.76 %
+100 bp	151,187	5,884	4.05 %
0 bp	145,303		
(100)bp	128,886	(16,417)	(11.30)%
(200)bp	101,144	(44,159)	(30.39)%

The preceding income simulation analysis does not represent a forecast of actual results and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions, which are subject to change, including: the nature and timing of interest rate levels including the yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacement of asset and liability cash flows, and others. Also, as market conditions vary, prepayment/refinancing levels, the varying impact of interest rate changes on caps and floors embedded in adjustable-rate loans, early withdrawal of deposits, changes in product preferences, and other internal/external variables will likely deviate from those assumed.

### ***Inflation***

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with GAAP and practices within the banking industry which require the measurement of financial condition and operating results in terms of historical dollars, without considering the changes in the relative purchasing power of money over time due to inflation. As a financial institution, virtually all of our assets and liabilities are monetary in nature and interest rates have a more significant impact on our performance than the effects of general levels of inflation. A prolonged period of inflation could cause interest rates, wages, and other costs to increase and could adversely affect our results of operations unless mitigated by increases in our revenues correspondingly. However, we believe that the impact of inflation on our operations was not material for 2019 or 2018.

### ***Subsequent Event***

On February 25, 2020, the Company's Board of Directors declared a \$0.04 per share dividend to stockholders of record on March 6, 2020, payable on March 17, 2020.

## **ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For a discussion of interest rate risk, see Item 7 of Part II of this Annual Report on Form 10-K under the heading "*Interest Rate Sensitivity*."

## **ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The attestation reports by the Company's independent registered public accounting firm, the Financial statements, and supplementary data are included herein at pages F-1 through F-46, and incorporated herein by reference.

## **ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## ITEM 9A CONTROLS AND PROCEDURES

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC. As of December 31, 2019, the Company's management, including the Company's CEO (Principal Executive Officer) and CFO (Principal Accounting Officer), has evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Rules 13a-15 and 15d-15(e) under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must necessarily reflect the fact that there are resource constraints and that management is required to apply its judgement in evaluating the benefits of possible controls and procedures relative to their costs. Based on this evaluation, the Company's CEO and CFO concluded that, as of the end of the period covered by this annual report, the Company's disclosure controls and procedures were effective.

### Management's Report on Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflects the transactions and disposition of the assets of the Company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the Company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework (2013). Based on our assessment, management concluded that as of December 31, 2019, the Company's internal control over financial reporting was effective.

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A material weakness is a deficiency or combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual financial statements will not be prevented or detected on a timely basis. The identification of the material weaknesses did not impact any of our consolidated financial statements for any prior annual or interim periods. Accordingly, management believes that the financial statements included in this Annual Report on Form 10-K present fairly in all material respects the Company's financial condition, results of operations and cash flows for the periods presented.

The Company had previously identified a material weakness in its internal control over financial reporting, specifically related to both management's review controls and risk rating controls over the Company's Allowance. The material weakness in internal control over financial reporting resulted from a lack of sufficient management review controls over the development and monitoring of qualitative factors and other relevant assumptions used in calculating the general component of the Allowance, a lack of sufficient management review controls over the relevant inputs and assumptions used to measure the fair value of impaired loans, lack of controls to identify the completeness of TDRs, and review over the completeness of changes to loans' risk ratings that are required to be modified within the Company's loan accounting system.

The Company has enhanced its management review controls over the development and monitoring of qualitative factors and other relevant assumptions used in calculating the general component of the Allowance. The Company has also enhanced its current review process over impaired loans to ensure a timely review is being performed at an appropriate level of precision as it pertains to the relevant inputs and assumptions to measure the fair value of impaired loans, including appraisal review controls. The Company has also implemented a process to ensure the completeness and accuracy of the population to provide assurance that all required loans are properly evaluated for TDR classification. Finally, the Company has enhanced controls over the review of the completeness of changes to loans' risk ratings that are required to be modified within the Company's loan accounting system.

The Company had also previously identified a material weakness in its internal control over financial reporting, specifically related to its reconciliation controls relating to LHFS. The material weakness in internal control over financial reporting resulted from a 2018 material reclassification entry identified during the audit. The impact of this reclassification was corrected on the consolidated statement of financial condition as of December 31, 2018. Management has since remediated this material weakness by incorporating stronger internal controls over the LHFS, including strengthening the reconciliation process to ensure accuracy of LHFS and the reflection of all loan sales.

Other than the remediation described above, there has been no change in the Company's internal control over financial reporting during the fourth quarter of the fiscal year ended December 31, 2019 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

The Report of Independent Registered Public Accounting Firm on internal controls is located on page F-2 of this Annual Report on Form 10-K.

### **ITEM 9B OTHER INFORMATION**

None.

### **PART III**

#### **ITEM 10 DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE**

The Company has adopted a code of ethics that applies to its employees, including its CEO, CFO, and persons performing similar functions, and directors. A copy of the code of ethics is filed as an exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, which was filed with the SEC on March 25, 2004. The Company 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 the Company's website: [www.severnbank.com](http://www.severnbank.com).

The additional information required by this item will be included in the Company's definitive Proxy Statement relating to the 2020 Annual Stockholders Meeting ("Proxy Statement") to be filed with the SEC and incorporated herein by reference.

#### **ITEM 11 EXECUTIVE COMPENSATION**

The information required by this item will be included in the Company's Proxy Statement to be filed with the SEC and incorporated herein by reference.

#### **ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item with respect to our equity compensation plans is incorporated herein by reference to the section entitled "*Equity Compensation Plan*" contained in Item 5 of Part II of this Annual Report on Form 10-K.

The additional information required by this item will be included in the Company's Proxy Statement to be filed with the SEC and incorporated herein by reference.

#### **ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information required by this item will be included in the Company's Proxy Statement to be filed with the SEC and incorporated herein by reference.

#### **ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this item will be included in the Company's Proxy Statement to be filed with the SEC and incorporated herein by reference.

### **PART IV**

#### **ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

(a)(1), (a)(2) and (c) Financial Statements	
<a href="#">Reports of Independent Registered Public Accounting Firm</a>	F-1
<a href="#">Consolidated Statements of Financial Condition as of December 31, 2019 and 2018</a>	F-4
<a href="#">Consolidated Statements of Income for the years ended December 31, 2019 and 2018</a>	F-5
<a href="#">Consolidated Statements of Comprehensive Income for the years ended December 31, 2019 and 2018</a>	F-6
<a href="#">Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2019 and 2018</a>	F-7
<a href="#">Consolidated Statements of Cash Flows for the years ended December 31, 2019 and 2018</a>	F-8
<a href="#">Notes to Consolidated Financial Statements as of and for the years ended December 31, 2019 and 2018</a>	F-9

(a)(3) and (b) Exhibits Required to be filed by Item 601 of Regulation S-K

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The following exhibits are filed as part of this Form 10-K:

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
3.1	<a href="#">Articles of Incorporation of Severn Bancorp, Inc., as amended <sup>(1)</sup></a>
3.2 *	<a href="#">Bylaws of Severn Bancorp, Inc., as amended</a>
4.1	Form of Common Stock Certificate
4.2 *	<a href="#">Description of Common Stock</a>
10.1+	<a href="#">Stock Option Plan <sup>(2)</sup></a>
10.2+	<a href="#">Employee Stock Ownership Plan <sup>(3)</sup></a>
10.3+	<a href="#">Form of Common Stock Option Agreement <sup>(4)</sup></a>
10.4+	<a href="#">2019 Equity Incentive Plan <sup>(7)</sup></a>
10.5+	<a href="#">Form of Subscription Agreement <sup>(6)</sup></a>
10.6	<a href="#">Form of Subordinated Note <sup>(6)</sup></a>
10.7+	<a href="#">Form of Restricted Stock Award Agreement <sup>(5)</sup></a>
10.8+	<a href="#">Form of Incentive Stock Option Award Agreement <sup>(5)</sup></a>
10.9+	<a href="#">Employment Agreement by and between Severn Bancorp, Inc, Severn Bank, and Vance W. Adkins dated August 27, 2019 <sup>(9)</sup></a>
10.10+	<a href="#">Form of Non-Qualified Stock Option Award Agreement <sup>(5)</sup></a>
10.11+	<a href="#">Separation Agreement and Release by and between Severn Savings Bank, FSB and Paul Susie dated June 10, 2019 <sup>(10)</sup></a>
10.12+	<a href="#">Change In Control Agreement by and between Severn Bancorp, Inc., Severn Bank, and Alan J. Hyatt, dated December 30, 2019 <sup>(11)</sup></a>
14.1	<a href="#">Code of Ethics <sup>(8)</sup></a>
21.1*	<a href="#">Subsidiaries of Severn Bancorp, Inc.</a>
23.1*	<a href="#">Consent of BDO USA, LLP</a>
31.1*	<a href="#">Certification of Principal Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002</a>
31.2*	<a href="#">Certification of Principal Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002</a>
32 *	<a href="#">Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002</a>
101*	The following financial statements from Severn Bancorp, Inc. Annual Report on Form 10-K as of December 31, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Stockholders' Equity; (v) the Consolidated Statements of Cash Flows; and (vi) the Notes to Consolidated Financial Statements.

+ Denotes management contract, compensatory plan, or arrangement.

\* Filed herewith.

- (1) Incorporated by reference from the Company'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 the Company's Annual Report on Form 10-K for fiscal year ended December 31, 2004 and filed with the Securities and Exchange Commission on March 21, 2005.
- (3) Incorporated by reference from the Company's Registration Statement on Form 10 filed with the Securities and Exchange Commission on June 7, 2002.
- (4) Incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 20, 2006.
- (5) Incorporated by reference from the Company's Form S-8 filed with Securities and Exchange Commission on June 21, 2019.
- (6) Incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 18, 2008.
- (7) Incorporated by reference from the Company's 2019 Proxy Statement filed with the Securities and Exchange Commission on April 23, 2019.
- (8) Incorporated by reference from the Company'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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- (9) Incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 29, 2019.
- (10) Incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 14, 2019.
- (11) Incorporated by reference from the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 3, 2020.

**ITEM 16 FORM 10-K SUMMARY**

None.

**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.

March 16, 2020

SEVERN BANCORP, INC.  
/s/ Alan J. Hyatt  
Alan J. Hyatt  
Chairman of the Board, President, and  
Chief Executive Officer

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 as indicated on March 16, 2020.

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

/s/ Vance W. Adkins  
Vance W. Adkins, Executive Vice  
President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

/s/ Konrad M. Wayson  
Konrad M. Wayson, Director  
Vice Chairman of the Board

/s/ Raymond S. Crosby  
Raymond S. Crosby, Director

/s/ James H. Johnson, Jr.  
James H. Johnson, Jr., Director

/s/ David S. Jones  
David S. Jones, Director

/s/ Eric M. Keitz  
Eric M. Keitz, Director

/s/ John A. Lamon III

John A. Lamon III, Director

/s/ Mary Kathleen Sulick

Mary Kathleen Sulick, Director

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## Report of Independent Registered Public Accounting Firm

Stockholders and Board of Directors  
Severn Bancorp, Inc.  
Annapolis, Maryland

### Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of financial condition of Severn Bancorp, Inc. and Subsidiaries, (the “Company”) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows for each of the two years in the period ended December 31, 2019, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at December 31, 2019 and 2018, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 16, 2020 expressed an unqualified opinion thereon.

### Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2013.

Philadelphia, Pennsylvania  
March 16, 2020



## **Report of Independent Registered Public Accounting Firm**

Stockholders and Board of Directors  
Severn Bancorp, Inc.  
Annapolis, Maryland

### **Opinion on Internal Control over Financial Reporting**

We have audited Severn Bancorp, Inc. and Subsidiaries' (the "Company's") internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated statements of financial condition of Severn Bancorp, Inc. and Subsidiaries, (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2019, and the related notes (collectively referred to as the "consolidated financial statements") and our report dated March 16, 2020 expressed an unqualified opinion thereon.

### **Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance

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regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania

March 16, 2020

**Severn Bancorp, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
*(dollars in thousands, except per share data)*

	December 31,	
	2019	2018
<b>ASSETS</b>		
Cash and due from banks	\$ 2,892	\$ 2,880
Federal funds sold and interest-bearing deposits in other banks	85,301	185,460
Cash and cash equivalents	88,193	188,340
Certificates of deposit held for investment	7,540	8,780
Securities available for sale, at fair value	12,906	11,978
Securities held to maturity (fair value of \$26,158 and \$38,212 at December 31, 2019 and 2018, respectively)	25,960	38,912
Mortgage loans held for sale, at fair value	10,910	9,686
Loans receivable	645,685	682,349
Allowance for loan losses	(7,138)	(8,044)
Loans, net	638,547	674,305
Real estate acquired through foreclosure	2,387	1,537
Restricted stock investments	2,431	3,766
Premises and equipment, net	22,144	22,745
Accrued interest receivable	2,458	2,848
Deferred income taxes	1,748	2,363
Bank owned life insurance	5,377	5,225
Goodwill	1,104	1,104
Other assets	5,214	2,644
<b>Total assets</b>	<b>\$ 826,919</b>	<b>\$ 974,233</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Deposits:		
Noninterest bearing	\$ 122,901	\$ 146,604
Interest-bearing	538,148	632,902
Total deposits	661,049	779,506
Long-term borrowings	35,000	73,500
Subordinated debentures	20,619	20,619
Accrued expenses and other liabilities	4,779	2,155
Total liabilities	721,447	875,780
<b>Stockholders' Equity:</b>		
Common stock, \$0.01 par value, 20,000,000 shares authorized; 12,810,926 and 12,759,576 shares issued and outstanding at December 31, 2019 and 2018, respectively	128	128
Additional paid-in capital	65,944	65,538
Retained earnings	39,445	32,860
Accumulated other comprehensive loss	(45)	(73)
Total stockholders' equity	105,472	98,453
<b>Total liabilities and stockholders' equity</b>	<b>\$ 826,919</b>	<b>\$ 974,233</b>

See accompanying notes to consolidated financial statements

**Severn Bancorp, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(dollars in thousands, except per share data)*

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Interest income:</b>		
Loans	\$ 36,201	\$ 34,877
Securities	930	1,196
Other earning assets	2,679	1,587
Total interest income	<u>39,810</u>	<u>37,660</u>
<b>Interest expense:</b>		
Deposits	7,350	5,688
Borrowings and subordinated debentures	1,953	2,915
Total interest expense	<u>9,303</u>	<u>8,603</u>
Net interest income	30,507	29,057
Reversal of provision for loan losses	(500)	(300)
Net interest income after reversal of provision for loan losses	<u>31,007</u>	<u>29,357</u>
<b>Noninterest income:</b>		
Mortgage-banking revenue	3,747	2,561
Real estate commissions	1,834	1,707
Real estate management fees	627	674
Deposit service charges	2,189	1,552
Title company revenue	1,126	1,045
ATM surcharges	239	195
Income from bank owned life insurance	152	161
Other noninterest income	350	534
Total noninterest income	<u>10,264</u>	<u>8,429</u>
<b>Noninterest expense:</b>		
Compensation and related expenses	19,738	17,819
Occupancy	1,703	1,555
Legal fees	157	149
Write-downs, losses, and costs of real estate acquired through foreclosure, net of gains	172	83
Federal Deposit Insurance Corporation insurance premiums	116	229
Professional fees	1,147	498
Advertising	936	1,021
Data processing	1,508	1,098
Credit report and appraisal fees	198	185
Licensing and software	946	596
Internal audit and compliance	338	242
Office expenses, printing, and postage	356	420
Telecommunications	378	326
Other noninterest expense	1,968	2,019
Total noninterest expense	<u>29,661</u>	<u>26,240</u>
Net income before income tax provision	11,610	11,546
Income tax provision	3,236	2,977
<b>Net income</b>	<b>8,374</b>	<b>8,569</b>
Dividends on preferred stock	—	(70)
<b>Net income available to common stockholders</b>	<b>\$ 8,374</b>	<b>\$ 8,499</b>
<b>Net income per common share - basic</b>	<b>\$ 0.66</b>	<b>\$ 0.68</b>
<b>Net income per common share - diluted</b>	<b>\$ 0.65</b>	<b>\$ 0.67</b>

