

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2021

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 0-22345

SHORE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Maryland	52-1974638
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
18 E. Dover Street, Easton, Maryland	21601
(Address of Principal Executive Offices)	(Zip Code)

(410) 763-7800

Registrant's Telephone Number, Including Area Code

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock	SHBI	NASDAQ

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 periods 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 or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	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 number of shares outstanding of the registrant's common stock as of August 13, 2021 was 11,752,990.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

SHORE BANCSHARES, INC. CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)	June 30, 2021 (Unaudited)	December 31, 2020
ASSETS		
Cash and due from banks	\$ 18,275	\$ 16,666
Interest-bearing deposits with other banks	218,913	170,251
Cash and cash equivalents	237,188	186,917
Investment securities:		
Available-for-sale, at fair value	113,957	139,568
Held to maturity, at amortized cost - fair value of \$197,991 (2021) and \$65,828 (2020)	198,884	65,706
Equity securities, at fair value	1,384	1,395
Restricted securities	3,189	3,626
Loans	1,472,429	1,454,256
Less: allowance for credit losses	(15,088)	(13,888)
Loans, net	1,457,341	1,440,368
Premises and equipment, net	25,313	24,924
Goodwill	17,518	17,518
Other intangible assets, net	1,473	1,719
Other real estate owned, net	203	—
Right-of-use assets	5,616	4,795
Other assets	58,194	46,779
TOTAL ASSETS	\$ 2,120,260	\$ 1,933,315
LIABILITIES		
Deposits:		
Noninterest-bearing	\$ 538,009	\$ 509,091
Interest-bearing	1,342,573	1,191,614
Total deposits	1,880,582	1,700,705
Securities sold under retail repurchase agreements	2,907	1,050
Subordinated debt	24,490	24,429
Total borrowings	27,397	25,479
Lease liabilities	5,757	4,874
Other liabilities	7,842	7,238
TOTAL LIABILITIES	1,921,578	1,738,296
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, par value \$.01 per share; shares authorized - 35,000,000; shares issued and outstanding - 11,751,859 (2021) and 11,783,380 (2020)	118	118
Additional paid in capital	51,544	52,167
Retained earnings	146,414	141,205
Accumulated other comprehensive income	606	1,529
TOTAL STOCKHOLDERS' EQUITY	198,682	195,019
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 2,120,260	\$ 1,933,315

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

(In thousands, except per share data)	For Three Months Ended June 30,		For Six Months Ended June 30,	
	2021	2020	2021	2020
INTEREST INCOME				
Interest and fees on loans	\$ 14,381	\$ 13,945	\$ 28,747	\$ 27,740
Interest and dividends on investment securities:				
Taxable	1,095	638	2,025	1,357
Interest on deposits with other banks	55	11	102	183
Total interest income	15,531	14,594	30,874	29,280
INTEREST EXPENSE				
Interest on deposits	1,056	1,556	2,240	3,615
Interest on short-term borrowings	2	1	3	3
Interest on long-term borrowings	370	6	729	113
Total interest expense	1,428	1,563	2,972	3,731
NET INTEREST INCOME	14,103	13,031	27,902	25,549
Provision for credit losses	650	1,000	1,075	1,350
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	13,453	12,031	26,827	24,199
NONINTEREST INCOME				
Service charges on deposit accounts	683	544	1,357	1,410
Trust and investment fee income	475	363	882	738
Gains on sales and calls of investment securities	—	347	—	347
Other noninterest income	1,745	1,515	3,221	2,626
Total noninterest income	2,903	2,769	5,460	5,121
NONINTEREST EXPENSE				
Salaries and wages	4,262	2,130	8,404	6,426
Employee benefits	1,493	1,535	3,337	3,257
Occupancy expense	770	702	1,584	1,400
Furniture and equipment expense	412	247	719	564
Data processing	1,217	1,037	2,344	2,081
Directors' fees	154	113	303	254
Amortization of other intangible assets	120	138	246	282
FDIC insurance premium expense	223	124	408	215
Other real estate owned expenses, net	1	—	2	18
Legal and professional fees	648	553	1,164	1,187
Merger-related expenses	377	—	377	—
Other noninterest expenses	1,199	1,084	2,486	2,328
Total noninterest expense	10,876	7,663	21,374	18,012
Income before income taxes	5,480	7,137	10,913	11,308
Income tax expense	1,449	1,802	2,884	2,855
NET INCOME	\$ 4,031	\$ 5,335	\$ 8,029	\$ 8,453
Earnings per common share - Basic and diluted	\$ 0.34	\$ 0.43	\$ 0.68	\$ 0.68
Dividends paid per common share	\$ 0.12	\$ 0.12	\$ 0.24	\$ 0.24

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(In thousands)	For Three Months Ended June 30,		For Six Months Ended June 30,	
	2021	2020	2021	2020
Net income	<u>\$ 4,031</u>	<u>\$ 5,335</u>	<u>\$ 8,029</u>	<u>\$ 8,453</u>
Other comprehensive (loss) income:				
Investment securities:				
Unrealized holding (losses) gains on available-for-sale-securities	(194)	1,093	(1,269)	2,807
Tax effect	53	(292)	346	(760)
Reclassification of (gains) recognized in net income	—	(347)	—	(347)
Tax effect	—	88	—	88
Amortization of unrealized loss on securities transferred from available-for-sale to held-to-maturity	—	4	—	12
Tax effect	—	—	—	(3)
Total other comprehensive (loss) income	<u>(141)</u>	<u>546</u>	<u>(923)</u>	<u>1,797</u>
Comprehensive income	<u>\$ 3,890</u>	<u>\$ 5,881</u>	<u>\$ 7,106</u>	<u>\$ 10,250</u>

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)
For the Three and Six months Ended June 30, 2021 and 2020

(In thousands)	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balances, January 1, 2021	\$ 118	\$ 52,167	\$ 141,205	\$ 1,529	\$ 195,019
Net income	—	—	3,998	—	3,998
Other comprehensive (loss)	—	—	—	(782)	(782)
Retirement of common stock	—	(819)	—	—	(819)
Stock-based compensation	—	97	—	—	97
Cash dividends declared	—	—	(1,409)	—	(1,409)
Balances, March 31, 2021	\$ 118	\$ 51,445	\$ 143,794	\$ 747	\$ 196,104
Net Income	—	—	4,031	—	4,031
Other comprehensive (loss)	—	—	—	(141)	(141)
Stock-based compensation	—	99	—	—	99
Cash dividends declared	—	—	(1,411)	—	(1,411)
Balances, June 30, 2021	\$ 118	\$ 51,544	\$ 146,414	\$ 606	\$ 198,682

(In thousands)	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balances, January 1, 2020	\$ 125	\$ 61,045	\$ 131,425	\$ 207	\$ 192,802
Net Income	—	—	3,118	—	3,118
Other comprehensive income	—	—	—	1,251	1,251
Stock-based compensation	—	61	—	—	61
Vesting of restricted stock, net of shares surrendered	—	(39)	—	—	(39)
Cash dividends declared	—	—	(1,499)	—	(1,499)
Balances, March 31, 2020	\$ 125	\$ 61,067	\$ 133,044	\$ 1,458	\$ 195,694
Net Income	—	—	5,335	—	5,335
Other comprehensive income	—	—	—	546	546
Stock-based compensation	—	62	—	—	62
Cash dividends declared	—	—	(1,503)	—	(1,503)
Balances, June 30, 2020	\$ 125	\$ 61,129	\$ 136,876	\$ 2,004	\$ 200,134

See accompanying notes to Consolidated Financial Statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)	For Six Months Ended June 30,	
	2021	2020
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 8,029	\$ 8,453
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion of acquisition accounting estimates	(142)	(172)
Provision for credit losses	1,075	1,350
Depreciation and amortization	1,277	1,225
Net amortization of securities	687	203
Amortization of debt issuance costs	61	—
Stock-based compensation expense	196	123
Deferred income tax (benefit)	(578)	(1,598)
(Gains) on sales and calls of securities	—	(347)
Losses on sales and disposals of premises and equipment	—	40
Losses on sales and valuation adjustments on other real estate owned	2	18
Fair value adjustment on equity securities	20	(32)
Bank owned life insurance income	(545)	(647)
Net changes in:		
Accrued interest receivable	1,229	(2,712)
Other assets	(1,127)	(455)
Accrued interest payable	(90)	(123)
Other liabilities	446	4,429
Net cash provided by operating activities	10,540	9,755
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal payments of investment securities available for sale	23,862	26,360
Proceeds from sales and calls of investment securities available for sale	—	13,019
Proceeds from maturities and principal payments of investment securities held to maturity	3,037	105
Purchases of securities held to maturity	(136,422)	(3,021)
Purchases of equity securities	(10)	(14)
Net change in loans	(18,156)	(159,251)
Purchases of premises and equipment	(1,048)	(1,476)
Proceeds from sales of premises and equipment	—	2
Proceeds from sales of other real estate owned	—	18
Net redemption of restricted securities	437	564
Purchases of bank owned life insurance	(10,109)	—
Net cash (used in) investing activities	(138,409)	(123,694)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in:		
Noninterest-bearing deposits	28,918	86,378
Interest-bearing deposits	151,004	77,077
Short-term borrowings	1,857	(162)
Long-term borrowings	—	(15,000)
Common stock dividends paid	(2,820)	(3,002)
Retirement of common stock	(819)	—
Repurchase of shares for tax withholding on exercised options and vested restricted stock	—	(39)
Net cash provided by financing activities	178,140	145,252
Net increase in cash and cash equivalents	50,271	31,313
Cash and cash equivalents at beginning of period	186,917	94,971
Cash and cash equivalents at end of period	\$ 237,188	\$ 126,284
Supplemental cash flows information:		
Interest paid	\$ 3,046	\$ 3,914
Income taxes paid	\$ 2,441	\$ 174
Lease liabilities arising from right-of-use assets	\$ 1,132	\$ 419
Unrealized (loss) gain on securities available for sale	\$ (1,269)	\$ 2,460
Transfers from loans to other real estate owned	\$ 205	\$ —
Amortization of unrealized loss on securities transferred from available for sale to held to maturity	\$ —	\$ 12

See accompanying notes to Consolidated Financial Statements.

Shore Bancshares, Inc.
Notes to Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2021 and 2020
(Unaudited)

Note 1 – Basis of Presentation

The consolidated financial statements include the accounts of Shore Bancshares, Inc. and its subsidiary with all significant intercompany transactions eliminated. The consolidated financial statements conform to accounting principles generally accepted in the United States of America (“GAAP”) and to prevailing practices within the banking industry. The accompanying interim financial statements are unaudited; however, in the opinion of management all adjustments necessary to present fairly the consolidated financial position at June 30, 2021, the consolidated results of income and comprehensive income for the three and six months ended June 30, 2021 and 2020, changes in stockholders’ equity for the three and six months ended June 30, 2021 and 2020 and cash flows for the six months ended June 30, 2021 and 2020, have been included. All such adjustments are of a normal recurring nature. The amounts as of December 31, 2020 were derived from the 2020 audited financial statements. The results of operations for the three and six months ended June 30, 2021 are not necessarily indicative of the results to be expected for any other interim period or for the full year. This Quarterly Report on Form 10-Q should be read in conjunction with the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2020. For purposes of comparability, certain immaterial reclassifications have been made to amounts previously reported to conform with the current period presentation.

When used in these notes, the term “the Company” refers to Shore Bancshares, Inc. and, unless the context requires otherwise, its consolidated subsidiary, Shore United Bank (the “Bank”).

Risks and Uncertainties

Since the novel coronavirus (“COVID-19”) was declared a pandemic in March 2020, COVID-19 has significantly affected our communities, customers, and operations. COVID-19 continues to have a significant impact in 2021, however, the extent of its effects are dependent upon multiple factors, such as the extent of distribution and efficacy of vaccines, COVID-19 variants, pandemic-related restrictions, and government response, among others. As a result, the ultimate effects of COVID-19 over the longer term cannot be reasonably estimated at this time. Risks and uncertainties arising from the pandemic remain, primarily concerning the ability of customers to fulfill their financial obligations to the Company as well as potential operational disruptions and the ability of the Company to generate demand for its products and services. Accordingly, estimates used in the preparation of our financial statements may be subject to significant adjustments in future periods.

Recent Accounting Standards and Other Authoritative Guidance

ASU No. 2016-13 – In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. At the FASB’s October 16, 2019 meeting, the Board affirmed its decision to amend the effective date of this ASU for many companies. Public business entities that are SEC filers, excluding those meeting the smaller reporting company definition, retained the initial required implementation date of fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. At this time, the Company has established a project management team which meets periodically to discuss and assign roles and responsibilities, key tasks to complete, and a general timeline to be followed for implementation. The team has been working with an advisory consultant and has purchased a vendor model for implementation. Historical data has been collected and uploaded to the new model and the team is in the process of finalizing the methodologies that will be utilized.

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The team is currently running a parallel simulation to its current incurred loss impairment model. The Company is continuing to evaluate the extent of the potential impact of this standard and continues to keep current on evolving interpretations and industry practices via webcasts, publications, conferences, and peer bank meetings.

Effective November 25, 2019, the SEC adopted Staff Accounting Bulletin (SAB) 119. SAB 119 updated portions of SEC interpretative guidance to align with FASB ASC 326, “Financial Instruments – Credit Losses.” It covers topics including (1) measuring current expected credit losses; (2) development, governance, and documentation of a systematic methodology; (3) documenting the results of a systematic methodology; and (4) validating a systematic methodology.

ASU No. 2020-04 – In March 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-04 “Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference the London Inter-bank Offered Rate (“LIBOR”) or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. At present, the Bank has limited exposure to LIBOR based pricing. LIBOR based loans only comprise 26 loans or 7.6% of the loan portfolio. The Bank is confident it can successfully negotiate a migration to the Secured Overnight Financing Rate (“SOFR”) between now and the implementation date. The Bank will notify customers within 120 days prior to migration to SOFR. The Bank acknowledges the replacement rate will be more volatile based on different countries migrating to different indexes and limited liquidity to support the rate. The Bank further acknowledges the volatility will be greatly influenced by the support provided by the Federal Reserve.

