

SANDY SPRING BANCORP INC
Form 10-Q
November 03, 2017

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 September 30, 2017

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: 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland

52-1532952

(State of incorporation)

(I.R.S. Employer Identification Number)

17801 Georgia Avenue, Olney, Maryland

20832

(Address of principal executive office)

(Zip Code)

301-774-6400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days.

Yes No

—

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

—

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No X

The number of outstanding shares of common stock outstanding as of November 3, 2017

Common stock, \$1.00 par value – 23,993,562 shares

SANDY SPRING BANCORP, INC.

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Condensed Consolidated Statements of Condition
September 30, 2017 and December 31, 2016

Condensed Consolidated Statements of Income -
Ended September 30, 2017 and 2016

Condensed Consolidated Statements of Comprehensive
the Three and Nine Months Ended September 30,

Condensed Consolidated Statements of Cash Flow
Months Ended September 30, 2017

Condensed Consolidated Statements of Changes
Three and Nine Months Ended September 30, 20

Notes to Condensed Consolidated Financial State

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES

ABOUT MARKET RISK

Item 4. CONTROLS AND PROCEDURES

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Item 1A. RISK FACTORS

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Item 3. DEFAULTS UPON SENIOR SECURITIES

Item 4. MINE SAFETY DISCLOSURES

Item 5. OTHER INFORMATION

Item 6. EXHIBITS

SIGNATURES

Forward-Looking Statements

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

Forward-looking statements reflect our expectation or prediction of future conditions, events or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risks and uncertainties include, but are not limited to, the risks identified in Item 1A of the Company’s 2016 Annual Report on Form 10-K, Item 1A of Part II of this report and the following:

- general business and economic conditions nationally or in the markets that the Company serves could adversely affect, among other things, real estate prices, unemployment levels, and consumer and business confidence, which could lead to decreases in the demand for loans, deposits and other financial services that we provide and increases in loan delinquencies and defaults;
- changes or volatility in the capital markets and interest rates may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet as well as our liquidity;
- our liquidity requirements could be adversely affected by changes in our assets and liabilities;
- our investment securities portfolio is subject to credit risk, market risk, and liquidity risk as well as changes in the estimates we use to value certain of the securities in our portfolio;
- the effect of legislative or regulatory developments including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;
- competitive factors among financial services companies, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;
- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the Securities and Exchange Commission, the Public Company Accounting Oversight Board and other regulatory agencies; and
- the effect of fiscal and governmental policies of the United States federal government.

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

Part I**Item 1. FINANCIAL STATEMENTS****Sandy Spring Bancorp, Inc. and Subsidiaries****CONDENSED CONSOLIDATED STATEMENTS OF CONDITION - UNAUDITED**

<i>(Dollars in thousands)</i>	September 30, 2017	December 31, 2016
Assets		
Cash and due from banks	\$ 50,076	\$ 53,190
Federal funds sold	2,838	1,953
Interest-bearing deposits with banks	49,267	78,982
Cash and cash equivalents	102,181	134,125
Residential mortgage loans held for sale (at fair value)	7,084	13,222
Investments available-for-sale (at fair value)	756,069	733,554
Other equity securities	39,853	46,094
Total loans	4,194,118	3,927,808
Less: allowance for loan losses	(44,924)	(44,067)
Net loans	4,149,194	3,883,741
Premises and equipment, net	54,108	53,562
Other real estate owned	1,448	1,911
Accrued interest receivable	16,045	14,589
Goodwill	85,768	85,768
Other intangible assets, net	604	680
Other assets	122,434	124,137
Total assets	\$ 5,334,788	\$ 5,091,383
Liabilities		
Noninterest-bearing deposits	\$ 1,312,710	\$ 1,138,139
Interest-bearing deposits	2,643,082	2,439,405
Total deposits	3,955,792	3,577,544
Securities sold under retail repurchase agreements and federal funds purchased	146,569	125,119
Advances from FHLB	632,917	790,000
Subordinated debentures	-	30,000
Accrued interest payable and other liabilities	35,030	35,148
Total liabilities	4,770,308	4,557,811
Stockholders' Equity		
Common stock -- par value \$1.00; shares authorized 50,000,000; shares issued and outstanding 23,990,370 and 23,901,084 at September 30, 2017 and December 31, 2016, respectively	23,990	23,901
Additional paid in capital	167,455	165,871
Retained earnings	376,512	350,414
Accumulated other comprehensive loss	(3,477)	(6,614)
Total stockholders' equity	564,480	533,572
Total liabilities and stockholders' equity	\$ 5,334,788	\$ 5,091,383

The accompanying notes are an integral part of these statements

SANDY SPRING BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME - UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
<i>(Dollars in thousands, except per share data)</i>	2017	2016	2017	2016
Interest income:				
Interest and fees on loans and leases	\$ 43,891	\$ 38,224	\$ 126,861	\$ 111,358
Interest on loans held for sale	119	96	273	294
Interest on deposits with banks	108	49	289	156
Interest and dividends on investment securities:				
Taxable	3,410	2,623	10,572	8,749
Exempt from federal income taxes	2,053	1,864	6,110	5,753
Interest on federal funds sold	8	1	18	3
Total interest income	49,589	42,857	144,123	126,313
Interest expense:				
Interest on deposits	3,701	2,128	9,212	6,006
Interest on retail repurchase agreements and federal funds purchased	83	74	238	212
Interest on advances from FHLB	3,108	2,699	9,385	8,812
Interest on subordinated debt	-	225	12	698
Total interest expense	6,892	5,126	18,847	15,728
Net interest income	42,697	37,731	125,276	110,585
Provision for loan losses	934	781	2,450	4,974
Net interest income after provision for loan losses	41,763	36,950	122,826	105,611
Non-interest income:				
Investment securities gains	-	-	1,275	1,919
Service charges on deposit accounts	2,140	2,035	6,121	5,894
Mortgage banking activities	632	1,129	2,080	2,770
Wealth management income	4,864	4,347	14,092	13,200
Insurance agency commissions	1,950	1,786	4,924	4,180
Income from bank owned life insurance	609	616	1,808	1,846
Bank card fees	1,211	1,189	3,609	3,498
Other income	1,340	1,482	5,040	5,391
Total non-interest income	12,746	12,584	38,949	38,698
Non-interest expense:				
Salaries and employee benefits	18,442	17,848	54,525	53,299
Occupancy expense of premises	3,294	3,130	9,907	9,765
Equipment expense	1,722	1,745	5,213	5,102
Marketing	784	628	2,223	1,971
Outside data services	1,286	1,349	4,045	4,067
FDIC insurance	850	726	2,478	2,012
Amortization of intangible assets	25	34	76	94
Merger expenses	345	-	1,332	-
Other expense	4,443	3,866	14,241	16,204
Total non-interest expense	31,191	29,326	94,040	92,514
Income before income taxes	23,318	20,208	67,735	51,795
Income tax expense	8,229	6,734	22,793	16,861
Net income	\$ 15,089	\$ 13,474	\$ 44,942	\$ 34,934

Per share information:

Basic net income per share	\$	0.62	\$	0.56	\$	1.86	\$	1.45
Diluted net income per share	\$	0.62	\$	0.56	\$	1.86	\$	1.45
Dividends declared per common share	\$	0.26	\$	0.24	\$	0.78	\$	0.72

The accompanying notes are an integral part of these statements

5

SANDY SPRING BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME - UNAUDITED

<i>(In thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net income	\$ 15,089	\$ 13,474	\$ 44,942	\$ 34,934
Other comprehensive income:				
Investments available-for-sale:				
Net change in unrealized gains/(losses) on investments available-for-sale	113	(2,641)	5,618	10,612
Related income tax (expense)/benefit	(45)	1,036	(2,236)	(4,227)
Net investment gains reclassified into earnings	-	-	(1,275)	(1,919)
Related income tax expense	-	-	508	765
Net effect on other comprehensive income for the period	68	(1,605)	2,615	5,231
Defined benefit pension plan:				
Recognition of unrealized loss	296	295	886	870
Related income tax benefit	(129)	(111)	(364)	(339)
Net effect on other comprehensive income for the period	167	184	522	531
Total other comprehensive income	235	(1,421)	3,137	5,762
Comprehensive income	\$ 15,324	\$ 12,053	\$ 48,079	\$ 40,696

The accompanying notes are an integral part of these statements

SANDY SPRING BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

<i>(Dollars in thousands)</i>	Nine Months Ended September 30,	
	2017	2016
Operating activities:		
Net income	\$ 44,942	\$ 34,934
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,939	5,940
Provision for loan losses	2,450	4,974
Share based compensation expense	1,611	1,341
Tax benefits associated with share based compensation	700	287
Deferred income tax expense	163	646
Origination of loans held for sale	(105,970)	(130,409)
Proceeds from sales of loans held for sale	114,474	151,077
Gains on sales of loans held for sale	(2,653)	(2,461)
(Gains) losses on sales of other real estate owned	(82)	48
Investment securities gains	(1,275)	(1,919)
Net (increase) decrease in accrued interest receivable	(1,456)	320
Net decrease in other assets	(5,314)	(1,731)
Net increase (decrease) in accrued expenses and other liabilities	19	(5,999)
Other – net	3,521	(731)
Net cash provided by operating activities	57,069	56,317
Investing activities:		
Proceeds of other equity securities	6,241	5,507
Purchases of investments available-for-sale	(125,028)	(120,273)
Proceeds from sales of investment available-for-sale	2,251	40,863
Proceeds from maturities, calls and principal payments of investments held-to-maturity	-	5,004
Proceeds from maturities, calls and principal payments of investments available-for-sale	103,775	227,419
Net increase in loans	(306,755)	(303,709)
Proceeds from the sales of other real estate owned	1,228	1,393
Proceeds from sales of loans previously held for investment	40,031	-
Acquisition of business activity, net of cash acquired	-	(1,347)
Expenditures for premises and equipment	(4,589)	(4,250)
Net cash (used) in investing activities	(282,846)	(149,393)
Financing activities:		
Net increase in deposits	378,248	273,427
Net increase in retail repurchase agreements and federal funds purchased	21,450	15,060
Proceeds from advances from FHLB	3,080,000	1,805,000
Repayment of advances from FHLB	(3,237,083)	(1,940,000)
Retirement of subordinated debt	(30,000)	(5,000)
Proceeds from issuance of common stock	1,015	1,268
Stock tendered for payment of withholding taxes	(953)	(683)
Repurchase of common stock	-	(13,273)
Dividends paid	(18,844)	(17,408)

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Net cash provided by financing activities	193,833	118,391
Net increase (decrease) in cash and cash equivalents	(31,944)	25,315
Cash and cash equivalents at beginning of period	134,125	72,882
Cash and cash equivalents at end of period	\$ 102,181	\$ 98,197
Supplemental disclosures:		
Interest payments	\$ 19,244	\$ 16,193
Income tax payments	22,927	16,825
Transfer of investments held-to-maturity to available-for-sale	-	203,118
Transfer from loans to residential mortgage loans held for sale	39,744	18,752
Transfer from loans to other real estate owned	700	-

The accompanying notes are an integral part of these statements

SANDY SPRING BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY -
UNAUDITED

	Common	Additional Paid-In	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
<i>(Dollars in thousands, except per share data)</i>	Stock	Capital	Earnings	(Loss)	Equity
Balances at January 1, 2017	\$ 23,901	\$ 165,871	\$ 350,414	\$ (6,614)	\$ 533,572
Net income	-	-	44,942	-	44,942
Other comprehensive income, net of tax	-	-	-	3,137	3,137
Common stock dividends - \$0.78 per share	-	-	(18,844)	-	(18,844)
Stock compensation expense	-	1,611	-	-	1,611
Common stock issued pursuant to:					
Stock option plan - 28,736 shares	29	521	-	-	550
Employee stock purchase plan - 13,486 shares	13	452	-	-	465
Restricted stock - 47,064 shares	47	(1,000)	-	-	(953)
Balances at September 30, 2017	\$ 23,990	\$ 167,455	\$ 376,512	\$ (3,477)	\$ 564,480
Balance at January 1, 2016	\$ 24,296	\$ 175,588	\$ 325,840	\$ (1,297)	\$ 524,427
Net income	-	-	34,934	-	34,934
Other comprehensive income, net of tax	-	-	-	5,762	5,762
Common stock dividends - \$0.72 per share	-	-	(17,408)	-	(17,408)
Stock compensation expense	-	1,628	-	-	1,628
Common stock issued pursuant to:					
Stock option plan - 34,646 shares	35	500	-	-	535
Employee stock purchase plan - 18,767 shares	19	433	-	-	452
Director's stock purchase plan - 258 shares	-	15	-	-	15
Restricted stock - 49,648 shares	49	(466)	-	-	(417)
Purchase of treasury shares - 512,459 shares	(512)	(12,761)	-	-	(13,273)
Balances at September 30, 2016	\$ 23,887	\$ 164,937	\$ 343,366	\$ 4,465	\$ 536,655

The accompanying notes are an integral part of these statements

8

Sandy Spring Bancorp, Inc. and Subsidiaries

Notes to the CONDENSED Consolidated Financial Statements - UNAUDITED

Note 1 – Significant Accounting Policies

Nature of Operations

Sandy Spring Bancorp (the “Company”), a Maryland corporation, is the bank holding company for Sandy Spring Bank (the “Bank”). The Bank offers a broad range of commercial banking, retail banking, mortgage and trust services throughout central Maryland, Northern Virginia and the greater Washington D.C. market through its operation of 44 community offices and six financial centers across the region. The Bank also offers a comprehensive menu of insurance and wealth management services through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc.

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and prevailing practices within the financial services industry for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements and prevailing practices within the banking industry. The following summary of significant accounting policies of the Company is presented to assist the reader in understanding the financial and other data presented in this report. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2017. In the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. Certain reclassifications have been made to prior period amounts, as necessary, to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

These statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s 2016 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 3, 2017. There have been no significant changes to the Company’s accounting policies as disclosed in the 2016 Annual Report on Form 10-K.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Sandy Spring Bank and its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc. Consolidation has resulted in the elimination of all intercompany accounts and transactions.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and affect the reported amounts of revenues earned and expenses incurred during the reporting period. Actual results could differ from those estimates. Estimates that could change significantly relate to the provision for loan losses and the related allowance, determination of impaired loans and the related measurement of impairment, potential impairment of goodwill or other intangible assets, valuation of investment securities and the determination of whether impaired securities are other-than-temporarily impaired, valuation of other real estate owned, prepayment rates, valuation of share-based compensation, the assessment that a liability should be recognized with respect to any matters under litigation, the calculation of current and deferred income taxes and the actuarial projections related to pension expense and the related liability.

Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, federal funds sold and interest-bearing deposits with banks (items with stated original maturity of three months or less).

Pending Accounting Pronouncements

The FASB issued Update No. 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, in March 2017. This guidance is intended to eliminate the current diversity in practice with respect to the amortization period for certain purchased callable debt securities held at a premium. Under current generally accepted accounting principles (GAAP), entities generally amortize the premium as an adjustment of yield over the contractual life. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The amendments in this update shorten the amortization period for such callable debt securities held at a premium requiring the premium to be amortized to the earliest call date. This guidance is effective for a public business entity that is a U.S. Securities and Exchange Commission (SEC) filer for its fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, in January 2017. The objective of this guidance is to simplify an entity's required test for impairment of goodwill by eliminating Step 2 from the goodwill impairment test. In Step 2 an entity measured a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. In computing the implied fair value of goodwill, an entity had to determine the fair value at the impairment date of its assets and liabilities, including any unrecognized assets and liabilities, following a procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Under this Update, an entity should perform its annual or quarterly goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount and record an impairment charge for the excess of the carrying amount over the reporting unit's fair value. The loss recognized should not exceed the total amount of goodwill allocated to the reporting unit and the entity must consider the income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. This guidance is effective for a public business entity that is an SEC filer for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update 2017-1, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, in January 2017. The objective of this guidance is to clarify the definition of a business to provide entities with assistance in evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The update provides a screen to determine when an integrated set of assets and activities (a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable assets or a group of similar identifiable assets, the set is not a business. The screen thus reduces the number of transactions that need to be further evaluated. If the screen is not met, the amendments in this Update (1) require that to be considered a business, a set must include, at a minimum, an input and substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present. The framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for an asset to be a business, outputs generally are a key element of a business; therefore, the Board has developed more stringent criteria

for sets without outputs. This guidance is effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those periods. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2016-15, *Statement of Cash Flow (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, in August 2016. This guidance is intended to reduce the diversity in practice with respect to the presentation and classification of items in the statement of cash flows. This guidance is effective for public business entities for the first interim or annual period beginning after December 15, 2017. The standard's provisions will be applied using a retrospective transition method to each period presented. An entity may elect early adoption but must adopt all of the amendments in the same period. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2016-13, *Current Expected Credit Losses (CECL)*, in June 2016. This guidance changes the impairment model for most financial assets measured at amortized cost and certain other instruments. Entities will be required to use an expected loss model, replacing the incurred loss model that is currently in use. Under the new guidance, an entity will measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current condition and reasonable and supportable forecasts. This will result in earlier recognition of loss allowances in most instances. Credit losses related to available-for-sale debt securities (regardless of whether the impairment is considered to be other-than-temporary) will be measured in a manner similar to the present, except that such losses will be recorded as allowances rather than as reductions in the amortized cost of the related securities. With respect to trade and other receivables, loans, held-to-maturity debt securities, net investments in leases and off-balance-sheet credit exposures, the guidance requires that an entity estimate its lifetime expected credit loss and record an allowance resulting in the net amount expected to be collected to be reflected as the financial asset. Entities are also required to provide significantly more disclosures, including information used to track credit quality by year of origination for most financing receivables. This guidance is effective for public business entities for the first interim or annual period beginning after December 15, 2019. The standard's provisions will be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Early adoption by public business entities is permitted for the first interim or annual period beginning after December 15, 2018. The Company is assessing this guidance to determine its impact on the Company's financial position, results of operations and cash flows.