*See accompanying notes to consolidated financial statements*

**Severn Bancorp, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
*(dollars in thousands)*

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
Net income	\$ 8,374	\$ 8,569
Other comprehensive income (loss) items:		
Unrealized holding gains (losses) on available-for-sale securities arising during the period (net of tax (expense) benefit of \$(10) and \$14	28	(38)
Total other comprehensive income (loss)	28	(38)
<b>Total comprehensive income</b>	<b>\$ 8,402</b>	<b>\$ 8,531</b>

*See accompanying notes to consolidated financial statements*

**Severn Bancorp, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
*(dollars in thousands, except per share data)*

	Number of Shares of Preferred Stock	Number of Shares of Common Stock	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
<b>Balance at January 1, 2018</b>	437,500	12,233,424	\$ 4	\$ 122	\$ 65,137	\$ 25,872	\$ (35)	\$ 91,100
Net income	—	—	—	—	—	8,569	—	8,569
Stock-based compensation	—	—	—	—	218	—	—	218
Redemption of preferred stock	(437,500)	437,500	(4)	4	—	—	—	—
Dividend declared on Series A preferred stock	—	—	—	—	—	(70)	—	(70)
Dividends paid on common stock at \$0.12 per share	—	—	—	—	—	(1,511)	—	(1,511)
Exercise of stock options	—	88,652	—	2	372	—	—	374
Other	—	—	—	—	(189)	—	—	(189)
Other comprehensive loss	—	—	—	—	—	—	(38)	(38)
<b>Balance at December 31, 2018</b>	—	12,759,576	—	128	65,538	32,860	(73)	98,453
Net income	—	—	—	—	—	8,374	—	8,374
Stock-based compensation	—	—	—	—	146	—	—	146
Dividends paid on common stock at \$0.14 per share	—	—	—	—	—	(1,789)	—	(1,789)
Exercise of stock options	—	51,350	—	—	260	—	—	260
Other comprehensive income	—	—	—	—	—	—	28	28
<b>Balance at December 31, 2019</b>	—	12,810,926	\$ —	\$ 128	\$ 65,944	\$ 39,445	\$ (45)	\$ 105,472

*See accompanying notes to consolidated financial statements*

**Severn Bancorp, Inc. and Subsidiaries**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(dollars in thousands, except per share data)*

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 8,374	\$ 8,569
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,443	1,312
Amortization of deferred loan fees	(1,911)	(1,835)
Net (amortization) accretion of premiums and discounts	(45)	219
Reversal of provision for loan losses	(500)	(300)
Write-downs and losses on real estate acquired through foreclosure, net of gains	259	61
Gain on sale of mortgage loans	(3,747)	(2,561)
Write off of restricted stock	—	100
Proceeds from sale of mortgage loans held for sale	173,630	98,224
Originations of loans held for sale	(171,755)	(100,819)
Stock-based compensation	146	218
Increase in cash surrender value of bank-owned life insurance	(152)	(161)
Deferred income taxes	604	2,952
Decrease (increase) in accrued interest receivable	390	(208)
(Increase) decrease in other assets	(32)	132
Increase (decrease) in accrued expenses and other liabilities	86	(186)
Net cash provided by operating activities	<u>6,790</u>	<u>5,717</u>
<b>Cash flows from investing activities:</b>		
Redemption of certificates of deposit held for investment	1,240	—
Loan principal repayments, net of (disbursements)	37,476	(13,440)
Redemption of restricted stock investments, net	1,335	623
Purchases of premises and equipment	(842)	(918)
Activity in securities held to maturity:		
Maturities/calls/repayments	12,850	15,263
Activity in available-for-sale securities:		
Purchases	(7,958)	(2,000)
Maturities/calls/repayments	7,215	—
Proceeds from sales of real estate acquired through foreclosure	233	171
Net cash provided by (used in) investing activities	<u>51,549</u>	<u>(301)</u>
<b>Cash flows from financing activities:</b>		
Net (decrease) increase in deposits	(118,457)	177,278
Additional long-term borrowings	—	46,500
Repayments of long-term borrowings	(38,500)	(61,500)
Common stock dividends	(1,789)	(1,511)
Preferred stock dividends	—	(70)
Exercise of stock options	260	374
Net cash (used in) provided by financing activities	<u>(158,486)</u>	<u>161,071</u>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(100,147)</b>	<b>166,487</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>188,340</b>	<b>21,853</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 88,193</b>	<b>\$ 188,340</b>
<b>Supplemental Noncash Disclosures:</b>		
Interest paid on deposits and borrowed funds	\$ 9,354	\$ 8,578
Income taxes paid	1,919	103
Real estate acquired in satisfaction of loans	1,342	1,366
Initial recognition of operating lease right-of-use asset	2,684	—
Initial recognition of operating lease liability	2,684	—
Transfers of loans held for sale to loan portfolio	648	—
Common stock issued upon conversion of preferred stock	—	4
Preferred stock converted to common stock	—	(4)

See accompanying notes to consolidated financial statements

**Severn Bancorp, Inc. and Subsidiaries**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 - Summary of Significant Accounting Policies**

***Basis of Presentation***

The accounting and reporting policies of Severn Bancorp, Inc. and subsidiaries (the “Company”) conform to accounting principles generally accepted in the United States of America (“U.S.”) (“GAAP”). Events occurring after the date of the financial statements up to March 16, 2020, the date the financial statements were available to be issued, were considered in the preparation of the consolidated financial statements.

***Principles of Consolidation***

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

***Business***

We provide financial services to customers primarily within the Anne Arundel County region of Maryland. A portion of activities related to mortgage lending are more dispersed and cover other parts of Maryland and the Mid-Atlantic region. We serve local consumers, small and medium sized businesses, professionals, and other customers by offering a broad range of financial products and services, including Internet and mobile banking, commercial banking, cash management, mortgage lending, and retail banking. We fund a variety of loan types including commercial and residential real estate loans, commercial term loans and lines and letters of credit, and consumer loans. We do not have any concentrations to any one industry or customer. However, our customers’ ability to repay loan agreements is dependent on the real estate and general economic conditions of the market area.

We have no reportable segments. Management does not separately allocate expenses, including the cost of funding loan demand, between any of the various operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

***Use of Estimates***

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and affect the reported amounts of revenues earned and expenses incurred during the reporting period. Actual results could differ from those estimates. Estimates that could change significantly relate to the provision for loan losses and the related allowance for loan losses (“Allowance”), determination of impaired loans and the related measurement of impairment, valuation of investment securities, valuation of real estate acquired through foreclosure, valuation of share-based compensation, the assessment that a liability should be recognized with respect to any matters under litigation, and the calculation of current and deferred income taxes and the realizability of deferred tax assets.

***Change in Accounting Estimate***

At December 31, 2018, due to a reevaluation of its qualitative factors, the Company changed its estimates of the Allowance relative to historical loss experience within specific loan portfolio segments in order to better align its qualitative factors with historical losses experienced over a longer period of time, relative to those specific loan segments. The result of this change in estimate did not result in a material increase in the Allowance compared to the year ended December 31, 2017, however there were material changes to the Allowance between loan segments. Due to the change in accounting estimate,



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Allowance allocated to commercial loans and construction, land acquisition, and development (“ADC”) loans increased approximately \$2.2 and \$1.1 million, respectively, while Allowance allocated to residential mortgage loans and commercial real estate loans decreased \$600,000 and \$2.7 million, respectively, as of December 31, 2018. This change in accounting estimate had no impact on earnings or diluted earnings per share.

### ***Cash and Cash Equivalents***

We consider all highly liquid securities with original maturities of three months or less to be cash equivalents. For reporting purposes, assets grouped in the Consolidated Statements of Financial Condition under the captions “Cash and due from banks” and “Federal funds sold and interest-bearing deposits in other banks” are considered cash or cash equivalents. For financial statement purposes, these assets are carried at cost. Federal funds sold and interest-bearing deposits in other banks generally have overnight maturities and are in excess of amounts that would be recoverable under Federal Deposit Insurance Corporation (“FDIC”) insurance.

### ***Significant Accounting Policies***

#### *Revenue Recognition*

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 606, *Revenue from Contracts with Customers*, effective January 1, 2018, established principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity’s contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage-banking and mortgage servicing activities. Our revenue-generating activities that are within the scope of ASC 606, which are presented in our Consolidated Statements of Income as components of noninterest income, are service charges on deposit accounts (including ATM surcharges), real estate commissions, real estate management fees, and title company revenue.

#### Service Charges on Deposit Accounts

Service charges on deposit accounts represent general service fees for monthly account maintenance and activity - or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when our performance obligation is completed which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

#### Real Estate Commissions

Real Estate Commissions represent commissions received on properties sold. Revenue is recognized when our performance obligation is completed, which is generally the time the property is sold and payment has been received.

#### Real Estate Management Fees

Real Estate Management Fees represent monthly fees received on property maintenance and management. We perform daily services for these fees and bill for those services on a monthly basis. We have determined that each day of the performance of the services represents a distinct service. The overall service of property management each day is substantially the same and has the same pattern of transfer (daily) over the term of the contract. Further, each distinct day of service represents a performance obligation that would be satisfied over time (over the length of the contract, not at a point in time) and has the same measure of progress (elapsed time). Management has therefore determined that property

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management services are a single performance obligation composed of a series of distinct services. In performing the daily management activities, the customer is simultaneously receiving and consuming the benefits provided by our performance of the contract. Revenue is earned evenly and daily over the life of the contract. For purposes of expedience, we record the fees when monthly invoices are processed. Each month contains 1/12 of the contract revenue.

### Title Company Revenue

Title Company Revenue consists of revenue earned on performing title work for real estate transactions. The revenue is earned when the title work is performed. Payment for such performance obligations generally occurs at the time of the settlement of a real estate transaction. As such settlement is generally within 90 days of the performance of the title work, we recognize the revenue at the time of the settlement.

All contract acquisition costs are expensed as incurred. We had no contract assets or liabilities at December 31, 2019 or 2018.

### *Securities*

We designate securities into one of three categories at the time of purchase. Debt securities that we have the intent and ability to hold to maturity are classified as held to maturity (“HTM”) and recorded at amortized cost. Debt securities are classified as trading if bought and held principally for the purpose of sale in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as HTM securities or trading securities are considered available for sale (“AFS”) and are reported at estimated fair value, with unrealized gains and losses reported as a separate component of stockholders’ equity, net of tax effects, in accumulated other comprehensive loss.

AFS and HTM securities are evaluated periodically to determine whether a decline in their value is other than temporary. The term “other than temporary” is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near-term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the security.

The initial indications of other-than-temporary impairment (“OTTI”) for debt securities are a decline in the market value below the amount recorded for a security and the severity and duration of the decline. In determining whether an impairment is other than temporary, we consider the length of time and the extent to which the market value has been below cost, recent events specific to the issuer, including investment downgrades by rating agencies and economic conditions of its industry, our intent to sell the security, and if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. We also consider the cause of the price decline (general level of interest rates and industry- and issuer-specific factors), the issuer’s financial condition, near-term prospects and current ability to make future payments in a timely manner, the issuer’s ability to service debt, and any change in agencies’ ratings at evaluation date from acquisition date and any likely imminent action. Once a decline in value is determined to be other than temporary, the security is segmented into credit- and noncredit-related components. Any impairment adjustment due to identified credit-related components is recorded as an adjustment to current period earnings, while noncredit-related fair value adjustments are recorded through accumulated other comprehensive loss. In situations where we intend to sell or it is more likely than not that we will be required to sell the security, the entire OTTI loss is recognized in earnings.

### *Loans Held for Sale (“LHFS”)*

Mortgage loans originated for sale are carried at fair value. Fair value is determined based on outstanding investor commitments or, in the absence of such commitments, on current investor yield requirements or third-party pricing models. Gains and losses on loan sales are determined using the specific-identification method and are recognized through mortgage-banking revenue in the Consolidated Statements of Income. LHFS are sold either with the mortgage servicing rights (“MSRs”) released or retained by the Bank.

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### *Loans Receivable*

Our loans receivable are stated at their principal balance outstanding, net of related deferred fees and costs. 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 the 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 consists of 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 ("LTV") 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.

### Income recognition

Interest income on loans is accrued at the contractual rate based on the outstanding principal balance. Loan origination fees and certain direct loan origination costs are deferred and amortized as a yield adjustment over the contractual loan term or until the date of sale or disposition. Accrual of interest is discontinued when its receipt is in doubt, which typically occurs when a loan becomes impaired. Any interest accrued to income in the year when interest accruals are discontinued is generally reversed. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the principal balance and accrued interest. See additional information on nonaccrual interest and loan impairment later in this section.

### Fees and costs

Origination and commitment fees and direct origination costs on loans held for investment generally are deferred and amortized to income over the contractual lives of the related loans using the interest method. Under certain circumstances, commitment fees are recognized over the commitment period or upon expiration of the commitment. Fees to extend loans three months or less are recognized in income upon receipt. Unamortized loan fees are recognized in income when the related loans are sold or prepaid.

### Transfers of LHFS

In accordance with FASB guidance on mortgage-banking activities, any loans which are originally originated for sale into the secondary market and which we subsequently elect to transfer into the Company's loan portfolio are valued at lower of cost or market value ("LCM") at the time of the transfer with any decline in value recorded as a charge against mortgage-banking revenue.

### Nonaccrual Interest

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 in nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed in nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, generally after six months of consecutive current payments and an updated analysis of the borrower's ability to service the loan. Our policy for recording payments received on nonaccrual loans is to record the payment towards principal and interest on a cash basis until such time as the loan is returned to accrual status.

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Loans that experience insignificant payment delays and payment shortfalls generally are not placed in nonaccrual status or 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.

### Loan Impairment

A loan is considered impaired if it meets any of the following three criteria:

- Loans that are 90 days or more in arrears (nonaccrual loans);
- 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; or
- Loans that are modified and qualify as troubled debt restructured loans ("TDR" or "TDRs") (see below).

If a loan is considered to be impaired, it is then determined to be either cash flow or collateral dependent for purposes of measuring an appropriate Allowance (see Allowance discussion below).

### TDRs

We strive to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. In situations where, for economic or legal reasons related to a borrower's financial difficulties, we may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related now-modified loan is classified as a TDR. These modified terms may include rate reductions, principal forgiveness, payment extensions, payment forbearance, and/or other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. These loans are excluded from pooled loss forecasts and a separate reserve is provided under the accounting guidance for loan impairment. At the time that a loan is modified, we evaluate any possible impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. Any impairment amount is then set up as an allocated portion of the Allowance.

### *Allowance for Loan Losses*

The Allowance is maintained at 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 requires the use of estimates and assumptions. Actual results could differ significantly from those estimates.

Future additions or reductions in the Allowance may be necessary based on changes in economic conditions, particularly in Anne Arundel County and the State of Maryland. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's Allowance. Such agencies may require the Bank to recognize additions to the Allowance based on their judgment about information available to them at the time of their examination.

The Allowance consists of specific, general, and unallocated 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 LTV ratio based on the original appraisal, and the condition of the property. Appraised values are discounted, if appropriate, 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 collateral other than real estate, 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.

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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 fair 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 the loan.

The general component relates to loans that are classified as doubtful, substandard, or special mention that are not considered impaired, as well as nonclassified loans. The general reserve is based on historical loss experience adjusted for qualitative factors. These qualitative factors include, but are not limited to:

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

We assign risk ratings to the loans in our portfolio. These credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful, and loss. Loans classified special mention have potential weaknesses that warrant 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. Loans not classified are rated pass.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. It also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. On a quarterly basis, management performs a detailed analysis of the Allowance to verify the adequacy and appropriateness of the Allowance in meeting probable losses in the loan portfolio.

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

- The property collateralizing the loan has been foreclosed upon. At the time of foreclosure, 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; or
- The collateral valuation on a collateral dependent impaired loan is less than the recorded balance. The loan is charged off for accounting purposes by the amount of the difference between the recorded balance and collateral value.

