SANDY SPRING BANCORP INC
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2016

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 X 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 X No ___

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

Large accelerated filer Accelerated filer X Non-accelerated filer Smaller reporting company

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

Yes No X

The number of outstanding shares of common stock outstanding as of November 4, 2016

Common stock, $1.00 par value – 23,889,625 shares

SANDY SPRING BANCORP, INC.

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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 2015 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

(Dollars in thousands)	**September 30, 2016**	December 31, 2015
Assets		
Cash and due from banks	**$ 48,666**	$ 46,956
Federal funds sold	**1,106**	472
Interest-bearing deposits with banks	**48,425**	25,454
Cash and cash equivalents	**98,197**	72,882
Residential mortgage loans held for sale (at fair value)	**15,822**	15,457
Investments available-for-sale (at fair value)	**655,642**	592,049
Investments held-to-maturity -- fair value of $211,704 at December 31, 2015	**-**	208,265
Other equity securities	**35,829**	41,336
Total loans	**3,780,507**	3,495,370
Less: allowance for loan losses	**(43,942)**	(40,895)
Net loans	**3,736,565**	3,454,475
Premises and equipment, net	**53,356**	53,214
Other real estate owned	**1,274**	2,742
Accrued interest receivable	**13,123**	13,443
Goodwill	**85,768**	84,171
Other intangible assets, net	**716**	138
Other assets	**114,319**	117,208
Total assets	**$ 4,810,611**	$ 4,655,380
Liabilities		
Noninterest-bearing deposits	**$ 1,154,227**	$ 1,001,841
Interest-bearing deposits	**2,382,930**	2,261,889
Total deposits	**3,537,157**	3,263,730
Securities sold under retail repurchase agreements and federal funds purchased	**124,205**	109,145
Advances from FHLB	**550,000**	685,000
Subordinated debentures	**30,000**	35,000
Accrued interest payable and other liabilities	**32,594**	38,078
Total liabilities	**4,273,956**	4,130,953
Stockholders' Equity		
Common stock -- par value $1.00; shares authorized 50,000,000; shares issued and outstanding 23,886,651 and 24,295,971 at September 30, 2016 and December 31, 2015, respectively	**23,887**	24,296
Additional paid in capital	**164,937**	175,588
Retained earnings	**343,366**	325,840
Accumulated other comprehensive income (loss)	**4,465**	(1,297)
Total stockholders' equity	**536,655**	524,427
Total liabilities and stockholders' equity	**$ 4,810,611**	$ 4,655,380

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,	
(Dollars in thousands, except per share data)	**2016**	2015	**2016**	2015
Interest income:				
Interest and fees on loans and leases	**$ 38,224**	$ 34,484	**$ 111,358**	$ 99,654
Interest on loans held for sale	**96**	214	**294**	422
Interest on deposits with banks	**49**	25	**156**	69
Interest and dividends on investment securities:				
Taxable	**2,623**	3,597	**8,749**	11,024
Exempt from federal income taxes	**1,864**	1,996	**5,753**	6,068
Interest on federal funds sold	**1**	1	**3**	1
Total interest income	**42,857**	40,317	**126,313**	117,238
Interest expense:				
Interest on deposits	**2,128**	1,632	**6,006**	4,193
Interest on retail repurchase agreements and federal funds purchased	**74**	69	**212**	179
Interest on advances from FHLB	**2,699**	3,272	**8,812**	9,774
Interest on subordinated debt	**225**	228	**698**	670
Total interest expense	**5,126**	5,201	**15,728**	14,816
Net interest income	**37,731**	35,116	**110,585**	102,422
Provision for loan losses	**781**	1,706	**4,974**	3,521
Net interest income after provision for loan losses	**36,950**	33,410	**105,611**	98,901
Non-interest income:				
Investment securities gains	**-**	1	**1,919**	20
Service charges on deposit accounts	**2,035**	1,936	**5,894**	5,657
Mortgage banking activities	**1,129**	566	**2,770**	2,566
Wealth management income	**4,347**	4,963	**13,200**	15,040
Insurance agency commissions	**1,786**	1,648	**4,180**	4,147
Income from bank owned life insurance	**616**	618	**1,846**	1,937
Visa check fees	**1,189**	1,198	**3,498**	3,475
Other income	**1,482**	1,460	**5,391**	4,816
Total non-interest income	**12,584**	12,390	**38,698**	37,658
Non-interest expense:				
Salaries and employee benefits	**17,848**	17,733	**53,299**	52,566
Occupancy expense of premises	**3,130**	3,086	**9,765**	9,748
Equipment expense	**1,745**	1,600	**5,102**	4,463
Marketing	**628**	688	**1,971**	2,161
Outside data services	**1,349**	1,329	**4,067**	3,692
FDIC insurance	**726**	565	**2,012**	1,850
Amortization of intangible assets	**34**	107	**94**	320
Litigation expense	**-**	155	**-**	517
Other expense	**3,866**	4,367	**16,204**	13,034
Total non-interest expense	**29,326**	29,630	**92,514**	88,351
Income before income taxes	**20,208**	16,170	**51,795**	48,208
Income tax expense	**6,734**	5,175	**16,861**	15,655
Net income	**$ 13,474**	$ 10,995	**$ 34,934**	$ 32,553