The FASB issued Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, in March 2016. This guidance is intended to clarify a potential implementation issue with respect to determining whether an entity is a principal or an agent in an arrangement. The guidance provides indicators to assist in this evaluation when another party is involved in the arrangement to identify which party is the principal and which party is the agent. The effective date for this guidance is the same as the effective date of Update 2014-09, Revenue from Contracts with Customers. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2016-02, *Leases*, in February 2016. From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. The guidance also eliminates the current real estate-specific provision and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs. With respect to lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. In applying this guidance entities will also need to determine whether an arrangement contains a lease or service agreement. Disclosures are required by lessees and lessors to meet the objective of enabling users of financials statements to assess the amount, timing, and uncertainty of cash flows arising from leases. For public entities, this guidance is effective for the first interim or annual period beginning after December 15, 2018. Early adoption is permitted. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is assessing this guidance to determine its impact on the Company's financial position, results of operations and cash flows.

The FASB issued Update No. 2016-01, *Financial Instruments - Overall*, in January 2016. This guidance requires entities to measure equity investments at fair value and recognize changes on fair value in net income. The guidance also provides a new measurement alternative for equity investments that do not have readily determinable fair values and don't qualify for the net asset value practical expedient. Entities will have to record changes in instrument-specific credit risk for financial liabilities measured under the fair value option in other comprehensive income, except for certain financial liabilities of consolidated collateralized financing entities. Entities will also have to reassess the

realizability of a deferred tax asset related to an available-for-sale debt security in combination with their other deferred tax assets. This simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. For public entities, the guidance in this update is effective for the first interim or annual period beginning after December 15, 2017. Early adoption by public entities is permitted as of the beginning of the year of adoption for selected amendments by a cumulative effect adjustment to the balance sheet. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, in May 2014 that provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to customers. The guidance also provides for a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. The guidance is effective for the first interim or annual period beginning after December 15, 2017. The guidance must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. The Company's revenue is comprised of net interest income and noninterest income. The guidance does not apply to revenue associated with financial instruments, net interest income, mortgage origination and servicing activities, and gains and losses from securities. Accordingly, the majority of the Company's revenues will not be affected. The following revenue streams were identified to be in scope of ASC 606: 1) wealth management income; 2) insurance agency commissions; 3) bank card fees; and 4) service charges on deposit accounts. The Company has completed an assessment of the revenue contracts for the revenue streams identified to be in scope as well as worked with industry participants on matters of interpretation and application. The Company's accounting policies and revenue recognition principles will not change materially as the principles of ASC 606 are largely consistent with the current revenue recognition practices. The Company plans to expand qualitative disclosures of non-interest income at adoption date in the first quarter of 2018.

Note 2 – Investments

Investments available-for-sale

The amortized cost and estimated fair values of investments available-for-sale at the dates indicated are presented in the following table:

(In thousands)	September 30, 2017				December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	\$109,348	\$ -	\$(2,008)	\$107,340	\$124,314	\$ 32	\$(2,556)	\$121,790
State and municipal	312,656	8,534	(63)	321,127	281,090	7,180	(586)	287,684
Mortgage-backed	316,770	2,724	(2,615)	316,879	314,029	2,851	(4,169)	312,711
Corporate debt	9,100	422	-	9,522	9,100	34	-	9,134
Trust preferred	931	58	-	989	1,089	-	(77)	1,012
Total debt securities	748,805	11,738	(4,686)	755,857	729,622	10,097	(7,388)	732,331
Marketable equity securities	212	-	-	212	1,223	-	-	1,223
Total investments available-for-sale	\$749,017	\$ 11,738	\$(4,686)	\$756,069	\$730,845	\$ 10,097	\$(7,388)	\$733,554

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at September 30, 2017 are not the result of credit related events but due to changes in interest

rates. These declines in fair market value are considered temporary in nature and are expected to recover over time as these securities approach maturity.

The mortgage-backed securities portfolio at September 30, 2017 is composed entirely of either the most senior tranches of GNMA, FNMA or FHLMC collateralized mortgage obligations (\$108.5 million), or GNMA, FNMA or FHLMC mortgage-backed securities (\$208.4 million). The Company does not intend to sell these securities and has sufficient liquidity to hold these securities for an adequate period of time to allow for any anticipated recovery in fair value.

At September 30, 2017 the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security, which is backed by debt issued by banks and thrifts, totaled \$0.9 million with a fair value of \$1.0 million. The fair value of this security was determined by management through the use of a third party valuation specialist due to the limited trading activity for this security.

As a result of this evaluation, it was determined that the pooled trust preferred security had not incurred any credit-related other-than-temporary impairment (“OTTI”) for the quarter ended September 30, 2017. The security had an insignificant unrealized gain at September 30, 2017 recognized in other comprehensive income (“OCI”). The security is not expected to be sold and the Company has the ability to hold it until maturity.

The following table provides the activity of OTTI on investment securities due to credit losses recognized in earnings for the period indicated:

(In thousands)

	OTTI Losses
Cumulative credit losses on investment securities, through December 31, 2016	\$ 531
Additions for credit losses not previously recognized	-
Cumulative credit losses on investment securities through September 30, 2017	\$ 531

Gross unrealized losses and fair value by length of time that the individual available-for-sale securities have been in an unrealized loss position at the dates indicated are presented in the following table:

<i>(Dollars in thousands)</i>	Number of Securities	Fair Value	September 30, 2017 Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
U.S. government agencies	12	\$ 102,340	\$ 2,008	\$ -	\$ 2,008
State and municipal	14	11,076	37	26	63
Mortgage-backed	34	171,833	2,012	603	2,615
Total	60	\$ 285,249	\$ 4,057	\$ 629	\$ 4,686

<i>(Dollars in thousands)</i>	Number of Securities	Fair Value	December 31, 2016 Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
U.S. government agencies	12	\$ 96,788	\$ 2,556	\$ -	\$ 2,556
State and municipal	53	48,010	516	70	586
Mortgage-backed	37	212,844	3,971	198	4,169
Trust preferred	1	1,012	-	77	77
Total	103	\$ 358,654	\$ 7,043	\$ 345	\$ 7,388

The amortized cost and estimated fair values of debt securities available-for-sale by contractual maturity at the dates indicated are provided in the following table. The Company has allocated mortgage-backed securities into the four maturity groupings reflected in the following table using the expected average life of the individual securities based on statistics provided by independent third party industry sources. Expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations with or without prepayment penalties.

<i>(In thousands)</i>	September 30, 2017		December 31, 2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 10,821	\$ 10,934	\$ 7,493	\$ 7,541
Due after one year through five years	173,513	179,386	156,953	162,233
Due after five years through ten years	244,098	245,324	282,468	282,713
Due after ten years	320,373	320,213	282,708	279,844
Total debt securities available for sale	\$ 748,805	\$ 755,857	\$ 729,622	\$ 732,331

At September 30, 2017 and December 31, 2016, investments available-for-sale with a book value of \$448.2 million and \$453.0 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agencies securities, exceeded ten percent of stockholders' equity at September 30, 2017 and December 31, 2016.

Equity securities

Other equity securities at the dates indicated are presented in the following table:

<i>(In thousands)</i>	September 30, 2017	December 31, 2016
Federal Reserve Bank stock	\$ 8,382	\$ 8,334
Federal Home Loan Bank of Atlanta stock	31,471	37,760
Total equity securities	\$ 39,853	\$ 46,094

Note 3 – LOANS

Outstanding loan balances at September 30, 2017 and December 31, 2016 are net of unearned income including net deferred loan costs of \$2.1 million and \$1.4 million, respectively. The loan portfolio segment balances at the dates indicated are presented in the following table:

<i>(In thousands)</i>	September 30, 2017	December 31, 2016
Residential real estate:		
Residential mortgage	\$ 882,890	\$ 841,692
Residential construction	171,814	150,229
Commercial real estate:		
Commercial owner occupied real estate	831,461	775,552
Commercial investor real estate	1,104,669	928,113
Commercial AD&C	295,222	308,279
Commercial business	451,667	467,286
Consumer	456,395	456,657
Total loans	\$ 4,194,118	\$ 3,927,808

Note 4 – CREDIT QUALITY ASSESSMENT

Allowance for Loan Losses

Summary information on the allowance for loan loss activity for the period indicated is provided in the following table:

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2017	2016
Balance at beginning of year	\$ 44,067	\$ 40,895
Provision for loan losses	2,450	4,974
Loan charge-offs	(2,044)	(2,586)
Loan recoveries	451	659
Net charge-offs	(1,593)	(1,927)
Balance at period end	\$ 44,924	\$ 43,942

The following tables provide information on the activity in the allowance for loan losses by the respective loan portfolio segment for the period indicated:

For the Nine Months Ended September 30, 2017

	Commercial Real Estate				Residential Real Estate			Total
	Commercial				Residential			
	Commercial	Commercial	Commercial Owner		Mortgage	Construction	Residential	
			Investor	Occupied				
<i>(Dollars in thousands)</i>	Business	AD&C	R/E	R/E	Consumer	Mortgage	Construction	
Balance at beginning of year	\$ 7,539	\$ 4,652	\$ 12,939	\$ 7,885	\$ 2,828	\$ 7,261	\$ 963	\$ 44,067
Provision (credit)	2,552	(829)	1,230	(481)	147	(241)	72	2,450
Charge-offs	(1,469)	-	-	(5)	(560)	(10)	-	(2,044)
Recoveries	73	103	93	-	101	61	20	451
Net recoveries (charge-offs)	(1,396)	103	93	(5)	(459)	51	20	(1,593)
Balance at end of period	\$ 8,695	\$ 3,926	\$ 14,262	\$ 7,399	\$ 2,516	\$ 7,071	\$ 1,055	\$ 44,924
Total loans and leases	\$ 451,667	\$ 295,222	\$ 1,104,669	\$ 831,461	\$ 456,395	\$ 882,890	\$ 171,814	\$ 4,194,118
Allowance for loans losses to total loans ratio	1.93%	1.33%	1.29%	0.89%	0.55%	0.80%	0.61%	1.07%
Balance of loans specifically evaluated for impairment	\$ 8,403	\$ 137	\$ 5,589	\$ 5,517	na.	\$ 2,867	\$ -	\$ 22,513
Allowance for loans specifically evaluated for impairment	\$ 3,841	\$ -	\$ 589	\$ 340	na.	\$ -	\$ -	\$ 4,770
Specific allowance to specific loans ratio	45.71%	-	10.54%	6.16%	na.	-	-	21.19%
Balance of loans collectively evaluated	\$ 443,264	\$ 295,085	\$ 1,099,080	\$ 825,944	\$ 456,395	\$ 880,023	\$ 171,814	\$ 4,171,605
Allowance for loans collectively evaluated	\$ 4,854	\$ 3,926	\$ 13,673	\$ 7,059	\$ 2,516	\$ 7,071	\$ 1,055	\$ 40,154
Collective allowance to collective loans ratio	1.10%	1.33%	1.24%	0.85%	0.55%	0.80%	0.61%	0.96%

For the Year Ended December 31, 2016

	Commercial Real Estate				Residential Real Estate			Total
	Commercial				Residential			
	Commercial	Commercial	Commercial Owner		Mortgage	Construction	Residential	
			Investor	Occupied				
<i>(Dollars in thousands)</i>	Business	AD&C	R/E	R/E	Consumer	Mortgage	Construction	
Balance at beginning of year	\$ 6,529	\$ 4,691	\$ 10,440	\$ 7,984	\$ 3,456	\$ 6,901	\$ 894	\$ 40,895
Provision (credit)	1,563	(31)	2,563	(104)	112	1,406	37	5,546
Charge-offs	(597)	(48)	(197)	-	(888)	(1,404)	-	(3,134)

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Recoveries	44	40	133	5	148	358	32	760
Net recoveries (charge-offs)	(553)	(8)	(64)	5	(740)	(1,046)	32	(2,374)
Balance at end of period	\$ 7,539	\$ 4,652	\$ 12,939	\$ 7,885	\$ 2,828	\$ 7,261	\$ 963	\$ 44,067
Total loans and leases	\$467,286	\$308,279	\$928,113	\$775,552	\$456,657	\$841,692	\$150,229	\$3,927,808
Allowance for loan losses to total loans ratio	1.61%	1.51%	1.39%	1.02%	0.62%	0.86%	0.64%	1.12%
Balance of loans specifically evaluated for impairment	\$ 7,018	\$ 137	\$ 8,107	\$ 5,567	na.	\$ 3,263	\$ -	\$ 24,092
Allowance for loans specifically evaluated for impairment	\$ 2,604	\$ -	\$ 1,736	\$ 485	na.	\$ -	\$ -	\$ 4,825
Specific allowance to specific loans ratio	37.10%	-	21.41%	8.71%	na.	-	-	20.03%
Balance of loans collectively evaluated	\$460,268	\$308,142	\$920,006	\$769,985	\$456,657	\$838,429	\$150,229	\$3,903,716
Allowance for loans collectively evaluated	\$ 4,935	\$ 4,652	\$ 11,203	\$ 7,400	\$ 2,828	\$ 7,261	\$ 963	\$ 39,242
Collective allowance to collective loans ratio	1.07%	1.51%	1.22%	0.96%	0.62%	0.87%	0.64%	1.01%

The following table provides summary information regarding impaired loans at the dates indicated and for the periods then ended:

<i>(In thousands)</i>	September 30, 2017	December 31, 2016
Impaired loans with a specific allowance	\$ 13,436	\$ 13,563
Impaired loans without a specific allowance	9,077	10,529
Total impaired loans	\$ 22,513	\$ 24,092
Allowance for loan losses related to impaired loans	\$ 4,770	\$ 4,825
Allowance for loan losses related to loans collectively evaluated	40,154	39,242
Total allowance for loan losses	\$ 44,924	\$ 44,067
Average impaired loans for the period	\$ 23,772	\$ 26,382
Contractual interest income due on impaired loans during the period	\$ 1,813	\$ 2,082
Interest income on impaired loans recognized on a cash basis	\$ 462	\$ 511
Interest income on impaired loans recognized on an accrual basis	\$ 215	\$ 186

The following tables present the recorded investment with respect to impaired loans, the associated allowance by the applicable portfolio segment and the principal balance of the impaired loans prior to amounts charged-off at the dates indicated:

<i>(In thousands)</i>	September 30, 2017					Total Recorded Investment in Impaired Loans
	Commercial Real Estate					
	Commercial	AD&C	Commercial		All Other Loans	
			Commercial Investor R/E	Commercial Owner Occupied R/E		
Impaired loans with a specific allowance						
Accruing	\$ 896	\$ -	\$ -	\$ -	\$ -	\$ 896
Non-accruing	4,355	-	5,177	1,223	-	10,755
Restructured accruing	1,138	-	-	-	-	1,138
Restructured non-accruing	8	-	-	639	-	647
Balance	\$ 6,397	\$ -	\$ 5,177	\$ 1,862	\$ -	\$ 13,436
Allowance	\$ 3,841	\$ -	\$ 589	\$ 340	\$ -	\$ 4,770
Impaired loans without a specific allowance						
Non-accruing	\$ 556	\$ -	\$ 412	\$ 1,629	\$ -	\$ 2,597
Restructured accruing	278	-	-	505	550	1,333
Restructured non-accruing	1,172	137	-	1,521	2,317	5,147
Balance	\$ 2,006	\$ 137	\$ 412	\$ 3,655	\$ 2,867	\$ 9,077
Total impaired loans						

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Accruing	\$ 896	\$ -	\$ -	\$ -	\$ -	\$ 896
Non-accruing	4,911	-	5,589	2,852	-	13,352
Restructured accruing	1,416	-	-	505	550	2,471
Restructured non-accruing	1,180	137	-	2,160	2,317	5,794
Balance	\$ 8,403	\$ 137	\$ 5,589	\$ 5,517	\$ 2,867	\$ 22,513
Unpaid principal balance in total impaired loans	\$ 11,331	\$ 4,398	\$ 10,173	\$ 7,707	\$ 3,699	\$ 37,308

17

	September 30, 2017					
	Commercial Real Estate			Commercial Owner		Total Recorded Investment in Impaired Loans
	Commercial	AD&C	R/E	R/E	Loans	Loans
<i>(In thousands)</i>						
Average impaired loans for the period	\$ 7,853	\$ 137	\$ 7,150	\$ 5,650	\$ 2,982	\$ 23,772
Contractual interest income due on impaired loans during the period	\$ 668	\$ 245	\$ 485	\$ 355	\$ 60	
Interest income on impaired loans recognized on a cash basis	\$ 182	\$ -	\$ 17	\$ 138	\$ 125	
Interest income on impaired loans recognized on an accrual basis	\$ 167	\$ -	\$ -	\$ 19	\$ 29	