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### *Real Estate Acquired Through Foreclosure*

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 “*Allowance for Loan Losses*” above. In the event of a subsequent change in fair value, the carrying amount is adjusted to the lesser of the new fair value, less disposal costs, or the carrying value recorded at acquisition. The amount of the change is charged or credited to noninterest expense. Expenses on real estate acquired through foreclosure 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. If a foreclosed property is sold for more or less than the carrying value, a gain or loss is recognized upon the sale of the property.

### *Restricted Stock Investments*

Our restricted stock investments include stock of the Federal Home Loan Bank of Atlanta (the “FHLB”) and capital stock of a bankers’ bank. Our investment in the FHLB stock is an equity interest in the FHLB, which does not have a readily determinable fair value for purposes of GAAP 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. The Bank’s investment in the capital stock of the bankers’ bank is carried at cost as no readily available market exists for this stock and it has no quoted market value. During 2018, we wrote off one such stock in the amount of \$100,000 as the Bankers bank was subsequently liquidated.

We evaluated the FHLB stock for impairment in accordance with GAAP. 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, 2019.

### *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.

### *Bank Owned Life Insurance (“BOLI”)*

BOLI is carried at the aggregate cash surrender value of life insurance policies owned where the Company or its subsidiary is named beneficiary. Increases in cash surrender value derived from crediting rates for underlying insurance policies is credited to noninterest income.

### *Goodwill and Other Intangible Assets*

Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination and is allocated to the Bank’s reporting units. Based upon an in-depth analysis performed in accordance with FASB guidance, we have determined that we have one reporting unit – commercial and consumer banking.

Goodwill is not amortized but is tested for impairment periodically. We assess goodwill for potential impairment annually as of September 30, or during the year if an event or other circumstance indicates that we may not be able to recover the carrying amount of the asset. As of September 30, 2019, we determined that there was no evidence of impairment of

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goodwill, nor were there any other events or circumstances which would change that conclusion through December 31, 2019.

### *Income Taxes*

Deferred income taxes are recognized for the tax consequences of temporary differences between financial statement carrying amounts and the tax bases of assets and liabilities. Deferred income taxes are provided on income and expense items when they are reported for financial statement purposes in periods different from the periods in which these items are recognized in the income tax returns. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based upon consideration of available evidence, including tax planning strategies and other factors.

The calculation of tax assets and liabilities is complex and requires the use of estimates and judgment since it involves the application of complex tax laws that are subject to different interpretations by us and the various tax authorities. These interpretations are subject to challenge by the tax authorities upon audit or to reinterpretation based on management's ongoing assessment of facts and evolving case law.

Periodically and in the ordinary course of business, we are involved in inquiries and reviews by tax authorities that normally require management to provide supplemental information to support certain tax positions we take in our tax returns. Uncertain tax positions are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are initially and subsequently measured as the largest amount of tax benefit or liability that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. For tax positions not meeting the "more likely than not" test, no tax benefit or liability is recorded. Management believes it has taken appropriate positions on its tax returns, although the ultimate outcome of any tax review cannot be predicted with certainty. No assurance can be given that the final outcome of these matters will not be different than what is reflected in the financial statements.

We recognize interest and penalties related to income tax matters in income tax expense.

### *Comprehensive Income*

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on AFS securities, are reported as a separate component of the equity section of the consolidated statements of financial condition, and, along with net income, are components of comprehensive income. The Company's sole component of accumulated other comprehensive loss is unrealized gains/losses on AFS securities.

### *Derivative Financial Instruments and Hedging*

We account for derivatives in accordance with FASB literature on accounting for derivative instruments and hedging activities. When we enter into a derivative contract, we designate the derivative as held for trading, an economic hedge, or a qualifying hedge as detailed in the literature. The designation may change based upon management's reassessment or changing circumstances. Derivatives utilized by the Company include interest rate lock commitments ("IRLC" or "IRLCs") and forward settlement contracts. IRLCs occur when we originate mortgage loans with interest rates determined prior to funding. Forward settlement contracts are agreements to buy or sell a quantity of a financial instrument, index, currency, or commodity at a predetermined future date, rate, or price.

We designate at inception whether a derivative contract is considered hedging or nonhedging. All of our derivatives are nonexchange traded contracts, and as such, their fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

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For qualifying hedges, we formally document at inception all relationships between hedging instruments and hedged items, as well as risk management objectives and strategies for undertaking various accounting hedges. We utilize derivatives to manage interest rate sensitivity in certain cases.

At December 31, 2019 and 2018, we did not have any designated hedges as we do not designate IRLCs or forward sales commitments on residential mortgage originations as hedges. We have elected the fair value option to record IRLCs and forward sales commitments on residential mortgage originations and recognize any related gains and losses in the Consolidated Statements of Income.

### *Impairment of Long-Lived Assets*

We continually monitor events and changes in circumstances that could indicate that our carrying amounts of long-lived assets, including intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through their undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets.

### *Transfers of Financial Assets*

Transfers of financial assets 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 the Company, (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) the Company does not maintain effective control over the transferred assets through a requirement to repurchase them before their maturity.

### *Advertising Costs*

We expense our advertising costs as incurred, except payments for major sponsorships which are amortized over an estimated life not to exceed one year. Advertising expenses were \$936,000 and \$1.0 million for the years ended December 31, 2019 and 2018, respectively.

## **Recent Accounting Pronouncements**

### *Pronouncements Adopted*

In February 2016, FASB issued Accounting Standards Update (“ASU”) 2016-02, *Leases*, which requires a lessee to recognize the assets and liabilities that arise from all leases with a term greater than 12 months. The core principle requires the lessee to recognize a liability to make lease payments and a right-of-use (“ROU”) asset. The accounting applied by the lessor is relatively unchanged. The ASU also requires expanded qualitative and quantitative disclosures. For public business entities, the guidance was effective for interim and annual reporting periods beginning after December 15, 2018 and mandated a modified retrospective transition for all entities. We adopted this standard using the option to apply the transition provisions of the new standard at the adoption date instead of the earliest period presented as provided in ASU 2018-11. Additionally, we elected to apply all practical expedients as provided in ASU 2016-02, with the exception of the hindsight practical expedient which was not elected. As a result of the adoption of this standard, effective January 1, 2019, we recognized both an ROU asset and a lease liability of \$2.7 million to be recorded in other assets and other liabilities, respectively, on the balance sheet. The original lease liability represented the present value of the future payments on five leased properties and six leased pieces of equipment within the Company’s footprint, while the ROU asset reflected the lease liability adjusted for deferred rent balances of the respective properties as of the adoption date of January 1, 2019.

In March 2017, FASB issued ASU No. 2017-08, *Receivables - Nonrefundable Fees and Other costs*, which provided guidance that called for the shortening of the amortization period for certain callable debt securities held at a premium. The standard was effective for interim and annual reporting periods beginning after December 15, 2018. The adoption of ASU No. 2017-08 did not have a material impact on our financial position, results of operations, or cash flows.



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In February 2018, FASB issued ASU No. 2018-02, *Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*, which allowed a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The ASU was effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The adoption of ASU No. 2018-02 did not have a material impact on its financial position, results of operations, or cash flows.

### *Pronouncements Issued*

In September 2016, FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses*, which sets forth a current expected credit loss (“CECL”) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU was originally effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. In July 2019, the FASB issued a proposal to delay the implementation for smaller reporting companies such as us until January 2023. In October, 2019, that proposal was finalized with the issuance of ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*. ASU 2019-05 was issued to address concerns with the adoption of ASU 2016-13. ASU 2019-05 gives entities the ability to irrevocably elect the fair value option in Subtopic 825-10 for certain existing financial assets upon transition to ASU 2016-03. Financial assets that are eligible for this fair value election are those that qualify under Subtopic 825-10 and are within the scope of Subtopic 326-10, *Financial Instruments - Credit Losses - Measured at Amortized Costs*. An exception to this is HTM debt securities, which do not qualify for this transition election. The effective date for the amendment is the same as the effective date in ASU 2016-03. In November 2019, FASB issued ASU 2019-10, *Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. ASU 2019-10 was issued to defer the effective dates for certain guidance for certain entities. The amendments in this update amend the mandatory effective dates for ASC 326, *Financial Instruments - Credit Losses*, for entities eligible to be smaller reporting companies as defined by the Securities and Exchange Commission for fiscal years beginning after December 15, 2022, including interim reporting periods within that reporting period.

We have contracted with a third party vendor to assist in the transition to CECL. The Bank has purchased the third party vendor’s CECL software and has separately contracted with their advisory services group to help with the installation and transition. As the Bank has been using other software of this specific vendor, they have access to the Bank’s historical data. The Bank has been updating the data and the process by which data will be transferred to the third party vendor, so that they have all of the information necessary for CECL calculations. This process is complete. The next stage in the process is to convert to the vendor’s incurred loss model, which must be completed prior to the final conversion to CECL. This process is almost complete. The third party vendor has also begun determining which economic factors are most directly responsible for Bank’s historical losses. They have also started to recommend pools to be used for CECL calculations, and appropriate methods (as proscribed by CECL) to calculate the reserve for the various pools. As the third party vendor has many financial institution clients, they will be able to provide peer group data to the extent the Bank’s data is not sufficient to make the many determinations required under CECL.

Although the implementation of CECL has been delayed, the Bank is continuing with the implementation at a pace to ensure that we will be in position to completely transition to CECL by the required date.

While we are currently in the process of evaluating the impact of the amended guidance on our Consolidated Financial Statements, it is quite possible that the Allowance will increase upon adoption given that the Allowance will be required to cover the full remaining expected life of the portfolio upon adoption, rather than the incurred loss model under current GAAP. The extent of this increase is still being evaluated and will depend on economic conditions and the composition of our loan and lease portfolio at the time of adoption.

In November 2019, FASB issued ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses*. ASU 2019-11 was issued to address issues raised by stakeholders during the implementation of ASU 2016-13. ASU 2019-11 provides transition relief when adjusting the effective interest rate for TDRs that exist as of the adoption date, extends the disclosure relief in ASU 2019-04 to disclose accrued interest receivable balances separately from the amortized cost basis to additional disclosures involving amortized cost basis, and provides clarification regarding application of the

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guidance in paragraph 326-20-35-6 for financial assets secured by collateral maintenance provisions that provides a practical expedient to measure the estimate of expected credit losses by comparing the amortized cost basis of a financial asset and the fair value of collateral securing the financial asset as of the reporting date. The effective date and transition requirements for the amendment are the same as the effective date and transition requirements in ASU 2016-13.

In December 2019, FASB issued ASU No. 2019-12, *Simplifying the Accounting for Taxes*, which simplifies the accounting for incomes taxes by removing certain exceptions in the current codification. The standard is effective for fiscal years beginning after December 15, 2020. The adoption of ASU No. 2019-12 is not expected to have a material impact on our financial position, results of operations, or cash flows.

In January 2020, FASB issued ASU No. 2020-01, *Investments – Equity securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)*, which clarifies the interaction between the three Topics. The standard is effective for fiscal years beginning after December 15, 2020. The adoption of ASU No. 2020-01 is not expected to have a material impact on our financial position, results of operations, or cash flows.

**Note 2 - Securities**

The amortized cost and estimated fair values of our AFS securities portfolio were as follows as of December 31, 2019:

	2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	<i>(dollars in thousands)</i>			
U.S. government agency notes	\$ 5,017	\$ 2	\$ —	\$ 5,019
Mortgage-backed securities	7,951	—	64	7,887
	<b>\$ 12,968</b>	<b>\$ 2</b>	<b>\$ 64</b>	<b>\$ 12,906</b>
	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	<i>(dollars in thousands)</i>			
U.S. Treasury securities	\$ 1,992	\$ —	\$ 11	\$ 1,981
U.S. government agency notes	10,086	—	89	9,997
	<b>\$ 12,078</b>	<b>\$ —</b>	<b>\$ 100</b>	<b>\$ 11,978</b>

The amortized cost and estimated fair values of our HTM securities portfolio were as follows as of December 31:

	2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	<i>(dollars in thousands)</i>			
U.S. Treasury securities	\$ 994	\$ 14	\$ —	\$ 1,008
U.S. government agency notes	4,986	100	5	5,081
Mortgage-backed securities	19,980	114	25	20,069
	<b>\$ 25,960</b>	<b>\$ 228</b>	<b>\$ 30</b>	<b>\$ 26,158</b>
	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	<i>(dollars in thousands)</i>			
U.S. Treasury securities	\$ 1,991	\$ 17	\$ —	\$ 2,008
U.S. government agency notes	11,992	45	92	11,945
Mortgage-backed securities	24,929	6	676	24,259
	<b>\$ 38,912</b>	<b>\$ 68</b>	<b>\$ 768</b>	<b>\$ 38,212</b>

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Gross unrealized losses and fair value by length of time that the individual AFS securities have been in an unrealized loss position at the dates indicated are presented in the following tables as of December 31:

	2019								
	Less than 12 months			12 months or more			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	<i>(dollars in thousands)</i>								
Mortgage-backed securities	7	\$ 7,887	\$ 64	—	\$ —	\$ —	7	\$ 7,887	\$ 64
	<u>7</u>	<u>\$ 7,887</u>	<u>\$ 64</u>	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>7</u>	<u>\$ 7,887</u>	<u>\$ 64</u>

	2018								
	Less than 12 months			12 months or more			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	<i>(dollars in thousands)</i>								
U.S. Treasury securities	1	\$ 990	\$ 5	1	\$ 991	\$ 6	2	\$ 1,981	\$ 11
U.S. government agency notes	—	—	—	8	9,997	89	8	9,997	89
	<u>1</u>	<u>\$ 990</u>	<u>\$ 5</u>	<u>9</u>	<u>\$ 10,988</u>	<u>\$ 95</u>	<u>10</u>	<u>\$ 11,978</u>	<u>\$ 100</u>

Gross unrealized losses and fair value by length of time that the individual HTM securities have been in an unrealized loss position at the dates indicated are presented in the following tables as of December 31:

	2019								
	Less than 12 months			12 months or more			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	<i>(dollars in thousands)</i>								
U.S. government agency notes	—	\$ —	\$ —	3	\$ 3,003	\$ 5	3	\$ 3,003	\$ 5
Mortgage-backed securities	2	2,544	17	2	1,238	8	4	3,782	25
	<u>2</u>	<u>\$ 2,544</u>	<u>\$ 17</u>	<u>5</u>	<u>\$ 4,241</u>	<u>\$ 13</u>	<u>7</u>	<u>\$ 6,785</u>	<u>\$ 30</u>

	2018								
	Less than 12 months			12 months or more			Total		
	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	<i>(dollars in thousands)</i>								
U.S. government agency notes	—	\$ —	\$ —	10	\$ 9,927	\$ 92	10	\$ 9,927	\$ 92
Mortgage-backed securities	—	—	—	18	24,011	676	18	24,011	676
	<u>—</u>	<u>\$ —</u>	<u>\$ —</u>	<u>28</u>	<u>\$ 33,938</u>	<u>\$ 768</u>	<u>28</u>	<u>\$ 33,938</u>	<u>\$ 768</u>

All of the securities that are currently in a gross unrealized loss position are so due to declines in fair values resulting from changes in interest rates or increased liquidity spreads since the time they were purchased. We have the intent and ability to hold these debt securities to maturity (including the AFS securities) and do not intend to sell, nor do we believe it will be more likely than not that we will be required to sell, any impaired securities prior to a recovery of amortized cost. We expect these securities will be repaid in full, with no losses realized. As such, management considers any impairment to be temporary.

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Contractual maturities of debt securities at December 31, 2019 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	AFS Securities		HTM Securities	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	<i>(dollars in thousands)</i>			
Due in one year or less	\$ 5,017	\$ 5,019	\$ 4,001	\$ 4,010
Due after one through five years	—	—	1,979	2,079
Mortgage-backed securities	7,951	7,887	19,980	20,069
	<b>\$ 12,968</b>	<b>\$ 12,906</b>	<b>\$ 25,960</b>	<b>\$ 26,158</b>

There were no securities pledged as collateral as of December 31, 2019 or 2018.

There were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity at either December 31, 2019 or 2018.