ASU No. 2021-04 - In May 2021, the FASB issued ASU 2021-04, “Earnings Per Share (Topic 260), Debt - Modifications and Extinguishments (Subtopic 470-50), Compensation - Stock Compensation (Topic 718), and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity – Classified Written Call Options (a consensus of the FASB Emerging Issues Task Force).” The ASU addresses how an issuer should account for modifications or an exchange of freestanding written call options classified as equity that is not within the scope of another Topic. For both public and private companies, the ASU is effective for fiscal years beginning after December 15, 2021. Transition is prospective. Early adoption is permitted. The Company does not expect the adoption of ASU 2021-04 to have a material impact on its consolidated financial statements.

Recent Accounting Developments

In December 2020, the Consolidated Appropriations Act of 2021 (“CAA”) was passed. Under Section 541 of the CAA, Congress extended or modified many of the relief programs first created by the CARES Act, including the PPP loan program and treatment of certain loan modifications related to the COVID-19 pandemic. The Bank participated in the second round of PPP lending under the CAA, which resulted in 959 PPP loans for approximately \$67.3 million. In addition, two hospitality loans remained in the COVID-19 relief program under the CARES Act.

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Note 2 – Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of potential common stock equivalents (stock-based awards). The following table provides information relating to the calculation of earnings per common share:

(In thousands, except per share data)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2021	2020	2021	2020
Net Income	<u>\$ 4,031</u>	<u>\$ 5,335</u>	<u>\$ 8,029</u>	<u>\$ 8,453</u>
Weighted average shares outstanding - Basic	11,752	12,524	11,749	12,519
Dilutive effect of common stock equivalents-options	2	1	1	2
Weighted average shares outstanding - Diluted	<u>11,754</u>	<u>12,525</u>	<u>11,750</u>	<u>12,521</u>
Earnings per common share - Basic and Diluted	<u>\$ 0.34</u>	<u>\$ 0.43</u>	<u>\$ 0.68</u>	<u>\$ 0.68</u>

There were no weighted average common stock equivalents excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2021 and 2020.

Note 3 – Investment Securities

The following tables provide information on the amortized cost and estimated fair values of debt securities.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
June 30, 2021				
U.S. Government agencies	\$ 18,574	\$ 5	\$ 592	\$ 17,987
Mortgage-backed	94,549	1,908	487	95,970
Total	<u>\$ 113,123</u>	<u>\$ 1,913</u>	<u>\$ 1,079</u>	<u>\$ 113,957</u>
December 31, 2020				
U.S. Government agencies	\$ 23,600	\$ 20	\$ 83	\$ 23,537
Mortgage-backed	113,865	2,234	68	116,031
Total	<u>\$ 137,465</u>	<u>\$ 2,254</u>	<u>\$ 151</u>	<u>\$ 139,568</u>

No available for sale securities were sold during the three and six months ended June 30, 2021. During the three and six months ended June 30, 2020, the Company sold available for sale securities for proceeds of \$13.0 million and recognized gross gains of \$347 thousand.

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(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity securities:				
June 30, 2021				
U.S. Government agencies	\$ 63,139	\$ 41	\$ 430	\$ 62,750
Mortgage-backed	116,305	157	869	115,593
States and political subdivisions	400	1	—	401
Other debt securities	19,040	222	15	19,247
Total	<u>\$ 198,884</u>	<u>\$ 421</u>	<u>\$ 1,314</u>	<u>\$ 197,991</u>
December 31, 2020				
U.S. Government agencies	\$ 18,893	\$ 38	\$ 43	\$ 18,888
Mortgage-backed	27,347	7	18	27,336
States and political subdivisions	400	1	—	401
Other debt securities	19,066	139	2	19,203
Total	<u>\$ 65,706</u>	<u>\$ 185</u>	<u>\$ 63</u>	<u>\$ 65,828</u>

Equity securities with an aggregate fair value of \$1.4 million at June 30, 2021 and December 31, 2020 are presented separately on the balance sheet. The fair value adjustment recorded through earnings totaled \$(20) thousand for the six months ended June 30, 2021 and \$32 thousand for the six months ended June 30, 2020, respectively.

The following tables provide information about gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2021 and December 31, 2020.

(Dollars in thousands)	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2021						
Available-for-sale securities:						
U.S. Government agencies	\$ 17,409	\$ 591	\$ 221	\$ 1	\$ 17,630	\$ 592
Mortgage-backed	45,318	487	—	—	45,318	487
Total	<u>\$ 62,727</u>	<u>\$ 1,078</u>	<u>\$ 221</u>	<u>\$ 1</u>	<u>\$ 62,948</u>	<u>\$ 1,079</u>
Held-to-maturity securities:						
U.S. Government agencies	\$ 36,696	\$ 430	\$ —	\$ —	\$ 36,696	\$ 430
Mortgage-backed	65,359	869	—	—	65,359	869
Other debt securities	3,985	15	—	—	3,985	15
Total	<u>\$ 106,040</u>	<u>\$ 1,314</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 106,040</u>	<u>\$ 1,314</u>

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(Dollars in thousands)	Less than 12 Months		More than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2020						
Available-for-sale securities:						
U.S. Government agencies	\$ 14,919	\$ 82	\$ 236	\$ 1	\$ 15,155	\$ 83
Mortgage-backed	11,869	68	—	—	11,869	68
Total	<u>\$ 26,788</u>	<u>\$ 150</u>	<u>\$ 236</u>	<u>\$ 1</u>	<u>\$ 27,024</u>	<u>\$ 151</u>
Held-to-maturity securities:						
U.S. Government agencies	\$ 6,646	\$ 43	\$ —	\$ —	\$ 6,646	\$ 43
Mortgage-backed	5,093	18	—	—	5,093	18
Other debt securities	498	2	—	—	498	2
Total	<u>\$ 12,237</u>	<u>\$ 63</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,237</u>	<u>\$ 63</u>

All of the securities with unrealized losses in the portfolio have modest duration risk, low credit risk, and minimal losses when compared to total amortized cost. The unrealized losses on debt securities that exist are the result of market changes in interest rates since original purchase. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost basis, which may be at maturity for debt securities, the Company considers the unrealized losses to be temporary.

There were eighteen available-for-sale securities and twenty-four held-to-maturity securities in an unrealized loss position at June 30, 2021.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at June 30, 2021.

(Dollars in thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ —	\$ —	\$ 2,529	\$ 2,574
Due after one year through five years	975	1,009	10,381	10,392
Due after five years through ten years	54,955	55,891	57,481	57,456
Due after ten years	57,193	57,057	128,493	127,569
Total	<u>\$ 113,123</u>	<u>\$ 113,957</u>	<u>\$ 198,884</u>	<u>\$ 197,991</u>

The maturity dates for debt securities are determined using contractual maturity dates.

Note 4 – Loans and Allowance for Credit Losses

The Company makes residential mortgage, commercial and consumer loans to customers primarily in Talbot County, Queen Anne's County, Kent County, Caroline County, Dorchester County, Worcester County, Baltimore County and

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Howard County in Maryland, Kent County, Delaware and Accomack County, Virginia. The following table provides information about the principal classes of the loan portfolio at June 30, 2021 and December 31, 2020.

(Dollars in thousands)	June 30, 2021	December 31, 2020
Construction	\$ 116,760	\$ 106,760
Residential real estate	449,867	443,542
Commercial real estate	655,252	661,232
Commercial	186,162	211,256
Consumer	64,388	31,466
Total loans	1,472,429	1,454,256
Allowance for credit losses	(15,088)	(13,888)
Total loans, net	\$ 1,457,341	\$ 1,440,368

Loans are stated at their principal amount outstanding net of any purchase premiums/discounts, deferred fees and costs. Loans included deferred fees, net of costs, of \$549 thousand and discounts on acquired loans of \$625 thousand at June 30, 2021. Loans included deferred costs, net of deferred fees, of \$622 thousand and discounts on acquired loans of \$754 thousand at December 31, 2020. At June 30, 2021 and December 31, 2020, included in total loans were \$42.5 million and \$52.3 million in loans, respectively, acquired as part of the NWBI branch acquisition in 2017. Interest income on loans is accrued at the contractual rate based on the principal amount outstanding. Fees charged and costs capitalized for originating loans are being amortized substantially on the interest method over the term of the loan. A loan is placed on nonaccrual (i.e., interest income is no longer accrued) when it is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more, unless the loan is well secured and in the process of collection. Any unpaid interest previously accrued on those loans is reversed from income.

Interest payments received on nonaccrual loans are applied as a reduction of the loan principal balance unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired if it is probable that the Company will not collect all principal and interest payments according to the loan's contractual terms when due. An impaired loan may show deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. The impairment of a loan is measured at the present value of expected future cash flows using the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Generally, the Company measures impairment on such loans by reference to the fair value of the collateral. Once the amount of impairment has been determined, the uncollectible portion is charged off. Loan payments received on nonaccrual impaired loans are generally applied to the outstanding principal balance. In certain circumstances, income may be recognized on a cash basis. Generally, interest income is not recognized on impaired loans unless the likelihood of further loss is remote. The allowance for credit losses may include specific reserves related to impaired loans. Specific reserves remain until charge offs are made. Impaired loans do not include groups of smaller balance homogenous loans such as residential mortgage and consumer installment loans that are evaluated collectively for impairment. Reserves for probable credit losses related to these loans are based on historical loss ratios and are included in the formula portion of the allowance for credit losses.

A loan is considered a TDR if a borrower is experiencing financial difficulties and a creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Loans are identified to be restructured when signs of impairment arise such as borrower interest rate reduction request, slowness to pay, or when an inability to repay becomes evident. The terms being offered are evaluated to determine if they are more liberal than those that would be indicated by policy or industry standards for similar, untroubled credits. In those situations where the terms or the interest rates are considered to be more favorable than industry standards or the Bank's current underwriting guidelines the loan is classified as a TDR. All loans designated as TDRs are considered impaired loans and may be on either accrual or nonaccrual status. In instances where the loan has been placed on nonaccrual status, six consecutive months of timely payments are required prior to returning the loan to accrual status.

All loans classified as TDRs which are restructured and accrue interest under revised terms require a full and comprehensive review of the borrower's financial condition, capacity for repayment, realistic assessment of collateral values, and the assessment of risk entered into any workout agreement. Current financial information on the borrower, guarantor, and underlying collateral is analyzed to determine if it supports the ultimate collection of principal and interest. For commercial loans, the cash flows are analyzed, both for the underlying project and globally. For consumer loans, updated salary, credit history and cash flow information is obtained. Current market conditions are also considered. Following a full analysis, the determination of the appropriate loan structure is made.

In April 2020, the Company began its participation in the Paycheck Protection Program ("PPP"). The PPP commenced subsequent to the passage of the Coronavirus Aid, Relief and Economic Security ("CARES") Act in March 2020, and was later expanded by the Paycheck Protection Program and Health Care Enhancement Act of April 2020. The PPP was designed to provide U.S. small businesses with cash-flow assistance during the COVID-19 pandemic through loans that are fully guaranteed by the Small Business Administration ("SBA") which may be forgiven upon satisfaction of certain criteria. In December 2020, the Consolidated Appropriations Act of 2021 ("CAA") was passed. Under Section 541 of the CAA, Congress extended or modified many of the relief programs first created by the CARES Act, including the PPP loan program and treatment of certain loan modifications related to the COVID-19 pandemic. This extension of PPP lending expired on May 31, 2021. Under both the CARES and CAA, the Company funded 2,454 loans for a cumulative balance of \$196.0 million. As of June 30, 2021, the Company held PPP loans with a total outstanding balance of \$86.8 million, which is included in the commercial loan segment in the table above. The decrease is due to repayment and forgiveness received as of June 30, 2021. As compensation for originating the loans, the Company received lender processing fees from the SBA, which were deferred, along with the related loan origination costs. These net fees are being accreted to interest income over the remaining contractual lives of the loans. Upon forgiveness of a PPP loan and repayment by the SBA, which may be prior to the loan's maturity, the remainder of any unrecognized net fees are recognized as interest income.

In the normal course of banking business, risks related to specific loan categories are as follows:

Construction loans – Construction loans are offered primarily to builders and individuals to finance the construction of single-family dwellings. In addition, the Bank periodically finances the construction of commercial projects. Credit risk factors include the borrower's ability to successfully complete the construction on time and within budget, changing market conditions which could affect the value and marketability of projects, changes in the borrower's ability or willingness to repay the loan and potentially rising interest rates which can impact both the borrower's ability to repay and the collateral value.

Residential real estate – Residential real estate loans are typically made to consumers and are secured by residential real estate. Credit risk arises from the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy, among other factors. Also impacting credit risk would be a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default or subsequent liquidation of the real estate collateral.

Commercial real estate – Commercial real estate loans consist of both loans secured by owner occupied properties and non-owner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. These loans are subject to adverse changes in the local economy and commercial real estate markets. Credit risk associated with owner occupied properties arises from the borrower's financial stability and the ability of the borrower and the business to repay the loan. Non-owner occupied properties carry the risk of a tenant's deteriorating credit strength, lease expirations in soft markets and sustained vacancies which can adversely impact cash flow.

Commercial – Commercial loans are secured or unsecured loans for business purposes. Loans are typically secured by accounts receivable, inventory, equipment and/or other assets of the business. Credit risk arises from the successful operation of the business which may be affected by competition, rising interest rates, regulatory changes and adverse conditions in the local and regional economy.

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Consumer – Consumer loans include home equity loans and lines, installment loans and personal lines of credit. Credit risk is similar to residential real estate loans above as it is subject to the borrower’s continuing financial stability and the value of the collateral securing the loan.