	December 31, 2016					
	Commercial Real Estate					Total Recorded Investment in Impaired Loans
	Commercial	AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Loans
<i>(In thousands)</i>						
Impaired loans with a specific allowance						
Non-accruing	\$ 2,807	\$ -	\$ 7,029	\$ 1,884	\$ -	\$ 11,720
Restructured accruing	1,140	-	-	-	-	1,140
Restructured non-accruing	64	-	-	639	-	703
Balance	\$ 4,011	\$ -	\$ 7,029	\$ 2,523	\$ -	\$ 13,563
Allowance	\$ 2,604	\$ -	\$ 1,736	\$ 485	\$ -	\$ 4,825
Impaired loans without a specific allowance						
Non-accruing	\$ 1,562	\$ -	\$ 562	\$ 1,083	\$ -	\$ 3,207
Restructured accruing	45	-	-	744	560	1,349
Restructured non-accruing	1,400	137	516	1,217	2,703	5,973
Balance	\$ 3,007	\$ 137	\$ 1,078	\$ 3,044	\$ 3,263	\$ 10,529
Total impaired loans						
Non-accruing	\$ 4,369	\$ -	\$ 7,591	\$ 2,967	\$ -	\$ 14,927
Restructured accruing	1,185	-	-	744	560	2,489
Restructured non-accruing	1,464	137	516	1,856	2,703	6,676
Balance	\$ 7,018	\$ 137	\$ 8,107	\$ 5,567	\$ 3,263	\$ 24,092
Unpaid principal balance in total impaired loans	\$ 10,082	\$ 4,398	\$ 12,805	\$ 7,760	\$ 3,971	\$ 39,016

December 31, 2016

	Commercial	Real Estate	Commercial	Owner	Other	Total Recorded Investment in Impaired Loans
	Investment	Investment	Occupied	Occupied	Loans	Loans
<i>(In thousands)</i>	Commercial	AD&C	R/E	R/E	Loans	Loans
Average impaired loans for the period	\$ 5,646	\$ 150	\$ 9,480	\$ 6,561	\$ 4,545	\$ 26,382
Contractual interest income due on impaired loans during the period	\$ 570	\$ 294	\$ 718	\$ 310	\$ 190	
Interest income on impaired loans recognized on a cash basis	\$ 153	\$ -	\$ 43	\$ 266	\$ 49	
Interest income on impaired loans recognized on an accrual basis	\$ 107	\$ -	\$ -	\$ 37	\$ 42	

Credit Quality

The following tables provide information on the credit quality of the loan portfolio by segment at the dates indicated:

September 30, 2017

<i>(In thousands)</i>	Commercial Real Estate				Residential Real Estate			Total
	Commercial				Residential			
	Commercial AD&C	Commercial Owner		Consumer Mortgage	Residential			
		Investor	Occupied		Construction			
Non-performing loans and assets:								
Non-accrual loans	\$ 6,091	\$ 137	\$ 5,589	\$ 5,012	\$ 3,152	\$ 7,345	\$ 182	\$ 27,508
Loans 90 days past due	-	-	-	-	1	225	-	226
Restructured loans	1,416	-	-	505	-	550	-	2,471
Total non-performing loans	7,507	137	5,589	5,517	3,153	8,120	182	30,205
Other real estate owned	39	365	-	-	-	1,044	-	1,448
Total non-performing assets	\$ 7,546	\$ 502	\$ 5,589	\$ 5,517	\$ 3,153	\$ 9,164	\$ 182	\$ 31,653

December 31, 2016

<i>(In thousands)</i>	Commercial Real Estate				Residential Real Estate			Total
	Commercial				Residential			
	Commercial AD&C	Commercial Owner		Consumer Mortgage	Residential			
		Investor	Occupied		Construction			
Non-performing loans and assets:								
Non-accrual loans	\$ 5,833	\$ 137	\$ 8,107	\$ 4,823	\$ 2,859	\$ 7,257	\$ 195	\$ 29,211
Loans 90 days past due	-	-	-	-	-	232	-	232
Restructured loans	1,185	-	-	744	-	560	-	2,489
Total non-performing loans	7,018	137	8,107	5,567	2,859	8,049	195	31,932
Other real estate owned	39	365	395	637	-	475	-	1,911
Total non-performing assets	\$ 7,057	\$ 502	\$ 8,502	\$ 6,204	\$ 2,859	\$ 8,524	\$ 195	\$ 33,843

September 30, 2017

<i>(In thousands)</i>	Commercial Real Estate				Residential Real Estate			Total
	Commercial				Residential			
	Commercial AD&C	Commercial Owner		Consumer Mortgage	Residential			
		Investor	Occupied		Construction			
Past due loans								
31-60 days	\$ 1,442	-	-	\$ 1,137	\$ 820	\$ 4,627	-	\$ 8,026

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

61-90 days	776	-	-	-	656	4,172	-	5,604
> 90 days	-	-	-	-	1	225	-	226
Total past due	2,218	-	-	1,137	1,477	9,024	-	13,856
Non-accrual loans	6,091	137	5,589	5,012	3,152	7,345	182	27,508
Current loans	443,358	295,085	1,099,080	825,312	451,766	866,521	171,632	4,152,754
Total loans	\$451,667	\$295,222	\$1,104,669	\$831,461	\$456,395	\$882,890	\$171,814	\$4,194,118

December 31, 2016

<i>(In thousands)</i>	Commercial Real Estate				Residential Real Estate				Total
	Commercial			Owner	Residential			Construction	
	Commercial	AD&C	Investor	Occupied	Consumer	Mortgage			
	Commercial	AD&C	R/E	R/E	Consumer	Mortgage			
<u>Past due loans</u>									
31-60 days	\$ 663	\$ 896	\$ 850	\$ 1,479	\$ 808	\$ 3,969	\$ -	\$ 8,665	
61-90 days	672	-	1,206	744	1,104	2,139	-	5,865	
> 90 days	-	-	-	-	-	232	-	232	
Total past due	1,335	896	2,056	2,223	1,912	6,340	-	14,762	
Non-accrual loans	5,833	137	8,107	4,823	2,859	7,257	195	29,211	
Current loans	460,118	307,246	917,950	768,506	451,886	828,095	150,034	3,883,835	
Total loans	\$467,286	\$308,279	\$928,113	\$775,552	\$456,657	\$841,692	\$150,229	\$3,927,808	

The following tables provide information by credit risk rating indicators for each segment of the commercial loan portfolio at the dates indicated:

September 30, 2017
Commercial Real Estate

<i>(In thousands)</i>	Commercial	AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	\$ 435,183	\$ 295,085	\$ 1,096,591	\$ 817,605	\$ 2,644,464
Special Mention	1,929	-	2,342	5,652	9,923
Substandard	14,555	137	5,736	8,204	28,632
Doubtful	-	-	-	-	-
Total	\$ 451,667	\$ 295,222	\$ 1,104,669	\$ 831,461	\$ 2,683,019

December 31, 2016
Commercial Real Estate

<i>(In thousands)</i>	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	\$ 442,725	\$ 308,142	\$ 917,255	\$ 758,651	\$ 2,426,773
Special Mention	10,010	-	2,395	9,255	21,660
Substandard	14,551	137	8,463	7,646	30,797
Doubtful	-	-	-	-	-
Total	\$ 467,286	\$ 308,279	\$ 928,113	\$ 775,552	\$ 2,479,230

Homogeneous loan pools do not have individual loans subjected to internal risk ratings therefore, the credit indicator applied to these pools is based on their delinquency status. The following tables provide information by credit risk rating indicators for those remaining segments of the loan portfolio at the dates indicated:

September 30, 2017					
Residential Real Estate					
<i>(In thousands)</i>	Consumer	Residential Mortgage	Residential Construction	Total	
Performing	\$ 453,242	\$ 874,770	\$ 171,632	\$ 1,499,644	
Non-performing:					
90 days past due	1	225	-	226	
Non-accruing	3,152	7,345	182	10,679	
Restructured loans	-	550	-	550	
Total	\$ 456,395	\$ 882,890	\$ 171,814	\$ 1,511,099	

December 31, 2016					
Residential Real Estate					
<i>(In thousands)</i>	Consumer	Residential Mortgage	Residential Construction	Total	

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Performing	\$ 453,798	\$ 833,643	\$ 150,034	\$ 1,437,475
Non-performing:				
90 days past due	-	232	-	232
Non-accruing	2,859	7,257	195	10,311
Restructured loans	-	560	-	560
Total	\$ 456,657	\$ 841,692	\$ 150,229	\$ 1,448,578

During the nine months ended September 30, 2017, the Company restructured \$1.3 million in loans. No modifications resulted in the reduction of the principal in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2017 did not have any specific reserves. For the year ended December 31, 2016, the Company restructured \$0.6 million in loans. Modifications consisted principally of interest rate concessions and no modifications resulted in the reduction of the recorded investment in the associated loan balances. Loans restructured during 2016 did not have significant specific reserves at December 31, 2016. The commitments to lend additional funds on loans that have been restructured at September 30, 2017 and December 31, 2016 were not significant.

The following table provides the amounts of the restructured loans at the date of restructuring for specific segments of the loan portfolio during the period indicated:

For the Nine Months Ended September 30, 2017						
Commercial Real Estate						
<i>(In thousands)</i>	Commercial	AD&C	Commercial		Commercial	All
			Investor	Owner	Other	Loans
	Commercial	AD&C	R/E	R/E	Loans	Total
Troubled debt restructurings						
Restructured accruing	\$ 492	\$ -	\$ -	\$ -	\$ -	\$ 492
Restructured non-accruing	387	-	-	396	-	783
Balance	\$ 879	\$ -	\$ -	\$ 396	\$ -	\$ 1,275
Specific allowance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Restructured and subsequently defaulted	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

For the Year Ended December 31, 2016						
Commercial Real Estate						
<i>(In thousands)</i>	Commercial	AD&C	Commercial		Commercial	All
			Investor	Owner	Other	Loans
	Commercial	AD&C	R/E	R/E	Loans	Total
Troubled debt restructurings						
Restructured accruing	\$ 42	\$ -	\$ -	\$ 508	\$ -	\$ 550
Restructured non-accruing	-	-	-	-	-	-
Balance	\$ 42	\$ -	\$ -	\$ 508	\$ -	\$ 550
Specific allowance	\$ 39	\$ -	\$ -	\$ -	\$ -	\$ 39
Restructured and subsequently defaulted	\$ -	\$ -	\$ 479	\$ -	\$ -	\$ 479

Other Real Estate Owned

Other real estate owned totaled \$1.5 million and \$1.9 million at September 30, 2017 and December 31, 2016, respectively. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process as of September 30, 2017 totaled \$0.5 million.

Note 5 – Goodwill and Other Intangible Assets

The gross carrying amounts and accumulated amortization of intangible assets and goodwill are presented at the dates indicated in the following table:

	September 30, 2017		Weighted Average Remaining Life	December 31, 2016		Weighted Average Remaining Life	
	Gross Carrying Amount	Accumulated Amortization Amount		Net Carrying Amount	Gross Carrying Amount		Accumulated Amortization Amount
<i>(Dollars in thousands)</i>							
Amortizing intangible assets:							
Other identifiable intangibles	\$ 786	\$ (182)	\$ 604	13.2 years	\$ 786	\$ (106) \$ 680	13.8 years
Total amortizing intangible assets	\$ 786	\$ (182)	\$ 604		\$ 786	\$ (106) \$ 680	
Goodwill			\$ 85,768		\$ 85,768	\$ 85,768	

The following table presents the estimated future amortization expense for amortizing intangible assets within the years ending December 31:

<i>(In thousands)</i>	Amount
2017	\$ 24
2018	95
2019	83
2020	66
Thereafter	336
Total amortizing intangible assets	\$ 604

Note 6 – Deposits

The following table presents the composition of deposits at the dates indicated:

<i>(In thousands)</i>	September 30, 2017	December 31, 2016
Noninterest-bearing deposits	\$ 1,312,710	\$ 1,138,139
Interest-bearing deposits:		
Demand	608,527	615,058
Money market savings	1,023,153	927,837
Regular savings	321,194	310,471
Time deposits of less than \$100,000	292,395	258,621
Time deposits of \$100,000 or more	397,813	327,418
Total interest-bearing deposits	2,643,082	2,439,405
Total deposits	\$ 3,955,792	\$ 3,577,544

Note 7 – Stockholders' Equity

The Company's 2015 stock repurchase program expired on August 31, 2017. Under the recently expired repurchase program a total of 736,139 shares of common stock were repurchased.

Note 8 – Share Based Compensation

At September 30, 2017, the Company had two share based compensation plans in existence, the 2005 Omnibus Stock Plan (“Omnibus Stock Plan”) and the 2015 Omnibus Incentive Plan (“Omnibus Incentive Plan”). The Omnibus Stock Plan expired during the second quarter of 2015 but has outstanding options that may still be exercised. The Omnibus Incentive Plan is described in the following paragraph.

The Company’s Omnibus Incentive Plan was approved on May 6, 2015 and provides for the granting of incentive stock options, non-qualifying stock options, stock appreciation rights, restricted stock grants, restricted stock units and performance awards to selected employees on a periodic basis at the discretion of the board. The Omnibus Incentive Plan authorizes the issuance of up to 1,500,000 shares of common stock, of which 1,339,989 are available for issuance at September 30, 2017, has a term of ten years, and is administered by a committee of at least three directors appointed by the board of directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within seven to ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The board committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

The fair values of all of the options granted for the periods indicated have been estimated using a binomial option-pricing model. The weighted-average assumptions for the periods shown are presented in the following table:

	Nine Months Ended September 30,	
	2017	2016
Dividend yield	2.45%	3.48%
Weighted average expected volatility	40.27%	41.54%
Weighted average risk-free interest rate	2.14%	1.42%
Weighted average expected lives (in years)	5.67	5.71
Weighted average grant-date fair value	\$13.42	\$7.75

The dividend yield is based on estimated future dividend yields. The risk-free rate for periods within the contractual term of the share option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatilities are generally based on historical volatilities. The expected term of share options granted is generally derived from historical experience.

Compensation expense is recognized on a straight-line basis over the vesting period of the respective stock option or restricted stock grant. The Company recognized compensation expense of \$0.5 million and \$0.5 million for the three months ended September 30, 2017 and 2016, respectively, related to the awards of stock options and restricted stock grants. Compensation expense of \$1.5 million and \$1.4 million was recognized for the nine months ended September 30, 2017 and 2016, respectively. The intrinsic value of stock options exercised in the nine months ended September 30, 2017 and 2016 was \$0.6 million and \$0.4 million, respectively. The total of unrecognized compensation cost related to stock options was approximately \$0.2 million as of September 30, 2017. That cost is expected to be recognized over a weighted average period of approximately 2.0 years. The total of unrecognized compensation cost related to restricted stock was approximately \$4.8 million as of September 30, 2017. That cost is expected to be recognized over a weighted average period of approximately 3.2 years. The fair value of the options vested during the nine months ended September 30, 2017 and 2016, was not significant.

In the first quarter of 2017, 12,941 stock options were granted, subject to a three year vesting schedule with one third of the options vesting on April 1st of each year. The Company granted 55,211 shares of restricted stock in the first quarter of 2017, 6,479 shares are subject to a three year vesting schedule with one third of the shares vesting each year and 41,859 shares are subject to a five year vesting schedule with one fifth of the shares vesting each year. All of these restricted shares will vest on April 1st of each year. An additional 6,873 shares of performance based restricted stock grants were also approved as part of the restricted shares granted in the first quarter. The performance shares are subject to cliff vesting after three years based on the relative performance of the Company's stock price in comparison to a selected peer group. Vesting can vary from 0-150% of the initial grant based on the results of the Company's stock performance.

A summary of share option activity for the period indicated is reflected in the following table:

	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life (Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2017	108,503	\$ 22.46		\$ 1,902
Granted	12,941	\$ 42.48		
Exercised	(28,736)	\$ 19.11		\$ 638
Forfeited or expired	(3,577)	\$ 30.07		
Balance at September 30, 2017	89,131	\$ 24.16	3.8	\$ 1,374
Exercisable at September 30, 2017	58,646	\$ 22.46	2.8	\$ 1,113
Weighted average fair value of options granted during the year		\$ 13.42		

A summary of the activity for the Company's restricted stock for the period indicated is presented in the following table:

<i>(In dollars, except share data):</i>	Number of Common Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2017	212,646	\$ 25.19
Granted	55,211	\$ 42.48
Vested	(70,382)	\$ 23.82
Forfeited	(7,800)	\$ 27.21
Restricted stock at September 30, 2017	189,675	\$ 30.67

Note 9 – Pension, Profit Sharing, and Other Employee Benefit Plans

Defined Benefit Pension Plan

The Company has a qualified, noncontributory, defined benefit pension plan (the “Plan”). Benefits after January 1, 2005, are based on the benefit earned as of December 31, 2004, plus benefits earned in future years of service based on the employee’s compensation during each such year. All benefit accruals for employees were frozen as of December 31, 2007 based on past service and thus salary increases and additional years of service after such date no longer affect the defined benefit provided by the plan although additional vesting may continue to occur.

The Company's funding policy is to contribute amounts to the plan sufficient to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974 (“ERISA”), as amended. In addition, the Company contributes additional amounts as it deems appropriate based on benefits attributed to service prior to the date of the plan freeze. The Plan invests primarily in a diversified portfolio of managed fixed income and equity funds.

The components of net periodic benefit cost for the periods indicated are presented in the following table:

<i>(In thousands)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest cost on projected benefit obligation	\$ 410	\$ 416	\$ 1,230	\$ 1,242
Expected return on plan assets	(497)	(404)	(1,489)	(1,151)
Recognized net actuarial loss	296	295	886	870
Net periodic benefit cost	\$ 209	\$ 307	\$ 627	\$ 961

Contributions

The decision as to whether or not to make a plan contribution and the amount of any such contribution is dependent on a number of factors. Such factors include the investment performance of the plan assets in the current economy and,

since the plan is currently frozen, the remaining investment horizon of the plan. After consideration of these factors, the Company made a contribution of \$2.2 million to the plan during the third quarter of 2017.