**Note 3 - Loans Receivable and Allowance for Loan Losses**

Loans receivable are summarized as follows at December 31:

	2019	2018
	<i>(dollars in thousands)</i>	
Residential mortgage	\$ 269,654	\$ 276,389
Commercial	43,127	35,884
Commercial real estate	229,257	244,088
Construction, land acquisition, and development	92,822	114,540
Home equity/2nds	12,031	13,386
Consumer	1,541	1,087
Total loans receivable	648,432	685,374
Unearned loan fees, net	(2,747)	(3,025)
<b>Loans receivable</b>	<b>\$ 645,685</b>	<b>\$ 682,349</b>

Certain loans in the amount of \$158.9 million have been pledged under a blanket floating lien to the FHLB as collateral against advances.

At December 31, 2019, the Bank was servicing \$25.9 million in loans for the Federal National Mortgage Association and \$13.0 million in loans for the Federal Home Loan Mortgage Corporation.

**Credit Quality**

An Allowance 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. Management has an established methodology to determine the adequacy of the Allowance that assesses the risks and losses inherent in the loan portfolio. The methodology takes 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 requires the use of estimates and assumptions. Actual results could differ significantly from those estimates. While management uses available information to estimate losses on loans, future additions to the Allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies periodically review the Allowance as an integral part of their examination process. Such agencies may require us to recognize additions to the Allowance based on their judgments about information available to them at the time of their examination. Management believes the Allowance is adequate as of both December 31, 2019 and 2018.

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At December 31, 2018, due to a reevaluation of its qualitative factors, the Company changed its estimates of the Allowance relative to historical loss experience within specific loan portfolio segments in order to better align its qualitative factors with historical losses experienced over a longer period of time, relative to those specific loan segments. The result of this change in estimate did not result in a material increase in the Allowance compared to the year ended December 31, 2017, however there were material changes to the Allowance between loan segments. Due to the change in accounting estimate, Allowance allocated to commercial loans and ADC loans increased approximately \$2.2 and \$1.1 million, respectively, while Allowance allocated to residential mortgage loans and commercial real estate loans decreased \$600,000 and \$2.7 million, respectively, as of December 31, 2018. This change in accounting estimate had no impact on earnings or diluted earnings per share.

For purposes of determining the Allowance, we have segmented our loan portfolio by product type. Our portfolio loan segments are residential mortgage, commercial, commercial real estate, ADC, home equity/2nds, and consumer. We have looked at all segments and have determined that no additional subcategorization is warranted based upon our credit review methodology and our portfolio classes are the same as our portfolio segments.

### *Inherent Credit Risks*

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

Residential mortgage - 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 LTV of 80% or less.

Commercial - underwritten in accordance with our policies and include evaluating historical and projected profitability and cash flow to determine the borrower's ability to repay the obligation as agreed. Commercial loans are made primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral supporting the loan. Accordingly, the repayment of a commercial 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.

Commercial lines of credit are subject to the underwriting standards and processes similar to commercial 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 - subject to the underwriting standards and processes similar to commercial loans and lines of credit, 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.

ADC - underwritten in accordance with our underwriting policies which include a financial analysis of the developers, property owners, construction cost estimates, and independent appraisal valuations. These loans will rely on the value associated with the project upon completion. 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. Additionally, land is underwritten according to our policies which include independent appraisal valuations as well as the estimated value associated with the land upon completion of development. Any or all of these costs and valuation estimates could be inaccurate.

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

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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.

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.

Home equity/2nds - subject to the underwriting standards and processes similar to residential mortgages and are secured by one to four family dwelling units. Home equity/2nds loans have greater risk than residential mortgages as a result of the Bank generally being in a junior lien position.

Consumer - 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 lower value of the underlying collateral, if any.

The following tables present, by portfolio segment, the changes in the Allowance and the recorded investment in loans as of and for the years ended December 31:

	2019							Total
	Residential Mortgage	Commercial	Commercial Real Estate	ADC <i>(dollars in thousands)</i>	Home Equity/2nds	Consumer	Unallocated	
<b>Beginning Balance</b>	\$ 2,224	\$ 2,736	\$ 457	\$ 2,239	\$ 222	\$ 1	\$ 165	\$ 8,044
Charge-offs	(20)	—	(537)	—	—	(14)	—	(571)
Recoveries	14	—	130	5	11	5	—	165
Net (charge-offs) recoveries	(6)	—	(407)	5	11	(9)	—	(406)
Provision for (reversal of) loan losses	46	(1,315)	934	42	(99)	8	(116)	(500)
<b>Ending Balance</b>	<b>\$ 2,264</b>	<b>\$ 1,421</b>	<b>\$ 984</b>	<b>\$ 2,286</b>	<b>\$ 134</b>	<b>\$ —</b>	<b>\$ 49</b>	<b>\$ 7,138</b>
Ending balance - individually evaluated for impairment	\$ 752	\$ —	\$ 64	\$ 32	\$ 2	\$ —	\$ —	\$ 850
Ending balance - collectively evaluated for impairment	1,512	1,421	920	2,254	132	—	49	6,288
	<b>\$ 2,264</b>	<b>\$ 1,421</b>	<b>\$ 984</b>	<b>\$ 2,286</b>	<b>\$ 134</b>	<b>\$ —</b>	<b>\$ 49</b>	<b>\$ 7,138</b>
Ending loan balance - individually evaluated for impairment	\$ 11,517	\$ —	\$ 1,221	\$ 880	\$ 563	\$ 69		\$ 14,250
Ending loan balance - collectively evaluated for impairment	256,635	43,127	226,791	91,942	11,468	1,472		631,435
	<b>\$ 268,152</b>	<b>\$ 43,127</b>	<b>\$ 228,012</b>	<b>\$ 92,822</b>	<b>\$ 12,031</b>	<b>\$ 1,541</b>		<b>\$ 645,685</b>

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	2018							
	Residential Mortgage	Commercial	Commercial Real Estate	ADC	Home Equity/2nds	Consumer	Unallocated	Total
	<i>(dollars in thousands)</i>							
<b>Beginning Balance</b>	\$ 3,099	\$ 527	\$ 2,805	\$ 1,236	\$ 386	\$ 2	\$ —	\$ 8,055
Charge-offs	(534)	—	(38)	(34)	—	—	—	(606)
Recoveries	228	—	424	—	243	—	—	895
Net (charge-offs) recoveries	(306)	—	386	(34)	243	—	—	289
(Reversal of) provision for loan losses	(569)	2,209	(2,734)	1,037	(407)	(1)	165	(300)
<b>Ending Balance</b>	<b>\$ 2,224</b>	<b>\$ 2,736</b>	<b>\$ 457</b>	<b>\$ 2,239</b>	<b>\$ 222</b>	<b>\$ 1</b>	<b>\$ 165</b>	<b>\$ 8,044</b>
Ending balance - individually evaluated for impairment	\$ 927	\$ 430	\$ 142	\$ 32	\$ 2	\$ —	\$ —	\$ 1,533
Ending balance - collectively evaluated for impairment	1,297	2,306	315	2,207	220	1	165	6,511
	<b>\$ 2,224</b>	<b>\$ 2,736</b>	<b>\$ 457</b>	<b>\$ 2,239</b>	<b>\$ 222</b>	<b>\$ 1</b>	<b>\$ 165</b>	<b>\$ 8,044</b>
Ending loan balance - individually evaluated for impairment	\$ 12,579	\$ 430	\$ 1,992	\$ 1,278	\$ 871	\$ 76		\$ 17,226
Ending loan balance - collectively evaluated for impairment	262,180	35,454	240,701	113,262	12,515	1,011		665,123
	<b>\$ 274,759</b>	<b>\$ 35,884</b>	<b>\$ 242,693</b>	<b>\$ 114,540</b>	<b>\$ 13,386</b>	<b>\$ 1,087</b>		<b>\$ 682,349</b>

The following tables present the credit quality breakdown of our loan portfolio by class as of December 31:

	2019			
	Pass	Special Mention	Substandard	Total
	<i>(dollars in thousands)</i>			
Residential mortgage	\$ 264,008	\$ —	\$ 4,144	\$ 268,152
Commercial	41,927	1,200	—	43,127
Commercial real estate	224,118	2,835	1,059	228,012
ADC	92,304	—	518	92,822
Home equity/2nds	11,490	402	139	12,031
Consumer	1,541	—	—	1,541
	<b>\$ 635,388</b>	<b>\$ 4,437</b>	<b>\$ 5,860</b>	<b>\$ 645,685</b>

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	2018			
	Pass	Special Mention	Substandard	Total
	<i>(dollars in thousands)</i>			
Residential mortgage	\$ 270,727	\$ 827	\$ 3,205	\$ 274,759
Commercial	35,435	19	430	35,884
Commercial real estate	237,387	3,523	1,783	242,693
ADC	113,072	—	1,468	114,540
Home equity/2nds	12,536	434	416	13,386
Consumer	1,087	—	—	1,087
	<b>\$ 670,244</b>	<b>\$ 4,803</b>	<b>\$ 7,302</b>	<b>\$ 682,349</b>

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due.

The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31:

	2019						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total	Non- Accrual
	<i>(dollars in thousands)</i>						
Residential mortgage	\$ 3,183	\$ 81	\$ 2,200	\$ 5,464	\$ 262,688	\$ 268,152	\$ 3,766
Commercial	—	—	—	—	43,127	43,127	—
Commercial real estate	—	—	126	126	227,886	228,012	237
ADC	—	89	—	89	92,733	92,822	89
Home equity/2nds	—	—	139	139	11,892	12,031	150
Consumer	—	15	—	15	1,526	1,541	—
	<b>\$ 3,183</b>	<b>\$ 185</b>	<b>\$ 2,465</b>	<b>\$ 5,833</b>	<b>\$ 639,852</b>	<b>\$ 645,685</b>	<b>\$ 4,242</b>

	2018						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total	Non- Accrual
	<i>(dollars in thousands)</i>						
Residential mortgage	\$ 1,060	\$ —	\$ 1,794	\$ 2,854	\$ 271,905	\$ 274,759	\$ 2,580
Commercial	—	—	430	430	35,454	35,884	430
Commercial real estate	137	—	660	797	241,896	242,693	660
ADC	255	—	387	642	113,898	114,540	558
Home equity/2nds	96	—	428	524	12,862	13,386	428
Consumer	13	—	—	13	1,074	1,087	—
	<b>\$ 1,561</b>	<b>\$ —</b>	<b>\$ 3,699</b>	<b>\$ 5,260</b>	<b>\$ 677,089</b>	<b>\$ 682,349</b>	<b>\$ 4,656</b>

We did not have any loans greater than 90 days past due and still accruing as of December 31, 2019 or 2018.

The interest which would have been recorded on the above nonaccrual loans if those loans had been performing in accordance with their contractual terms was approximately \$537,000 and \$716,000 for the years ended December 31, 2019 and 2018, respectively. The actual interest income recorded on those loans was approximately \$184,000 and \$273,000 for the years ended December 31, 2019 and 2018, respectively.



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The following tables summarize impaired loans as of and for the years ended December 31:

	2019			2018		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Unpaid Principal Balance	Recorded Investment	Related Allowance
With no related Allowance:	<i>(dollars in thousands)</i>					
Residential mortgage	\$ 7,258	\$ 7,035	\$ —	\$ 7,054	\$ 6,808	\$ —
Commercial	—	—	—	—	—	—
Commercial real estate	908	668	—	1,244	1,206	—
ADC	752	752	—	1,142	1,143	—
Home equity/2nds	996	553	—	1,290	859	—
Consumer	69	69	—	76	76	—
With a related Allowance:						
Residential mortgage	4,604	4,482	752	5,888	5,771	927
Commercial	—	—	—	476	430	430
Commercial real estate	553	553	64	795	786	142
ADC	128	128	32	135	135	32
Home equity/2nds	12	10	2	13	12	2
Consumer	—	—	—	—	—	—
<b>Totals:</b>						
<b>Residential mortgage</b>	<b>11,862</b>	<b>11,517</b>	<b>752</b>	<b>12,942</b>	<b>12,579</b>	<b>927</b>
<b>Commercial</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>476</b>	<b>430</b>	<b>430</b>
<b>Commercial real estate</b>	<b>1,461</b>	<b>1,221</b>	<b>64</b>	<b>2,039</b>	<b>1,992</b>	<b>142</b>
<b>ADC</b>	<b>880</b>	<b>880</b>	<b>32</b>	<b>1,277</b>	<b>1,278</b>	<b>32</b>
<b>Home equity/2nds</b>	<b>1,008</b>	<b>563</b>	<b>2</b>	<b>1,303</b>	<b>871</b>	<b>2</b>
<b>Consumer</b>	<b>69</b>	<b>69</b>	<b>—</b>	<b>76</b>	<b>76</b>	<b>—</b>

	2019		2018	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related Allowance:	<i>(dollars in thousands)</i>			
Residential mortgage	\$ 6,844	\$ 318	\$ 9,232	\$ 344
Commercial	—	—	47	30
Commercial real estate	1,105	63	1,223	52
ADC	891	36	542	52
Home equity/2nds	730	28	570	42
Consumer	73	5	80	2
With a related Allowance:				
Residential mortgage	5,322	259	6,673	288
Commercial	86	—	86	71
Commercial real estate	639	33	1,151	26
ADC	132	8	909	8
Home equity/2nds	16	1	7	1
Consumer	—	—	—	—
<b>Totals:</b>				
<b>Residential mortgage</b>	<b>12,166</b>	<b>577</b>	<b>15,905</b>	<b>632</b>
<b>Commercial</b>	<b>86</b>	<b>—</b>	<b>133</b>	<b>101</b>
<b>Commercial real estate</b>	<b>1,744</b>	<b>96</b>	<b>2,374</b>	<b>78</b>
<b>ADC</b>	<b>1,023</b>	<b>44</b>	<b>1,451</b>	<b>60</b>
<b>Home equity/2nds</b>	<b>746</b>	<b>29</b>	<b>577</b>	<b>43</b>
<b>Consumer</b>	<b>73</b>	<b>5</b>	<b>80</b>	<b>2</b>

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There were \$1.4 million in consumer mortgage properties included in real estate acquired through foreclosure at both December 31, 2019 and 2018. 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 \$2.3 million as of December 31, 2019.

**TDRs**

There were no loans modified during the year ended December 31, 2019 that were deemed to be TDRs.

The following table presents loans that were modified (as TDRs) during the year ended December 31, 2018:

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
	<i>(dollars in thousands)</i>		
Residential Mortgage	1	\$ 127	\$ 127
	<b>1</b>	<b>\$ 127</b>	<b>\$ 127</b>

Interest on our portfolio of TDRs was accounted for under the following methods as of December 31:

	2019					
	Number of Modifications	Accrual Status	Number of Modifications	Nonaccrual Status	Total Number of Modifications	Total Balance of Modifications
	<i>(dollars in thousands)</i>					
Residential mortgage	31	\$ 7,675	1	\$ 85	32	\$ 7,760
Commercial real estate	2	984	—	—	2	984
ADC	1	130	—	—	1	130
Consumer	2	69	—	—	2	69
	<b>36</b>	<b>\$ 8,858</b>	<b>1</b>	<b>\$ 85</b>	<b>37</b>	<b>\$ 8,943</b>

	2018					
	Number of Modifications	Accrual Status	Number of Modifications	Nonaccrual Status	Total Number of Modifications	Total Balance of Modifications
	<i>(dollars in thousands)</i>					
Residential mortgage	36	\$ 9,469	3	\$ 446	39	\$ 9,915
Commercial real estate	2	1,019	—	—	2	1,019
ADC	1	134	—	—	1	134
Consumer	3	76	—	—	3	76
	<b>42</b>	<b>\$ 10,698</b>	<b>3</b>	<b>\$ 446</b>	<b>45</b>	<b>\$ 11,144</b>

During 2019 and 2018, there were no TDRs that subsequently defaulted during the 12 month period ended December 31, 2019 and 2018.