The following tables include impairment information relating to loans and the allowance for credit losses as of June 30, 2021 and December 31, 2020.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
June 30, 2021						
Loans individually evaluated for impairment	\$ 327	\$ 4,898	\$ 5,575	\$ 237	\$ —	\$ 11,037
Loans collectively evaluated for impairment	116,433	444,969	649,677	185,925	64,388	1,461,392
Total loans	<u>\$ 116,760</u>	<u>\$ 449,867</u>	<u>\$ 655,252</u>	<u>\$ 186,162</u>	<u>\$ 64,388</u>	<u>\$ 1,472,429</u>

Allowance for credit losses allocated to:

Loans individually evaluated for impairment	\$ —	\$ 90	\$ —	\$ —	\$ —	\$ 90
Loans collectively evaluated for impairment	2,574	3,722	5,600	1,879	1,223	14,998
Total allowance	<u>\$ 2,574</u>	<u>\$ 3,812</u>	<u>\$ 5,600</u>	<u>\$ 1,879</u>	<u>\$ 1,223</u>	<u>\$ 15,088</u>

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
December 31, 2020						
Loans individually evaluated for impairment	\$ 331	\$ 5,722	\$ 6,917	\$ 258	\$ 28	\$ 13,256
Loans collectively evaluated for impairment	106,429	437,820	654,315	210,998	31,438	1,441,000
Total loans	<u>\$ 106,760</u>	<u>\$ 443,542</u>	<u>\$ 661,232</u>	<u>\$ 211,256</u>	<u>\$ 31,466</u>	<u>\$ 1,454,256</u>

Allowance for credit losses allocated to:

Loans individually evaluated for impairment	\$ —	\$ 135	\$ 78	\$ —	\$ —	\$ 213
Loans collectively evaluated for impairment	2,022	3,564	5,348	2,089	652	13,675
Total allowance	<u>\$ 2,022</u>	<u>\$ 3,699</u>	<u>\$ 5,426</u>	<u>\$ 2,089</u>	<u>\$ 652</u>	<u>\$ 13,888</u>

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The following tables provide information on impaired loans and any related allowance by loan class as of June 30, 2021 and December 31, 2020. The difference between the unpaid principal balance and the recorded investment is the amount of partial charge-offs that have been taken and interest paid on nonaccrual loans that has been applied to principal.

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest recorded investment
June 30, 2021							
Impaired nonaccrual loans:							
Construction	\$ 297	\$ 297	\$ —	\$ —	\$ 297	\$ 297	\$ —
Residential real estate	1,318	1,239	—	—	1,204	1,307	—
Commercial real estate	2,562	2,174	—	—	2,214	2,613	—
Commercial	391	237	—	—	241	246	—
Consumer	—	—	—	—	9	19	—
Total	<u>\$ 4,568</u>	<u>\$ 3,947</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,965</u>	<u>\$ 4,482</u>	<u>\$ —</u>
Impaired accruing TDRs:							
Construction	\$ 30	\$ 30	\$ —	\$ —	\$ 31	\$ 32	\$ 1
Residential real estate	3,329	2,209	1,120	90	3,354	3,442	89
Commercial real estate	2,979	2,979	—	—	3,005	3,035	46
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	<u>\$ 6,338</u>	<u>\$ 5,218</u>	<u>\$ 1,120</u>	<u>\$ 90</u>	<u>\$ 6,390</u>	<u>\$ 6,509</u>	<u>\$ 136</u>
Other impaired accruing loans:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential real estate	330	330	—	—	359	606	7
Commercial real estate	422	422	—	—	479	495	2
Commercial	—	—	—	—	—	25	—
Consumer	—	—	—	—	—	—	—
Total	<u>\$ 752</u>	<u>\$ 752</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 838</u>	<u>\$ 1,126</u>	<u>\$ 9</u>
Total impaired loans:							
Construction	\$ 327	\$ 327	\$ —	\$ —	\$ 328	\$ 329	\$ 1
Residential real estate	4,977	3,778	1,120	90	4,917	5,355	96
Commercial real estate	5,963	5,575	—	—	5,698	6,143	48
Commercial	391	237	—	—	241	271	—
Consumer	—	—	—	—	9	19	—
Total	<u>\$ 11,658</u>	<u>\$ 9,917</u>	<u>\$ 1,120</u>	<u>\$ 90</u>	<u>\$ 11,193</u>	<u>\$ 12,117</u>	<u>\$ 145</u>

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(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	June 30, 2020		
					Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest income recognized
December 31, 2020							
Impaired nonaccrual loans:							
Construction	\$ 297	\$ 297	\$ —	\$ —	\$ 297	\$ 198	\$ —
Residential real estate	1,665	1,585	—	—	3,555	3,213	—
Commercial real estate	4,288	3,220	67	67	6,853	7,103	—
Commercial	401	258	—	—	551	466	—
Consumer	28	28	—	—	—	—	—
Total	<u>\$ 6,679</u>	<u>\$ 5,388</u>	<u>\$ 67</u>	<u>\$ 67</u>	<u>\$ 11,256</u>	<u>\$ 10,980</u>	<u>\$ —</u>
Impaired accruing TDRs:							
Construction	\$ 34	\$ 34	\$ —	\$ —	\$ 38	\$ 38	\$ 1
Residential real estate	3,845	2,617	1,228	135	3,912	3,967	79
Commercial real estate	3,118	2,479	639	11	3,373	3,390	47
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	<u>\$ 6,997</u>	<u>\$ 5,130</u>	<u>\$ 1,867</u>	<u>\$ 146</u>	<u>\$ 7,323</u>	<u>\$ 7,395</u>	<u>\$ 127</u>
Other impaired accruing loans:							
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 49	\$ —
Residential real estate	292	292	—	—	179	394	1
Commercial real estate	512	512	—	—	1,053	867	3
Commercial	—	—	—	—	6	5	—
Consumer	—	—	—	—	16	9	—
Total	<u>\$ 804</u>	<u>\$ 804</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,254</u>	<u>\$ 1,324</u>	<u>\$ 4</u>
Total impaired loans:							
Construction	\$ 331	\$ 331	\$ —	\$ —	\$ 335	\$ 285	\$ 1
Residential real estate	5,802	4,494	1,228	135	7,646	7,574	80
Commercial real estate	7,918	6,211	706	78	11,279	11,360	50
Commercial	401	258	—	—	557	471	—
Consumer	28	28	—	—	16	9	—
Total	<u>\$ 14,480</u>	<u>\$ 11,322</u>	<u>\$ 1,934</u>	<u>\$ 213</u>	<u>\$ 19,833</u>	<u>\$ 19,699</u>	<u>\$ 131</u>

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The following tables provide a roll-forward for TDRs as of June 30, 2021 and June 30, 2020.

(Dollars in thousands)	1/1/2021 TDR Balance	New TDRs	Disbursements (Payments)	Charge- offs	Reclassifications/ Transfer In/(Out)	Payoffs	6/30/2021 TDR Balance	Related Allowance
For six months ended								
June 30, 2021								
Accruing TDRs								
Construction	\$ 34	\$ —	\$ (4)	\$ —	\$ —	\$ —	\$ 30	\$ —
Residential real estate	3,845	—	(57)	—	—	(459)	3,329	90
Commercial real estate	3,118	—	(139)	—	—	—	2,979	—
Commercial	—	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—	—
Total	<u>\$ 6,997</u>	<u>\$ —</u>	<u>\$ (200)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (459)</u>	<u>\$ 6,338</u>	<u>\$ 90</u>
Nonaccrual TDRs								
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential real estate	—	—	—	—	—	—	—	—
Commercial real estate	—	—	—	—	—	—	—	—
Commercial	258	—	(21)	—	—	—	237	—
Consumer	—	—	—	—	—	—	—	—
Total	<u>\$ 258</u>	<u>\$ —</u>	<u>\$ (21)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 237</u>	<u>\$ —</u>
Total	<u>\$ 7,255</u>	<u>\$ —</u>	<u>\$ (221)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (459)</u>	<u>\$ 6,575</u>	<u>\$ 90</u>
For six months ended								
June 30, 2020								
Accruing TDRs								
Construction	\$ 41	\$ —	\$ (3)	\$ —	\$ —	\$ —	\$ 38	\$ —
Residential real estate	4,041	—	(53)	—	—	(83)	3,905	190
Commercial real estate	3,419	—	(50)	—	—	—	3,369	14
Commercial	—	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—	—
Total	<u>\$ 7,501</u>	<u>\$ —</u>	<u>\$ (106)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (83)</u>	<u>\$ 7,312</u>	<u>\$ 204</u>
Nonaccrual TDRs								
Construction	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential real estate	1,393	—	(51)	—	—	—	1,342	75
Commercial real estate	—	1,506	(373)	—	—	—	1,133	—
Commercial	299	—	(19)	—	—	—	280	—
Consumer	—	—	—	—	—	—	—	—
Total	<u>\$ 1,692</u>	<u>\$ 1,506</u>	<u>\$ (443)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,755</u>	<u>\$ 75</u>
Total	<u>\$ 9,193</u>	<u>\$ 1,506</u>	<u>\$ (549)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (83)</u>	<u>\$ 10,067</u>	<u>\$ 279</u>

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There were no loans modified and considered to be TDRs during the three months ended June 30, 2021 and June 30, 2020. The following tables provide information on loans that were modified and considered to be TDRs during the six months ended June 30, 2021 and June 30, 2020.

(Dollars in thousands)	Number of contracts	Premodification outstanding recorded investment	Postmodification outstanding recorded investment	Related allowance
TDRs:				
For six months ended				
June 30, 2021				
Construction	—	\$ —	\$ —	\$ —
Residential real estate	—	—	—	—
Commercial real estate	—	—	—	—
Commercial	—	—	—	—
Consumer	—	—	—	—
Total	—	\$ —	\$ —	\$ —
For six months ended				
June 30, 2020				
Construction	—	\$ —	\$ —	\$ —
Residential real estate	—	—	—	—
Commercial real estate	1	1,535	1,506	—
Commercial	—	—	—	—
Consumer	—	—	—	—
Total	1	\$ 1,535	\$ 1,506	\$ —

Since the beginning of the pandemic and through June 30, 2021, the Company had executed principal and/or interest deferrals on outstanding loan balances of \$221.1 million, of which only \$9.5 million, or 0.65% of the total portfolio, remained on deferral as of June 30, 2021. These deferrals were not considered TDRs based on the relief provisions of the CARES Act and CAA or recent interagency regulatory guidance.

There were no TDRs which subsequently defaulted within 12 months of modification for the three and six months ended June 30, 2021 and 2020. Generally, a loan is considered in default when principal or interest is past due 90 days or more, the loan is placed on nonaccrual, the loan is charged off, or there is a transfer to OREO or repossessed assets.

Management uses risk ratings as part of its monitoring of the credit quality in the Company's loan portfolio. Loans that are identified as special mention, substandard or doubtful are adversely rated. These loans and the pass/watch loans are assigned higher qualitative factors than favorably rated loans in the calculation of the formula portion of the allowance for credit losses. At June 30, 2021, there were no nonaccrual loans classified as special mention or doubtful and \$3.9 million of nonaccrual loans were classified as substandard. Similarly, at December 31, 2020, there were no nonaccrual loans classified as special mention or doubtful and \$5.5 million of nonaccrual loans were classified as substandard.

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The following tables provide information on loan risk ratings as of June 30, 2021 and December 31, 2020.

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
June 30, 2021						
Construction	\$ 87,587	\$ 26,923	\$ 1,953	\$ 297	\$ —	\$ 116,760
Residential real estate	411,746	34,370	2,221	1,530	—	449,867
Commercial real estate	495,840	149,825	2,925	6,662	—	655,252
Commercial	167,089	18,133	689	251	—	186,162
Consumer	64,220	166	—	2	—	64,388
Total	<u>\$ 1,226,482</u>	<u>\$ 229,417</u>	<u>\$ 7,788</u>	<u>\$ 8,742</u>	<u>\$ —</u>	<u>\$ 1,472,429</u>

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
December 31, 2020						
Construction	\$ 81,926	\$ 22,547	\$ 1,990	\$ 297	\$ —	\$ 106,760
Residential real estate	401,494	36,759	2,946	2,343	—	443,542
Commercial real estate	514,524	133,892	3,504	9,312	—	661,232
Commercial	182,166	25,870	2,948	272	—	211,256
Consumer	31,221	215	—	30	—	31,466
Total	<u>\$ 1,211,331</u>	<u>\$ 219,283</u>	<u>\$ 11,388</u>	<u>\$ 12,254</u>	<u>\$ —</u>	<u>\$ 1,454,256</u>

The following tables provide information on the aging of the loan portfolio as of June 30, 2021 and December 31, 2020.

(Dollars in thousands)	Accruing					Nonaccrual	Total
	Current	30-59 days past due	60-89 days past due	Greater than 90 days	Total past due		
June 30, 2021							
Construction	\$ 116,433	\$ —	\$ 30	\$ —	\$ 30	\$ 297	\$ 116,760
Residential real estate	447,705	593	—	330	923	1,239	449,867
Commercial real estate	652,484	172	—	422	594	2,174	655,252
Commercial	185,748	36	141	—	177	237	186,162
Consumer	64,262	126	—	—	126	—	64,388
Total	<u>\$ 1,466,632</u>	<u>\$ 927</u>	<u>\$ 171</u>	<u>\$ 752</u>	<u>\$ 1,850</u>	<u>\$ 3,947</u>	<u>\$ 1,472,429</u>
Percent of total loans	99.5 %	0.1 %	— %	0.1 %	0.2 %	0.3 %	100.0 %

(Dollars in thousands)	Accruing					Nonaccrual	Total
	Current	30-59 days past due	60-89 days past due	Greater than 90 days	Total past due		
December 31, 2020							
Construction	\$ 106,463	\$ —	\$ —	\$ —	\$ —	\$ 297	\$ 106,760
Residential real estate	440,210	517	938	292	1,747	1,585	443,542
Commercial real estate	657,066	367	—	512	879	3,287	661,232
Commercial	210,704	226	68	—	294	258	211,256
Consumer	31,318	119	1	—	120	28	31,466
Total	<u>\$ 1,445,761</u>	<u>\$ 1,229</u>	<u>\$ 1,007</u>	<u>\$ 804</u>	<u>\$ 3,040</u>	<u>\$ 5,455</u>	<u>\$ 1,454,256</u>
Percent of total loans	99.3 %	0.1 %	0.1 %	0.1 %	0.3 %	0.4 %	100.0 %