Note 10 – Net Income per Common Share

The calculation of net income per common share for the periods indicated is presented in the following table:

<i>(Dollars and amounts in thousands, except per share data)</i>	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	\$ 15,089	\$ 13,474	\$ 44,942	\$ 34,934
Basic:				
Basic weighted average EPS shares	24,200	24,096	24,171	24,124
Basic net income per share	\$ 0.62	\$ 0.56	\$ 1.86	\$ 1.45
Diluted:				
Basic weighted average EPS shares	24,200	24,096	24,171	24,124
Dilutive common stock equivalents	23	27	30	27
Dilutive EPS shares	24,223	24,123	24,201	24,151
Diluted net income per share	\$ 0.62	\$ 0.56	\$ 1.86	\$ 1.45
Anti-dilutive shares	5	3	3	5

NOTE 11 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income is defined as net income plus transactions and other occurrences that are the result of non-owner changes in equity. For condensed financial statements presented for the Company, non-owner changes in equity are comprised of unrealized gains or losses on available-for-sale debt securities and any minimum pension liability adjustments. The following table presents the activity in net accumulated other comprehensive income (loss) and the components of the activity for the periods indicated:

<i>(In thousands)</i>	Unrealized Gains (Losses) on Defined Investments Benefit Pension Plan		Total
	Available-for-Sale	Plan	
Balance at January 1, 2017	\$ 1,642	\$ (8,256)	\$ (6,614)
Other comprehensive income before reclassification, net of tax	3,382	-	3,382
Reclassifications from accumulated other comprehensive income, net of tax	(767)	522	(245)
Current period change in other comprehensive income, net of tax	2,615	522	3,137
Balance at September 30, 2017	\$ 4,257	\$ (7,734)	\$ (3,477)

Unrealized
Gains

<i>(In thousands)</i>	(Losses)		Total
	Investments	Defined Benefit Pension	
Balance at January 1, 2016	\$ 6,566	\$ (7,863)	\$ (1,297)
Other comprehensive income before reclassification, net of tax	6,385	-	6,385
Reclassifications from accumulated other comprehensive income, net of tax	(1,154)	531	(623)
Current period change in other comprehensive income, net of tax	5,231	531	5,762
Balance at September 30, 2016	\$ 11,797	\$ (7,332)	\$ 4,465

The following table provides the information on the reclassification adjustments out of accumulated other comprehensive income for the periods indicated:

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2017	2016
Unrealized gains/(losses) on investments available-for-sale		
Affected line item in the Statements of Income:		
Investment securities gains	\$ 1,275	\$ 1,919
Income before taxes	1,275	1,919
Tax expense	(508)	(765)
Net income	\$ 767	\$ 1,154
Amortization of defined benefit pension plan items		
Affected line item in the Statements of Income:		
Recognized actuarial loss ⁽¹⁾	\$ (886)	\$ (870)
Income before taxes	(886)	(870)
Tax benefit	364	339
Net loss	\$ (522)	\$ (531)

(1) This amount is included in the computation of net periodic benefit cost, see Note 9

Note 12 – Financial Instruments with Off-balance Sheet Risk and Derivatives

The Company has entered into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk. The notional value of commercial loan swaps outstanding was \$18.1 million with a fair value of \$0.8 million as of September 30, 2017 compared to \$18.9 million with a fair value of \$1.0 million as of December 31, 2016. The swap positions are offset to minimize the potential impact on the Company’s financial statements. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The associated net gains and losses on the swaps are recorded in other non-interest income.

Note 13 – Litigation

The Company and its subsidiaries are subject in the ordinary course of business to various pending or threatened legal proceedings in which claims for monetary damages are asserted. After consultation with legal counsel, management does not anticipate that the ultimate liability, if any, arising out of these legal matters will have a material adverse effect on the Company's financial condition, operating results or liquidity.

Note 14 – Fair Value

Generally accepted accounting principles provide entities the option to measure eligible financial assets, financial liabilities and commitments at fair value (i.e. the fair value option), on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability or upon entering into a commitment. Subsequent changes in fair value must be recorded in earnings. The Company applies the fair value option on residential mortgage loans held for sale. The fair value option on residential mortgage loans allows the recognition of gains on sale of mortgage loans to more accurately reflect the timing and economics of the transaction.

The standard for fair value measurement establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below.

Basis of Fair Value Measurement:

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

Level 2- Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

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

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Changes to interest rates may result in changes in the cash flows due to prepayments or extinguishments. Accordingly, this could result in higher or lower measurements of the fair values.

Assets and Liabilities

Mortgage loans held for sale

Mortgage loans held for sale are valued based on quotations from the secondary market for similar instruments and are classified as Level 2 of the fair value hierarchy.

Investments available-for-sale

U.S. government agencies and mortgage-backed securities

Valuations are based on active market data and use of evaluated broker pricing models that vary based by asset class and includes available trade, bid, and other market information. Generally, the methodology includes broker quotes, proprietary models, descriptive terms and conditions databases coupled with extensive quality control programs. Multiple quality control evaluation processes review available market, credit and deal level information to support the evaluation of the security. If there is a lack of objectively verifiable information available to support the valuation, the evaluation of the security is discontinued. Additionally, proprietary models and pricing systems, mathematical tools, actual transacted prices, integration of market developments and experienced evaluators are used to determine the value of a security based on a hierarchy of market information regarding a security or securities with similar characteristics. The Company does not adjust the quoted price for such securities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

State and municipal securities

Proprietary valuation matrices are used for valuing all tax-exempt municipals that can incorporate changes in the municipal market as they occur. Market evaluation models include the ability to value bank qualified municipals and general market municipals that can be broken down further according to insurer, credit support, state of issuance and

rating to incorporate additional spreads and municipal curves. Taxable municipals are valued using a third party model that incorporates a methodology that captures the trading nuances associated with these bonds. Such instruments are generally classified within Level 2 of the fair value hierarchy.

Trust preferred securities and corporate debt

In active markets, these types of instruments are valued based on quoted market prices that are readily accessible at the measurement date and are classified within Level 1 of the fair value hierarchy. Positions that are not traded in active markets or are subject to transfer restrictions are valued or adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management uses a process that employs certain assumptions to determine the present value. Positions that are not traded in active markets or are subject to transfer restrictions are classified within Level 3 of the fair value hierarchy.

Interest rate swap agreements

Interest rate swap agreements are measured by alternative pricing sources with reasonable levels of price transparency in markets that are not active. Based on the complex nature of interest rate swap agreements, the markets these instruments trade in are not as efficient and are less liquid than that of the more mature Level 1 markets. These markets do however have comparable, observable inputs in which an alternative pricing source values these assets in order to arrive at a fair market value. These characteristics classify interest rate swap agreements as Level 2.

Assets Measured at Fair Value on a Recurring Basis

The following tables set forth the Company's financial assets and liabilities at the dates indicated that were accounted for or disclosed at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	September 30, 2017				Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<i>(In thousands)</i>					
Assets					
Residential mortgage loans held for sale	\$ -	\$ 7,084	\$ -		\$ 7,084
Investments available-for-sale:					
U.S. government agencies	-	107,340	-		107,340
State and municipal	-	321,127	-		321,127
Mortgage-backed	-	316,879	-		316,879
Corporate debt	-	-	9,522		9,522
Trust preferred	-	-	989		989
Marketable equity securities	-	212	-		212
Interest rate swap agreements	-	816	-		816
Liabilities					
Interest rate swap agreements	\$ -	\$ (816)	\$ -		\$ (816)

	December 31, 2016				Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<i>(In thousands)</i>					
Assets					
Residential mortgage loans held for sale	\$ -	\$ 13,222	\$ -		\$ 13,222
Investments available-for-sale:					
U.S. government agencies	-	121,790	-		121,790
State and municipal	-	287,684	-		287,684
Mortgage-backed	-	312,711	-		312,711
Corporate debt	-	-	9,134		9,134
Trust preferred	-	-	1,012		1,012
Marketable equity securities	-	1,223	-		1,223

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Interest rate swap agreements	-	1,010	-	1,010
-------------------------------	---	-------	---	-------

Liabilities

Interest rate swap agreements	\$ -	\$ (1,010)	\$ -	\$ (1,010)
-------------------------------	------	------------	------	------------

28

The following table provides unrealized losses included in assets measured in the Condensed Consolidated Statements of Condition at fair value on a recurring basis for the period indicated:

<i>(In thousands)</i>	Significant Unobservable Inputs (Level 3)
Investments available-for-sale:	
Balance at January 1, 2017	\$ 10,146
Principal redemption	(159)
Total unrealized gains included in other comprehensive loss	524
Balance at September 30, 2017	\$ 10,511

Assets Measured at Fair Value on a Nonrecurring Basis

The following table sets forth the Company's financial assets subject to fair value adjustments (impairment) on a nonrecurring basis at the date indicated 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:

<i>(In thousands)</i>	September 30, 2017					Total	Total Losses
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)				
Impaired loans	\$ -	\$ -	\$ 8,521	\$	8,521	\$	(11,806)
Other real estate owned	-	-	1,448	-	1,448	-	(136)
Total	\$ -	\$ -	\$ 9,969	\$	9,969	\$	(11,942)

<i>(In thousands)</i>	December 31, 2016					Total	Total Losses
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)				
Impaired loans	\$ -	\$ -	\$ 8,981	\$	8,981	\$	(10,600)
Other real estate owned	-	-	1,911	-	1,911	-	(107)
Total	\$ -	\$ -	\$ 10,892	\$	10,892	\$	(10,707)

At September 30, 2017, impaired loans totaling \$22.5 million were written down to fair value of \$17.7 million as a result of specific loan loss allowances of \$4.8 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling \$24.1 million were written down to fair value of \$19.3 million at December 31, 2016 as a result of specific loan loss allowances of \$4.8 million associated with the impaired loans.

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. 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 collateral is based on net book value on the business' financial statements and, if necessary, discounted based 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 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 (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. The estimated fair value for other real estate owned included in Level 3 is determined by independent market based appraisals and other available market information, less cost 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 initial recognition, the Company records the OREO as a non-recurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

Fair Value of Financial Instruments

The Company discloses fair value information about financial instruments for which it is practicable to estimate the value, whether or not such financial instruments are recognized on the balance sheet. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price, if one exists.

Quoted market prices, where available, are shown as estimates of fair market values. Because no quoted market prices are available for a significant portion of the Company's financial instruments, the fair value of such instruments has been derived based on the amount and timing of future cash flows and estimated discount rates based on observable inputs (“Level 2”) or unobservable inputs (“Level 3”).

Present value techniques used in estimating the fair value of many of the Company's financial instruments are significantly affected by the assumptions used. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate cash settlement of the instrument. Additionally, the accompanying estimates of fair values are only representative of the fair values of the individual financial assets and liabilities, and should not be considered an indication of the fair value of the Company.

The carrying amounts and fair values of the Company's financial instruments at the dates indicated are presented in the following table:

	Fair Value Measurements				
	September 30, 2017	Quoted Prices in Active Markets	Estimated for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Carrying Amount					
<i>(In thousands)</i>					
<u>Financial Assets</u>					
Other equity securities	\$ 39,853	\$ 39,853	\$ -	\$ 39,853	\$ -
Loans, net of allowance	4,149,194	4,200,409	-	-	4,200,409
Other assets	95,136	95,136	-	95,136	-
<u>Financial Liabilities</u>					
Time deposits	\$ 690,208	\$ 688,271	\$ -	\$ 688,271	\$ -
Securities sold under retail repurchase agreements and federal funds purchased	146,569	146,569	-	146,569	-
Advances from FHLB	632,917	639,022	-	639,022	-

	Fair Value Measurements				
	December 31, 2016	Quoted Prices in Active Markets	Estimated for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Carrying Amount					
<i>(In thousands)</i>					
<u>Financial Assets</u>					
Other equity securities	\$ 46,094	\$ 46,094	\$ -	\$ 46,094	\$ -
Loans, net of allowance	3,883,741	3,933,700	-	-	3,933,700
Other assets	93,328	93,328	-	93,328	-
<u>Financial Liabilities</u>					
Time deposits	\$ 586,039	\$ 584,868	\$ -	\$ 584,868	\$ -
Securities sold under retail repurchase agreements and federal funds purchased	125,119	125,119	-	125,119	-
Advances from FHLB	790,000	800,756	-	800,756	-

Subordinated debentures	30,000	29,985	-	-	29,985
-------------------------	--------	--------	---	---	--------

The following methods and assumptions were used to estimate the fair value of each category of financial instruments for which it is practicable to estimate that value:

Cash and Temporary Investments: The carrying amounts of cash and cash equivalents approximate their fair value and have been excluded from the table above.

Investments: The fair value of marketable securities is based on quoted market prices, prices quoted for similar instruments, and prices obtained from independent pricing services.

Loans: For certain categories of loans, such as mortgage, installment and commercial loans, the fair value is estimated by discounting the expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and similar remaining maturities. Expected cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Accrued interest receivable: The carrying value of accrued interest receivable approximates fair value due to the short-term duration and has been excluded from the table above.

Other assets: The investment in bank-owned life insurance represents the cash surrender value of the policies at September 30, 2017 and December 31, 2016 as determined by each insurance carrier.

Deposits: The fair value of demand, money market savings and regular savings deposits, which have no stated maturity, were considered equal to their carrying amount, representing the amount payable on demand. While management believes that the Bank's core deposit relationships provide a relatively stable, low-cost funding source that has a substantial intangible value separate from the value of the deposit balances, these estimated fair values do not include the intangible value of core deposit relationships, which comprise a significant portion of the Bank's deposit base.

Short-term borrowings: The carrying values of short-term borrowings, including overnight, securities sold under agreements to repurchase and federal funds purchased approximates the fair values due to the short maturities of those instruments.

Long-term borrowings: The fair value of the Federal Home Loan Bank of Atlanta ("FHLB") advances and subordinated debentures was estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms. The Company's credit risk is not material to calculation of fair value because the FHLB borrowings are collateralized. The Company classifies advances from the Federal Home Loan Bank of Atlanta within Level 2 of the fair value hierarchy since the fair value of such borrowings is based on rates currently available for borrowings with similar terms and remaining maturities. Subordinated debentures are classified as Level 3 in the fair value hierarchy due to the lack of market activity of such instruments.

Accrued interest payable: The carrying value of accrued interest payable approximates fair value due to the short-term duration and has been excluded from the previous table.

Note 15 - Segment Reporting

Currently, the Company conducts business in three operating segments—Community Banking, Insurance and Investment Management. Each of the operating segments is a strategic business unit that offers different products and services. The Insurance and Investment Management segments were businesses that were acquired in separate transactions where management of the acquired business was retained. The accounting policies of the segments are the same as those of the Company. However, the segment data reflect inter-segment transactions and balances.

The Community Banking segment is conducted through Sandy Spring Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. Parent company income is included in the Community Banking segment, as the majority of effort of these functions is related to this segment. Major revenue sources include net interest income, gains on sales of mortgage loans, trust income fees and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Non-cash charges associated with amortization of intangibles was not significant for the three and nine months ended September 30, 2017 and 2016, respectively.

The Insurance segment is conducted through Sandy Spring Insurance Corporation, a subsidiary of the Bank, and offers annuities as an alternative to traditional deposit accounts. Sandy Spring Insurance Corporation operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff and Associates, located in Ocean City, Maryland. Major sources of revenue are insurance commissions from commercial lines, personal lines, and medical liability lines. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles was not significant for the three and nine months ended September 30, 2017 and 2016, respectively.

The Investment Management segment is conducted through West Financial Services, Inc., a subsidiary of the Bank. This asset management and financial planning firm, located in McLean, Virginia, provides comprehensive investment management and financial planning to individuals, families, small businesses and associations including cash flow analysis, investment review, tax planning, retirement planning, insurance analysis and estate planning. West Financial currently has approximately \$1.3 billion in assets under management. Major revenue sources include non-interest income earned on the above services. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles was not significant for the three and nine months ended September 30, 2017 and 2016, respectively.