**Note 4 - Premises and Equipment**

Premises and equipment are summarized by major classification as follows at December 31:

	<b>2019</b>	<b>2018</b>
	<i>(dollars in thousands)</i>	
Land	\$ 1,537	\$ 1,537
Building	29,834	29,755
Leasehold improvements	3,015	2,792
Furniture, fixtures, and equipment	3,718	3,178
Total, at cost	38,104	37,262
Less: Accumulated depreciation and amortization	(15,960)	(14,517)
<b>Net premises and equipment</b>	<b>\$ 22,144</b>	<b>\$ 22,745</b>

Depreciation expense was \$1.4 million and \$1.3 million for the years ended December 31, 2019 and 2018, respectively.

**Leases**

A lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment for a period of time in exchange for consideration. On January 1, 2019, we adopted ASU No. 2016-02 "Leases" ("Topic 842") and all subsequent ASUs that modified Topic 842. For us, Topic 842 primarily affected the accounting treatment for operating lease agreements in which we are the lessee.

Substantially all of the leases in which we are the lessee are comprised of real estate property for branches, ATM locations, office equipment, and office space with terms extending through 2035. All of our leases are classified as operating leases, and therefore, were previously not recognized on the our Consolidated Statements of Financial Condition. With the adoption of Topic 842, operating lease agreements are required to be recognized on the Consolidated Statements of Financial Condition as an ROU asset and a corresponding lease liability.

The following table represents the Consolidated Statements of Financial Condition classification of our ROU assets and lease liabilities, included in other assets and other liabilities, respectively, as of December 31, 2019. We elected not to include short-term leases (i.e., leases with initial terms of twelve months or less) on the Consolidated Statements of Financial Condition.

	<i>(in thousands)</i>
Lease ROU assets	\$ 2,538
Lease liabilities	2,597

The calculated amount of the ROU assets and lease liabilities in the table above are impacted by the length of the lease term and the discount rate used to present value the minimum lease payments. Our lease agreements often include one or more options to renew at our discretion. If at lease inception, we consider the exercising of a renewal option to be reasonably certain we will include the extended term in the calculation of the ROU asset and lease liability. Regarding the discount rate, Topic 842 requires the use of the rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, we utilize our incremental borrowing rate at lease inception over a similar term. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used. The weighted-average remaining lease term was 11.2 years and the weighted-average discount rate was 3.17% as of December 31, 2019.

The following table represents lease costs and other lease information for the year ended December 31, 2019. As we elected, for all classes of underlying assets, not to separate lease and non-lease components and instead to account for them as a single lease component, the variable lease cost primarily represents variable payments such as common area maintenance and utilities. Variable lease cost also includes payments for ATM location leases in which payments are based on a percentage of ATM transactions (i.e., ATM surcharge fees), rather than a fixed amount.

*(in thousands)*

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Operating lease costs	\$	433
Variable lease cost		—
<b>Total lease cost</b>	<b>\$</b>	<b>433</b>

Cash paid on operating lease liabilities amounted to \$321,000 for the year ended December 31, 2019.

Total rent expense for all real property leases amounted to \$321,000 for the year ended December 31, 2018.

Future minimum payments for finance leases and operating leases with initial or remaining terms of one year or more were as follows as of December 31, 2019:

<b>Lease payments due in years ended December 31:</b>	<i>(in thousands)</i>	
2020	\$	357
2021		348
2022		346
2023		288
2024		259
Thereafter		1,572
Total future minimum lease payments		3,170
Amounts representing interest		(573)
<b>Present value of net future minimum lease payments</b>	<b>\$</b>	<b>2,597</b>

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 the Company and the Bank is a partner. Total gross rental income included in occupancy expense on the Consolidated Statements of Income was approximately \$945,000 and \$1.0 million for the years ended December 31, 2019 and 2018, respectively.

Our minimum future annual rental income on such leases is as follows as of December 31, 2019:

<b>Years Ended December 31,</b>	<i>(in thousands)</i>	
2020	\$	708
2021		712
2022		470
2023		442
2024		201
Thereafter		52
	<b>\$</b>	<b>2,585</b>

**Note 5 - Goodwill and Other Intangible Assets**

We held \$1.1 million in goodwill at both December 31, 2019 and 2018. The goodwill relates to the acquisition of Louis Hyatt, Inc. and the Title Company. During 2018, we reached the end of the period for determination of the goodwill for the Title Company.

No impairment charge was required in either 2019 or 2018.

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**Note 6 - Deposits**

Deposits are summarized as follows as of December 31:

	2019		2018	
	<i>(dollars in thousands)</i>			
NOW	\$ 83,612	12.6 %	\$ 106,508	13.7 %
Money market	162,621	24.6 %	203,351	26.1 %
Savings	61,514	9.3 %	75,692	9.7 %
Certificates of deposit	230,401	34.9 %	247,351	31.7 %
Total interest-bearing deposits	538,148	81.4 %	632,902	81.2 %
Noninterest-bearing deposits	122,901	18.6 %	146,604	18.8 %
<b>Total deposits</b>	<b>\$ 661,049</b>	<b>100.0 %</b>	<b>\$ 779,506</b>	<b>100.0 %</b>

Scheduled maturities of certificates of deposit were as follows as of December 31:

	2019		2018	
	<i>(dollars in thousands)</i>			
One year or less	\$ 126,156		\$ 126,980	
Greater than one year to two years	57,310		62,040	
Greater than two years to three years	34,278		38,140	
Greater than three years to four years	5,078		16,942	
Greater than four years to five years	7,579		3,249	
	<b>\$ 230,401</b>		<b>\$ 247,351</b>	

Certificates of deposit of \$250,000 or more totaled \$31.2 million and \$46.4 million as of December 31, 2019 and 2018, respectively. We held \$2.7 million and \$10.2 million in brokered certificates of deposit at December 31, 2019 and 2018, respectively.

**Note 7 - Borrowings**

Our borrowings consist of advances from the FHLB and a term loan from a commercial bank. The FHLB advances are available under a specific collateral pledge and security agreement, which requires that we maintain collateral for all of our borrowings equal to 30% of total assets. Our advances from the FHLB may be in the form of short-term or long-term obligations. Short-term advances have maturities of one year or less and may contain prepayment penalties. Long-term borrowings through the FHLB have original maturities up to 20 years and generally contain prepayment penalties. As of December 31, 2019, our total credit line with the FHLB was \$246.7 million, with outstanding balances of \$35.0 million and \$70.0 million at December 31, 2019 and 2018, respectively.

On September 30, 2016, we entered into a loan agreement with a commercial bank whereby we borrowed \$3.5 million for a term of eight years. The unsecured note bore interest at a fixed rate of 4.25% for the first 36 months then converted to a floating rate of the Wall Street Journal Prime plus 50 basis points for the remaining five years. Repayment terms were monthly interest only payments for the first 36 months, then quarterly principal payments of \$175,000 plus interest. During the fourth quarter of 2019, we repaid the loan without penalty.

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Certain information regarding our borrowings is as follows as of December 31:

	2019	2018
<b>Amount outstanding at year-end:</b>	<i>(dollars in thousands)</i>	
FHLB advances	\$ 35,000	\$ 70,000
Commercial note payable	—	3,500
<b>Weighted-average interest rate at year-end:</b>		
FHLB advances	1.92 %	2.27 %
Commercial note payable	— %	4.25 %
<b>Maximum outstanding at any month-end:</b>		
FHLB advances	\$ 70,000	\$ 96,000
Commercial note payable	3,500	3,500
<b>Average outstanding:</b>		
FHLB advances	\$ 50,897	\$ 87,669
Commercial note payable	3,433	3,500
<b>Weighted-average interest rate during the year:</b>		
FHLB advances	1.74 %	2.17 %
Commercial note payable	4.20 %	5.04 %

The following table sets forth information concerning the interest rates and maturity dates of the advances from the FHLB as of December 31, 2019:

Principal Amount <i>(in thousands)</i>	Rate	Maturity
\$ 25,000	1.75% to 1.92%	2020
10,000	2.19%	2022
<b>\$ 35,000</b>		

Certain loans in the amount of \$158.9 million have been pledged under a blanket floating lien to the FHLB as collateral against advances.

**Note 8 - Subordinated Debentures**

As of December 31, 2019 and 2018, the Company had outstanding \$20.6 million in principal amount of Junior Subordinated Debt Securities, due in 2035 (the “2035 Debentures”). The 2035 Debentures were issued pursuant to an Indenture dated as of December 17, 2004 (the “2035 Indenture”) between the Company and Wells Fargo Bank, National Association as Trustee. The 2035 Debentures pay interest quarterly at a floating rate of interest of 3-month LIBOR 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 the Company, as defined in the 2035 Indenture. The 2035 Debentures became redeemable, in whole or in part, by the Company 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 the Company. 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. We have 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 Debentures, we are 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, 2019, we were current on all interest due on the 2035 Debentures.

#### **Note 9 - 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 matches 50% of the first 6% of an employee's contribution. All employees who have completed one year of service with the Bank are eligible to participate in the company match. The Bank's contributions to this plan were \$285,000 and \$214,000 for the years ended December 31, 2019 and 2018, respectively.

The Bank has an Employee Stock Ownership Plan ("ESOP") for the exclusive benefit of participating employees. The Bank recognized ESOP expense of \$134,000 and \$129,000 for the years ended December 31, 2019 and 2018, respectively. The plan had allocated shares totaling 492,029 and 518,654, respectively, and had unallocated shares to participants in the plan totaling 47,380 shares and 2,000 shares, respectively, as of December 31, 2019 and 2018. The fair value of the unallocated shares at December 31, 2019 was approximately \$441,108.

#### **Note 10 - Regulatory Matters**

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

In July 2013, federal bank regulatory agencies issued final rules to revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act ("Basel III"). On January 1, 2015, the Basel III rules became effective and included transition provisions which implement certain portions of the rules through January 1, 2019. Under the final rules, the effects of certain accumulated other comprehensive income items are not excluded, however, banking organizations like us that are not considered "advanced approaches" banking organizations may make a one-time permanent election to continue to exclude these items. With the submission of the Call Report for the first quarter of 2015, we made this election in order to avoid significant variations in the level of capital that can be caused by interest rate fluctuations on the fair value of the Bank's AFS securities portfolio.

The Basel III rules also establish a "capital conservation buffer" of 2.5% above the regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses to executive officers if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

As a result of the Economic Growth, Regulatory Relief, and Consumer Protection Act, the federal banking agencies have developed a "Community Bank Leverage Ratio" (the ratio of a bank's tier 1 capital to average quarterly assets) for financial institutions with assets of less than \$10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies have set the Community Bank Leverage Ratio at 9%. A financial institution can elect to be subject to this new definition. The new rule will take effect on January 1, 2020.

As of the date of the last regulatory exam, the Bank was considered "well capitalized" and as of December 31, 2019, the Bank continued to meet the requirements to be considered "well capitalized" based on applicable U.S. regulatory capital ratio requirements.

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Our regulatory capital amounts and ratios were as follows:

	Actual Amount	Ratio	Minimum Requirements for Capital Adequacy Purposes		Minimum Requirements with Capital Conservation Buffer		To be Well Capitalized Under Prompt Corrective Action Provision	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2019</b>								
<i>(dollars in thousands)</i>								
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 117,492	18.5 %	\$ 28,617	4.5 %	\$ 44,515	7.0 %	\$ 41,336	6.5 %
Total capital (to risk-weighted assets)	124,619	19.6 %	50,875	8.0 %	66,773	10.5 %	63,593	10.0 %
Tier 1 capital (to risk-weighted assets)	117,492	18.5 %	38,156	6.0 %	54,054	8.5 %	50,875	8.0 %
Tier 1 capital (to average quarterly assets)	117,492	13.4 %	34,995	4.0 %	56,867	6.5 %	43,744	5.0 %
<b>December 31, 2018</b>								
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 114,749	17.4 %	\$ 29,651	4.5 %	\$ 42,006	6.4 %	\$ 42,830	6.5 %
Total capital (to risk-weighted assets)	122,889	18.7 %	52,713	8.0 %	65,068	9.9 %	65,892	10.0 %
Tier 1 capital (to risk-weighted assets)	114,749	17.4 %	39,535	6.0 %	51,890	7.9 %	52,713	8.0 %
Tier 1 capital (to average quarterly assets)	114,749	13.5 %	33,932	4.0 %	49,838	5.9 %	42,415	5.0 %

**Note 11 - Stockholders' Equity**

**Series A Preferred Stock**

On November 15, 2008, the Company 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 the Company's Series A 8.0% Non-Cumulative Convertible Preferred Stock. On March 13, 2018, the Company notified holders of its Series A preferred stock that the Company had exercised its option to convert each of the 437,500 outstanding shares of Series A preferred stock for one share of common stock and converted such shares on April 2, 2018. As of that date, the Series A preferred stock was no longer deemed outstanding and all rights with respect to such stock ceased and terminated.

**Dividend Restrictions**

The Company's ability to declare dividends on its common stock was previously limited by the terms of the Company's Series A Preferred Stock. As of December 31, 2018, those restrictions had been removed. In 2019, we paid dividends of \$1.8 million (\$0.14 per share) to common stockholders.

**Note 12 - Earnings Per Share**

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding for each period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options, warrants, and convertible preferred stock, and are determined using the treasury stock method. There were no anti-dilutive shares for either year ended December 31, 2019 or 2018.



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Information relating to the calculations of our income per common share is summarized as follows for the years ended December 31:

	2019	2018
	<i>(dollars in thousands, except for per share data)</i>	
Weighted-average shares outstanding - basic	12,780,980	12,585,961
Dilution	74,371	111,659
<b>Weighted-average share outstanding - diluted</b>	<b>12,855,351</b>	<b>12,697,620</b>
<b>Net income available to common stockholders</b>	<b>\$ 8,374</b>	<b>\$ 8,499</b>
<b>Net income per share - basic</b>	<b>\$ 0.66</b>	<b>\$ 0.68</b>
<b>Net income per share - diluted</b>	<b>\$ 0.65</b>	<b>\$ 0.67</b>

**Note 13 - Stock-Based Compensation**

We have maintained a stock-based compensation plan for directors, officers, and other key employees of the Company. The aggregate number of shares of common stock that could be issued with respect to the awards granted under the 2008 plan was 500,000 plus any shares forfeited under the Company's old stock-based compensation plan. Under the terms of the 2008 stock-based compensation plan, the Company had the ability to grant various stock compensation incentives, including stock options, stock appreciation rights, and restricted stock. The 2008 stock-based compensation was granted under terms and conditions determined by the Compensation Committee of the Board of Directors. Under the 2008 stock-based compensation plan, stock options generally had a maximum term of ten years, and were granted with an exercise price at least equal to the fair market value of the common stock on the date the options were granted. Generally, options granted to directors, officers, and employees of the Company vested over a five-year period, although the Compensation Committee had the authority to provide for different vesting schedules. The ability to grant new options from the 2008 plan expired in March of 2018. The 2019 Equity Incentive Plan, with similar provisions as the 2008 plan and 500,000 shares available for grant was approved at the stockholders' meeting in May of 2019. No shares have been granted from this plan as of December 31, 2019.

We account for stock-based compensation in accordance with FASB ASC Topic 718, *Compensation – Stock Compensation*, which requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the Consolidated Statements of Income at fair value. Additionally, we are required 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 Income for the years ended December 31, 2019 and 2018 totaled \$146,000 and \$218,000, respectively.

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Information regarding our stock-based compensation plan is as follows as of and for the years ended December 31:

	2019				2018			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
<b>Outstanding at beginning of period</b>	<b>349,023</b>	<b>\$ 6.32</b>			<b>434,025</b>	<b>\$ 5.87</b>		
Granted	—	—			6,500	7.41		
Exercised	(51,350)	5.08			(88,652)	4.21		
Forfeited	(63,500)	6.32			(2,850)	5.89		
<b>Outstanding at end of period</b>	<b>234,173</b>	<b>\$ 6.60</b>	<b>2.8</b>	<b>\$ 635</b>	<b>349,023</b>	<b>\$ 6.32</b>	<b>3.4</b>	<b>\$ 578</b>
<b>Exercisable at end of period</b>	<b>148,215</b>	<b>\$ 6.35</b>	<b>2.4</b>	<b>\$ 438</b>	<b>179,379</b>	<b>\$ 5.75</b>	<b>2.6</b>	<b>\$ 399</b>

The cash received from the exercise of stock options during 2019 and 2018 was \$260,000 and \$374,000, respectively.