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The following tables provide a summary of the activity in the allowance for credit losses allocated by loan class for the three and six months ended June 30, 2021 and June 30, 2020. Allocation of a portion of the allowance to one loan class does not preclude its availability to absorb losses in other loan classes.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For three months ended June 30, 2021						
Allowance for credit losses:						
Beginning Balance	\$ 2,796	\$ 3,699	\$ 5,097	\$ 2,000	\$ 721	\$ 14,313
Charge-offs	—	—	—	(46)	—	(46)
Recoveries	5	57	64	44	1	171
Net (charge-offs) recoveries	5	57	64	(2)	1	125
Provision	(227)	56	439	(119)	501	650
Ending Balance	<u>\$ 2,574</u>	<u>\$ 3,812</u>	<u>\$ 5,600</u>	<u>\$ 1,879</u>	<u>\$ 1,223</u>	<u>\$ 15,088</u>
For three months ended June 30, 2020						
Allowance for credit losses:						
Beginning Balance	\$ 1,128	\$ 2,482	\$ 3,965	\$ 2,263	\$ 540	\$ 10,378
Charge-offs	—	—	(331)	(37)	—	(368)
Recoveries	5	4	—	61	10	80
Net (charge-offs) recoveries	5	4	(331)	24	10	(288)
Provision	364	153	463	68	(48)	1,000
Ending Balance	<u>\$ 1,497</u>	<u>\$ 2,639</u>	<u>\$ 4,097</u>	<u>\$ 2,355</u>	<u>\$ 502</u>	<u>\$ 11,090</u>

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(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
For six months ended June 30, 2021						
Allowance for credit losses:						
Beginning Balance	\$ 2,022	\$ 3,699	\$ 5,426	\$ 2,089	\$ 652	\$ 13,888
Charge-offs	—	—	—	(107)	(4)	(111)
Recoveries	10	63	64	96	3	236
Net (charge-offs) recoveries	10	63	64	(11)	(1)	125
Provision	542	50	110	(199)	572	1,075
Ending Balance	<u>\$ 2,574</u>	<u>\$ 3,812</u>	<u>\$ 5,600</u>	<u>\$ 1,879</u>	<u>\$ 1,223</u>	<u>\$ 15,088</u>
For six months ended June 30, 2020						
Allowance for credit losses:						
Beginning Balance	\$ 1,576	\$ 2,501	\$ 4,032	\$ 1,929	\$ 469	\$ 10,507
Charge-offs	—	(191)	(601)	(119)	(7)	(918)
Recoveries	8	7	—	124	12	151
Net (charge-offs) recoveries	8	(184)	(601)	5	5	(767)
Provision	(87)	322	666	421	28	1,350
Ending Balance	<u>\$ 1,497</u>	<u>\$ 2,639</u>	<u>\$ 4,097</u>	<u>\$ 2,355</u>	<u>\$ 502</u>	<u>\$ 11,090</u>

Foreclosure Proceedings

There were no consumer mortgage loans collateralized by residential real estate property that were in the process of foreclosure as of June 30, 2021 and December 31, 2020, respectively. There was 1 residential real estate property included in the balance of other real estate owned totaling \$203 thousand at June 30, 2021 and \$0 at December 31, 2020.

All accruing TDRs were in compliance with their modified terms. Both performing and non-performing TDRs had no further commitments associated with them as of June 30, 2021 and December 31, 2020.

Note 5 – Leases

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company's long-term lease agreements are classified as operating leases. Certain leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably certain of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

During the second quarter of 2021, one of the Company's long-term branch leases was reassessed by management and it was determined that it was not reasonably certain that the options to renew would be exercised after the initial lease term of 10 years. This resulted in a shorter lease term and a reduction of the lease liability and right-to-use assets as compared to the first quarter of 2021 when the lease was initially placed into service.

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The following tables present information about the Company's leases:

(Dollars in thousands)	June 30, 2021	December 31, 2020
Lease liabilities	\$ 5,757	\$ 4,874
Right-of-use assets	\$ 5,616	\$ 4,795
Weighted average remaining lease term	10.08 years	10.49 years
Weighted average discount rate	2.84 %	2.89 %

	For the Three Months Ended		For the Six Months Ended	
Lease cost (in thousands)	June 30, 2021	June 30, 2020	June 30, 2021	June 30, 2020
Operating lease cost	\$ 208	\$ 177	\$ 395	\$ 358
Short-term lease cost	—	—	—	—
Total lease cost	\$ 208	\$ 177	\$ 395	\$ 358

Cash paid for amounts included in the measurement of lease liabilities	\$ 165	\$ 167	\$ 331	\$ 330
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A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows:

Lease payments due (in thousands)	As of June 30, 2021
Six months ending December 31, 2021	\$ 366
Twelve months ending December 31, 2022	742
Twelve months ending December 31, 2023	753
Twelve months ending December 31, 2024	707
Twelve months ending December 31, 2025	620
Twelve months ending December 31, 2026	566
Thereafter	3,308
Total undiscounted cash flows	\$ 7,062
Discount	1,305
Lease liabilities	\$ 5,757

Note 6 – Goodwill and Other Intangibles

The Company concluded there was no impairment of goodwill during its annual fourth quarter assessment in 2020. Following the fourth quarter evaluation, management evaluated the events and circumstances that could indicate that goodwill may be impaired and concluded that an interim test was not necessary. The Company will continue to monitor the impact of COVID-19 on the Company as well as the financial markets in evaluating the necessity of interim testing during 2021.

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The following table provides information on the significant components of goodwill and other acquired intangible assets at June 30, 2021 and December 31, 2020.

June 30, 2021

(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	<u>\$ 19,728</u>	<u>\$ (1,543)</u>	<u>\$ (667)</u>	<u>\$ 17,518</u>	—
Other intangible assets					
Amortizable					
Core deposit intangible	<u>\$ 3,954</u>	<u>\$ —</u>	<u>\$ (2,481)</u>	<u>\$ 1,473</u>	3.8
Total other intangible assets	<u>\$ 3,954</u>	<u>\$ —</u>	<u>\$ (2,481)</u>	<u>\$ 1,473</u>	

December 31, 2020

(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	<u>\$ 19,728</u>	<u>\$ (1,543)</u>	<u>\$ (667)</u>	<u>\$ 17,518</u>	—
Other intangible assets					
Amortizable					
Core deposit intangible	<u>\$ 3,954</u>	<u>\$ —</u>	<u>\$ (2,235)</u>	<u>\$ 1,719</u>	4.7
Total other intangible assets	<u>\$ 3,954</u>	<u>\$ —</u>	<u>\$ (2,235)</u>	<u>\$ 1,719</u>	

The aggregate amortization expense was \$246 thousand for the six months ended June 30, 2021 and \$282 thousand for the six months ended June 30, 2020.

At June 30, 2021, estimated future remaining amortization for amortizing intangibles within the years ending December 31, is as follows:

(Dollars in thousands)	Amortization Expense
2021	\$ 216
2022	389
2023	317
2024	246
2025	174
2026	102
Thereafter	29
Total amortizing intangible assets	<u>\$ 1,473</u>

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Note 7 – Other Assets

The Company had the following other assets at June 30, 2021 and December 31, 2020.

(Dollars in thousands)	June 30, 2021	December 31, 2020
Accrued interest receivable	\$ 5,387	\$ 6,616
Deferred income taxes	5,367	4,442
Prepaid expenses	1,535	1,472
Cash surrender value on life insurance	41,672	31,018
Income taxes receivable	—	156
Other assets	4,233	3,075
Total	<u>\$ 58,194</u>	<u>\$ 46,779</u>

The following table provides information on significant components of the Company's deferred tax assets and liabilities as of June 30, 2021 and December 31, 2020.

(Dollars in thousands)	June 30, 2021	December 31, 2020
Deferred tax assets:		
Allowance for credit losses	\$ 4,040	\$ 3,721
Write-downs of other real estate owned	12	12
Nonaccrual loan interest	297	367
Other	2,650	2,152
Total deferred tax assets	6,999	6,252
Less valuation allowance	(271)	(169)
Deferred tax assets, net of valuation allowance	6,728	6,083
Deferred tax liabilities:		
Depreciation	166	177
Acquisition accounting adjustments	683	580
Deferred capital gain on branch sale	184	187
Unrealized gains on available-for-sale securities	220	567
Other	108	130
Total deferred tax liabilities	1,361	1,641
Net deferred tax assets	<u>\$ 5,367</u>	<u>\$ 4,442</u>

Note 8 - Subordinated Debt

On August 25, 2020, the Company entered into Subordinated Note Purchase Agreements with certain Purchasers pursuant to which the Company issued and sold \$25.0 million in aggregate principal amount with an initial interest rate of 5.375% Fixed-to-Floating Rate Subordinated Notes due September 1, 2030.

The Company has and continues to use the net proceeds of this offering for general corporate purposes, organic growth and to support the Bank's regulatory capital ratios. The Notes were structured to qualify as Tier 2 capital for regulatory capital purposes and bear an initial interest rate of 5.375% until September 1, 2025, with interest during this period payable semi-annually in arrears. From and including September 1, 2025, to but excluding the maturity date or early redemption date, the interest rate will reset quarterly to an annual floating rate equal to three-month SOFR, plus 526.5 basis points, with interest during this period payable quarterly in arrears. The Notes are redeemable by the Company at its option, in whole or in part, on or after September 1, 2025. Initial debt issuance costs were \$611 thousand. The debt balance of \$24.5 million is presented net of unamortized issuance costs of \$510 thousand at June 30, 2021.

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Note 9 – Other Liabilities

The Company had the following other liabilities at June 30, 2021 and December 31, 2020.

(Dollars in thousands)	June 30, 2021	December 31, 2020
Accrued interest payable	\$ 557	\$ 647
Deferred compensation liability	3,669	2,905
Income taxes payable	1,007	—
Other liabilities	2,609	3,686
Total	<u>\$ 7,842</u>	<u>\$ 7,238</u>

Note 10 - Stock-Based Compensation

At the 2016 annual meeting, stockholders approved the Shore Bancshares, Inc. 2016 Stock and Incentive Plan (“2016 Equity Plan”), replacing the Shore Bancshares, Inc. 2006 Stock and Incentive Plan (“2006 Equity Plan”), which expired on that date. The Company may issue shares of common stock or grant other equity-based awards pursuant to the 2016 Equity Plan. Stock-based awards granted to date generally are time-based, vest in equal installments on each anniversary of the grant date and range over a one- to five-year period of time, and, in the case of stock options, expire 10 years from the grant date. As part of the 2016 Equity Plan, a performance equity incentive award program, known as the “Long-term incentive plan” allows participating officers of the Company to earn incentive awards of performance share/restricted stock units if certain pre-determined targets are achieved at the end of a three-year performance cycle. Stock-based compensation expense based on the grant date fair value is recognized ratably over the requisite service period for all awards and reflects forfeitures as they occur. The 2016 Equity Plan originally reserved 750,000 shares of common stock for grant, and 583,831 shares remained available for grant at June 30, 2021.

The following tables provide information on stock-based compensation expense for the three and six months ended June 30, 2021 and 2020.

(Dollars in thousands)	For Three Months Ended June 30,		For Six Months Ended June 30,	
	2021	2020	2021	2020
Stock-based compensation expense	\$ 99	\$ 62	\$ 196	\$ 123
Excess tax benefits related to stock-based compensation	2	7	3	14

(Dollars in thousands)	June 30,	
	2021	2020
Unrecognized stock-based compensation expense	\$ 230	\$ 198
Weighted average period unrecognized expense is expected to be recognized	0.6 years	0.7 years

The following table summarizes restricted stock award activity for the Company under the 2016 Equity Plan for the six months ended June 30, 2021.

	Six Months Ended June 30, 2021	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	24,505	\$ 13.78
Granted	24,583	13.34
Vested	(16,999)	13.93
Forfeited	—	—
Nonvested at end of period	<u>32,089</u>	<u>\$ 13.29</u>

The fair value of restricted stock awards that vested during the first six months of 2021 and 2020 was \$236 thousand and \$254 thousand, respectively.

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The following table summarizes stock option activity for the Company under the 2016 Equity Plan for the six months ended June 30, 2021.

	Six Months Ended June 30, 2021	
	Number of Shares	Weighted Average Grant Date Exercise Price
Outstanding at beginning of period	2,709	\$ 6.64
Granted	—	—
Exercised	—	—
Expired/Cancelled	—	—
Outstanding at end of period	2,709	\$ 6.64
Exercisable at end of period	2,709	\$ 6.64

There were no stock options granted during the three and six months ended June 30, 2021 and June 30, 2020.

At the end of the second quarter of 2021, the aggregate intrinsic value of the options outstanding under the 2016 Equity Plan was \$27 thousand based on the \$16.75 market value per share of the Company's common stock at June 30, 2021. Similarly, the aggregate intrinsic value of the options exercisable was \$27 thousand at June 30, 2021. At June 30, 2021, the weighted average remaining contract life of options outstanding and exercisable was 9 months.

Note 11 – Accumulated Other Comprehensive Income

The Company records unrealized holding gains (losses), net of tax, on investment securities available for sale as accumulated other comprehensive income (loss), a separate component of stockholders' equity. The following table provides information on the changes in the components of accumulated other comprehensive income (loss) for the six months ended June 30, 2021 and 2020.

(Dollars in thousands)	Unrealized gains (losses) on available for sale securities	Unrealized gains (losses) on securities transferred from Available-for-sale to Held-to-maturity	Accumulated other comprehensive income (loss)
Balance, December 31, 2020	\$ 1,529	\$ —	\$ 1,529
Other comprehensive loss	(923)	—	(923)
Balance, June 30, 2021	\$ 606	\$ —	\$ 606
Balance, December 31, 2019	\$ 218	\$ (11)	\$ 207
Other comprehensive income	2,047	9	2,056
Reclassification of (gain) recognized	(259)	—	(259)
Balances, June 30, 2020	\$ 2,006	\$ (2)	\$ 2,004

Note 12 – Fair Value Measurements

Accounting guidance under GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This accounting guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as

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impaired loans, loans held for sale and other real estate owned (foreclosed assets). These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under fair value accounting guidance, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine their fair values. These hierarchy levels are:

Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Below is a discussion on the Company's assets measured at fair value on a recurring basis.

Investment Securities Available for Sale

Fair value measurement for investment securities available for sale is based on quoted prices from an independent pricing service. The fair value measurements consider observable data that may include present value of future cash flows, prepayment assumptions, credit loss assumptions and other factors. The Company classifies its investments in U.S. Treasury securities, if any, as Level 1 in the fair value hierarchy, and it classifies its investments in U.S. Government agencies securities and mortgage-backed securities issued or guaranteed by U.S. Government sponsored entities as Level 2.

Equity Securities

Fair value measurement for equity securities is based on quoted market prices retrieved by the Company via on-line resources. Although these securities have readily available fair market values, the Company determined that they should be classified as level 2 investments in the fair value hierarchy due to not being considered traded in a highly active market.