Information for the operating segments and reconciliation of the information to the condensed consolidated financial statements for the periods indicated is presented in the following tables:

<i>(In thousands)</i>	Three Months Ended September 30, 2017				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 49,590	\$ -	\$ 2	\$ (3)	\$ 49,589
Interest expense	6,895	-	-	(3)	6,892
Provision for loan losses	934	-	-	-	934
Noninterest income	8,915	1,948	2,092	(209)	12,746
Noninterest expense	28,634	1,559	1,207	(209)	31,191
Income before income taxes	22,042	389	887	-	23,318
Income tax expense	7,725	158	346	-	8,229
Net income	\$ 14,317	\$ 231	\$ 541	\$ -	\$ 15,089
Assets	\$ 5,333,539	\$ 7,499	\$ 11,807	\$ (18,057)	\$ 5,334,788

<i>(In thousands)</i>	Three Months Ended September 30, 2016				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 42,856	\$ 1	\$ 2	\$ (2)	\$ 42,857
Interest expense	5,128	-	-	(2)	5,126
Provision for loan losses	781	-	-	-	781
Non-interest income	9,071	1,783	1,909	(179)	12,584
Non-interest expense	26,822	1,510	1,173	(179)	29,326
Income before income taxes	19,196	274	738	-	20,208
Income tax expense	6,339	108	287	-	6,734
Net income	\$ 12,857	\$ 166	\$ 451	\$ -	\$ 13,474
Assets	\$ 4,811,948	\$ 7,986	\$ 12,064	\$ (21,387)	\$ 4,810,611

<i>(In thousands)</i>	Nine Months Ended September 30, 2017				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 144,123	\$ 1	\$ 6	\$ (7)	\$ 144,123
Interest expense	18,854	-	-	(7)	18,847
Provision for loan losses	2,450	-	-	-	2,450
Noninterest income	28,545	4,923	6,109	(628)	38,949
Noninterest expense	87,035	4,238	3,395	(628)	94,040
Income before income taxes	64,329	686	2,720	-	67,735
Income tax expense	21,454	279	1,060	-	22,793

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Net income	\$ 42,875	\$ 407	\$ 1,660	\$ -	\$ 44,942
Assets	\$ 5,333,539	\$ 7,499	\$ 11,807	\$ (18,057)	\$ 5,334,788

<i>(In thousands)</i>	Nine Months Ended September 30, 2016				Total
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	
Interest income	\$ 126,313	\$ 2	\$ 4	\$ (6)	\$ 126,313
Interest expense	15,734	-	-	(6)	15,728
Provision for loan losses	4,974	-	-	-	4,974
Non-interest income	29,426	4,186	5,621	(535)	38,698
Non-interest expense	86,201	3,711	3,137	(535)	92,514
Income before income taxes	48,830	477	2,488	-	51,795
Income tax expense	15,701	191	969	-	16,861
Net income	\$ 33,129	\$ 286	\$ 1,519	\$ -	\$ 34,934
Assets	\$ 4,811,948	\$ 7,986	\$ 12,064	\$ (21,387)	\$ 4,810,611

Note 16 – PENDING AQUISITION

On May 15, 2017, the Company and WashingtonFirst Bankshares, Inc., a Virginia corporation (“WashingtonFirst”) and parent company for WashingtonFirst Bank, entered into a definitive agreement and plan of merger that provides for WashingtonFirst to merge with and into the Company (the “Merger”). At the effective time of the Merger, the combined entity shall exist as a Maryland corporation.

Subsequent to the effective date of the Merger, WashingtonFirst Bank, a Virginia state-chartered bank and a wholly-owned subsidiary of WashingtonFirst, will merge with and into the Bank (the “Bank Merger”). The Bank will survive the Bank Merger and continue to exist as a Maryland banking corporation.

Under the terms of the agreement, WashingtonFirst shareholders are expected to receive 0.8713 shares of Company common stock for each share owned of WashingtonFirst common stock, subject to adjustment if the Company’s average stock price during a specified measurement period prior to closing is more than \$50.15 or less than \$37.07 per share. The transaction, which is expected to close in the fourth quarter of 2017, has a value of approximately \$498 million in the aggregate, based on the Company’s closing price of \$42.72 on May 15, 2017. Upon closing, Sandy Spring shareholders will own approximately 67.8% of the combined company and WashingtonFirst’s shareholders will own approximately 32.2% of the combined company.

As of June 30, 2017, WashingtonFirst had \$2.1 billion in assets with 19 full-service community banking offices throughout the Washington D.C. metropolitan region. In addition, WashingtonFirst also provides wealth management services through its subsidiary, 1st Portfolio Wealth Advisors, and mortgage banking services through the bank’s subsidiary, WashingtonFirst Mortgage Corporation.

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

The Company

Sandy Spring Bancorp, Inc. (the "Company") is the bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. The Bank traces its origin to 1868, making it among the oldest institutions in the region. The Bank is an independent, community oriented commercial banking business that conducts full-service banking through 44 community offices located in Central Maryland, Northern Virginia and Washington D.C. The Bank is a state chartered bank subject to supervision and regulation by the Federal Reserve and the State of Maryland. The Bank's deposit accounts are insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum permitted by law. The Bank is a member of the Federal Reserve System and is an Equal Housing Lender. The Company, the Bank, and its other subsidiaries are Affirmative Action/Equal Opportunity Employers.

The Company is a \$5.3 billion community banking organization that focuses its lending and other services on businesses and consumers in the local market area. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank offers a comprehensive menu of insurance and investment management services.

On May 16, 2017, the Company announced it had entered into a definitive agreement and plan of merger pursuant to which WashingtonFirst Bankshares, Inc., the parent company for WashingtonFirst Bank, will merge with and into the Company in a transaction valued at approximately \$498 million. WashingtonFirst, headquartered in Reston, Virginia, has 19 community banking offices and more than \$2.1 billion in assets (as of June 30, 2017).

Overview

Net income for the Company for the third quarter of 2017 totaled \$15.1 million (\$0.62 per diluted share) as compared to net income of \$13.5 million (\$0.56 per diluted share) for the third quarter of 2016. These results reflect the following events:

- Average total loans for the third quarter of 2017 increased 11% compared to the third quarter of 2016 due primarily to organic growth of 15% in the commercial loan portfolio. Overall, the entire portfolio grew \$414 million over the prior year period.
- Average total deposits grew 12% to \$4.0 billion for the third quarter of 2017 as compared to \$3.5 billion for the third quarter of 2016.

- The net interest margin was 3.54% for the third quarter of 2017, compared to 3.50% for the third quarter of 2016.
- The return on average equity for the third quarter of 2017 increased to 10.74% as compared to 10.11% from the prior year.
- The Non-GAAP efficiency ratio was 53.76% for the current quarter as compared to 56.33% for the third quarter of 2016.

The local economy continues to exhibit positive trends such as low unemployment and increased housing starts; however, these trends have been tempered by other concerns such as the impact of recent weather related events, lack of wage growth and the strength of the dollar. These factors in concert have acted to restrict the pace of economic expansion. Volatility in global economic markets and geo-political unrest continues to cause some concern. Additionally, the prospect of rising interest rates has acted to restrain confidence among individual consumers and small and mid-sized businesses. Despite this mixed economic environment, management is optimistic that the regional economy will continue to present further growth opportunities for the Company.

Total assets at September 30, 2017 increased 5% compared to December 31, 2016 driven by loan balances that increased 7% during this period due to growth in commercial loans. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 11% compared to balances at December 31, 2016. The increase in customer funding sources was driven primarily by increases of 10% in noninterest-bearing and interest-bearing transaction accounts and 10% in money market savings accounts. Additionally, certificates of deposit increased 18% compared to the balances at December 31, 2016 as the Company increased rates to fund loan growth. Liquidity remained strong due to the borrowing lines with the Federal Home Loan Bank of Atlanta and the Federal Reserve and the size and composition of the investment portfolio. During the first nine months of 2017, stockholders' equity increased \$31 million to \$564 million due to the increase in retained earnings during the period.

Non-performing loans represented 0.72% of total loans at September 30, 2017 compared to 0.85% at September 30, 2016 due to asset growth. The Company's non-performing loans were \$30.2 million at September 30, 2017 compared to \$32.0 million at September 30, 2016. The ratio of net charge-offs to average loans was 0.10% for the third quarter of 2017 compared to 0.02% for the prior year quarter.

The net interest margin was 3.54% for the third quarter of 2017, compared to 3.50% for the third quarter of 2016. The margin improvement reflects the impact of loan growth, increase yields in the investment portfolio and the cumulative benefits associated with the previous execution of funding strategies.

The provision for loan losses was \$0.9 million for the third quarter of 2017 compared to \$0.8 million for the third quarter of 2016. The current quarter's provision as compared to the prior year quarter was driven by qualitative adjustments related to the composition and concentration of loan credits that offset the impact of lower quarterly loan growth in 2017 versus 2016.

Non-interest income increased marginally to \$12.7 million for the third quarter of 2017 compared to \$12.6 million for the third quarter of 2016. The current quarter reflected increases in wealth management and insurance agency commissions compared to the same period of the prior year that were offset by a decline in mortgage banking income.

Non-interest expenses increased 6% to \$31.2 million for the third quarter of 2017 compared to \$29.3 million in the third quarter of 2016. The increase in the current quarter was driven by performance incentives and volume driven compensation costs, merger costs and other miscellaneous expenses. The non-GAAP efficiency ratio was 53.76% for the third quarter of 2017 compared to 56.33% for the third quarter of 2016 as a result of the growth in net interest income.

Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED AVERAGE BALANCES, YIELDS AND RATES

	Nine Months Ended September 30,				
	2017		Annualized	2016	
	Average	(1)	Average	Average	(1)
<i>(Dollars in thousands and tax-equivalent)</i>	Balances	Interest	Yield/Rate	Balances	Interest
Assets					
Residential mortgage loans	\$ 863,040	\$ 22,651	3.50%	\$ 818,599	\$ 21,010
Residential construction loans	166,459	4,656	3.74	141,743	3,804
Total mortgage loans	1,029,499	27,307	3.54	960,342	24,814
Commercial AD&C loans	301,537	11,126	4.93	273,922	9,511
Commercial investor real estate loans	1,015,903	33,978	4.47	790,864	27,087
Commercial owner occupied real estate loans	786,805	28,501	4.84	693,442	24,946
Commercial business loans	458,973	15,321	4.46	453,468	14,819
Total commercial loans	2,563,218	88,926	4.64	2,211,696	76,363
Consumer loans	459,118	12,496	3.67	450,280	11,691
Total loans (2)	4,051,835	128,729	4.25	3,622,318	112,868
Loans held for sale	7,189	273	5.06	10,854	294
Taxable securities	526,931	10,944	2.77	470,987	9,073
Tax-exempt securities (3)	297,818	9,455	4.23	281,938	8,912
Total investment securities	824,749	20,399	3.30	752,925	17,985
Interest-bearing deposits with banks	38,006	289	1.02	41,433	156
Federal funds sold	2,493	18	0.97	688	3
Total interest-earning assets	4,924,272	149,708	4.06	4,428,218	131,306
Less: allowance for loan losses	(44,324)			(42,215)	
Cash and due from banks	48,184			46,255	
Premises and equipment, net	53,680			53,318	
Other assets	222,682			214,284	
Total assets	\$5,204,494			\$4,699,860	
Liabilities and Stockholders' Equity					
Interest-bearing demand deposits	\$ 613,498	372	0.08%	\$ 578,473	335
Regular savings deposits	322,683	163	0.07	297,944	137
Money market savings deposits	992,069	3,333	0.45	914,499	1,446
Time deposits	637,478	5,344	1.12	550,195	4,088
Total interest-bearing deposits	2,565,728	9,212	0.48	2,341,111	6,006
Other borrowings	131,412	238	0.24	118,105	212
Advances from FHLB	683,231	9,385	1.84	565,493	8,812
Subordinated debentures	549	12	2.93	31,989	698
Total interest-bearing liabilities	3,380,920	18,847	0.75	3,056,698	15,728
Noninterest-bearing demand deposits	1,235,350			1,078,851	
Other liabilities	41,537			38,981	
Stockholders' equity	546,687			525,330	
Total liabilities and stockholders' equity	\$5,204,494			\$4,699,860	

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Net interest income and spread	130,861	3.31%	115,578
Less: tax-equivalent adjustment	5,585		4,993
Net interest income	\$125,276		\$110,585

Interest income/earning assets	4.06%
Interest expense/earning assets	0.51
Net interest margin	3.55%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2017 and 2016. annualized taxable-equivalent

adjustments utilized in the above table to compute yields aggregated to \$5.6 million and \$5.0 million in 2017 and 2016, res

(2) Non-accrual loans are included in the average balances.

(3) Includes only investments that are exempt from federal taxes.

Results of Operations

For the Nine Months Ended September 30, 2017 Compared to the Nine Months Ended September 30, 2016

Net income for the Company for the first nine months of 2017 totaled \$44.9 million (\$1.86 per diluted share) compared to net income of \$34.9 million (\$1.45 per diluted share) for the first nine months of 2016.

Net Interest Income

The largest source of the Company's operating revenue is net interest income, which is the difference between the interest earned on interest-earning assets and the interest paid on interest-bearing liabilities. For purposes of this discussion and analysis, the interest earned on tax-exempt loans and investment securities has been adjusted to an amount comparable to interest subject to normal income taxes. The result is referred to as tax-equivalent interest income and tax-equivalent net interest income. The following discussion of net interest income should be considered in conjunction with the review of the information provided in the preceding table.

Net interest income for the first nine months of 2017 was \$125.3 million compared to \$110.6 million for the first nine months of 2016. On a tax-equivalent basis, net interest income for the first nine months of 2017 was \$130.9 million compared to \$115.6 million for the first nine months of 2016, a 13% increase. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that has increased to 3.55% for the first nine months of 2017 compared to 3.49% for the first nine months of 2016.

The higher net interest margin was driven by an increase in the yield on interest-earning assets as a result of loan growth. Additionally, the yields associated with the investment portfolio also increased compared to the prior year period. Average interest-earning assets increased by 11% while average interest-bearing liabilities increased 11% in the first nine months of 2017 compared to the first nine months of 2016. Average noninterest-bearing deposits increased 15% in the first nine months of 2017. Percentage of average noninterest-bearing deposits to total deposits remained at 32% in the first nine months of 2017 compared to the first nine months of 2016.

Interest Income

The Company's total tax-equivalent interest income increased 14% for the first nine months of 2017 compared to the prior year period. The previous and following table reflects that the increase in interest income has been driven predominantly by loan growth and to a lesser extent by the performance of the investment portfolio.

The average balance of the loan portfolio increased 12% for the first nine months of 2017 compared to the first nine months of 2016. This growth occurred in all segments of the loan portfolio with the most significant growth in the commercial portfolio. The increases were driven by organic loan growth as the regional economy improved. Excluding the \$0.7 million interest recovery from the full payoff of a previously acquired credit impaired loan, the yield on average loans increased by 6 basis points to 4.22% from the prior year's 4.16%. The rise in the portfolio yield was driven primarily by an increase in the yields in most of the major segments of the loan portfolio as loan volumes had a greater impact than their associated rates on the increase in the overall yield.

The average yield on total investment securities increased 11 basis points as the average balance of the portfolio increased 10% for the first nine months of 2017 compared to the first nine months of 2016. The increase in the yield on investments was due primarily to securities purchased in early 2017 at favorable yields in addition to the decline in the size of the lower-yielding mortgage-backed securities portfolio due sales of such securities that occurred in early 2016. The effect of these transactions was to increase the relative size of the higher yielding state and municipal portfolio as part of the total investment securities portfolio.

Interest Expense

Interest expense increased 20% in the first nine months of 2017 compared to the first nine months of 2016. The cost of interest-bearing deposits increased as the Company increased rates to maintain deposit relationships and to provide funding for loan growth. The average rate paid on Federal Home Loan Bank advances decreased due to the prepayments of high rate advances over the past year. Average interest-bearing deposits increased 10% in the first nine months of 2017 compared to the first nine months of 2016. This increase was primarily due to increases of \$192 million or 12% in average noninterest-bearing and interest-bearing checking accounts together with increases of \$87 million or 16% in certificates of deposit and \$78 million or 8% in money market accounts as the Company increased rates on the deposit products.

Effect of Volume and Rate Changes on Net Interest Income

The following table analyzes the reasons for the changes from year-to-year in the principal elements that comprise net interest income:

<i>(Dollars in thousands and tax equivalent)</i>	2017 vs. 2016			2016 vs. 2015		
	Increase	Due to Change In		Increase	Due to Change In	
	Or	Average:*		Or	Average:*	
	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate
Interest income from earning assets:						
Residential mortgage loans	\$ 1,641	\$ 1,147	\$ 494	\$ 2,385	\$ 2,101	\$ 284
Residential construction loans	852	688	164	75	189	(114)
Commercial AD&C loans	1,615	997	618	2,047	1,965	82
Commercial investor real estate loans	6,891	7,497	(606)	3,384	4,099	(715)
Commercial owner occupied real estate loans	3,555	3,398	157	1,680	2,258	(578)
Commercial business loans	502	186	316	1,712	1,802	(90)
Leasing	-	-	-	(1)	(1)	-
Consumer loans	805	230	575	884	420	464
Loans held for sale	(21)	(117)	96	(128)	(91)	(37)
Taxable securities	1,871	1,130	741	(2,391)	(2,612)	221
Tax exempt securities	543	501	42	(484)	(313)	(171)
Interest-bearing deposits with banks	133	(14)	147	87	10	77
Federal funds sold	15	10	5	2	1	1
Total interest income	18,402	15,653	2,749	9,252	9,828	(576)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	37	37	-	23	23	-
Regular savings deposits	26	8	18	29	8	21
Money market savings deposits	1,887	129	1,758	463	74	389
Time deposits	1,256	687	569	1,298	513	785
Other borrowings	26	26	-	33	24	9
Advances from FHLB	573	1,675	(1,102)	(962)	(420)	(542)
Subordinated debentures	(686)	(686)	-	28	(61)	89
Total interest expense	3,119	1,876	1,243	912	161	751
Net interest income	\$ 15,283	\$ 13,777	\$ 1,506	\$ 8,340	\$ 9,667	\$ (1,327)

* Variances that are the combined effect of volume and rate, but cannot be separately identified, are allocated to the volume and rate variances based on their respective relative amounts.