The stock-based compensation expense amounts and fair values of options at the time of the grants were derived using the Black-Scholes option-pricing model. The following weighted average assumptions were used to value options granted for the year ended December 31, 2018. There were no options granted in 2019.

Expected life	5.5 years
Risk-free interest rate	2.67 %
Expected volatility	32.20 %
Expected dividend yield	—
Weighted average per share fair value of options granted	\$ 2.57

The expected life is based on the vesting period and the expiration date of the option 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 the Company over a five year period. The expected dividend yield was based on the Company's prior policy of not paying a common stock dividend. The grant that occurred in 2018 was prior to any dividend declaration and therefore, did not contain an expected dividend yield component in the fair value calculation. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

As of December 31, 2019, there was \$254,000 of total unrecognized stock-based compensation expense related to nonvested stock options, which is expected to be recognized over a period of 38 months.

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**Note 14 – Other Noninterest Expense**

The breakout of our other noninterest expenses is as follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
Directors fees	\$ 253	\$ 246
Stock expense	198	143
Insurance	252	238
Dues and subscriptions	134	141
OCC assessments	211	206
Recruiting	233	159
Contributions	221	198
Other	466	688
<b>Total other noninterest expense</b>	<b>\$ 1,968</b>	<b>\$ 2,019</b>

**Note 15 - Income Taxes**

Our income tax expense consists of the following for the years ended December 31:

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
Current	\$ 2,632	\$ 25
Deferred	604	2,952
<b>Income tax expense</b>	<b>\$ 3,236</b>	<b>\$ 2,977</b>

The income tax expense is reconciled to the amount computed by applying the federal corporate tax rates of 21% to the net income before taxes as follows for the years ended December 31:

	<u>2019</u>		<u>2018</u>	
	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
	<i>(dollars in thousands)</i>			
Tax at statutory federal rate	\$ 2,438	21.0 %	\$ 2,425	21.0 %
State tax net of Federal income tax benefit	744	6.4 %	685	5.9 %
Other adjustments	54	0.5 %	(133)	(1.1)%
	<b>\$ 3,236</b>	<b>27.9 %</b>	<b>\$ 2,977</b>	<b>25.8 %</b>

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The tax effects of temporary differences between the financial reporting basis and income tax basis of assets and liabilities relate to the following at December 31:

	2019	2018
<b>Deferred tax assets:</b>		
	<i>(dollars in thousands)</i>	
Net operating loss carryforward	\$ 891	\$ 972
Allowance	2,492	2,710
Reserve on real estate acquired through foreclosure	45	—
Reserve for uncollected interest	58	192
Reserve for contingent liability	7	47
Charitable contributions	—	174
Unrealized losses on AFS securities	17	28
AMT	93	185
Total gross deferred tax assets	3,603	4,308
<b>Deferred tax liabilities:</b>		
FHLB stock dividends	57	57
Loan origination costs	580	734
Accelerated depreciation	896	817
Prepaid expenses	185	186
MSRs	89	120
Reserve on real estate acquired through foreclosure	—	3
Other	48	28
Total gross deferred tax liabilities	1,855	1,945
<b>Net deferred tax assets</b>	<b>\$ 1,748</b>	<b>\$ 2,363</b>

At December 31, 2019, state net operating losses totaled \$13.7 million and expire at various times from 2023 through 2033.

In assessing the realizability of federal or state deferred tax assets at December 31, 2019, management considered 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 considered 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. Given the consistent earnings and improving asset quality, the Company's analysis concluded that, as of December 31, 2019, it was more likely than not that it will generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset. The Company 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 the Company's federal consolidated tax returns remains open for tax years 2016 through 2019.

Our income tax returns are subject to review and examination by federal and state taxing authorities. We are no longer subject to examination by federal tax authorities for the years ended before 2015. The years open to examination by state taxing authorities vary by jurisdiction.

**Note 16 - Commitments and Contingencies**

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 we have in each class of financial instruments.

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Our exposure to credit loss from nonperformance by the other party to the above mentioned financial instruments is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments. Unless otherwise noted, we require collateral or other security to support financial instruments with off-balance sheet credit risk.

The following table shows the contract amounts for our off-balance sheet instruments as of December 31:

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
Standby letters of credit	\$ 3,325	\$ 3,321
Home equity lines of credit	16,917	17,015
Unadvanced construction commitments	79,378	75,326
Mortgage loan commitments	701	1,649
Lines of credit	16,501	20,990
Loans sold and serviced with limited repurchase provisions	76,536	49,623

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 and are limited to real estate transactions. The majority of these standby letters of credit expire within 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 amount of the liability as of December 31, 2019 and 2018 for guarantees under standby letters of credit issued was \$14,000 and \$42,000, 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. We evaluate each customer's credit worthiness on a case-by-case basis.

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

Mortgage loan commitments not reflected in the accompanying statements of financial condition at December 31, 2019 included three loans totaling \$701,000. At December 31, 2018, such commitments included three loans totaling \$1.6 million.

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. 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. There were no repurchases during the year ended December 31, 2019 or 2018.

The Company provides banking services to customers who do business in the medical-use cannabis industry. While the growing, processing, and sales of medical-use cannabis is legal in the state of Maryland, the business currently violates Federal law. The Company may be deemed to be aiding and abetting illegal activities through the services that it provides to these customers. The strict enforcement of Federal laws regarding medical-use cannabis would likely result in the Company's inability to continue to provide banking services to these customers and the Company could have legal action taken against it by the Federal government, including imprisonment and fines. There is an uncertainty of the potential impact to the Company's consolidated financial statements if the Federal government takes actions against the Company. As of December 31, 2019, the Company has not accrued an amount for the potential impact of any such actions.

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Following is a summary of the level of business activities with our medical-use cannabis customers:

- Deposit and loan balances at December 31, 2019 were approximately \$22.8 million, or 3.4% of total deposits, and \$14.0 million, or 2.2% of total loans, respectively. Deposit and loan balances at December 31, 2018 were approximately \$17.0 million, or 2.2% of total deposits, and \$14.1 million, or 2.1% of total loans, respectively.
- Interest and noninterest income for the year ended December 31, 2019 were approximately \$773,000 and \$2.0 million, respectively. Interest and noninterest income for the year ended December 31, 2018 were approximately \$720,000 and \$1.4 million, respectively.
- The volume of deposits accepted from medical-use cannabis licensed (“licensed”) customers in 2019 was approximately \$267.6 million. The volume of deposits accepted from licensed customers in 2018 was approximately \$138.9 million.

**Note 17 - 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: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

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

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

We record transfers between levels at the end of the reporting period in which the change in significant inputs occurs.

**Assets and Liabilities Measured on a Recurring Basis**

The following table presents fair value measurements for assets and liabilities that are measured at fair value on a recurring basis as of and for the year ended December 31, 2019:

	Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Changes In Fair Values Included In Period Income
<b>Assets:</b>					
			<i>(dollars in thousands)</i>		
AFS Securities - U.S. government agency notes	\$ 5,019	\$ —	\$ 5,019	\$ —	\$ —
AFS Securities - mortgage-backed securities	7,887	—	7,887	—	—
LHFS	10,910	—	10,910	—	(5)
MSRs	323	—	—	323	(114)
IRLCs	179	—	—	179	79
Best efforts forward contracts	23	—	23	—	23
Mandatory forward contracts	23	—	23	—	39

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The following table presents fair value measurements for assets and liabilities that are measured at fair value on a recurring basis as of and for the year ended December 31, 2018:

	Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Changes In Fair Values Included In Period Income
<b>Assets:</b>					
<i>(dollars in thousands)</i>					
AFS Securities - U.S. Treasury notes	\$ 1,981	\$ 1,981	\$ —	\$ —	\$ —
AFS Securities - U.S. government agency notes	9,997	—	9,997	—	—
LHFS	9,686	—	9,686	—	192
MSRs	437	—	—	437	(40)
IRLCs	100	—	—	100	78
<b>Liabilities:</b>					
Mandatory forward contracts	16	—	16	—	(30)
Best efforts forward contracts	—	—	—	—	(3)

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

	Fair Value Estimate	Valuation Technique	Unobservable Input	Range (Weighted-Average)
<b>December 31, 2019:</b>				
<i>(dollars in thousands)</i>				
MSRs	\$ 323	Market Approach	Weighted average prepayment speed	11.10 %
IRLCs	179	Market Approach	Range of pull through rate	70% - 95 %
			Average pull through rate	83 %
<b>December 31, 2018:</b>				
MSRs	\$ 437	Market Approach	Weighted average prepayment speed	9.80 %
IRLCs	100	Market Approach	Range of pull through rate	70% - 95 %
			Average pull through rate	84 %

The activity in MSRs was as follows for the years ended December 31:

	2019	2018
<i>(dollars in thousands)</i>		
<b>Beginning balance</b>	\$ 437	\$ 477
Valuation adjustment	(114)	(40)
<b>Ending balance</b>	\$ 323	\$ 437

The activity in IRLCs was as follows for the years ended December 31:

	2019	2018
<i>(dollars in thousands)</i>		
<b>Beginning balance</b>	\$ 100	\$ 22
Valuation adjustment	79	78
<b>Ending balance</b>	\$ 179	\$ 100

*AFS Securities*

The estimated fair values of AFS debt securities are obtained from a nationally-recognized pricing service. This pricing service develops estimated fair values by analyzing like securities and applying available market information through processes such as benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing, to prepare valuations. Matrix pricing is a mathematical technique widely used in the industry to value debt securities without relying

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exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things, and are based on market data obtained from sources independent from the Bank. We consider our U.S. Treasury securities to be Level 1. The Level 2 investments in the Bank's portfolio are priced using those inputs that, based on the analysis prepared by the pricing service, reflect the assumptions that market participants would use to price the assets. The Bank has determined that the Level 2 designation is appropriate for these securities because, as with most fixed-income securities, those in the Bank's portfolio are not exchange-traded, and such nonexchange-traded fixed income securities are typically priced by correlation to observed market data.

### *LHFS*

LHFS are carried at fair value, which is determined based on outstanding investor commitments or, in the absence of such commitments, on current investor yield requirements or third-party pricing models.

### *MSRs*

The fair value of MSRs 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 quarterly 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.

### *IRLCs*

We utilize a third-party specialist model to estimate the fair value of our IRLCs, which are valued based upon mandatory pricing quotes from correspondent lenders less estimated costs to process and settle the loan. Fair value is adjusted for the estimated probability of the loan closing with the borrower.

### *Forward Contracts*

To avoid interest rate risk, we enter into best efforts forward sales commitments with investors at the time we make an IRLC to a borrower. Once a loan has been closed and funded, the best efforts commitments convert to mandatory forward sales commitments. The mandatory commitments are derivatives, and we measure and report them at fair value. Fair value is based on the gain or loss that would occur if we were to pair-off the transaction with the investor at the measurement date. This is a level 2 input. We have elected to measure and report best efforts commitments at fair value using a valuation methodology similar to that used for mandatory commitments.

### ***Assets Measured on a Nonrecurring Basis***

We may be required, from time to time, to measure certain other assets at fair value on a nonrecurring basis. These adjustments to fair value usually result from application of LCM accounting or write-downs of individual assets.



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For assets measured at fair value on a nonrecurring basis, the following tables provide the level of valuation assumptions used to determine each adjustment and the carrying value of assets as of December 31:

2019						
Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Range of Discount (1)	Weighted Average	
<i>(dollars in thousands)</i>						
Impaired loans	\$ 4,437	\$ —	\$ —	\$ 4,437	0% - 160%	8 %
Real estate acquired through foreclosure	1,174	—	—	1,174	0% - 16%	10 %

2018						
Carrying Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Range of Discount (1)	Weighted Average	
<i>(dollars in thousands)</i>						
Impaired loans	\$ 5,678	\$ —	\$ —	\$ 5,678	0% - 16%	6.7 %

(1) Discount based on current market conditions and estimated selling costs

*Impaired Loans*

Impaired loans are those for which we have 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. 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 LCM. 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 impaired loans that are classified as collateral dependent, 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.

*Real Estate Acquired Through Foreclosure*

We record foreclosed real estate assets at the fair value less estimated selling costs on their acquisition dates and at the lower of such initial amount or estimated fair value less estimated selling costs thereafter. We generally obtain certified external appraisals of real estate acquired through foreclosure and estimate fair value using those appraisals. Other valuation sources may be used, including broker price opinions, letters of intent, and executed sale agreements.

*Fair Value of All Financial Instruments*

The carrying value and estimated fair value of all financial instruments are summarized in the following tables. The descriptions of the fair value calculations for AFS securities, LHFS, MSRs, IRLCs, best efforts forward contracts, mandatory forward contracts, impaired loans, and real estate acquired through foreclosure are included in the discussions above.



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conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect estimates. The above information should not be interpreted as an estimate of the fair value of the Company since a fair value calculation is only provided for a limited portion of our assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between our disclosures and those of other companies may not be meaningful.

There were no transfers between any of Levels 1, 2, and 3 for the years ended December 31, 2019 or 2018.

**Note 18 - Related Party Transactions**

During the ordinary course of business, we make loans to our directors and their affiliates and several of our policy making officers on substantially the same terms, including interest rates and collateral, as those prevailing for comparable transactions with other customers.

Transactions in related party loans were as follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>
	<i>(dollars in thousands)</i>	
Beginning Balance	\$ 3,628	\$ 6,455
Additions	13,751	771
Repayments	(28)	(3,598)
Change in Directors/Officers	2,181	—
	<u>\$ 19,532</u>	<u>\$ 3,628</u>

During January 2007, a law firm, in which the President of the Company and the Bank is a partner, entered into a five year lease agreement with a subsidiary of the Company. The term of the lease was five years with the option to renew the lease for three additional five year terms. The second option to renew was exercised in January 2017. The total rent payments received by the subsidiary were \$287,000 and \$281,000 for the years ended December 31, 2019 and 2018, respectively. The law firm also reimburses the Company for its share of common area maintenance and utilities. In addition, the law firm represents the Company and the Bank in certain legal matters. The fees for law services rendered by that firm were \$149,000 and \$158,000 for the years ended December 31, 2019 and 2018 respectively.

Total related party deposits in the Bank amounted to \$5.8 million and \$3.9 million at December 31, 2019 and 2018, respectively. Additionally, the law firm of the President of the Company and Bank, described above, maintained deposits in the Bank of \$1.4 million and \$270,000 at December 31, 2019 and 2018, respectively.