The tables below present the recorded amount of assets measured at fair value on a recurring basis at June 30, 2021 and December 31, 2020. No assets were transferred from one hierarchy level to another during the first six months of 2021 or 2020.

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2021				
Securities available for sale:				
U.S. Government agencies	\$ 17,987	\$ —	\$ 17,987	\$ —
Mortgage-backed	95,970	—	95,970	—
	<u>113,957</u>	<u>—</u>	<u>113,957</u>	<u>—</u>
Equity	1,384	—	1,384	—
Total	<u>\$ 115,341</u>	<u>\$ —</u>	<u>\$ 115,341</u>	<u>\$ —</u>

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(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2020				
Securities available for sale:				
U.S. Government agencies	\$ 23,537	\$ —	\$ 23,537	\$ —
Mortgage-backed	116,031	—	116,031	—
	139,568	—	139,568	—
Equity	1,395	—	1,395	—
Total	<u>\$ 140,963</u>	<u>\$ —</u>	<u>\$ 140,963</u>	<u>\$ —</u>

Below is a discussion on the Company's assets measured at fair value on a nonrecurring basis.

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts according to the contractual terms of the loan agreement when due. Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent and these are considered Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable, discounted on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and the client's business.

Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the factors identified above. Valuation techniques are consistent with those techniques applied in prior periods.

Other Real Estate Owned (Foreclosed Assets)

Foreclosed assets are adjusted for fair value upon transfer of loans to foreclosed assets establishing a new cost basis. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. The estimated fair value for foreclosed assets included in Level 3 are determined by independent market based appraisals and other available market information, less costs to sell, that may be reduced further based on market expectations or an executed sales agreement. If the fair value of the collateral deteriorates subsequent to the initial recognition, the Company records the foreclosed asset as a non-recurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

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The following tables set forth the Company's financial and nonfinancial assets subject to fair value adjustments (impairment) on a nonrecurring basis at June 30, 2021 and December 31, 2020, that are valued at the lower of cost or market. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Quantitative Information about Level 3 Fair Value Measurements					
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average (3)	
June 30, 2021						
Nonrecurring measurements:						
Impaired loans	\$ 617	Appraisal of collateral	(1)Liquidation expense (2)	10%	(10%)	
Impaired loans	\$ 413	Discounted cash flow analysis	(1)Discount rate	4% - 7.25%	(6%)	
Other real estate owned	\$ 203	Appraisal of collateral	(1)Appraisal adjustments (2)	0% - 19%	(1%)	

	Quantitative Information about Level 3 Fair Value Measurements				
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Range	Weighted Average (3)
December 31, 2020					
Nonrecurring measurements:					
Impaired loans	\$ 610	Appraisal of collateral	(1)Liquidation expense (2)	10%	(10%)
Impaired loans	\$ 1,110	Discounted cash flow analysis	(1)Discount rate	6% - 7.25%	(6%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral (impaired loans and OREO) or discounted cash flow analyses (impaired loans), which generally include various level III inputs which are not identifiable.
- (2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.
- (3) Unobservable inputs were weighted by the relative fair value of the instruments.

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The carrying amounts and estimated fair values of the Company's financial instruments not carried at fair value on the Company's Consolidated Balance Sheets are presented in the following table. Fair values for June 30, 2021 and December 31, 2020 were estimated using an exit price notion.

	June 30, 2021		December 31, 2020	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(Dollars in thousands)				
Financial assets				
Level 1 inputs				
Cash and cash equivalents	\$ 237,188	\$ 237,188	\$ 186,917	\$ 186,917
Level 2 inputs				
Investment securities held to maturity	\$ 198,884	\$ 197,991	\$ 65,706	\$ 65,828
Restricted securities	3,189	3,189	3,626	3,626
Cash surrender value on life insurance	41,672	41,672	31,018	31,018
Level 3 inputs				
Loans, net	\$ 1,457,341	\$ 1,458,057	\$ 1,440,368	\$ 1,436,292
Financial liabilities				
Level 2 inputs				
Deposits:				
Noninterest-bearing demand	\$ 538,009	\$ 538,009	\$ 509,091	\$ 509,091
Checking plus interest	443,919	443,919	446,243	446,243
Money market	406,009	406,009	292,974	292,974
Savings	215,063	215,063	177,524	177,524
Club	1,138	1,138	392	392
Certificates of deposit, \$100,000 or more	134,670	136,059	129,623	131,271
Other time	141,774	142,534	144,858	146,137
Securities sold under retail repurchase agreement	2,907	2,907	1,050	1,050
Subordinated debt	24,490	26,871	24,429	25,745

Note 13 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, to meet the financial needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

The following table provides information on commitments outstanding at June 30, 2021 and December 31, 2020.

	June 30, 2021	December 31, 2020
(Dollars in thousands)		
Commitments to extend credit	\$ 291,141	\$ 248,607
Letters of credit	7,386	7,944
Total	<u>\$ 298,527</u>	<u>\$ 256,551</u>

Note 14 – Revenue Recognition

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees and merchant income. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided.

Check orders and other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers' accounts.

Trust and Investment Fee Income

Trust and investment fee income are primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives.

Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered.

Other Noninterest Income

Other noninterest income consists of: fees, exchange, other service charges, safety deposit box rental fees, and other miscellaneous revenue streams. Fees and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that rentals and renewals of safe deposit boxes will be recognized on a monthly basis consistent with the duration of the performance obligation.

The following presents noninterest income from continuing operations, segregated by revenue streams in-scope and out-of-scope of Topic 606, for the three and six months ended June 30, 2021 and 2020.

(Dollars in thousands)	For Three Months Ended June 30,		For Six Months Ended June 30,	
	2021	2020	2021	2020
Noninterest Income				
<i>In-scope of Topic 606:</i>				
Service charges on deposit accounts	\$ 683	\$ 544	\$ 1,357	\$ 1,410
Trust and investment fee income	475	363	882	738
Interchange income	1,036	708	1,906	1,361
Other noninterest income	456	407	760	686
Noninterest Income (in-scope of Topic 606)	2,650	2,022	4,905	4,195
Noninterest Income (out-of-scope of Topic 606)	253	747	555	926
Total Noninterest Income	\$ 2,903	\$ 2,769	\$ 5,460	\$ 5,121

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2021, and December 31, 2020, the Company did not have any significant contract balances.

Note 15 – Proposed Merger

On March 3, 2021, the Company and Severn Bancorp, Inc. ("Severn") entered into a definitive agreement for the Company to acquire the Maryland-based Severn.

This transaction will create the third largest community bank headquartered in Maryland. One of the primary reasons for the proposed acquisition of Severn was the ability to access and deploy excess capital and deposits into a high growth market, while also enhancing scale to drive efficiency and profitability. Additionally, this transaction will create a competitive position in the Columbia/Baltimore/Towson MSA, while filling in our current market footprint.

Under the terms of the agreement, Severn shareholders will receive 0.6207 shares of Shore common stock and \$1.59 in cash for each share of Severn common stock. Upon closing, Shore shareholders will own approximately 59.6% of the combined Company and Severn shareholders will own approximately 40.4% of the combined Company. The transaction is still subject to satisfaction of customary closing conditions, including regulatory approvals and shareholder approval from Shore and Severn shareholders. The transaction is expected to close in the fourth quarter of 2021.

As of June 30, 2021, Severn had more than \$1.1 billion in assets and operated 7 full-service community banking offices throughout Anne Arundel County, Maryland.

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

Unless the context clearly suggests otherwise, references to "the Company", "we", "our", and "us" in the remainder of this report are to Shore Bancshares, Inc. and its consolidated subsidiary.

Forward-Looking Information

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "should," "could," "predict," "potential," "believe," "will likely result," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "project," "projection," "forecast," "goal," "target," "would," "aim" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry and management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. The inclusion of these forward-looking statements should not be regarded as a representation by us or any other person that such expectations, estimates and projections will be achieved. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions and uncertainties that are difficult to predict. New risks and uncertainties may emerge from time to time, and it is not possible for us to predict their occurrence. In addition, we cannot assess the impact of each risk and uncertainty on our business or the extent to which any risk or uncertainty, or combination of risks and uncertainties, may cause actual results to differ materially from those contained in any forward-looking statements.

Further, given its ongoing and dynamic nature, it is difficult to predict the full impact of the novel coronavirus ("COVID-19") outbreak on our business. The extent of such impact will depend on future developments, which are highly uncertain, including when the coronavirus can be controlled and abated and when and how the economy may be fully reopened. As the result of the COVID-19 pandemic and the related adverse local and national economic consequences, we could be subject to any of the following risks, any of which could have a material, adverse effect on our business, financial condition, liquidity, and results of operations: the demand for our products and services may decline, making it difficult to grow assets and income; if the economy is unable to substantially reopen, and high levels of unemployment continue for an extended period of time, loan delinquencies, problem assets, and foreclosures may increase, resulting in increased charges and reduced income; collateral for loans, especially real estate, may decline in value, which could cause loan losses to increase; our allowance for loan losses may increase if borrowers experience financial difficulties, which will adversely affect our net income; the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; as the result of the decline in the Federal Reserve's target federal funds rate to near 0%, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread and reducing net income; our cybersecurity risks are increased as the result of an increase in the number of employees working remotely; and FDIC premiums may increase if the agency experiences additional resolution costs.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking information and statements contained in this Quarterly Report on Form 10-Q and other reports and registration statements filed by us with the Securities and Exchange Commission ("SEC"). For information on the factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A of our 2020 Form 10-K and other reports as filed with the SEC.

Any forward-looking statement speaks only as of the date of this report, and we do not undertake any obligation to publicly update or review any forward-looking statement, whether because of new information, future developments or otherwise, except as required by law.

Introduction

The following discussion and analysis is intended as a review of significant factors affecting the Company's financial condition and results of operations for the periods indicated. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes presented elsewhere in this report, as well as the audited consolidated financial statements and related notes included in the 2020 Annual Report.

Shore Bancshares, Inc. is the largest independent financial holding company headquartered on the Eastern Shore of Maryland. It is the parent company of Shore United Bank. The Bank operates 22 full-service branches in Baltimore County, Howard County, Kent County, Queen Anne's County, Talbot County, Caroline County, Dorchester County and Worcester County in Maryland, Kent County, Delaware and Accomack County, Virginia. The Company engages in trust and wealth management services through Wye Financial Partners, a division of Shore United Bank.

The shares of common stock of Shore Bancshares, Inc. are listed on the NASDAQ Global Select Market under the symbol "SHBI".

Shore Bancshares, Inc. maintains an Internet site at www.shorebancshares.com on which it makes available free of charge its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC.

COVID-19 Pandemic

The outbreak of COVID-19 has led to adverse impacts on economic conditions and created uncertainty in financial markets. Correspondingly, in early March 2020, the Company began preparing for potential disruptions and government limitations of activity in the markets in which we serve. Our team activated our Business Continuity Program and was able to quickly execute on multiple initiatives to adjust our operations to protect the health and safety of our employees and clients. Since the beginning of the crisis, we have been in close contact with our clients, assessing the level of impact on their businesses, and providing relief programs according to each client's specific situation and qualifications. We have also enhanced awareness of digital banking offerings, expanded services at our drive through locations, and allowed customers to make appointments in the branch for critical services. The Company's branches remain open and have taken steps to comply with various government directives regarding "social distancing," as well as, enhanced cleaning and disinfecting of all surface areas to protect its clients and employees.

Small Business Administration's Paycheck Protection Program

We established our process for participating in the Small Business Administration's Paycheck Protection Program ("PPP") that enabled our clients to utilize this valuable resource beginning in April 2020. Loans under the PPP are designed to provide assistance for small businesses during the COVID-19 pandemic to help meet the costs associated with payroll, mortgage interest, rent and utilities. These loans are guaranteed by the SBA and forgiveness of the loans, by the SBA, is granted to the borrower if the borrower uses at least 60% of the funds to cover payroll costs and benefits. Forgiveness is also based on the small business maintaining or quickly rehiring their employees and maintaining salary levels for their employees. Loans under the PPP do not require any collateral or personal guarantees, as such, these loans are included in the Company's commercial loans segment. The first round of PPP lending resulted in 1,495 loans for \$129.0 million, of which 1,037 loans have been forgiven or paid down in the amount of \$102.3 million as of June 30, 2021. The second round of PPP lending which began in 2021, resulted in 959 loans for \$67.3 million, of which 223 loans have been forgiven or paid down in the amount of \$7.2 million. As of June 30, 2021, the Company had 1,195 PPP loans totaling \$86.8 million that were outstanding, inclusive of loans issued during both the first and second rounds of the PPP. This has allowed us to further strengthen and deepen our client relationships, while positively impacting thousands of individuals. We are also closely monitoring the credit quality of the loan portfolio and monitor lines of credit draws for deviation from normal activity to improve loan performance and reduce credit risk.

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Short-term Modifications for Borrowers

In keeping with regulatory guidance to work with borrowers during this unprecedented situation and as outlined in Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) and the Consolidated Appropriations Act of 2021 (“CAA”), the Company is providing modifications where appropriate, including interest only payments or payment deferrals for clients that could be adversely affected by the COVID-19 pandemic. Section 4013 of the CARES Act and CAA addressed COVID-19 related modifications and specified that such modifications made on loans that were current as of December 31, 2019 are not TDRs. In accordance with interagency guidance issued in April 2020 and December 2020, short-term modifications made to borrowers affected by the COVID-19 pandemic and governmental shutdown orders, such as payment deferrals, fee waivers and extensions of repayment terms, do not need to be identified as TDRs if the loans were current at the time a modification plan was implemented. Since the beginning of the pandemic and through June 30, 2021, the Company had executed principal and/or interest deferrals on outstanding loan balances of \$221.1 million, of which only \$9.5 million, or 0.65% of the total portfolio, remained on deferral as of June 30, 2021.