Non-interest Income

Non-interest income amounts and trends are presented in the following table for the periods indicated:

<i>(Dollars in thousands)</i>	Nine Months Ended		2017/2016 \$ Change	2017/2016 % Change
	September 30, 2017	2016		
Securities gains	\$ 1,275	\$ 1,919	\$ (644)	(33.6)%
Service charges on deposit accounts	6,121	5,894	227	3.9
Mortgage banking activities	2,080	2,770	(690)	(24.9)
Wealth management income	14,092	13,200	892	6.8
Insurance agency commissions	4,924	4,180	744	17.8
Income from bank owned life insurance	1,808	1,846	(38)	(2.1)
Bank card fees	3,609	3,498	111	3.2
Other income	5,040	5,391	(351)	(6.5)
Total non-interest income	\$ 38,949	\$ 38,698	\$ 251	0.6

40

Total non-interest income was \$38.9 million for the first nine months of 2017 compared to \$38.7 million for the first nine months of 2016. The first nine months of 2017 includes \$1.3 million in gains on sales of investment securities.

The prior year period included a \$1.2 million gain on the extinguishment of subordinated debentures and \$1.9 million in gains on the sales of investment securities. Excluding these gains, non-interest income increased 8% compared to the prior year period. Further detail by type of non-interest income follows:

- Gains on the sales of investment securities declined to \$1.3 million for the first nine months of 2017 compared to \$1.9 million for the first nine months of 2016. During the first nine months of 2017 the Company sold specific equity securities for gains that were applied to offset the impact of prepayment penalties incurred on FHLB advances during the second quarter of 2017. A similar strategy was executed for the same period of the prior year.
- Income from mortgage banking activities decreased in the first nine months of 2017 compared to the first nine months of 2016 due primarily due to lower volumes of loan originations compared to the prior year period.
- Wealth management income is comprised of income from trust and estate services and investment management fees earned by the Company's investment management subsidiary. Overall, wealth management income increased 7% for the first nine months of 2017 compared to the same period of the prior year. The prior year's wealth management income included \$0.4 million in fees on sales of investment products. The portfolio responsible for these fees was sold in early 2016. Excluding these fees from the prior year period, wealth management income grew 10% from prior year levels. Trust services fees increased 10% for the first nine months of 2017 compared to the prior year period. Investment management fees increased 10% for the first nine months of 2017 compared to the same period of 2016, due to an increase in assets under management. Overall total assets under management increased to \$2.7 billion at September 30, 2017 compared to \$2.4 billion at September 30, 2016 primarily as a result of positive trends occurring in the financial markets and increased sales efforts.
- Insurance agency commissions increased for the first nine months of 2017 compared to the same period of 2016 primarily due to the increased commission income resulting from the agency acquisition that occurred during the third quarter of the prior year.
- Other non-interest income decreased mainly due to a \$1.2 million gain realized on the extinguishment of subordinated debentures in the first nine months of 2016. Excluding this gain, other non-interest income increased 20% for the first nine months of 2017 as compared to the first nine months of 2016 due to prepayment fees, commissions and incentives.

Non-interest Expense

Non-interest expense amounts and trends are presented in the following table for the periods indicated:

<i>(Dollars in thousands)</i>	Nine Months Ended		2017/2016 \$ Change	2017/2016 % Change
	2017	September 30, 2016		

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Salaries and employee benefits	\$	54,525	\$	53,299	\$	1,226	2.3 %
Occupancy expense of premises		9,907		9,765		142	1.5
Equipment expenses		5,213		5,102		111	2.2
Marketing		2,223		1,971		252	12.8
Outside data services		4,045		4,067		(22)	(0.5)
FDIC insurance		2,478		2,012		466	23.2
Amortization of intangible assets		76		94		(18)	(19.1)
Merger expenses		1,332		-		1,332	100.0
Professional fees		3,053		3,572		(519)	(14.5)
Other real estate owned		3		17		(14)	(82.4)
Other expense		11,185		12,615		(1,430)	(11.3)
Total non-interest expense	\$	94,040	\$	92,514	\$	1,526	1.6

Non-interest expenses totaled \$94.0 million in the first nine months of 2017 compared to \$92.5 million in the first nine months of 2016, a 2% increase. The non-interest expenses for nine months ended September 30, 2017, included \$1.3 million in prepayment penalties for the early payoff of high-rate FHLB advances as compared to \$3.2 million in prepayment penalties included for the nine months ended September 30, 2016. The current period also included \$1.3 million in merger expenses. Excluding the impact of prepayment penalties and merger expenses, non-interest expenses increased 2% over the prior year period. Further detail by category of non-interest expense follows:

- Salaries and employee benefits, the largest component of non-interest expenses, increased in the first nine months of 2017 due to higher compensation expense as a result of merit increases, performance incentives and volume based compensation costs. The increased compensation costs were partially offset by a decrease in healthcare and pension expense. The average number of full-time equivalent employees remained at 727 for the first nine months of 2017 compared to the first nine months of 2016.
- Occupancy expenses increased 1% compared to the prior year as rental expense associated with relocated facilities increased.
- Equipment expenses increased 2% in 2017 compared to 2016 due to increases in software and general maintenance expense.
- Marketing expense increased 13% as a result of focused marketing initiatives.
- FDIC insurance experienced a 23% increase directly associated with the asset growth of the Company over the past twelve months.
- Merger expense is the direct result of costs associated with the prospective WashingtonFirst acquisition.
- Outside data services and intangible amortization expense levels remained comparable to the prior year period.
- Other non-interest expenses decreased in the first nine months of 2017 compared to the prior year period. The current year included \$1.3 million in penalties related to the prepayment of FHLB advances as compared to the previous year which included \$3.2 million in prepayment penalties. Excluding these expenses, other non-interest expenses increased 4% for the first nine months compared to the prior year period.

Operating Expense Performance

Management views the GAAP efficiency ratio as an important financial measure of expense performance and cost management. The ratio expresses the level of non-interest expenses as a percentage of total revenue (net interest income plus total non-interest income). Lower ratios indicate improved productivity.

Non-GAAP Financial Measures

The Company also uses a traditional efficiency ratio that is a non-GAAP financial measure of operating expense control and efficiency of operations. Management believes that its traditional ratio better focuses attention on the operating performance of the Company over time than does a GAAP ratio, and is highly useful in comparing period-to-period operating performance of the Company's core business operations. It is used by management as part of its assessment of its performance in managing non-interest expenses. However, this measure is supplemental, and is not a substitute for an analysis of performance based on GAAP measures. The reader is cautioned that the non-GAAP efficiency ratio used by the Company may not be comparable to GAAP or non-GAAP efficiency ratios reported by other financial institutions.

In general, the efficiency ratio is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation of the non-GAAP efficiency ratio exclude goodwill impairment losses, the amortization of intangibles, and non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Condensed Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. The GAAP efficiency ratio improved in the first nine months of 2017 compared to the first nine months of 2016 due primarily to the increase in net interest income discussed previously.

In addition, the Company uses pre-tax, pre-provision income as a measure of the level of recurring income before taxes. Management believes this provides financial statement users with a useful metric of the run-rate of revenues and expenses which is readily comparable to other financial institutions. This measure is calculated by adding the provision for loan losses, and the provision for income taxes back to net income. This metric increased in the first nine months of 2017 compared to the first nine months of 2016 due primarily to the increase in net interest income.

<i>(Dollars in thousands)</i>	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
	2016	2016	2016	2016
Pre-tax pre-provision income:				
Net income	\$ 15,089	\$ 13,474	\$ 44,942	\$ 34,934
Plus non-GAAP adjustment:				
Merger expenses	345	-	1,332	-
Income taxes	8,229	6,734	22,793	16,861
Provision for loan losses	934	781	2,450	4,974
Pre-tax pre-provision income	\$ 24,597	\$ 20,989	\$ 71,517	\$ 56,769
Efficiency ratio - GAAP basis:				
Non-interest expense	\$ 31,191	\$ 29,326	\$ 94,040	\$ 92,514
Net interest income plus non-interest income	\$ 55,443	\$ 50,315	\$ 164,225	\$ 149,283
Efficiency ratio - GAAP basis	56.26%	58.28%	57.26%	61.97%
Efficiency ratio - Non-GAAP basis:				
Non-interest expense	\$ 31,191	\$ 29,326	\$ 94,040	\$ 92,514
Less non-GAAP adjustment:				
Amortization of intangible assets	25	34	76	94
Loss on FHLB redemption	-	-	1,275	3,167
Merger expenses	345	-	1,332	-
Non-interest expenses - as adjusted	\$ 30,821	\$ 29,292	\$ 91,357	\$ 89,253
Net interest income plus non-interest income	\$ 55,443	\$ 50,315	\$ 164,225	\$ 149,283
Plus non-GAAP adjustment:				
Tax-equivalent income	1,888	1,688	5,585	4,993
Less non-GAAP adjustments:				
Securities gains	-	-	1,275	1,919
Gain on redemption of subordinated debentures	-	-	-	1,200
Net interest income plus non-interest income - as adjusted	\$ 57,331	\$ 52,003	\$ 168,535	\$ 151,157
Efficiency ratio - Non-GAAP basis	53.76%	56.33%	54.21%	59.05%

Income Taxes

The Company had income tax expense of \$22.8 million in the first nine months of 2017, compared to income tax expense of \$16.9 million in the first nine months of 2016. The resulting effective tax rates were 33.7% for the first nine months of 2017 and 32.6% for the first nine months of 2016. This rate increase was due to the decline in tax-advantaged interest income in proportion to total interest income.

Results of Operations

For the Three Months Ended September 30, 2017 Compared to the Three Months Ended September 30, 2016

Net income for the Company for the third quarter of 2017 totaled \$15.1 million (\$0.62 per diluted share) compared to net income of \$13.5 million (\$0.56 per diluted share) for the third quarter of 2016.

Net Interest Income

Net interest income for the third quarter of 2017 was \$42.7 million compared to \$37.7 million for the third quarter of 2016. On a tax-equivalent basis, net interest income for the third quarter of 2017 was \$44.6 million compared to \$39.4 million for the third quarter of 2016, an increase of 13%. The following table provides an analysis of net interest income performance that reflects a net interest margin that has increased to 3.54% for the third quarter of 2017 compared to 3.50% for the third quarter of 2016.

Average interest-earning assets and average interest-bearing liabilities increased by 12% in the third quarter of 2017 compared to the third quarter of 2016. Average noninterest-bearing deposits increased 14% in the third quarter of 2017 while the percentage of average noninterest-bearing deposits to total deposits increased to 33% in the current quarter compared to 32% in the third quarter of 2016. During the quarter the increase in the net interest margin was driven by an increase in the yield on interest-earning assets, loan and investment portfolio growth, and a reduced borrowing costs resulting from the prepayment of FHLB advances over the previous twelve months and the extinguishment of subordinated debentures early in the first quarter of 2017. The impact of these factors were partially offset by an increase in the cost of deposits as the Company increased rates to maintain deposit relationships and fund loan growth.

Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED AVERAGE BALANCES, YIELDS AND RATES

	Three Months Ended September 30,				
	2017			2016	
	Average	(1)	Annualized	Average	(1)
<i>(Dollars in thousands and tax-equivalent)</i>	Balances	Interest	Yield/Rate	Balances	Interest
Assets					
Residential mortgage loans	\$ 880,782	\$ 7,772	3.53%	\$ 836,452	\$ 7,208
Residential construction loans	172,921	1,641	3.77	147,602	1,341
Total mortgage loans	1,053,703	9,413	3.57	984,054	8,549
Commercial AD&C loans	291,569	3,705	5.04	287,836	3,398
Commercial investor real estate loans	1,090,641	12,279	4.47	832,529	9,487
Commercial owner occupied real estate loans	808,802	9,492	4.66	717,371	8,581
Commercial business loans	459,779	5,252	4.53	446,123	4,863
Total commercial loans	2,650,791	30,728	4.60	2,283,859	26,329
Consumer loans	457,526	4,395	3.84	450,171	3,916
Total loans (2)	4,162,020	44,536	4.25	3,718,084	38,794
Loans held for sale	7,093	119	6.69	10,207	96
Taxable securities	512,420	3,531	2.76	432,706	2,717
Tax-exempt securities (3)	300,759	3,175	4.22	276,821	2,888
Total investment securities	813,179	6,706	3.30	709,527	5,605
Interest-bearing deposits with banks	34,007	108	1.26	38,773	49
Federal funds sold	2,834	8	1.16	847	1
Total interest-earning assets	5,019,133	51,477	4.08	4,477,438	44,545
Less: allowance for loan losses	(45,546)			(43,498)	
Cash and due from banks	48,221			45,210	
Premises and equipment, net	53,938			53,162	
Other assets	221,622			214,708	
Total assets	\$5,297,368			\$4,747,020	
Liabilities and Stockholders' Equity					
Interest-bearing demand deposits	\$ 615,250	135	0.09%	\$ 579,863	112
Regular savings deposits	326,827	57	0.07	305,077	48
Money market savings deposits	1,002,779	1,479	0.59	938,528	514
Time deposits	678,331	2,030	1.19	573,458	1,454
Total interest-bearing deposits	2,623,187	3,701	0.56	2,396,926	2,128
Other borrowings	133,145	83	0.25	120,702	74
Advances from FHLB	650,947	3,108	1.89	498,370	2,699
Subordinated debentures	-	-	-	30,000	225
Total interest-bearing liabilities	3,407,279	6,892	0.80	3,045,998	5,126
Noninterest-bearing demand deposits	1,293,470			1,131,739	
Other liabilities	39,337			39,042	
Stockholders' equity	557,282			530,241	
Total liabilities and stockholders' equity	\$5,297,368			\$4,747,020	

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Net interest income and spread	44,585	3.28%	39,419
Less: tax-equivalent adjustment	1,888		1,688
Net interest income	\$42,697		\$37,731
Interest income/earning assets		4.08%	
Interest expense/earning assets		0.54	
Net interest margin		3.54%	

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2017 and 2016. annualized taxable-equivalent

adjustments utilized in the above table to compute yields aggregated to \$1.9 million and \$1.7 million in 2017 and 2016, res

(2) Non-accrual loans are included in the average balances.

(3) Includes only investments that are exempt from federal taxes.

Interest Income

The Company's total tax-equivalent interest income increased 16% for the third quarter of 2017 compared to the prior year quarter. The previous table shows that this increase was driven primarily by loan growth and to a lesser degree by an increase in the investment portfolio during the previous twelve months.

The average balance of the loan portfolio increased 12% for the third quarter of 2017 compared to the prior year period. The increase has been driven by organic loan growth due to the strength of the regional economy. The majority of growth was concentrated in the commercial real estate loan portfolios. The yield on average loans increased by 9 basis points compared to the prior year quarter.

The average yield on total investment securities increased 14 basis points while the average balance of the investment portfolio increased 15% for the third quarter of 2017 compared to the third quarter of 2016. The increase in the yield on investments was due to the addition of relatively higher-yielding tax-exempt municipal securities in 2017.

Average deposits increased 11% in the third quarter of 2017 compared to the third quarter of 2016. This increase was primarily due to increases of \$197 million or 12% in average noninterest-bearing and interest-bearing checking accounts together with increases of \$105 million or 18% in certificates of deposit and \$64 million or 7% in money market accounts as the Company increased rates on these products to maintain deposit relationships and fund loan growth. This increase was partially offset by the lower average rates paid on FHLB advances due in part to the prepayment of such advances during the previous twelve months.

Non-interest Income

Non-interest income amounts and trends are presented in the following table for the periods indicated:

<i>(Dollars in thousands)</i>	Three Months Ended		2017/2016 \$ Change	2017/2016 % Change
	2017	September 30, 2016		
Service charges on deposit accounts	\$ 2,140	\$ 2,035	\$ 105	5.2 %
Mortgage banking activities	632	1,129	(497)	(44.0)
Wealth management income	4,864	4,347	517	11.9
Insurance agency commissions	1,950	1,786	164	9.2
Income from bank owned life insurance	609	616	(7)	(1.1)
Bank card fees	1,211	1,189	22	1.9

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Other income		1,340		1,482	(142)	(9.6)
Total non-interest income	\$	12,746	\$	12,584	\$ 162	1.3

46

Total non-interest income was \$12.7 million for the third quarter of 2017 compared to \$12.6 million for the third quarter of 2016, an increase of 1%. Further detail by type of non-interest income follows:

- Income from mortgage banking activities decreased in the third quarter of 2017 compared to the third quarter of 2016 due to reduced lending volumes in the third quarter.
- Wealth management income is comprised of income from trust and estate services and investment management fees earned by the Company's investment management subsidiary. Overall, wealth management income increased 12% for the quarter ended September 30, 2017 compared to the same quarter of the prior year. Trust services fees increased 14% for the third quarter of 2017 compared to the prior year period. Investment management fees increased 10% for the third quarter of 2017 compared to the same period of 2016, due to an increase in assets under management. Overall total assets under management increased to \$2.7 billion at September 30, 2017 compared to \$2.4 billion at September 30, 2016.
- Insurance agency commissions increased 9% during the third quarter of 2017 compared to the third quarter of 2016 due primarily to commission income from the agency acquisition in the third quarter of the prior year.
- Other income for the three months ended September 30, 2017 compared to the same period of 2016 decreased 10%. The decrease for the third quarter of 2017 compared to the third quarter of 2016 was due to a decline in gains resulting from asset sales and letter of credit fees.