[Table of Contents](#)**Note 19 - Parent Company Financial Statements**

The following is financial information of Severn Bancorp (parent company only):

**Statements of Financial Condition**

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>ASSETS</b>	<i>(dollars in thousands)</i>	
Cash	\$ 1,481	\$ 1,378
Equity in net assets of subsidiaries:		
Bank	118,712	115,799
Nonbank	4,516	4,152
Other assets	1,505	1,431
<b>Total assets</b>	<b>\$ 126,214</b>	<b>\$ 122,760</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Subordinated debentures	\$ 20,619	\$ 20,619
Other liabilities	123	3,688
Total liabilities	20,742	24,307
Stockholders' Equity	105,472	98,453
<b>Total liabilities and stockholders' equity</b>	<b>\$ 126,214</b>	<b>\$ 122,760</b>

**Statements of Income**

	<b>Years Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
	<i>(dollars in thousands)</i>	
Interest income	\$ —	\$ 1
Interest expense on subordinated debentures	1,066	1,006
Net interest expense	(1,066)	(1,005)
Dividend from subsidiary	6,340	2,215
General and administrative expenses	(235)	(167)
Income before income taxes and equity in undistributed net income of subsidiaries	5,039	1,043
Income tax benefit	87	159
Equity in undistributed net income of subsidiaries	3,248	7,367
<b>Net income</b>	<b>8,374</b>	<b>8,569</b>
Other comprehensive income (loss) item - unrealized holding gains (losses) on AFS securities arising during the period (net of tax (expense) benefit of \$(10) and \$14)	28	(38)
<b>Total comprehensive income</b>	<b>\$ 8,402</b>	<b>\$ 8,531</b>

**Statements of Cash Flows**

	<b>Years Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income		<i>(dollars in thousands)</i>
	\$ 8,374	\$ 8,569
Adjustments to reconcile net income to net cash from operating activities:		
Equity in undistributed earnings of subsidiaries	(3,248)	(7,367)
Stock-based compensation	146	218
Deferred income taxes	(885)	(80)
Decrease (increase) in other assets	811	(120)
(Decrease) increase in accrued expenses and other liabilities	(66)	55
Net cash provided by operating activities	<u>5,132</u>	<u>1,275</u>
<b>Cash flows from financing activities:</b>		
Repayment of borrowings	(3,500)	—
Preferred stock dividends	—	(70)
Common stock dividends	(1,789)	(1,511)
Proceeds from common stock issuance	<u>260</u>	<u>374</u>
Net cash used in financing activities	<u>(5,029)</u>	<u>(1,207)</u>
<b>Increase in cash and cash equivalents</b>	<b>103</b>	<b>68</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>1,378</b>	<b>1,310</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 1,481</b>	<b>\$ 1,378</b>

**Note 20 – Subsequent Event**

On February 25, 2020, the Company's Board of Directors declared a \$0.04 per share dividend to stockholders of record on March 6, 2020, payable on March 17, 2020.

## BYLAWS

OF

SEVERN BANCORP, INC.

## ARTICLE I. HOME OFFICE

The home office of Severn Bancorp, Inc. (the "Corporation") is 1919A West Street, Annapolis, in the County of Anne Arundel, in the State of Maryland.

## ARTICLE II. SHAREHOLDERS

Section 1. Place of Meetings. All annual and special meetings of Shareholders shall be held at the home office of the Corporation or at such other place in the State in which the principal place of business of the Corporation is located as the Board of Directors may determine.

Section 2. Annual Meeting. A meeting of the shareholders of the Corporation for the election of directors and for the transaction of any other business of the Corporation shall be held annually within 150 days after the end of the Corporation's fiscal year as the Board of Directors may determine.

Section 3. Special Meetings. Special Meetings for any purpose or purposes may be called at any time by the Chairman of the Board, the President or a majority of the Board of Directors, and shall be called by the Chairman of the Board, the President or the Secretary upon the written request of the holders of no less than 25% of all the outstanding capital stock of the Corporation entitled to vote at the meeting. Such written request shall state the purpose or purposes of the meeting and shall be delivered to the home office of the Corporation addressed to the Chairman of the Board, the President or the Secretary.

Section 4. Conduct of Meetings. Annual and Special Meetings shall be conducted in accordance with the most current edition of Robert's Rules of Order unless otherwise prescribed by regulations of the Board or these Bylaws. The Board of Directors shall designate, when present, either the Chairman of the Board or President to preside at such meetings.

Section 5. Notice of Meetings. Written notice stating the place, day and hour of the meeting and the purpose(s) for which the meeting is called shall be delivered no fewer than 10 nor more than 50 days before the date of the meeting, either personally or by mail, by or at the direction of the Chairman of the Board, the President, or the secretary, or the directors calling the meeting, to each Shareholder of record entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the

mail, addressed to the Shareholder at the address as it appears on the stock transfer books or records of the Corporation as of the record date prescribed in Section 6 of this Article II, with postage prepaid. When any Shareholders' meeting, either Annual or Special, is adjourned for 30 days or more, notice of the adjourned meeting shall be given as in the case of an original meeting. It shall not be necessary to give any notice of the time and place of any meeting adjourned for less than 30 days or of the business to be transacted at the meeting, other than an announcement at the meeting at which such adjournment is taken.

Section 6.            Fixing of Record Date. For the purpose of determining Shareholders entitled to notice of or to vote at any meeting of Shareholders or any adjournment , or Shareholders entitled to receive payment of any dividend, or in order to make a determination of Shareholders for any other proper purpose, the Board of Directors shall fix in advance a date as the record date for any such determination of Shareholders. Such date in any case shall be not more than 90 days and, in case of a meeting of Shareholders, not fewer than 10 days prior to the date on which the particular action, requiring such determination of Shareholders, is to be taken. When a determination of Shareholders entitled to vote at any meeting of Shareholders has been made as provided in this section, such determination shall apply to any adjournment.

Section 7.            Voting Lists. At least 20 days before each meeting of the Shareholders, the officer or agent having charge of the stock transfer books for shares of the Corporation shall make a complete list of the Shareholders entitled to vote at such meeting, or any adjournment, arranged in alphabetical order, with the address and the number of shares held by each. This list of Shareholders shall be kept on file at the home office of the Corporation and shall be subject to inspection by any Shareholder at any time during usual business hours, for a period of 20 days prior to such meeting. Such list shall also be produced and kept open at the time and place of the meeting and shall be subject to inspection by any Shareholder during the entire time of the meeting. The original stock transfer book shall constitute prima facie evidence of the Shareholders entitled to examine such list or transfer books or to vote at any meeting of Shareholders.

Section 8.            Quorum. A majority of the outstanding shares of the Corporation entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of Shareholders. If less than a majority of the outstanding shares is represented at a meeting, a majority of the shares so represented may adjourn the meeting from time to time without further notice. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified. The Shareholders present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough Shareholders to constitute less than a quorum.

Section 9.        Proxies. At all meetings of Shareholders, a Shareholder may vote by proxy executed in writing by the Shareholder or by his duly authorized attorney in fact. Proxies solicited on behalf of the management shall be voted as directed by the Shareholder or, in the absence of such direction, as determined by a majority of the Board of Directors. No proxy shall be valid more than eleven months from the date of its execution except for a proxy coupled with an interest.

Section 10.       Voting of Shares in the Name of Two or More Persons. When ownership stands in the name of two or more persons, in the absence of written directions to the Corporation to the contrary, at any meeting of the Shareholders of the Corporation any one or more of such Shareholders may cast, in person or by proxy, all votes to which such ownership is entitled. In the event an attempt is made to cast conflicting votes, in person or by proxy, by the several persons in whose names shares of stock stand, the vote or votes to which those persons are entitled shall be cast as directed by a majority of those holding such and present in person or by proxy at such meeting, but no votes shall be cast for such stock if a majority cannot agree.

Section 11.       Voting of Shares by Certain Holders. Shares standing in the name of another corporation may be voted by any officer, agent or proxy as the Bylaws of such corporation may prescribe, or, in the absence of such provision, as the Board of Directors of such corporation may determine. Shares held by an administrator, executor, guardian or conservator may be voted by him, either in person or by proxy, without a transfer of such shares into his name. Shares standing in the name of a trustee may be voted by him, either in person or by proxy, but no trustee shall be entitled to vote shares held by him without a transfer of such shares into his name. Shares standing in the name of a receiver may be voted by such receiver, and shares held by or under the control of a receiver may be voted by such receiver without the transfer into his name if authority to do so is contained in an appropriate order of the court or other public authority by which such receiver was appointed.

A Shareholder whose shares are pledged shall be entitled to vote such shares until the shares have been transferred into the name of the pledgee and thereafter the pledgee shall be entitled to vote the shares so transferred.

Neither treasury shares of its own stock held by the Corporation nor shares held by another corporation, if a majority of the shares entitled to vote for the election of directors of such other corporation are held by the Corporation, shall be voted at any meeting or counted in determining the total number of outstanding shares at any given time for purposes of any meeting.

Section 12.       Voting. At each election for directors every shareholder entitled to vote at such election shall be entitled to one vote for each share of stock held by him. Unless otherwise provided by



these Bylaws, the Articles of Incorporation, or the General Laws of the State of Maryland, a majority of those votes cast by shareholders at a lawful meeting shall be sufficient to pass on a transaction or matter.

Section 13.            Inspectors of Election. In advance of any meeting of Shareholders, the Board of Directors may appoint any persons other than nominees for office as inspectors of election to act at such meeting or any adjournment. The number of inspectors shall be either one or three. Any such appointment shall not be altered at the meeting. If inspectors of election are not so appointed, the Chairman of the Board or the President may, or on the request of not fewer than 10% of the votes represented at the meeting shall, make such appointment at the meeting. If appointed at the meeting, the majority of the votes present shall determine whether one or three inspectors are to be appointed. In case any person appointed as inspector fails to appear or fails or refuses to act, the vacancy may be filled by appointment by the Board of Directors in advance of the meeting, or at the meeting by the Chairman of the Board or the President. Unless otherwise prescribed by regulations of the Board, the duties of such inspectors shall include: determining the number of shares represented at the meeting, the existence of a quorum, and the authenticity, validity and effect of proxies; receiving votes, ballots, or consents; hearing and determining all challenges and questions in any way arising in connection with the rights to vote; counting and tabulating all votes or consents; determining the result; and such acts as may be proper to conduct the election or vote with fairness to all Shareholders.

Section 14.            Nominating Committee. The Board of Directors shall act as a nominating committee for selecting the management nominees for election as directors. Except in the case of a nominee substituted as a result of the death or other incapacity of a management nominee, the nominating committee shall deliver written nominations to the Secretary at least 60 days prior to the date of the Annual Meeting. No nominations for directors except those made by the nominating committee shall be voted upon at the Annual Meeting unless other nominations by Shareholders are made in writing and delivered to the Secretary of the Corporation at least 60 days prior to the date of the Annual Meeting. Ballots bearing the names of all persons nominated by the nominating committee and by Shareholders shall be provided for use at the Annual meeting. However, if the nominating committee shall fail or refuse to act at least 20 days prior to the Annual Meeting, nominations for directors may be made at the Annual Meeting by any Shareholder entitled to vote and shall be voted upon.

Section 15.            New Business. Any new business to be taken up at the Annual Meeting shall be stated in writing and filed with the Secretary of the Corporation at least 60 days before the date of the Annual Meeting, and all business so stated, proposed, and filed shall be considered at the Annual Meeting but no other proposal shall be acted upon at the Annual Meeting. Any shareholder may make any other

proposal at the Annual Meeting and the same may be discussed and considered, but unless stated in writing and filed with the Secretary at least 60 days before the meeting, such proposal shall be laid over for action at an Adjourned, Special, or Annual Meeting of the Shareholders taking place 30 days or more thereafter. This provision shall not prevent the consideration and approval or disapproval at the Annual Meeting of reports of officers, directors and committees; but in connection with such reports no new business shall be acted upon at such Annual Meeting unless stated and filed as herein provided.

Section 16. Informal Action by Shareholders. Any action required to be taken at a meeting of the Shareholders, or any other action which may be taken at a meeting of the Shareholders, may be taken without a meeting if consent in writing, setting forth the action so taken, shall be given by all of the Shareholders entitled to vote with respect to the subject matter.

### ARTICLE III. BOARD OF DIRECTORS

Section 1. General Powers. The business and affairs of the Corporation shall be under the direction of its Board of Directors. The Board of Directors shall annually elect a Chairman of the Board and a President from among its members and shall designate, when present, either the Chairman of the Board or the President to preside at its meetings.

Section 2. Number and Term. The Board of Directors shall consist of up to eleven directors and no less than seven directors. The directors shall be divided into three classes as nearly equal in number as possible. The directors of each class shall be elected for a term of three years and until their successors are elected and qualified. One class shall be elected by ballot annually.

Section 3. Regular Meetings. A Regular Meeting of the Board of Directors shall be held without other notice than this Bylaw immediately after, and at the same place as, the Annual Meeting of Shareholders. The Board of Directors may provide, by resolution, the time and place for the holding of additional regular meetings without other notice than such resolution.

Section 4. Special Meetings. Special Meetings of the Board of Directors may be called by or at the request of the Chairman of the Board, the President or one-third of the directors. The persons authorized to call Special Meetings of the Board of Directors may fix any place as the place for holding any Special Meeting of the Board of Directors called by such persons.

Members of the Board of Directors may participate in Special Meetings by means of conference telephone, or by means of similar communications equipment by which all persons participating in the meeting can hear each other. Such participation shall constitute

presence in person but shall not constitute attendance for the purpose of compensation pursuant to Section 12 of this Article.

Section 5.      Notice. Written notice of any Special Meeting shall be given to each director at least two days prior thereto when delivered personally or by telegram, or at least five days prior thereto when delivered by mail at the address at which the director is most likely to be reached. Such notice shall be deemed to be delivered when deposited in the mail so addressed, with postage prepaid if mailed, or when delivered to the telegraph company if sent by telegram. Any director may waive notice of any meeting by a writing filed with the Secretary. The attendance of a director at a meeting shall constitute a waiver of notice of such meeting, except where a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any meeting of the Board of Directors need be specified in the notice of waiver of notice of such meeting.

Section 6.      Quorum. A majority of the number of directors fixed by Section 2 of this Article III shall constitute a quorum for the transaction of business at any meeting of the Board of Directors, but if less than such majority is present at a meeting; a majority of the directors present may adjourn the meeting from time to time. Notice of any Adjourned Meeting shall be given in the same manner as prescribed by Section 5 of this Article III.

Section 7.      Manner of Acting. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors, unless a greater number is prescribed by regulation of the Board or by these Bylaws.

Section 8.      Action Without a Meeting. Any action required or permitted to be taken by the Board of Directors at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the directors.

Section 9.      Resignation. Any director may resign at any time by sending a written notice of such resignation to the home office of the Corporation addressed to the Chairman of the Board or President. Unless otherwise specified, such resignation shall take effect upon receipt by the Chairman of the Board or President. More than three consecutive absences from regular meetings of the Board of Directors, unless excused by resolution of the Board of Directors, shall automatically constitute a resignation, effective when such resignation is accepted by the Board of Directors.

Section 10.     Vacancies. Any vacancy occurring in the Board of Directors may be filled by the affirmative vote of a majority of the remaining directors although less than a quorum of the Board of Directors. A director elected to fill a vacancy shall be elected to serve until the next election of directors by the Shareholders. Any

directorship to be filled by reason of an increase in the number of directors may be filled by election by the Board of Directors for a term of office continuing only until the next election of directors by the Shareholders.

Section 11.      Compensation. Directors, as such, may receive a stated salary for their services. By resolution of the Board of Directors, a reasonable fixed sum, and reasonable expenses of attendance, if any, may be allowed for actual attendance at each Regular or Special Meeting of the Board of Directors. Members of either standing or special committees may be allowed such compensation for actual attendance at committee meetings as the Board of Directors may determine.

Section 12.      Presumption of Assent. A director of the Corporation who is present at a meeting of the Board of Directors at which action on any Corporation matter is taken shall be presumed to have assented to the action taken unless his dissent or abstention shall be entered in the minutes of the meeting or unless he shall file a written dissent to such action with the person acting as the Secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the Secretary of the Corporation within five days after the date a copy of the minutes of the meeting is received. Such right to dissent shall not apply to a director who voted in favor of such action.

Section 13.      Removal of Directors. At a meeting of Shareholders called expressly for that purpose, any Director may be removed for cause by a vote of the holders of 75% of the shares then entitled to vote at an election of directors. If less than the entire board is to be removed, no one of the directors may be removed if the votes cast against the removal would be sufficient to elect a director if then cumulatively voted at an election of the class of directors of which such director is a part. Whenever the holders of the shares of any class are entitled to elect one or more directors by the provisions of the Charter or supplemental sections thereto, the provisions of this selection shall apply, in respect to the removal of a director or directors so elected, to the vote of the holders of the outstanding shares of that class and not to the vote of the outstanding shares as a whole.

#### ARTICLE IV. EXECUTIVE AND OTHER COMMITTEES

Section 1.      Appointment. The Board of Directors, by resolution adopted by a majority of the full Board, may designate the President and two or more of the other directors to constitute an executive committee. The designation of any committee pursuant to this Article IV and the delegation of authority shall not operate to relieve the Board of Directors, or any director, of any responsibility imposed by law or regulation.