(Dollars in thousands)	Total Loan Balance as of June 30, 2021	Total Loans Modified as of June 30, 2021	Loans Modified to Interest Only Payments (6 months or less)	Loans Modified to Payment Deferral (3 months)	Percentage of Loans Modified
Hospitality Industry	\$ 108,823	\$ 9,526	\$ 9,526	\$ -	8.75 %
Non-owner occupied Retail Stores	139,580	-	-	-	—
Non-owner occupied Restaurants	6,255	-	-	-	—
Owner-occupied Retail Stores	13,741	-	-	-	—
Owner-occupied Restaurants	16,276	-	-	-	—
Oil & Gas Industry	-	-	-	-	—
Other Commercial Loans	754,139	-	-	-	—
Total Commercial Loans	1,038,814	9,526	9,526	-	0.92
Residential 1-4 family Personal	222,713	-	-	-	—
Residential 1-4 family Rentals	107,939	-	-	-	—
Home Equity Loans	43,809	-	-	-	—
Total Residential Real Estate Loans	374,461	-	-	-	—
Consumer Loans	62,823	-	-	-	—
Mortgage Warehouse Loans	-	-	-	-	—
Credit Card, Overdrafts and Other	(3,669)	-	-	-	—
TOTAL LOANS	\$ 1,472,429	\$ 9,526	\$ 9,526	\$ -	0.65 %

Liquidity

We are vigilantly monitoring our liquidity position on an ongoing basis. The Company has several available sources of on and off-balance sheet liquidity. Currently, the Company has not needed to tap into these available liquidity sources due to payment deferrals by customers, funding of PPP loans, or organic loan growth. Additional discussion on our liquidity as of the report date is reflected in the “Liquidity and Capital Resources” section of management’s discussion and analysis.

Share Repurchases

At the present time all share repurchases have been suspended due to the current status of our merger with Severn. Once the merger is consummated, the Company intends to resume its current share buyback program in which \$546 thousand remains available. The Board of directors and management will re-evaluate the need for an additional stock repurchase program once the current plan is exhausted or expires.

Dividends and Capital

We currently expect to maintain our quarterly cash dividend based on our strong capital position. At June 30, 2021, the Bank exceeded all the capital requirements to which it was subject, and based on the most recent notification from its primary federal regulator is considered to be well-capitalized. There are no conditions or events since that notification that management believes would change the Bank’s classification. We are closely monitoring our capital position and

are taking appropriate steps to ensure our level of capital remains strong. Our capital, while significant, may deteriorate in future periods due to the impact of the pandemic and limit our ability to pay dividends.

Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

The most significant accounting policies that the Company follows are presented in Note 1 of the 2020 Annual Report. These policies, along with the disclosures presented in the notes to the financial statements and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has determined that the accounting policies with respect to the allowance for credit losses and goodwill and other intangible assets are critical accounting policies. These policies are considered critical because they relate to accounting areas that require the most subjective or complex judgments, and, as such, could be most subject to revision as new information becomes available.

The allowance for credit losses represents management's estimate of credit losses inherent in the loan portfolio as of the balance sheet date. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of similar loans based on historical loss experience, and consideration of current economic trends and conditions and other factors, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheets. Note 1 to the 2020 Annual Report describes the methodology used to determine the allowance for credit losses. A discussion of the allowance determination and factors driving changes in the amount of the allowance for credit losses is included in the Provision for Credit Losses and Allowance for Credit Losses sections below.

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Determining fair value is subjective, requiring the use of estimates, assumptions and management judgment. Goodwill is tested at least annually for impairment, usually during the fourth quarter, or on an interim basis if circumstances dictate. Impairment testing requires a qualitative assessment or that the fair value of each of the Company's reporting units be compared to the carrying amount of its net assets, including goodwill. If the fair value of a reporting unit is less than book value, an expense may be required to write down the related goodwill to record an impairment loss. As of June 30, 2021, the Company had only one banking reporting unit.

OVERVIEW

The Company reported net income of \$4.0 million for the second quarter of 2021, or diluted income per common share of \$0.34, compared to net income of \$5.3 million, or diluted income per common share of \$0.43, for the second quarter of 2020. For the first quarter of 2021, the Company reported net income of \$4.0 million, or diluted income per common share of \$0.34. When comparing net income for the second quarter of 2021 to the second quarter of 2020, the decrease was due to salary and wages being deferred in the second quarter of 2020 due to the originations of the first round of PPP loans. Despite these salary and wage deferrals, net interest income increased when compared to the second quarter of 2020 by \$1.1 million, while a reduced provision for credit losses of \$350 thousand and higher noninterest income of \$134 thousand had a positive impact on net income. When comparing the second quarter of 2021 to the first quarter of 2021, the net income was essentially unchanged, from period to period with offsetting variances related to higher net interest income of \$303 thousand and noninterest income of \$346 thousand, partially offset by an increase in the provision for credit losses of \$225 thousand and noninterest expense of \$377 thousand. Merger-related expenses of \$377 thousand were recorded in

the second quarter of 2021, which had an impact on the profitability of the quarter when compared to the linked and previous quarters.

For the first six months of 2021, the Company reported net income of \$8.0 million, or diluted income per common share of \$0.68, compared to net income of \$8.5 million, or diluted income per common share of \$0.68, for the first six months of 2020. When comparing net income for the first six months of 2021 to the first six months of 2020, the decrease in net income was primarily due to the deferral of salaries and wages as previously mentioned above, as well as an increase in almost all noninterest expense line items for a total of \$3.4 million, partially offset by improvements in net interest income of \$2.4 million, noninterest income of \$339 thousand and a reduced provision for credit losses of \$275 thousand. The reason for the similar diluted income per share for both periods despite the lower net income in 2021, was due to buybacks of the Company's common stock, resulting in fewer outstanding shares period over period.

RESULTS OF OPERATIONS

Net Interest Income

Tax-equivalent net interest income is net interest income adjusted for the tax-favored status of income from certain loans and investments. As shown in the table below, tax-equivalent net interest income was \$14.1 million for the second quarter of 2021 and \$13.1 million for the second quarter of 2020. Tax-equivalent net interest income was \$13.8 million for the first quarter of 2021. The increase in net interest income when comparing the second quarter of 2021 to the second quarter of 2020, was the result of higher interest and fees on loans and income from taxable investment securities, coupled with a decrease in interest expense. Net interest income increased for the second quarter of 2021 when compared to the first quarter of 2021 due to an increase in income from taxable investment securities and a decrease in interest expense. Net interest margin is tax-equivalent net interest income (annualized) divided by average earning assets. The net interest margin for the second quarter of 2021 was 2.91%, which was a decrease of 50bps when compared to 3.41% for the second quarter of 2020 and a decrease of 9bps when compared to 3.00% for the first quarter of 2021. The decline in net interest margin in the second quarter of 2021 when compared to the first quarter of 2021 and the second quarter of 2020, was significantly impacted by excess liquidity and the decrease in yields of taxable investment securities. Without excess liquidity of \$100 million, the margin for the second quarter of 2021 would have been 3.07%.

Interest Income

On a tax-equivalent basis, interest income increased \$938 thousand, or 6.4%, for the second quarter of 2021 when compared to the second quarter of 2020. The increase was the result of higher interest and fees on loans and income from investment securities. The primary driver for the increase in interest income on loans was the higher average volume of loans of \$70.4 million, which included PPP lending. The average balance of investment securities increased \$178.2 million, providing \$457 thousand of additional income, despite a decrease in the average yield of 84bps.

On a tax-equivalent basis, interest income increased \$189 thousand, or 1.2%, for the second quarter of 2021 when compared to the first quarter of 2021. The increase was primarily a result of taxable investment securities which were purchased during the second quarter of 2021, resulting in a higher average balance in these securities of \$58.3 million.

Interest Expense

Interest expense decreased \$135 thousand, or 8.6%, when comparing the second quarter of 2021 to the second quarter of 2020. The decrease in interest expense from the second quarter of 2020 was a result of the decrease in the average rate paid on interest-bearing deposits of 29bps. This decrease in interest expense was partially offset by the issuance of subordinated debt in the third quarter of 2020 which added \$370 thousand of additional expense for the second quarter of 2021.

Interest expense decreased \$116 thousand, or 7.5%, when comparing the second quarter of 2021 to the first quarter of 2021. The decrease in interest expense on deposits was due to a 6bps decline in the average rate paid on interest-bearing deposits, specifically time deposits that matured and renewed during the second quarter of 2021.

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The following tables present the distribution of the average consolidated balance sheets, interest income/expense, and annualized yields earned and rates paid for the three months ended June 30, 2021 and 2020.

(Dollars in thousands)	For Three Months Ended June 30, 2021			For Three Months Ended June 30, 2020		
	Average Balance	Income(1)/ Expense	Yield/ Rate	Average Balance	Income(1)/ Expense	Yield/ Rate
Earning assets						
Loans (2), (3)	\$ 1,444,684	\$ 14,419	4.00 %	\$ 1,374,324	\$ 13,982	4.09 %
Investment securities:						
Taxable	286,121	1,095	1.53	107,908	638	2.37
Interest-bearing deposits	218,704	55	0.10	57,713	11	0.07
Total earning assets	1,949,509	15,569	3.20 %	1,539,945	14,631	3.82 %
Cash and due from banks	16,908			18,167		
Other assets	109,457			90,981		
Allowance for credit losses	(14,660)			(10,706)		
Total assets	\$ 2,061,214			\$ 1,638,387		
Interest-bearing liabilities						
Demand deposits	\$ 405,473	132	0.13 %	\$ 298,568	145	0.20 %
Money market and savings deposits	605,202	251	0.17	426,963	246	0.23
Certificates of deposit \$100,000 or more	135,376	350	1.04	130,582	586	1.81
Other time deposits	143,821	323	0.90	150,675	579	1.54
Interest-bearing deposits	1,289,872	1,056	0.33	1,006,788	1,556	0.62
Securities sold under retail repurchase agreements and short-term FHLB advances	3,123	2	0.26	2,030	1	0.20
Advances from FHLB - long-term	—	—	—	824	6	2.93
Subordinated debt	24,474	370	6.06	—	—	—
Total interest-bearing liabilities	1,317,469	1,428	0.43 %	1,009,642	1,563	0.62 %
Noninterest-bearing deposits	532,276			420,275		
Other liabilities	13,937			9,628		
Stockholders' equity	197,532			198,842		
Total liabilities and stockholders' equity	\$ 2,061,214			\$ 1,638,387		
Net interest spread		\$ 14,141	2.77 %		\$ 13,068	3.20 %
Net interest margin			2.91 %			3.41 %
Tax-equivalent adjustment						
Loans	\$ 38			\$ 37		
Total	\$ 38			\$ 37		

- (1) All amounts are reported on a tax-equivalent basis computed using the statutory federal income tax rate of 21.0%, exclusive of nondeductible interest expense.
- (2) Average loan balances include nonaccrual loans.
- (3) Interest income on loans includes accreted loan fees, net of costs and accretion of discounts on acquired loans, which are included in the yield calculations.

Net Interest Income

Tax-equivalent net interest income increased \$2.4 million, or 9.2%, during the six months ended June 30, 2021 compared to the six months ended June 30, 2020. The higher net interest income was due to an increase in interest income of \$1.6 million, or 5.4% and a decrease in interest expenses on interest-bearing deposits of \$1.4 million, or 38.0%. Despite the improved results, compression in the margin was due to lower yields on earning assets, specifically taxable investment securities of 71bps and interest-bearing deposits with the Fed of 54bps. This resulted in a net interest margin of 2.96% for the six months ended June 30, 2021 compared to 3.45% for the six months ended June 30, 2020.

Interest Income

On a tax-equivalent basis, interest income increased \$1.6 million, or 5.4%, for the six months ended June 30, 2021 when compared to the six months ended June 30, 2020. The increase was primarily due to higher interest and fees on loans of \$1.0 million, or 3.6% and taxable investment securities of \$668 thousand, or 49.2%. The increase in interest and fees on

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loans was due to a higher average balance of loans of \$128.9 million, or 9.8%, which included PPP loans which have a lower yield than more traditional loans, resulting in a lower overall yield of 23bps. The increase in interest on taxable investment securities was due to a higher average balance in these securities of \$138.5 million, or 116.7%, despite the decline in the average yield of such securities of 71bps.

Interest Expense

Interest expense decreased \$760 thousand, or 20.4%, when comparing the six months ended June 30, 2021 to the six months ended June 30, 2020. The decrease in interest expense was due to a decline in the rates paid on interest-bearing deposits of 37bps and the elimination of long-term advances from FHLB. These improvements were partially offset by the addition of subordinated debt, issued in the third quarter of 2020, which added \$729 thousand in interest expense for the first six months of 2021.

The following tables present the distribution of the average consolidated balance sheets, interest income/expense, and annualized yields earned and rates paid for the six months ended June 30, 2021 and 2020.

(Dollars in thousands)	For Six Months Ended June 30, 2021			For Six Months Ended June 30, 2020		
	Average Balance	Income(1)/ Expense	Yield/ Rate	Average Balance	Income(1)/ Expense	Yield/ Rate
Earning assets						
Loans (2), (3)	\$ 1,447,767	\$ 28,821	4.01 %	\$ 1,318,883	\$ 27,813	4.24 %
Investment securities:						
Taxable	257,130	2,025	1.59	118,659	1,357	2.30
Interest-bearing deposits	204,048	102	0.10	57,685	183	0.64
Total earning assets	1,908,945	30,948	3.27 %	1,495,227	29,353	3.95 %
Cash and due from banks	18,070			18,020		
Other assets	106,251			90,068		
Allowance for credit losses	(14,448)			(10,626)		
Total assets	\$ 2,018,818			\$ 1,592,689		
Interest-bearing liabilities						
Demand deposits	\$ 421,816	288	0.14 %	\$ 291,372	540	0.37 %
Money market and savings deposits	565,341	481	0.17	418,608	712	0.34
Brokered Deposits	—	—	—	—	—	—
Certificates of deposit \$100,000 or more	133,073	756	1.14	129,995	1,183	1.83
Other time deposits	144,367	715	1.00	150,659	1,180	1.58
Interest-bearing deposits	1,264,597	2,240	0.36	990,634	3,615	0.73
Securities sold under retail repurchase agreements and federal funds purchased	2,683	3	0.23	1,632	3	0.37
Advances from FHLB - short-term	—	—	—	—	—	—
Advances from FHLB - long-term	—	—	—	7,912	113	2.87
Subordinated debt	24,459	729	6.01	—	—	—
Total interest-bearing liabilities	1,291,739	2,972	0.46 %	1,000,178	3,731	0.75 %
Noninterest-bearing deposits	518,030			386,478		
Other liabilities	12,383			9,446		
Stockholders' equity	196,666			196,587		
Total liabilities and stockholders' equity	\$ 2,018,818			\$ 1,592,689		
Net interest spread		\$ 27,976	2.81 %		\$ 25,622	3.20 %
Net interest margin			2.96 %			3.45 %
Tax-equivalent adjustment						
Loans		\$ 74			\$ 73	
Total		<u>\$ 74</u>			<u>\$ 73</u>	

- (1) All amounts are reported on a tax-equivalent basis computed using the statutory federal income tax rate of 21.0%, exclusive of nondeductible interest expense.
- (2) Average loan balances include nonaccrual loans.
- (3) Interest income on loans includes accreted loan fees, net of costs and accretion of discounts on acquired loans, which are included in the yield calculations.