Non-interest Expense

Non-interest expense amounts and trends are presented in the following table for the periods indicated:

<i>(Dollars in thousands)</i>	Three Months Ended September		2017/2016	2017/2016
	2017	30, 2016	\$ Change	% Change
Salaries and employee benefits	\$ 18,442	\$ 17,848	\$ 594	3.3 %
Occupancy expense of premises	3,294	3,130	164	5.2
Equipment expenses	1,722	1,745	(23)	(1.3)
Marketing	784	628	156	24.8
Outside data services	1,286	1,349	(63)	(4.7)
FDIC insurance	850	726	124	17.1
Amortization of intangible assets	25	34	(9)	(26.5)
Merger expenses	345	-	345	100.0
Professional fees	1,053	987	66	6.7
Other real estate owned	4	5	(1)	(20.0)
Other expense	3,386	2,874	512	17.8

Total non-interest expense	\$	31,191	\$	29,326	\$	1,865	6.4
----------------------------	----	---------------	----	--------	----	-------	-----

Non-interest expenses totaled \$31.2 million in the third quarter of 2017 compared to \$29.3 million in the third quarter of 2016 and increase of 6%. Further detail by category of non-interest expense follows:

- Salaries and employee benefits, the largest component of non-interest expenses, increased in the third quarter of 2017 due primarily to an increase in compensation expenses as a result of performance incentives and volume driven compensation costs. The average number of full-time equivalent employees was 725 in the third quarter of 2017 compared to 729 in the third quarter of 2016.
- Occupancy expense increased due to higher rental expense associated with relocated facilities.
- Marketing expense increased 25% from the prior year quarter due to an increase in focused advertising campaigns.
- FDIC insurance expense increased due to asset growth.
- Merger expense is the direct result of costs associated with the prospective Washington First acquisition.
- Professional fees increased in the third quarter of 2017 due to increases in various professional and consulting fees.
- Other expenses for the third quarter of 2017 increased \$0.5 million from the prior year quarter due to the use of various third party vendors to provide specific services.

Income Taxes

The Company had income tax expense of \$8.2 million in the third quarter of 2017, compared to income tax expense of \$6.7 million in the third quarter of 2016. The resulting effective tax rate was 35.3% for the third quarter of 2017 compared to 33.3% for the third quarter of 2016. The effective tax rate for the current quarter increased compared to the prior year quarter as tax-advantaged interest income declined in proportion to total interest income.

Non-GAAP Financial Measures

The Company also uses a traditional efficiency ratio that is a non-GAAP financial measure of operating expense control and efficiency of operations. Management believes that its traditional ratio better focuses attention on the operating performance of the Company over time than does a GAAP ratio, and is highly useful in comparing period-to-period operating performance of the Company's core business operations. It is used by management as part of its assessment of its performance in managing non-interest expenses. However, this measure is supplemental, and is not a substitute for an analysis of performance based on GAAP measures. The reader is cautioned that the non-GAAP efficiency ratio used by the Company may not be comparable to GAAP or non-GAAP efficiency ratios reported by other financial institutions.

In general, the efficiency ratio is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation of the non-GAAP efficiency ratio exclude goodwill impairment losses, the amortization of intangibles, and non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Condensed Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the table on page 43. The GAAP efficiency ratio improved in the third quarter of 2017 compared to the third quarter of 2016 as a direct result of the growth in net interest income.

In addition, the Company uses pre-tax, pre-provision income as a measure of the level of recurring income before taxes. Management believes this provides financial statement users with a useful metric of the run-rate of revenues and expenses which is readily comparable to other financial institutions. This measure is calculated by adding the provision for loan losses, and the provision for income taxes back to net income. This metric increased in the third quarter of 2017 compared to the third quarter of 2016 primarily due to an increase in net interest income.

FINANCIAL CONDITION

The Company's total assets were \$5.3 billion at September 30, 2017, an increase of \$243 million or 5% compared to December 31, 2016. The increase was primarily due to the growth in total loans, which increased 7% compared to the previous year end.

Analysis of Loans

A comparison of the loan portfolio at the dates indicated is presented in the following table:

<i>(Dollars in thousands)</i>	September 30, 2017		December 31, 2016		Period-to-Period Change	
	Amount	%	Amount	%	\$	%
Residential real estate:						
Residential mortgage	\$ 882,890	21.1%	\$ 841,692	21.4%	\$ 41,198	4.9%
Residential construction	171,814	4.1	150,229	3.8	21,585	14.4
Commercial real estate:						
Commercial owner occupied real estate	831,461	19.8	775,552	19.8	55,909	7.2
Commercial investor real estate	1,104,669	26.3	928,113	23.6	176,556	19.0
Commercial AD&C	295,222	7.0	308,279	7.9	(13,057)	(4.2)
Commercial business	451,667	10.8	467,286	11.9	(15,619)	(3.3)
Consumer	456,395	10.9	456,657	11.6	(262)	(0.1)
Total loans	\$4,194,118	100.0%	\$3,927,808	100.0%	\$ 266,310	6.8

Total loans, excluding loans held for sale, increased 7% at September 30, 2017 compared to December 31, 2016. The commercial loan portfolio increased 8% at September 30, 2017 driven by an increase of 19% in investor real estate loans. The owner occupied real estate portfolio increased 7% which was partially offset by decreases of 3% in the commercial business and 4% in the AD&C loan portfolios. The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, increased 6% at September 30, 2017 compared to December 31, 2016. This increase was driven by a 14% increase in residential construction loans during the third quarter. The consumer loan portfolio remained stable at September 30, 2017 compared to December 31, 2016.

Analysis of Investment Securities

The composition of investment securities at the periods indicated is presented in the following table:

<i>(Dollars in thousands)</i>	September 30, 2017		December 31, 2016		Period-to-Period Change	
	Amount	%	Amount	%	\$	%
Investments available-for-sale:						
U.S. government agencies and corporations	\$ 107,340	13.5%	\$ 121,790	15.6%	\$ (14,450)	(11.9)%
State and municipal	321,127	40.3	287,684	36.9	33,443	11.6
Mortgage-backed	316,879	39.9	312,711	40.1	4,168	1.3
Corporate debt	9,522	1.2	9,134	1.2	388	4.2
Trust preferred	989	0.1	1,012	0.1	(23)	(2.3)
Marketable equity securities	212	-	1,223	0.2	(1,011)	(82.7)

Edgar Filing: SANDY SPRING BANCORP INC - Form 10-Q

Total available-for-sale securities	756,069	95.0	733,554	94.1	22,515	3.1
Investments held-to-maturity and other equity:						
Other equity securities	39,853	5.0	46,094	5.9	(6,241)	(13.5)
Total held-to-maturity and other equity	39,853	5.0	46,094	5.9	(6,241)	(13.5)
Total securities	\$ 795,922	100.0%	\$ 779,648	100.0%	\$ 16,274	2.1

The investment portfolio increased 2% at September 30, 2017 compared to December 31, 2016 as funds from increased deposits were invested at favorable rates.

The investment portfolio consists primarily of U.S. Agency securities, U.S. Agency mortgage-backed securities, U.S. Agency collateralized mortgage obligations and state and municipal securities. The duration of the portfolio was 3.4 years at September 30, 2017 and 3.3 years at December 31, 2016. The Company considers the duration of the portfolio to be adequate for liquidity purposes. This investment strategy has resulted in a portfolio with low credit risk that would provide the liquidity necessary to meet loan demand. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis.

Other Earning Assets

Residential mortgage loans held for sale were \$7 million at September 30, 2017 compared to \$13 million at December 31, 2016 due to the effect of the timing of loan sales on the amounts held for sale at quarter end. The aggregate of federal funds sold and interest-bearing deposits with banks decreased by \$29 million to \$52 million at September 30, 2017 compared to December 31, 2016 due to the timing of cash flows.

Deposits

The composition of deposits at the periods indicated is presented in the following table:

<i>(Dollars in thousands)</i>	September 30, 2017		December 31, 2016		Period-to-Period Change	
	Amount	%	Amount	%	\$	%
Noninterest-bearing deposits	\$ 1,312,710	33.2%	\$ 1,138,139	31.8%	\$ 174,571	15.3%
Interest-bearing deposits:						
Demand	608,527	15.4	615,058	17.2	(6,531)	(1.1)
Money market savings	1,023,153	25.9	927,837	25.9	95,316	10.3
Regular savings	321,194	8.1	310,471	8.7	10,723	3.5
Time deposits of less than \$100,000	292,395	7.4	258,621	7.2	33,774	13.1
Time deposits of \$100,000 or more	397,813	10.0	327,418	9.2	70,395	21.5
Total interest-bearing deposits	2,643,082	66.8	2,439,405	68.2	203,677	8.3
Total deposits	\$ 3,955,792	100.0%	\$ 3,577,544	100.0%	\$ 378,248	10.6

Deposits and Borrowings

Total deposits increased \$378 million or 11% at September 30, 2017 compared to December 31, 2016. This increase was due primarily to increases of 15% in noninterest-bearing checking accounts and 10% in money market savings accounts. In addition, regular savings accounts increased 3% and certificates of deposit increased 18% compared to December 31, 2016. The increase in interest-bearing products occurred as the Company raised rates to maintain client relationships and to fund loan growth. Total borrowings decreased 18% at September 30, 2017 compared to December 31, 2016 due to the reduced dependence on borrowings as a result of the growth in deposits and the extinguishment of \$30 million in subordinated debentures during the first three months of 2017.

Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. Total stockholders' equity was \$564 million at September 30, 2017 compared to \$534 million at December 31, 2016 as net income during the period exceeded the payment of dividends. The ratio of average equity to average assets was 10.50% for the nine months ended September 30, 2017, as compared to 11.18% for the first nine months of 2016 as the ratio was affected by the growth of average assets.

Bank holding companies and banks are required to maintain capital ratios in accordance with guidelines adopted by the federal bank regulators. These guidelines are commonly known as Risk-Based Capital guidelines. The actual regulatory ratios and required ratios for capital adequacy are summarized for the Company in the following table.

Risk-Based Capital Ratios

	September 30, 2017	Ratios at December 31, 2016	Minimum Regulatory Requirements
Total capital to risk-weighted assets	12.01%	12.80%	8.00%
Tier 1 capital to risk-weighted assets	10.99%	11.74%	6.00%
Common equity tier 1 capital	10.99%	11.01%	4.50%
Tier 1 leverage	9.28%	10.14%	4.00%

As of September 30, 2017, the most recent notification from the Bank's primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

In July 2013, the Federal Reserve Board approved revisions to its capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of the Dodd-Frank Act. The rules include new risk-based capital and leverage ratios, which were effective January 1, 2015, and revise the definition of what constitutes "capital" for calculating those ratios. The minimum capital level requirements applicable to the Company and the Bank are: (1) a common equity Tier 1 capital ratio of 4.5%; (2) a Tier 1 capital ratio of 6%; (3) a total capital ratio of 8%; and (4) a Tier 1 leverage ratio of 4%. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010 have been grandfathered for companies with consolidated assets of \$15 billion or less. The rules also establish a "capital conservation buffer" of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The new capital conservation buffer requirement began to phase in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses to executive officers if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Tangible Common Equity

Tangible equity, tangible assets and tangible book value per share are non-GAAP financial measures calculated using GAAP amounts. Tangible common equity and tangible assets exclude the balances of goodwill and other intangible assets from stockholder's equity and total assets, respectively. Management believes that this non-GAAP financial measure provides information to investors that may be useful in understanding our financial condition. Because not all companies use the same calculation of tangible equity and tangible assets, this presentation may not be comparable to other similarly titled measures calculated by other companies. A reconciliation of the non-GAAP ratio of tangible equity to tangible assets and tangible book value per share are provided in the following table.

Tangible Common Equity Ratio – Non-GAAP

<i>(Dollars in thousands, except per share data)</i>	September 30, 2017	December 31, 2016
Tangible common equity ratio:		
Total stockholders' equity	\$ 564,480	\$ 533,572
Accumulated other comprehensive loss	3,477	6,614
Goodwill	(85,768)	(85,768)
Other intangible assets, net	(604)	(680)
Tangible common equity	\$ 481,585	\$ 453,738
Total assets	\$ 5,334,788	\$ 5,091,383
Goodwill	(85,768)	(85,768)
Other intangible assets, net	(604)	(680)
Tangible assets	\$ 5,248,416	\$ 5,004,935
Tangible common equity ratio	9.18%	9.07%
Tangible book value per share	\$ 20.07	\$ 18.98

Credit Risk

The fundamental lending business of the Company is based on understanding, measuring and controlling the credit risk inherent in the loan portfolio. The Company's loan portfolio is subject to varying degrees of credit risk. Credit risk entails both general risks, which are inherent in the process of lending, and risk specific to individual borrowers. The Company's credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry or collateral type. Typically, each consumer and residential lending product has a generally predictable level of credit losses based on historical loss experience. Residential mortgage and home equity loans and lines generally have the lowest credit loss experience. Loans secured by personal property, such as auto loans, generally experience medium credit losses. Unsecured loan products, such as personal revolving credit, have the highest credit loss experience and for that reason, the Company has chosen not to engage in a significant amount of this type of lending. Credit risk in commercial lending can vary significantly, as losses as a percentage of outstanding loans can shift widely during economic cycles and are particularly sensitive to changing economic conditions. Generally, improving economic conditions result in improved operating results on the part of commercial customers, enhancing their ability to meet their particular debt service requirements. Improvements, if any, in operating cash flows can be offset by the impact of rising interest rates that may occur during improved economic times. Inconsistent economic conditions may have an adverse effect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

Total non-performing loans decreased 5% to \$30.2 million at September 30, 2017 compared to the balance at December 31, 2016. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore

metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by the conditions being experienced in various business sectors of the economy on both a regional and national level.

To control and manage credit risk, management has a credit process in place to reasonably ensure that credit standards are maintained along with an in-house loan administration accompanied by oversight and review procedures. The primary purpose of loan underwriting is the evaluation of specific lending risks and involves the analysis of the borrower's ability to service the debt as well as the assessment of the value of the underlying collateral. Oversight and review procedures include the monitoring of portfolio credit quality, early identification of potential problem credits and the proactive management of problem credits. As part of the oversight and review process, the Company maintains an allowance for loan losses (the "allowance").

The allowance represents an estimation of the losses that are inherent in the loan portfolio. The adequacy of the allowance is determined through the ongoing evaluation of the credit portfolio, and involves consideration of a number of factors, as outlined below, to establish an adequate allowance for loan losses. Determination of the allowance is inherently subjective and requires significant estimates, including estimated losses on pools of homogeneous loans based on historical loss experience and consideration of current economic trends, which may be susceptible to significant change. Loans deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense.

The methodology for assessing the appropriateness of the allowance includes: (1) a general allowance that reflects historical losses, as adjusted, by credit category, and (2) a specific allowance for impaired credits on an individual or portfolio basis. This methodology is further described in “Note 1 – Significant Accounting Policies” of the Notes to the Consolidated Financial Statements. The amount of the allowance is reviewed and approved quarterly by the Risk Committee of the board of directors.

The Company recognizes a collateral dependent lending relationship as non-performing when either the loan becomes 90 days delinquent or as a result of factors (such as bankruptcy, interruption of cash flows, etc.) considered at the monthly credit committee meeting. When a commercial loan is placed on non-accrual status, it is considered to be impaired and all accrued but unpaid interest is reversed. Classification as an impaired loan is based on a determination that the Company may not collect all principal and interest payments according to contractual terms. Impaired loans exclude large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment such as residential real estate and consumer loans. Typically, all payments received on non-accrual loans are first applied to the remaining principal balance of the loans. Any additional recoveries are credited to the allowance. Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific allowance on an impaired loan is warranted and, when losses are confirmed, a charge-off is taken to reduce the loan to its net realizable value. Any further collateral deterioration results in either further specific allowances being established or additional charge-offs. At such time an action plan is agreed upon for the particular loan and an appraisal will be ordered depending on the time elapsed since the prior appraisal, the loan balance and/or the result of the internal evaluation. A current appraisal on large loans is usually obtained if the appraisal on file is more than 12 months old and there has been a material change in market conditions, zoning, physical use or the adequacy of the collateral based on an internal evaluation. The Company’s policy is to strictly adhere to regulatory appraisal standards. If an appraisal is ordered, no more than a 30 day turnaround is requested from the appraiser, who is selected by Credit Administration from an approved appraiser list. After receipt of the updated appraisal, the assigned credit officer will recommend to the Chief Credit Officer whether a specific allowance or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to ensure that there are no significant time lapses during this process.

The Company’s methodology for evaluating whether a loan is impaired begins with risk-rating credits on an individual basis and includes consideration of the borrower’s overall financial condition, payment record and available cash resources that may include the sufficiency of collateral value and, in a select few cases, verifiable support from financial guarantors. In measuring impairment, the Company looks primarily to the discounted cash flows of the project itself or to the value of the collateral as the primary sources of repayment of the loan. The Company may consider the existence of guarantees and the financial strength and wherewithal of the guarantors involved in any loan

relationship. Guarantees may be considered as a source of repayment based on the guarantor's financial condition and respective payment capacity. Accordingly, absent a verifiable payment capacity, a guarantee alone would not be sufficient to avoid classifying the loan as impaired.

Management has established a credit process that dictates that structured procedures be performed to monitor these loans between the receipt of an original appraisal and the updated appraisal. These procedures include the following:

- An internal evaluation is updated quarterly to include borrower financial statements and/or cash flow projections.
- The borrower may be contacted for a meeting to discuss an updated or revised action plan which may include a request for additional collateral.
- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.
- At the monthly credit committee meeting the loan may be downgraded and a specific allowance may be decided upon in advance of the receipt of the appraisal.

- Upon receipt of the updated appraisal (or based on an updated internal financial evaluation) the loan balance is compared to the appraisal and a specific allowance is decided upon for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal net of closing costs.