Section 2.        Authority. The executive committee, when the Board of Directors is not in session, shall have and may exercise all of the authority of the Board of Directors except to the extent, if any, that such authority shall be limited by the resolution appointing the executive committee; and except also that the executive committee shall not have the authority of the Board of Directors with reference to: the declaration of dividends; the amendment of the Articles of Incorporation or Bylaws of the Corporation, or recommending to the Shareholders a plan of merger, consolidation, or conversion; the sale, lease or other, disposition of all or substantially all of the property and assets of the Corporation otherwise than in the usual and regular course of its business; a voluntary dissolution of the Corporation; a revocation of any of the foregoing; or the approval of a transaction in which any member of the executive committee, directly or indirectly, has any material beneficial interest.

Section 3.        Tenure. Subject to the provisions of Section 8 of this Article IV, each member of the executive committee shall hold office until the next Regular Annual Meeting of the Board of Directors following his or her designation and until a successor is designated as a member of the executive committee.

Section 4.        Meetings. Regular Meetings of the executive committee may be held without notice at such times and places as the executive committee may fix from time to time by resolution. Special Meetings of the executive committee may be called by any member thereof upon not less than one day's notice stating the place, date and hour of the meeting, which notice may be written or oral. Any member of the executive committee may waive notice of any meeting and no notice of any meeting need be given to any member thereof who attends in person. The notice of a meeting of the executive committee need not state the business proposed to be transacted at the meeting.

Section 5.        Quorum. A majority of the members of the executive committee shall constitute a quorum for the transaction of business at any meeting thereof, and action of the executive committee must be authorized by the affirmative vote of a majority of the members present at a meeting at which a quorum is present.

Section 6.        Action Without a Meeting. Any action required or permitted to be taken by the executive committee at a meeting may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all of the members of the executive committee.

Section 7.        Vacancies. Any vacancy in the executive committee may be filled by a resolution adopted by a majority of the full Board of Directors.

Section 8.        Resignations and Removal. Any member of the executive committee may be removed at any time with or without cause by resolution adopted by a majority of the full Board of Directors. Any member of the executive committee may resign from the executive committee at any time by giving written notice to the President or Secretary of the Corporation. Unless otherwise specified, such resignation shall take effect upon its receipt; the acceptance of such resignation shall not be necessary to make it effective.

Section 9.        Procedure. The executive committee shall elect a presiding officer from its members and may fix its own rules of procedure which shall not be inconsistent with these Bylaws. It shall keep regular minutes of its proceedings and report the same to the Board of Directors for its information at the meeting held next after the proceedings shall have occurred.

Section 10.      Other Committees. The Board of Directors may by resolution establish an audit, loan, or other committees composed of directors as they may determine to be necessary or appropriate for the conduct of the business of the Corporation and may prescribe the duties, constitution and procedures thereof.

#### ARTICLE V. OFFICERS

Section 1.        Positions. The officers of the Corporation shall be a President, one or more Vice Presidents, a Secretary, and a Treasurer, each of whom shall be elected by the Board of Directors. The Board of Directors may also designate the Chairman of the Board as an officer. The Chairman of the Board shall be the Chief Executive officer, and the President will be Chief Operating Officer. The President shall be a director of the Corporation. The offices of the Secretary and Treasurer may be held by the same person and a Vice President may also be either the Secretary or the Treasurer. The Board of Directors may designate one or more Vice Presidents as Executive Vice President or Senior Vice President. The Board of Directors may also elect or authorize the appointment of such other officers as the business of the Corporation may require. The officers shall have such authority and perform such duties as the Board of Directors may from time to time authorize or determine. In the absence of action by the Board of Directors, the officers shall have such powers and duties as generally pertain to their respective offices.

Section 2.        Election and Term of Office . The officers of the Corporation shall be elected annually at the first meeting of the Board of Directors held after each annual meeting of the Shareholders. If the election of officers is not held at such meeting, such election shall be held as soon thereafter as possible. Each officer shall hold office until a successor has been duly elected and qualified or until the officer's death, resignation or removal in the manner hereinafter provided. Election or appointment of an officer, employee or agent shall not of itself create contractual rights. The Board of Directors

may authorize the Corporation to enter into an employment contract with any officer in accordance with regulations of the Board; but no such contract shall impair the right of the Board of Directors to remove any officer at any time in accordance with Section 3 of this Article V.

Section 3.        Removal. Any officer may be removed by the Board of Directors whenever in its judgment the best interests of the Corporation will be served thereby, but such removal, other than for cause, shall be without prejudice to the contractual rights, if any, of the person so removed.

Section 4.        Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or otherwise, may be filled by the Board of Directors for the unexpired portion of the term.

Section 5.        Remuneration. The remuneration of the officers shall be fixed from time to time by the Board of Directors.

#### ARTICLE VI. CONTRACTS, LOANS, CHECKS AND DEPOSITS

Section 1.        Contracts. To the extent permitted by regulations of the Board, and except as otherwise prescribed by these Bylaws with respect to certificates for shares, the Board of Directors may authorize any officer, employee, or agent of the Corporation to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Corporation. Such authority may be general or confined to specific instances.

Section 2.        Loans. No loans shall be contracted on behalf of the Corporation and no evidence of indebtedness shall be issued in its name unless authorized by the Board of Directors. Such authority may be general or confined to specific instances.

Section 3.        Checks, Drafts, Etc. All checks, drafts or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Corporation shall be signed by one or more officers, employees or agents of the Corporation in such manner as shall from time to time be determined by the Board of Directors.

Section 4.        Deposits. All funds of the Corporation not otherwise employed shall be deposited from time to time to the credit of the Corporation in any duly authorized depository as the Board of Directors may select.

ARTICLE VII. CERTIFICATES FOR SHARES  
AND THEIR TRANSFER

Section 1.        Certificates for Shares. Certificates representing shares of capital stock of the Corporation shall be in such form as shall be determined by the Board of Directors and approved by the Board. Such certificates shall be signed by the chief executive officer or by any other officer of the Corporation authorized by the Board of Directors, attested by the Secretary or an Assistant Secretary, and sealed with the corporate seal or a facsimile thereof. The signatures of such officers upon a certificate may be facsimiles if the certificate is manually signed on behalf of a transfer agent or a registrar other than the Corporation itself or one of its employees. Each certificate for shares of capital stock shall be consecutively numbered or otherwise identified. The name and address of the person to whom the shares are issued with the number of shares and date of issue, shall be entered on the stock transfer books of the Corporation. All certificates surrendered to the Corporation for transfer shall be cancelled and no new certificate shall be issued until the former certificate for a like number of shares has been surrendered and cancelled, except that in case of a lost or destroyed certificate, a new certificate may be issued upon such terms and indemnity to the Corporation as the Board of Directors may prescribe.

Section 2.        Transfer of Shares. Transfer of shares of capital stock of the Corporation shall be made only on its stock transfer books. Authority for such transfer shall be given only by the holder of record or by his legal representative, who shall furnish proper evidence of such authority, or by his attorney authorized by a duly executed power of attorney and filed with the Corporation. Such transfer shall be made only on surrender for cancellation of the certificate for such shares. The person in whose name shares of capital stock stand on the books of the Corporation shall be deemed by the Corporation to be the owner for all purposes.

Section 3.        Lost Certificates. The Board of Directors may direct a new certificate to be issued in place of any certificate theretofore issued by the Corporation alleged to have been lost stolen, or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen, or destroyed. When authorizing such issue of a new certificate, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost stolen, or destroyed certificate or his legal representative, to give the Corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the Corporation with respect to the certificate alleged to have been lost, stolen, or destroyed.

Section 4.        Beneficial Owners. The Corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other



claim to or interest in such shares on the part of any other person, whether or not the Corporation shall have express or other notice thereof, except as otherwise provided by law.

ARTICLE VIII. FISCAL YEAR; ANNUAL AUDIT

The fiscal year of the Corporation shall end on the 31st day of December of each year. The Corporation shall be subject to an annual audit as of the end of its fiscal year by independent public accountants appointed by and responsible to the Board of Directors.

ARTICLE IX. DIVIDENDS

Subject to the terms of the Corporation's Articles of Incorporation and the regulations and orders of the Board, the Board of Directors may, from time to time, declare, and the Corporation may pay, dividends on its outstanding shares of capital stock.

ARTICLE X . CORPORATE SEAL

The Corporate Seal of the Corporation shall be in such form as the Board of Directors shall prescribe.

ARTICLE XI. AMENDMENTS

In accordance with the Corporation's Articles of Incorporation, these Bylaws may be repealed, altered, amended or rescinded by the Shareholders of the Corporation only by vote of not less a majority of the outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors (considered for this purpose as one class) cast at a meeting of the Shareholders called for that purpose (provided that notice of such proposed repeal, alteration, amendment or rescission is included in the notice of such meeting). In addition, except as expressly reserved for the Shareholders of the Corporation in the Articles of Incorporation, the Board of Directors may repeal, alter, amend or rescind these Bylaws by vote of a majority of the Board of Directors at a legal meeting held in accordance with the provisions of these Bylaws.

## DESCRIPTION OF COMMON STOCK

As of December 31, 2019, the common stock of Severn Bancorp, Inc. (the “Company”) is registered under Section 12(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

The following description of our common stock, certain provisions of our articles of incorporation and bylaws and certain provisions of Maryland law is a summary and is qualified in its entirety by reference to our articles of incorporation, bylaws and the Maryland General Corporation Law, (the “MGCL”). Copies of our articles of incorporation and our bylaws have been filed with the SEC and are filed as exhibits to the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission of which this exhibit is a part.

### General

We are authorized to issue 20,000,000 shares of common stock, par value \$0.01 per share. As of December 31, 2019, we had [•] shares of common stock outstanding. Our articles of incorporation permit our board of directors, without action by the stockholders, to amend the articles of incorporation to increase or decrease the aggregate number of shares of common stock. Our common stock is listed on the Nasdaq Capital Market under the symbol “SVBL.”

### Dividends

The Company generally may pay dividends on its common stock if, after giving effect to such distribution, (i) it would be able to pay its indebtedness as the indebtedness comes due in the usual course of business or (ii) its total assets exceed the sum of its liabilities and the amount needed, if the Company were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of any holders of capital stock who have a preference in the event of dissolution. The holders of common stock of the Company are entitled to receive and share equally in dividends as may be declared by the Company’s board of directors out of funds legally available therefor. If the Company issues shares of preferred stock, the holders thereof may have a priority over the holders of the common stock with respect to dividends. The payment of dividends by the Company is also subject to limitations that are imposed by federal law, regulation and policy.

The Board of Governors of the Federal Reserve System has issued a policy statement providing that dividends should be paid only out of current earnings and only if the holding company’s prospective rate of earnings retention is consistent with its capital needs, asset quality and overall financial condition. Federal regulatory guidance also provides for prior regulatory consultation with respect to capital distributions in certain circumstances such as where the holding company’s net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the holding company’s overall rate or earnings retention is inconsistent with its capital needs and overall financial condition.

### Voting Rights

Holders of common stock of the Company have voting rights in the Company. They elect the Company’s board of directors and act on other matters that are required to be presented to them under Maryland law or that are otherwise presented to them by the board of directors. Each holder of common stock is entitled to one vote per share and does not have any right to cumulate votes in the election of directors. If the Company issues shares of preferred stock, holders of the preferred stock may also possess voting rights.

### Liquidation

In the event of liquidation, dissolution or winding up of the Company, the holders of its common stock would be entitled to receive, after payment or provision for payment of all its debts and liabilities, all of the assets of the Company available for distribution. If preferred stock is issued, the holders thereof may have a priority over the holders of the common stock in the event of liquidation or dissolution.

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## **No Preemptive Rights**

Holders of the common stock of the Company are not entitled to preemptive rights with respect to any shares that may be issued. Our common stock is not subject to redemption.

## **Certain Anti-Takeover Provisions**

Our articles of incorporation and bylaws contain several provisions that may be deemed to have the effect of discouraging or delaying attempts to gain control of us. Such provisions include, among other things, special procedural rules regarding nomination for election to the board of directors or the introduction of new business at meetings of stockholders, restrictions on the ability of stockholders to call a special meeting of stockholders, approval by at least 80% of the outstanding voting stock to amend certain provisions of the articles of incorporation, a staggered board of directors, and no cumulative voting for any purpose. The foregoing provisions could impede a change of control. In particular, classification of the board of directors has the effect of decreasing the number of directors that could be elected in a single year by any person who seeks to elect its designees to a majority of the seats on the board.

Additionally, in certain instances, the issuance of authorized but unissued shares of common stock or preferred stock may have an anti-takeover effect. The authority of the board of directors to issue preferred stock with rights and privileges, including voting rights, as it may deem appropriate, may enable the board to prevent a change of control despite a shift in ownership of our common stock. In addition, the board's authority to issue additional shares of common stock may help deter or delay a change of control by increasing the number of shares needed to gain control.

The articles of incorporation of the Company provide that its board of directors, when evaluating a transaction involving an acquisition proposal of the Company (the consolidation or merger of the Company with another company, any share exchange involving the Company's outstanding capital stock, any liquidation or dissolution of the Company, any transfer of all or a material portion of the assets of the Company, and any tender offer or exchange offer for any of the Company's outstanding stock), may, in connection with the exercise of its business judgment in determining what is in the best interests of the Company consider the best interests of stockholders, depositors and such other factors as the social, legal and economic effects upon employees, suppliers, customers and the business of the Company and its subsidiaries and on the communities in which the Company and its subsidiaries operate or are located.

Maryland law restricts mergers, consolidations, sales of assets and other business combinations between the Company and an "interested stockholder."

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**Subsidiaries of Severn Bancorp, Inc.**

The following is a list of subsidiaries of Severn Bancorp, Inc. at December 31, 2019. All entities listed below are subsidiaries of Severn Bancorp, Inc. and, if indented, subsidiaries of the entity under which they are listed.

<b><u>Entity</u></b>	<b><u>Jurisdiction of Formation</u></b>
Severn Savings Bank, FSB.	United States of America (federally chartered savings association)
Louis Hyatt, Inc. (d/b/a Hyatt Commercial)	Maryland
HS West, LLC	Maryland
Severn Financial Services Corporation	Maryland
SSB Realty Holdings, LLC	Maryland
SSB Realty Holdings II, LLC	Maryland
Homeowners Title and Escrow Corporation	Maryland
SBI Mortgage Company	Maryland
Crownsville Development Corporation (d/b/a Annapolis Equity Group)	Maryland
Crownsville Holdings I, LLC	Maryland
Severn Mortgage Company	Maryland
Mid-Maryland Title Company, Inc.	Maryland

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Consent of Independent Registered Public Accounting Firm

Severn Bancorp, Inc.  
Annapolis, Maryland

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 333-156343) and Forms S-8 (No. 333-152657, No. 333-133242, and No. 333-232280) of Severn Bancorp, Inc. of our reports dated March 16, 2020, relating to the consolidated financial statements and effectiveness of Severn Bancorp's internal control over financial reporting, which are included in this Annual Report on Form 10-K.

/s/ BDO USA, LLP

Philadelphia, Pennsylvania

March 16, 2020

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## Certification of Principal Executive Officer

I, Alan J. Hyatt, certify that:

- 1) I have reviewed this annual report on Form 10-K of Severn Bancorp, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2020

/s/ Alan J. Hyatt

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President and Chief Executive Officer  
(Principal Executive Officer)

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## Certification of Principal Financial Officer

I, Vance W. Adkins, certify that:

- 1) I have reviewed this annual report on Form 10-K of Severn Bancorp, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2020

/s/ Vance W. Adkins

Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

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## CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350

## AS ADOPTED PURSUANT TO

## SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code), each of the undersigned officers of Severn Bancorp, Inc. ("Bancorp") does hereby certify with respect to the Annual Report of Bancorp on Form 10-K for the period ended December 31, 2019 (the "Report") that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Bancorp.

SEVERN BANCORP, INC.

Date: March 16, 2020

/s/ Alan J. Hyatt

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

Date: March 16, 2020

/s/ Vance W. Adkins

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Vance W. Adkins, Executive Vice President,  
and Chief Financial Officer  
(Principal Financial and Accounting Officer)

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code) and is not being filed as part of the Report or as a separate disclosure document.

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