Noninterest Income

Total noninterest income for the second quarter of 2021 increased \$134 thousand, or 4.8%, when compared to the second quarter of 2020. The increase from the second quarter of 2020 was due to higher deposit related fees, other bank service charges and trust and investment fee income, partially offset by the absence of gains on sale of investment securities. Noninterest income increased \$346 thousand, or 13.5%, when compared to the first quarter of 2021 primarily due to higher deposit related fees and service charges.

Total noninterest income for the six months ended June 30, 2021 increased \$339 thousand, or 6.6%, when compared to the same period in 2020. The increase in noninterest income primarily consisted of increases in deposit related fees, other bank service charges and trust and investment fee income, partially offset by the absence of gains on sale of investment securities. The increases in deposit related fees and other bank service charges were mostly due to the local government-imposed shutdowns in 2020 and a return to a more normalized local economy and consumer demand for products and services in 2021.

Noninterest Expense

Total noninterest expense for the second quarter of 2021 increased \$3.2 million, or 41.9%, when compared to the second quarter of 2020 and increased \$377 thousand, or 3.6%, when compared to the first quarter of 2021. The increase in noninterest expenses when compared to the second quarter of 2020 was primarily driven by salary and wages being deferred in the second quarter of 2020, the result of originating first round PPP loans. Absent the increased deferrals of salaries and wages related to the first round of PPP, increases in furniture and fixtures, data processing, FDIC insurance and merger-related expenses resulted in the overall increase in noninterest expenses. The significant growth in new and existing customer accounts accounted for the increase in data processing costs and FDIC insurance premiums. The increase in noninterest expense when compared to the first quarter of 2021 was primarily due to merger-related expenses, salaries and wages, furniture and fixtures and legal and professional fees, partially offset by lower employee benefit costs due to lower payroll taxes and medical claims. The increase in salaries and wages was mainly attributed to the deferral of costs associated with originating the second round of PPP loans in the first quarter of 2021. The increase in furniture and fixtures when compared to both the second quarter of 2020 and the first quarter of 2021 was due to an on-going branch renovation.

Total noninterest expense for the six months ended June 30, 2021 increased \$3.4 million, or 18.7%, when compared to the same period in 2020. The increase was mainly the result of the absence of the deferral in salaries and wages due to PPP loan originations in 2020, higher data processing costs, FDIC insurance premiums and occupancy costs. The higher occupancy costs are associated with a new branch lease in Ocean City, Maryland which will open in 2022. In addition, the Company recorded merger-related expenses of \$377 thousand for the first six months of 2021 due to the pending acquisition of Severn.

Provision for Credit Losses

The provision for credit losses was \$650 thousand for the second quarter of 2021, \$1.0 million for the second quarter of 2020 and \$425 thousand for the first quarter of 2021. The ratio of the allowance for credit losses to period-end loans was 1.02% at June 30, 2021, 0.95% at December 31, 2020 and 0.98% at March 31, 2021. Excluding PPP loans, the ratio of the allowance for credit losses to period-end loans was 1.09% at June 30, 2021, higher than both the 1.04% at December 31, 2020 and the 1.07% at March 31, 2021. The primary drivers of the increased percentage of the allowance to total loans, excluding PPP loans, as compared to December 31, 2020 and March 31, 2021, were significant loan originations in the second quarter of 2021, specifically within the construction and consumer loan portfolios, which require a higher level of allowance than the PPP loans which were forgiven during the second quarter of 2021, coupled with pandemic related qualitative factors which have remained elevated due to uncertainty and associated risks with the COVID-19 virus/variants and lagging vaccination rates. The Company reported net recoveries in the second quarter of 2021 of \$125 thousand, compared to net recoveries of \$61 thousand for the fourth quarter of 2020 and no net charge offs or recoveries for the first quarter of 2021.

The provision for credit losses for the six months ended June 30, 2021 and 2020 was \$1.1 million and \$1.4 million, respectively, while net recoveries were \$125 thousand and net charge-offs were \$767 thousand, respectively. The decrease in provision for credit losses was the result of lower charge-offs in 2021 and overall improved credit quality. The ratio of allowance to total loans increased from 0.95% at December 31, 2020, to 1.02% at June 30, 2021. Excluding PPP loans, the ratio of the allowance for credit losses to period-end loans was 1.09% at June 30, 2021, higher than the 1.04% at December 31, 2020. The primary drivers for the increase in the percentage of allowance for credit losses to total loans were significant originations within the construction and consumer loan portfolios, which require a higher level of allowance than the PPP loans that were forgiven during the second quarter of 2021, as well as continued elevated pandemic related qualitative factors. The ratio of annualized net recoveries to average loans was 0.03% for the first half of 2021, compared to annualized net charge-offs of 0.12% for the first half of 2020. Management will continue to evaluate the adequacy of the allowance for credit losses as more economic data becomes available and as changes within the Company's portfolio are known.

Income Taxes

The Company reported income tax expense of \$1.4 million for the second quarter of 2021, \$1.8 million for the second quarter of 2020 and \$1.4 million for the first quarter of 2021. Income tax expense decreased when compared to the second quarter of 2020 due to lower pre-tax earnings and stayed flat when compared to the first quarter of 2021. The effective tax rate for the first and second quarter of 2021 was 26.4% and was 25.2% for the second quarter of 2020. Income tax expense for the six months ended June 30, 2021 and the six months ended June 30, 2020 remained flat at \$2.9 million.

ANALYSIS OF FINANCIAL CONDITION

Loans

Loans totaled \$1.472 billion at June 30, 2021 and \$1.454 billion at December 31, 2020, an increase of \$18.2 million, or 1.2%. Excluding PPP loans, the increase in total loans was \$68.6 million, or 4.7%, due to significant loan growth late in the second quarter of 2021. The increase in loans, excluding PPP loans, was comprised of increases in consumer loans of \$32.9 million, or 104.6%, commercial loans of \$10.9 million, or 5.2%, construction loans of \$10.0 million, or 9.4%, and residential real estate loans of \$6.3 million, or 1.4%. These increases were partially offset by a decrease in commercial real estate loans of \$6.0 million, or less than 1%. Construction loans included deferred fees, net of deferred costs, of \$549 thousand and discounts on acquired loans of \$625 thousand at June 30, 2021, compared to deferred costs, net of deferred fees, of \$622 thousand and discounts on acquired loans of \$754 thousand at December 31, 2020. Outstanding PPP loans totaled \$86.8 million at June 30, 2021 and \$122.8 million at December 31, 2020, a decrease of \$36.0 million or 29.3%. The decrease was primarily due to forgiveness on first round PPP loans originated in 2020, partially offset by the origination of second round PPP loans in 2021. We do not engage in foreign or subprime lending activities. See Note 4, "Loans and Allowance for Credit Losses", in the Notes to Consolidated Financial Statements and below under the caption "Allowance for Credit Losses" for additional information.

Our loan portfolio has a commercial real estate loan concentration, which is generally defined as a combination of certain construction and commercial real estate loans. Construction loans were \$116.8 million, or 7.9% of total loans, at June 30, 2021 and \$106.8 million, or 7.3% of total loans, at December 31, 2020. Commercial real estate loans were \$655.3 million, or 44.5% of total loans, at June 30, 2021, compared to \$661.2 million, or 45.5% of total loans, at December 31, 2020.

The federal banking regulators have issued guidance for those institutions which are deemed to have concentrations in commercial real estate lending. Pursuant to the supervisory criteria contained in the guidance for identifying institutions with a potential commercial real estate concentration risk, institutions which have (1) total reported loans for construction, land development, and other land acquisitions which represent 100% or more of an institution's total risk-based capital; or (2) total non-owner occupied commercial real estate loans representing 300% or more of the institution's total risk-based capital and the institution's non-owner occupied commercial real estate loan portfolio (including construction) has increased 50% or more during the prior 36 months are identified as having potential commercial real estate concentration risk. Institutions which are deemed to have concentrations in commercial real estate lending are expected to employ heightened levels of risk management with respect to their commercial real estate portfolios, and may be required to hold higher levels of capital. The Company, like many community banks, has a concentration in commercial real estate loans,

and the Company has experienced significant growth in its commercial real estate portfolio in recent years. At June 30, 2021, non-owner-occupied commercial real estate loans (including construction, land and land development loans) represented 302.3% of total risk-based capital. At such time, construction, land and land development loans represented 56.8% of total risk-based capital.

The commercial real estate portfolio (including construction) has increased 41.7% during the prior 36 months. Management has extensive experience in commercial real estate lending, and has implemented and continues to maintain heightened risk management procedures, as well as strong underwriting criteria with respect to its commercial real estate portfolio. Monitoring practices include periodic stress testing analysis to evaluate changes to cash flows, owing to interest rate increases and declines in net operating income. We may be required to maintain higher levels of capital as a result of our commercial real estate concentrations, which could require us to obtain additional capital or be required to sell/participate portions of loans, which may adversely affect shareholder returns.

Allowance for Credit Losses

We have established an allowance for credit losses, which is increased by provisions charged against earnings and recoveries of previously charged-off loans and is decreased by current period charge-offs of uncollectible loans. Management evaluates the adequacy of the allowance for credit losses at least quarterly and adjusts the provision for credit losses based on this analysis. The evaluation of the adequacy of the allowance for credit losses is based primarily on a risk rating system of individual loans, as well as on a collective evaluation of smaller balance homogenous loans, each grouped by loan type. Each loan type is assigned allowance factors based on criteria such as past credit loss experience, local economic and industry trends, and other measures which may impact collectability. Please refer to the discussion above under the caption “Critical Accounting Policies” for an overview of the underlying methodology management employs to maintain the allowance.

The allowance for credit losses was \$15.1 million at June 30, 2021, \$13.9 million at December 31, 2020 and \$14.3 million at March 31, 2021. There were net recoveries of \$125 thousand for the second quarter of 2021, compared to net recoveries of \$61 thousand for the fourth quarter of 2020 and no net charge offs or recoveries for the first quarter of 2021. The ratio of annualized net recoveries to average loans was 0.03% for the second quarter of 2021, compared to annualized net recoveries of 0.02% for the fourth quarter of 2020 and 0% for the first quarter of 2021.

Management remains focused on its efforts to dispose of problem loans and to prudently charge-off nonperforming loans to enable the Company to continue to improve its overall credit quality. The allowance for credit losses as a percentage of period-end loans was 1.02% at June 30, 2021 and 0.95% at December 31, 2020. Excluding PPP loans, the ratio of the allowance for credit losses to period-end loans as 1.09% at June 30, 2021, higher than the 1.04% at December 31, 2020. The increase in the percentage of the allowance to total loans at June 30, 2021, compared to December 31, 2020, was primarily due to significant loan growth in the second quarter of 2021 as previously discussed. Management currently believes that the provision for credit losses and the resulting allowance were adequate to provide for probable losses inherent in our loan portfolio at June 30, 2021.

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The following tables present a summary of the activity in the allowance for credit losses at or for the three and six months ended June 30, 2021 and 2020.

	For the Three Months Ended June 30,			
	2021		2020	
	Net (charge-offs) recoveries	Percentage of net charge-offs (recoveries) (annualized) to average loans outstanding during the year	Net (charge-offs) recoveries	Percentage of net charge-offs (recoveries) (annualized) to average loans outstanding during the year
(Dollars in thousands)				
Construction	\$ 5	(0.02)%	\$ 5	(0.02)%
Residential real estate	57	(0.05)	4	-
Commercial real estate	64	(0.04)	(331)	0.21
Commercial	(2)	-	24	(0.04)
Consumer	1	(0.01)	10	(0.16)
Total	\$ 125	(0.03)%	\$ (288)	0.08 %
Average loans outstanding during the period	\$ 1,444,684		\$ 1,374,324	
Allowance for credit losses at period end as a percentage of total period end loans ⁽¹⁾		1.02 %		0.79 %
Allowance for credit losses at period end as a percentage of average loans ⁽²⁾		1.04 %		0.81 %
Allowance for credit losses at period end as a percentage of period end nonaccrual loans		382.27 %		95.20 %

(1) At June 30, 2021, the loan balances used to calculate the ratio include PPP loans of \$86.8 million. Excluding PPP loans, the ratio is 1.09%. At June 30, 2020, the loan balances used to calculate the ratio included PPP loans of \$122.9 million. Excluding PPP loans, the ratio is 0.86%.

(2) At June 30, 2021, the quarter-to-date average loan balances used to calculate the ratio include PPP loans of \$116.9 million. Excluding PPP loans, the ratio is 1.14%. At June 30, 2020, the quarter-to-date average loan balances used to calculate the ratio included PPP loans of \$90.2 million. Excluding PPP loans, the ratio is 0.86%.

	For the Six Months Ended June 30,			
	2021		2020	
(Dollars in thousands)	Net (charge-offs) recoveries	Percentage of net charge-offs (recoveries) (annualized) to average loans outstanding during the year	Net (charge-offs) recoveries	Percentage of net charge-offs (recoveries) (annualized) to average loans outstanding during the year
Construction	\$ 10	(0.02)%	\$ 8	(0.01)%
Residential real estate	63	(0.03)	(184)	0.09
Commercial real estate	64	(0.02)	(601)	0.20
Commercial	(11)	0.01	5	(0.01)
Consumer	(1)	-	5	(0.04)
Total	\$ 125	(0.03)%	\$ (767)	0.12 %
Average loans outstanding during the period	\$ 1,447,767		\$ 1,318,883	
Allowance for credit losses at period end as a percentage of total period end loans ⁽¹⁾		1.02 %		0.79 %
Allowance for credit losses at period end as a percentage of average loans ⁽²⁾		1.04 %		0.84 %
Allowance for credit losses at period end as a percentage of period end nonaccrual loans		382.27 %		95.20 %

(1) At June 30, 2021, the loan balances used to calculate the ratio include PPP loans of \$86.8 million. Excluding PPP loans, the ratio is 1.09%. At June 30, 2020, the loan balances used to calculate the ratio included PPP loans of \$122.9 million. Excluding PPP loans, the ratio is 0.86%.