If an updated appraisal is received subsequent to the preliminary determination of a specific allowance or partial charge-off, and it is less than the initial appraisal used in the initial assessment, an additional specific allowance or charge-off is taken on the related credit. Partially charged-off loans are not written back up based on updated appraisals and always remain on non-accrual with any and all subsequent payments first applied to the remaining balance of the loan as principal reductions. No interest income is recognized on loans that have been partially charged-off.

Loans that have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief or other concessions, to a borrower experiencing financial difficulty are considered troubled debt restructured loans (TDR's). All restructurings that constitute concessions to a borrower experiencing financial difficulties are considered impaired loans and may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from disclosure as a troubled debt restructuring if their revised loans terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk.

The Company may extend the maturity of a performing or current loan that may have some inherent weakness associated with the loan. However, the Company generally follows a policy of not extending maturities on non-performing loans under existing terms. Maturity date extensions only occur under revised terms that clearly place the Company in a position to increase the likelihood of or assure full collection of the loan under the contractual terms and /or terms at the time of the extension that may eliminate or mitigate the inherent weakness in the loan. These terms may incorporate, but are not limited to additional assignment of collateral, significant balance curtailments/liquidations and assignments of additional project cash flows. Guarantees may be a consideration in the extension of loan maturities. As a general matter, the Company does not view extension of a loan to be a satisfactory approach to resolving non-performing credits. On an exception basis, certain performing loans that have displayed some inherent weakness in the underlying collateral values, an inability to comply with certain loan covenants which are not affecting the performance of the credit or other identified weakness may be extended.

Collateral values or estimates of discounted cash flows (inclusive of any potential cash flow from guarantees) are evaluated to estimate the probability and severity of potential losses. The actual occurrence and severity of losses involving impaired credits can differ substantially from estimates.

The determination of the allowance requires significant judgment, and estimates of probable losses in the loan portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions to the allowance may be necessary based on changes in the credits comprising the portfolio and changes in the financial condition of borrowers, such as may result from changes in economic conditions. In addition, federal and state regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Bank, periodically review the loan portfolio and the allowance. Such reviews may result in adjustments to the allowance based upon their analysis of the information available at the time of each examination.

The Company makes provisions for loan losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology previously discussed. The provision for loan losses was \$2.5 million in the first nine months of 2017 compared to \$5.0 million in the first nine months of 2016. The decrease in the provision in the first nine months of 2017 reflects the continuation of improved loan portfolio credit quality as evidenced in the declining ratio of non-performing loans to total loans over the past year.

The Company typically sells a substantial portion of its fixed-rate residential mortgage originations in the secondary mortgage market. Concurrent with such sales, the Company is required to make customary representations and warranties to the purchasers about the mortgage loans and the manner in which they were originated. The related sale agreements grant the purchasers recourse back to the Company, which could require the Company to repurchase loans or to share in any losses incurred by the purchasers. This recourse exposure typically extends for a period of six to twelve months after the sale of the loan although the time frame for repurchase requests can extend for an indefinite period. Such transactions could be due to a number of causes including borrower fraud or early payment default. The Company has seen a very limited number of repurchase and indemnity demands from purchasers for such events and routinely monitors its exposure in this regard. The Company maintains a liability of \$0.5 million for probable losses due to repurchases.

The Company periodically engages in whole loan sale transactions of its residential mortgage loans as a part its interest rate risk management strategy. The Company sold \$39.7 million of loans on a servicing-retained basis during the nine months ended September 30, 2017, and realized a total gain on sale of \$422 thousand. Servicing asset associated with these sales during the nine months ended September 30, 2017, was \$346 thousand. Income earned by the Company on its loan servicing rights is derived primarily from contractually specified servicing fees and other ancillary fees. Such income earned for the three and nine months ended September 30, 2017, was not significant.

Mortgage loan servicing rights are accounted for at amortized cost and are monitored for impairment on an ongoing basis. At September 30, 2017, and December 31, 2016, the amortized cost of the Company's mortgage loan servicing rights was \$723 thousand and \$418 thousand, respectively. The Company did not incur any impairment losses during the nine months ended September 30, 2017.

Allowance for Loan Losses

During the third quarter of 2017, there were no changes in the Company's methodology for assessing the appropriateness of the allowance for loan losses from the prior year. Variations can occur over time in the estimation of the allowance as a result of the credit performance of borrowers.

At September 30, 2017, total non-performing loans were \$30.2 million, or 0.72% of total loans, compared to \$31.9 million, or 0.81% of total loans, at December 31, 2016. The allowance represented 149% of non-performing loans at September 30, 2017 as compared to 138% at December 31, 2016. The allowance for loan losses as a percent of total loans was 1.07% at September 30, 2017 as compared to 1.12% at December 31, 2016.

Continued analysis of the actual loss history on the problem credits in 2016 and 2017 provided an indication that the coverage of the inherent losses on the problem credits was adequate. The Company continues to monitor the impact of the economic conditions on our commercial customers together with the reduced inflow of non-accruals and criticized

loans. The improvement in these credit metrics supports management's outlook for continued improved credit quality performance.

The balance of impaired loans was \$22.5 million, with specific allowances of \$4.8 million against those loans at September 30, 2017, as compared to \$24.1 million with specific allowances of \$4.8 million, at December 31, 2016.

The Company's borrowers are concentrated in nine counties in Maryland, three counties in Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 78% of total loans at both September 30, 2017 and December 31, 2016. Certain loan terms may create concentrations of credit risk and increase the Company's exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

Summary of Loan Loss Experience

The following table presents the activity in the allowance for loan losses for the periods indicated:

<i>(Dollars in thousands)</i>	Nine Months Ended September 30, 2017	Year Ended December 31, 2016
Balance, January 1	\$ 44,067	\$ 40,895
Provision for loan losses	2,450	5,546
Loan charge-offs:		
Residential real estate:		
Residential mortgage	(10)	(1,404)
Residential construction	-	-
Commercial real estate:		
Commercial investor	-	(197)
Commercial owner occupied	(5)	-
Commercial AD&C	-	(48)
Commercial business	(1,469)	(597)
Consumer	(560)	(888)
Total charge-offs	(2,044)	(3,134)
Loan recoveries:		
Residential real estate:		
Residential mortgage	61	358
Residential construction	20	32
Commercial real estate:		
Commercial investor	93	133
Commercial owner occupied	-	5
Commercial AD&C	103	40
Commercial business	73	44
Consumer	101	148
Total recoveries	451	760
Net charge-offs	(1,593)	(2,374)
Balance, period end	\$ 44,924	\$ 44,067
Net charge-offs to average loans	0.05%	0.06%
Allowance for loan losses to loans	1.07%	1.12%

Analysis of Credit Risk

The following table presents information with respect to non-performing assets and 90-day delinquencies for the periods indicated:

<i>(Dollars in thousands)</i>	September 30, 2017	December 31, 2016
Non-accrual loans:		
Residential real estate:		
Residential mortgage	\$ 7,345	\$ 7,257
Residential construction	182	195
Commercial real estate:		
Commercial investor	5,589	8,107
Commercial owner occupied	5,012	4,823
Commercial AD&C	137	137
Commercial business	6,091	5,833
Consumer	3,152	2,859
Total non-accrual loans	27,508	29,211
Loans 90 days past due		
Residential real estate:		
Residential mortgage	225	232
Residential construction	-	-
Commercial real estate:		
Commercial investor	-	-
Commercial owner occupied	-	-
Commercial AD&C	-	-
Commercial business	-	-
Consumer	1	-
Total 90 days past due loans	226	232
Restructured loans (accruing)	2,471	2,489
Total non-performing loans	30,205	31,932
Other real estate owned, net	1,448	1,911
Total non-performing assets	\$ 31,653	\$ 33,843
Non-performing loans to total loans	0.72%	0.81%
Non-performing assets to total assets	0.59%	0.66%
Allowance for loan to non-performing loans	148.73%	138.00%

Market Risk Management

The Company's net income is largely dependent on its net interest income. Net interest income is susceptible to interest rate risk to the extent that interest-bearing liabilities mature or re-price on a different basis than

interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and stockholders' equity.

The Company's interest rate risk management goals are (1) to increase net interest income at a growth rate consistent with the growth rate of total assets, and (2) to minimize fluctuations in net interest margin as a percentage of interest-earning assets. Management attempts to achieve these goals by balancing, within policy limits, the volume of floating-rate liabilities with a similar volume of floating-rate assets; by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched; by maintaining a pool of administered core deposits; and by adjusting pricing rates to market conditions on a continuing basis.

The Company's board of directors has established a comprehensive interest rate risk management policy, which is administered by management's Asset Liability Management Committee ("ALCO"). The policy establishes limits on risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity or "EVE" at risk) resulting from a hypothetical change in U.S. Treasury interest rates for maturities from one day to thirty years. The Company measures the potential adverse impacts that changing interest rates may have on its short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors embedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by the Company. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. As an example, certain money market deposit accounts are assumed to reprice at 100% of the interest rate change in each of the up rate shock scenarios even though this is not a contractual requirement. As a practical matter, management would likely lag the impact of any upward movement in market rates on these accounts as a mechanism to manage the bank's net interest margin. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan customers' ability to service their debts, or the impact of rate changes on demand for loan, lease, and deposit products.

The Company prepares a current base case and eight alternative simulations at least once a quarter and reports the analysis to the board of directors. In addition, more frequent forecasts are produced when interest rates are particularly uncertain or when other business conditions so dictate.

The statement of condition is subject to quarterly testing for eight alternative interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by +/- 100, 200, 300, and 400 basis points ("bp"), although the Company may elect not to use particular scenarios that it determines are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over a twelve-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.

The Company augments its quarterly interest rate shock analysis with alternative external interest rate scenarios on a monthly basis. These alternative interest rate scenarios may include non-parallel rate ramps and non-parallel yield curve twists. If a measure of risk produced by the alternative simulations of the entire balance sheet violates policy guidelines, ALCO is required to develop a plan to restore the measure of risk to a level that complies with policy limits within two quarters.

Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

Estimated Changes in Net Interest Income

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	400 bp
Policy Limit	23.50%	17.50%	15.00%	10.00%	10.00%	15.00%	17.50%	23.50%
September 30, 2017	(5.34%)	(3.59%)	(1.88%)	(0.67%)	(2.50%)	N/A	N/A	N/A
December 31, 2016	(8.55%)	(5.76%)	(2.84%)	(1.20%)	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk improved from December 31, 2016 at all shock levels. All measures remained well within prescribed policy limits.

The decrease in the risk position with respect to net interest income from December 31, 2016 to September 30, 2017 at all shock levels was the result of restructuring of FHLB advances in 2017 and the elimination of subordinated debt in January. The elimination of the optionality associated with the related interest rates reduces the Company's exposure to potential future increases in interest rates.

The measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The difference between these discounted values of the assets and liabilities is the economic value of equity, which, in theory, approximates the fair value of the Company's net assets.

Estimated Changes in Economic Value of Equity (EVE)

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	35.00%	25.00%	20.00%	10.00%	10.00%	20.00%	25.00%	35.00%
September 30, 2017	(18.36%)	(12.82%)	(7.72%)	(3.15%)	(1.93%)	N/A	N/A	N/A
December 31, 2016	(14.83%)	(10.72%)	(6.42%)	(2.86%)	N/A	N/A	N/A	N/A

Measures of the economic value of equity (“EVE”) at risk increased from December 31, 2016 to September 30, 2017 in all of the shock scenarios. The increase in EVE’s exposure position is the result of the lengthening duration of loans as a result of rising interest rates.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan repayments, maturing investments, deposit growth, borrowed funds, capital and the sale of highly marketable assets such as investment securities and residential mortgage loans. The Company's liquidity position, considering both internal and external sources available, exceeded anticipated short-term and long-term needs at September 30, 2017. Management considers core deposits, defined to include all deposits other than time deposits of \$100 thousand or more, to be a relatively stable funding source. Core deposits equaled 70% of total interest-earning assets at September 30, 2017. In addition, loan payments, maturities, calls and pay downs of securities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements. In assessing liquidity, management considers operating requirements, the seasonality of deposit flows, investment, loan and deposit maturities and calls, expected funding of loans and deposit withdrawals, and the market values of available-for-sale investments, so that sufficient funds are available on short notice to meet obligations as they arise and to ensure that the Company is able to pursue new business opportunities.

Liquidity is measured using an approach designed to take into account, in addition to factors already discussed above, the Company’s growth and mortgage banking activities. Also considered are changes in the liquidity of the investment portfolio due to fluctuations in interest rates. Under this approach, implemented by the Funds Management Subcommittee of ALCO under formal policy guidelines, the Company’s liquidity position is measured weekly, looking forward at thirty day intervals from thirty (30) to three hundred sixty (360) days. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Resulting projections as of September 30, 2017, show short-term investments exceeding short-term borrowings by \$21 million over the subsequent 360 days. This projected excess of liquidity versus requirements provides the Company with flexibility in how it funds loans and other earning assets.

The Company also has external sources of funds, which can be drawn upon when required. The main sources of external liquidity are available lines of credit with the Federal Home Loan Bank of Atlanta and the Federal Reserve. The line of credit with the Federal Home Loan Bank of Atlanta totaled \$1.6 billion, of which \$1.6 billion was available for borrowing based on pledged collateral, with \$633 million borrowed against it as of September 30, 2017. The line of credit at the Federal Reserve totaled \$343 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of September 30, 2017. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled \$70 million at September 30, 2017, against which there were no outstanding borrowings. In addition, the Company had a secured

line of credit with a correspondent bank of \$20 million as of September 30, 2017. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at September 30, 2017.

The parent company (“Bancorp”) is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Bancorp is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. Bancorp’s primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Bancorp in any calendar year, without the receipt of prior approval from the Federal Reserve, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. Based on this requirement, as of September 30, 2017, the Bank could have declared a dividend of \$32 million to Bancorp. At September 30, 2017, Bancorp had liquid assets of \$13 million.

Arrangements to fund credit products or guarantee financing take the form of loan commitments (including lines of credit on revolving credit structures) and letters of credit. Approvals for these arrangements are obtained in the same manner as loans. Generally, cash flows, collateral value and risk assessment are considered when determining the amount and structure of credit arrangements.

Commitments to extend credit in the form of consumer, commercial real estate and business at the dates indicated were as follows:

<i>(In thousands)</i>	September 30, 2017	December 31, 2016
Commercial	\$ 427,597	\$ 334,552
Real estate-development and construction	131,144	97,524
Real estate-residential mortgage	16,651	22,970
Lines of credit, principally home equity and business lines	1,047,227	949,939
Standby letters of credit	68,607	68,748
Total commitments to extend credit and available credit lines	\$ 1,691,226	\$ 1,473,733

Commitments to extend credit are agreements to provide financing to a customer with the provision that there are no violations of any condition established in the agreement. Commitments generally have interest rates determined by current market rates, expirations dates or other termination clauses and may require payment of a fee. Lines of credit typically represent unused portions of lines of credit that were provided and remain available as long as there is no violation of any contractual condition. Commitments to extend credit are evaluated on a case by case basis periodically. Many of the commitments are expected to expire without being drawn upon. It would be highly unlikely that all customers would draw on their lines of credit in full at any time and, therefore, the total commitment amount or line of credit amounts do not necessarily represent future cash requirements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See “Financial Condition - Market Risk and Interest Rate Sensitivity” in Management’s Discussion and Analysis of Financial Condition and Results of Operations, above, which is incorporated herein by reference.

Item 4. CONTROLS AND PROCEDURES

The Company’s management, under the supervision and with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report, the effectiveness of the design and operation of the Company’s disclosure controls and procedures, as defined in Rule 13a-15 under the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer

concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the three months ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business, the Company becomes involved in litigation arising from the banking, financial and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising from these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Item 1A. Risk Factors

There have been no material changes in the risk factors as discussed in the 2016 Annual Report on Form 10-K.

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

The Company's 2015 stock repurchase program expired on August 31, 2017. Under the recently expired repurchase program a total of 736,139 shares of common stock were repurchased. Those repurchases were conducted through open market purchases or privately negotiated transactions. The following table provides information regarding repurchase transactions executed during the quarter ended September 30, 2017.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number that may yet be purchased under the plans or programs
July 1, 2017 through July 31, 2017	-	N/A	-	463,861
August 1, 2017 through August 31, 2017	-	N/A	-	463,861
September 1, 2017 through September 30, 2017	-	N/A	-	-

Item 3. Defaults Upon Senior Securities – None**Item 4. Mine Safety Disclosures – Not applicable****Item 5. Other Information - None****Item 6. Exhibits**

Exhibit 31(a)	Certification of Chief Executive Officer
Exhibit 31(b)	Certification of Chief Financial Officer
Exhibit 32(a)	Certification of Chief Executive Officer pursuant to 18 U.S. Section 1350
Exhibit 32(b)	Certification of Chief Financial Officer pursuant to 18 U.S. Section 1350

Exhibit 101 The following materials from the Sandy Spring Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter end September 30, 2017 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Condition; (ii) The Condensed Consolidated Statements of Income; (iii) The Condensed Consolidated Statements of Comprehensive Income; (iv) The Condensed Consolidated Statements of Cash Flows; (v) The Condensed Consolidated Statements of Changes in Stockholders' Equity; (vi) related notes.

Signatures

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Registrant has duly caused this quarterly report to be signed on its behalf by the undersigned, thereunto duly authorized.

SANDY SPRING BANCORP, INC.

(Registrant)

By: /s/ Daniel J. Schrider

Daniel J. Schrider

President and Chief Executive Officer

Date: November 3, 2017

By: /s/ Philip J. Mantua

Philip J. Mantua

Executive Vice President and Chief Financial Officer

Date: November 3, 2017