(2) At June 30, 2021, the year-to-date average loan balances used to calculate the ratio include PPP loans of \$124.3 million. Excluding PPP loans, the ratio is 1.14%. At June 30, 2020, the year-to-date average loan balances used to calculate the ratio included PPP loans of \$45.1 million. Excluding PPP loans, the ratio is 0.87%.

Nonperforming Assets and Accruing TDRs

As shown in the following table, nonperforming assets were \$4.9 million and \$6.3 million at June 30, 2021 and December 31, 2020, respectively. The balance of nonperforming assets decreased primarily due to a decline in nonaccrual loans of \$1.5 million, or 27.6%. Accruing troubled debt restructurings (“TDRs”) decreased \$659 thousand, or 9.4%, over the same time period. Other real estate owned properties increased to \$203 thousand from \$0 at December 31, 2020. The ratio of nonaccrual loans and accruing TDRs to total loans decreased to 0.70% at June 30, 2021 from 0.86% at December 31, 2020.

The Company continues to focus on the resolution of its nonperforming and problem assets. The efforts to accomplish this goal include frequently contacting borrowers until the delinquency is cured or until an acceptable payment plan has been agreed upon; obtaining updated appraisals; provisioning for credit losses; charging-off loans; transferring loans to other real estate owned; aggressively marketing other real estate owned. The reduction of nonperforming and problem assets is and will continue to be a high priority for the Company.

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The following table summarizes our nonperforming assets and accruing TDRs at June 30, 2021 and December 31, 2020.

(Dollars in thousands)	June 30, 2021	December 31, 2020
Nonperforming assets		
Nonaccrual loans	\$ 3,947	\$ 5,455
Total loans 90 days or more past due and still accruing	752	804
Other real estate owned	203	—
Total nonperforming assets	<u>\$ 4,902</u>	<u>\$ 6,259</u>
 Total accruing TDRs	 <u>\$ 6,338</u>	 <u>\$ 6,997</u>
 As a percent of total loans:		
Nonaccrual loans	0.27 %	0.38 %
Accruing TDRs	0.43 %	0.48 %
Nonaccrual loans and accruing TDRs	0.70 %	0.86 %
 As a percent of total loans and other real estate owned:		
Nonperforming assets	0.33 %	0.43 %
Nonperforming assets and accruing TDRs	0.76 %	0.91 %
 As a percent of total assets:		
Nonaccrual loans	0.19 %	0.28 %
Nonperforming assets	0.23 %	0.32 %
Accruing TDRs	0.30 %	0.36 %
Nonperforming assets and accruing TDRs	0.53 %	0.69 %

Investment Securities

The investment portfolio is comprised of debt and equity securities. Debt securities are classified as either available for sale or held to maturity. Investment securities available for sale are stated at estimated fair value based on quoted prices. They represent securities which may be sold as part of the asset/liability management strategy or in response to changing interest rates. Net unrealized holding gains and losses on these securities are reported net of related income taxes as accumulated other comprehensive income (loss), a separate component of stockholders' equity.

Investment securities in the held to maturity category are stated at cost adjusted for amortization of premiums and accretion of discounts. We have the intent and current ability to hold such securities until maturity. At June 30, 2021, 36.5% of the portfolio of debt securities was classified as available for sale and 63.5% was classified as held to maturity, compared to 68.0% and 32.0% respectively, at December 31, 2020. See Note 3 – "Investment Securities", in the Notes to Consolidated Financial Statements for additional details on the composition of our investment portfolio.

Investment securities including restricted stock totaled \$317.4 million at June 30, 2021, a \$107.1 million, or 50.9%, increase since December 31, 2020. The increase was primarily due to the purchases of held to maturity securities of \$136.4 million, partially offset by proceeds from maturities and sales of available for sale securities of \$23.9 million, during 2021. Due to the excess liquidity experienced in 2020 and 2021, the Company strategically purchased short duration held to maturity securities and subordinated debt of other banks which earn significantly higher average yields than interest-bearing deposits with other banks. As loan demand begins to strengthen, the Company will redeploy proceeds from maturities and paydowns, as well as excess liquidity to fund loan growth. At June 30, 2021, 84.2% of the securities available for sale were mortgage-backed and 15.8% were U.S. Government agencies, compared to 83.1% and 16.9%, respectively, at year-end 2020. At June 30, 2021, 58.4% of the securities held to maturity were mortgage-backed, 31.7% were U.S. Government agencies and 9.9% were other debt securities, compared to 41.5%, 28.7% and 29.2%, respectively, at year-end 2020. Our investments in mortgage-backed securities are issued or guaranteed by U.S. Government agencies or government-sponsored agencies.

Deposits

Total deposits at June 30, 2021 amounted to \$1.88 billion, an increase of \$179.9 million, or 10.6%, when compared to the level at December 31, 2020. The increase in total deposits consisted of increases in the following categories: Savings and money market accounts of \$150.6 million, noninterest-bearing deposits of \$28.9 million and other time deposits of \$2.7 million, partially offset by a decrease in checking accounts of \$2.3 million. The significant movement within deposit accounts continues to be impacted by direct government stimulus payments to our customers and new account openings.

Short-Term Borrowings

Short-term borrowings consisted of securities sold under agreements to repurchase, which increased by \$1.9 million, or 176.9%, to \$2.9 million at June 30, 2021 when compared to December 31, 2020. Securities sold under agreements to repurchase are issued in conjunction with cash management services for commercial depositors. Other short-term borrowings may consist of overnight borrowing from correspondent banks or advances from the FHLB. Short-term advances are defined as those with original maturities of one year or less. At June 30, 2021 and December 31, 2020, the Company had no outstanding short-term or long-term advances with FHLB.

Long-Term Debt

The Company uses long-term borrowings to meet longer term liquidity needs, specifically to fund loan growth when liquidity from deposit growth is not sufficient. On August 25, 2020, the Company entered into Subordinated Note Purchase Agreements with certain Purchasers pursuant to which the Company issued and sold \$25.0 million in aggregate principal amount with an initial interest rate of 5.375% Fixed-to-Floating Rate Subordinated Notes due September 1, 2030.

Liquidity and Capital Resources

We derive liquidity through increased customer deposits, non-reinvestment of the cash flow from the investment portfolio, loan repayments, borrowings and income from earning assets. As seen in the Consolidated Statements of Cash Flows in the Financial Statements, the net increase in cash and cash equivalents was \$50.3 million for the first six months of 2021 compared to an increase of \$31.3 million for the first six months of 2020. The increase in cash and cash equivalents in 2021 was mainly due to the significant increase in deposits, the direct result of new account openings, government stimulus and significant increases in municipal accounts. The Company expects these funds to be utilized over the coming months, which may result in deposit balance fluctuations.

To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term fund markets. The Bank has arrangements with other correspondent banks whereby it has \$15 million available in federal funds lines of credit and a reverse repurchase agreement available to meet any short-term needs which may not otherwise be funded by the Bank's portfolio of readily marketable investments that can be converted to cash. The Bank is also a member of the FHLB, which provides another source of liquidity. Through the FHLB, the Bank had collateral pledged of approximately \$298.9 million and \$316.7 million at June 30, 2021 and December 31, 2020, respectively. The Bank has pledged, under a blanket lien, all qualifying residential and commercial real estate loans under borrowing agreements with the FHLB.

Total stockholders' equity increased \$3.7 million to \$198.7 million at June 30, 2021 when compared to December 31, 2020 primarily due to the current year's retained earnings, partially offset by dividends paid during the first six months of 2021 and the change in fair value of available-for-sale securities recorded in accumulated other comprehensive income.

CBLR

On September 17, 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio ("CBLR") framework), as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework.

On April 6, 2020, in a joint statement, the FDIC, Federal Reserve and the Office of Comptroller of the Currency (“OCC”), issued two interim final rules regarding temporary changes to the CBLR framework to implement provisions of the CARES Act. Under the interim final rules, the community bank leverage ratio was reduced to 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 8%, less than \$10 billion in total consolidated assets, and limited amounts of off-balance-sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The Company has not opted-in to the CBLR framework.

Basel III

Under final Federal Reserve and FDIC approved rules implementing the Basel Committee on Banking Supervision’s capital guidelines for U.S. banks minimum requirements increased for both the quantity and quality of capital held by the Bank. The Basel III capital standards substantially revised the risk based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including the definitions and the components of Tier 1 capital and Total Capital, the method of evaluating risk-weighted assets, institutions of a capital conservation buffer, and other matters affecting regulatory capital ratios. Strict eligibility criteria for regulatory capital instruments were also implemented under the rules.

The phase-in period for the final rules became effective for the Bank on January 1, 2015, with full compliance with all of the final rules’ requirements phased in over a multi-year schedule, which was fully phased in on January 1, 2019. As of June 30, 2021, the Bank’s capital levels remained characterized as “well-capitalized” under the rules.

The following tables present the applicable capital ratios as of June 30, 2021 and December 31, 2020.

	Tier 1 leverage ratio	Common Equity Tier 1 ratio	Tier 1 risk-based capital ratio	Total risk-based capital ratio
June 30, 2021				
Shore United Bank	9.32 %	13.15 %	13.15 %	14.21 %
	Tier 1 leverage ratio	Common Equity Tier 1 ratio	Tier 1 risk-based capital ratio	Total risk-based capital ratio
December 31, 2020				
Shore United Bank	9.73 %	13.21 %	13.21 %	14.25 %

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Our primary market risk is interest rate fluctuation and management has procedures in place to evaluate and mitigate this risk. This risk and these procedures are discussed in Item 7 of Part II of the 2020 Annual Report under the caption “Market Risk Management and Interest Sensitivity”. Management believes that there have been no material changes in our market risks, the procedures used to evaluate and mitigate these risks, or our actual and simulated sensitivity positions since December 31, 2020.

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that Shore Bancshares, Inc. files under the Securities Exchange Act of 1934, as amended (“Exchange Act”) with the SEC, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in those rules and forms, and that such information is accumulated and communicated to management, including Shore Bancshares, Inc.’s principal executive officer (“PEO”) and its principal financial officer (“PFO”), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design

of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls and procedures as of June 30, 2021 was carried out under the supervision and with the participation of management, including the PEO and the PFO. Based on that evaluation, the Company's management, including the PEO and the PFO, has concluded that our disclosure controls and procedures are, in fact, effective at the reasonable assurance level at June 30, 2021.

There was no change in our internal control over financial reporting during the second quarter of 2021 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

From time to time the Company may become involved in legal proceedings. At the present time, there are no proceedings which the Company believes will have a material adverse impact on the financial condition or earnings of the Company.

Item 1A. Risk Factors

The section titled Risk Factors in Part I, Item 1A of our 2020 Form 10-K includes a discussion of the many risks and uncertainties we face, any one or more of which could have a material adverse effect on our business, results of operations, financial condition (including capital and liquidity), or prospects or the value of or return on an investment in the Company. Management does not believe that any material changes in our risk factors have occurred since they were last disclosed in our 2020 Annual Report.

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

On November 24, 2020, the Company announced a stock repurchase program which was approved by the Board and authorized management to repurchase up to \$5.0 million of the Company's common stock. There were no purchases of the Company's common stock during the second quarter of 2021. The stock repurchase program is currently suspended due to the recent announcement of our merger with Severn.

The following table provides information with respect to purchases made by or on behalf of us or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the second quarter of 2021.

Stock Repurchase Plan \$5.0 million (2020-2021)

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of the Publicly Announced Plans or Programs	Maximum Dollar Value Of Shares that May Yet Be Purchased Under the Plans or Programs
April 1, 2021 to April 30, 2021	—	\$ —	—	\$ 541,973
May 1, 2021 to May 31, 2021	—	—	—	541,973
June 1, 2021 to June 30, 2021	—	—	—	541,973
Total	—	\$ —	—	

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

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Item 6. Exhibits.

Exhibit Number	Description
3.1(i)	Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on December 14, 2000).
3.1(ii)	Articles Supplementary relating to the Fixed Rate Cumulative Perpetual Preferred Stock Series A (incorporated by reference to Exhibit 4.1 of the Company's Form 8-K filed on January 13, 2009).
3.1(iii)	Articles Supplementary relating to the reclassification of the Fixed Rate Cumulative Perpetual Preferred Stock Series A, as common stock (incorporated by reference to Exhibit 3.1(i) of the Company's Form 8-K filed on June 17, 2009).
3.2	Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 of the Company's Form 10-K for the year ended December 31, 2020).
4.1	Description of Registrant's Securities (incorporated by reference to Exhibit 4.1 to the Company's Form 10-K filed March 13, 2020).
4.2	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Company's Form S-3 filed on June 25, 2010).
31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
31.2	Certifications of the Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith).
101	Inline Interactive Data File
101.INS	Inline XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
101.SCH	Inline XBRL Taxonomy Extension Schema (filed herewith)
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase (filed herewith)
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase (filed herewith)
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase (filed herewith)
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase (filed herewith)
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHORE BANCSHARES, INC.

Date: August 13, 2021

By: /s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President & Chief Executive Officer
(Principal Executive Officer)

Date: August 13, 2021

By: /s/ Edward C. Allen
Edward C. Allen
Executive Vice President & Chief Financial
Officer
(Principal Accounting Officer)

**Certifications of the Principal Executive Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Lloyd L. Beatty, Jr., certify that:

1. I have reviewed this report on Form 10-Q of Shore Bancshares, 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: August 13, 2021

By: /s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

Certifications of the Principal Accounting Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Edward C. Allen, certify that:

1. I have reviewed this report on Form 10-Q of Shore Bancshares, 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 annual 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: August 13, 2021

By: /s/ Edward C. Allen

Edward C. Allen

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

Certification of Periodic Report
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, the undersigned hereby certify that (i) the Quarter Report of Shore Bancshares, Inc. on Form 10-Q for the Quarter ended June 30, 2021 filed with the Securities and Exchange Commission (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Shore Bancshares, Inc.

Date: August 13, 2021

/s/ Lloyd L. Beatty, Jr.

Lloyd L. Beatty, Jr.

President and Chief Executive Officer

(Principal Executive Officer)

Date: August 13, 2021

/s/ Edward C. Allen

Edward C. Allen

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)