Per share information:								
Basic net income per share	**$**	**0.56**	$	0.45	**$**	**1.45**	$	1.32
Diluted net income per share	**$**	**0.56**	$	0.45	**$**	**1.45**	$	1.31
Dividends declared per common share	**$**	**0.24**	$	0.22	**$**	**0.72**	$	0.66

The accompanying notes are an integral part of these statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2016**	2015	**2016**	2015
Net income	**$ 13,474**	$ 10,995	**$ 34,934**	$ 32,553
Other comprehensive income:				
Investments available-for-sale:				
Net change in unrealized gains (losses) on investments available-for-sale	**(2,641)**	3,729	**10,612**	3,582
Related income tax (expense) benefit	**1,036**	(1,472)	**(4,227)**	(1,414)
Net investment gains reclassified into earnings	**-**	(1)	**(1,919)**	(20)
Related income tax expense	**-**	-	**765**	8
Net effect on other comprehensive income (loss) for the period	**(1,605)**	2,256	**5,231**	2,156
Defined benefit pension plan:				
Recognition of unrealized gain	**295**	240	**870**	791
Related income tax expense	**(111)**	(103)	**(339)**	(323)
Net effect on other comprehensive income for the period	**184**	137	**531**	468
Total other comprehensive income	**(1,421)**	2,393	**5,762**	2,624
Comprehensive income	**$ 12,053**	$ 13,388	**$ 40,696**	$ 35,177

The accompanying notes are an integral part of these statements

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

	Nine Months Ended September 30,	
(Dollars in thousands)	**2016**	2015
Operating activities:		
Net income	**$ 34,934**	$ 32,553
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**5,940**	5,422
Provision for loan losses	**4,974**	3,521
Share based compensation expense	**1,341**	1,450
Deferred income tax expense	**646**	1,412
Origination of loans held for sale	**(130,409)**	(150,686)
Proceeds from sales of loans held for sale	**151,077**	153,020
Gains on sales of loans held for sale	**(2,461)**	(2,240)
Loss on sales of other real estate owned	**48**	224
Investment securities gains	**(1,919)**	(20)
Net (increase) decrease in accrued interest receivable	**320**	(468)
Net increase in other assets	**(1,731)**	(2,772)
Net decrease in accrued expenses and other liabilities	**(5,999)**	(176)
Other – net	**(731)**	3,063
Net cash provided by operating activities	**56,030**	44,303
Investing activities:		
Proceeds of other equity securities	**5,507**	3,289
Purchases of investments held-to-maturity	**-**	(2,100)
Purchases of investments available-for-sale	**(120,273)**	-
Proceeds from sales of investment available-for-sale	**40,863**	-
Proceeds from maturities, calls and principal payments of investments held-to-maturity	**5,004**	4,791
Proceeds from maturities, calls and principal payments of investments available-for-sale	**227,419**	66,727
Net increase in loans	**(303,709)**	(288,233)
Proceeds from the sales of other real estate owned	**1,393**	1,855
Acquisition of business activity, net of cash acquired	**(1,347)**	-
Expenditures for premises and equipment	**(4,250)**	(6,739)
Net cash used in investing activities	**(149,393)**	(220,410)
Financing activities:		
Net increase in deposits	**273,427**	209,159
Net increase in retail repurchase agreements and federal funds purchased	**15,060**	46,946
Proceeds from advances from FHLB	**1,805,000**	1,649,000
Repayment of advances from FHLB	**(1,940,000)**	(1,694,000)
Retirement of subordinated debt	**(5,000)**	-
Proceeds from issuance of common stock	**585**	581
Tax benefits associated with share based compensation	**287**	-
Repurchase of common stock	**(13,273)**	(18,869)
Dividends paid	**(17,408)**	(16,496)
Net cash used by financing activities	**118,678**	176,321

Net increase in cash and cash equivalents		**25,315**		214
Cash and cash equivalents at beginning of period		**72,882**		96,217
Cash and cash equivalents at end of period	**$**	**98,197**	$	96,431
Supplemental disclosures:				
Interest payments	**$**	**16,193**	$	14,779
Income tax payments		**16,825**		14,825
Transfer of investments held-to-maturity to available-for-sale		**203,118**		-
Transfer from loans to residential mortgage loans held for sale		**18,572**		-
Transfer from loans to other real estate owned		**-**		1,524

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

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(Dollars in thousands, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances 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 - $0.72 per share	**-**	**-**	**(17,408)**	**-**	**(17,408)**
Stock compensation expense	**-**	**1,628**	**-**	**-**	**1,628**
Common stock issued pursuant to:					
Stock option plan - 34,646 shares	**35**	**500**	**-**	**-**	**535**
Employee stock purchase plan - 18,767 shares	**19**	**433**	**-**	**-**	**452**
Director stock purchase plan - 258 shares	**-**	**15**	**-**	**-**	**15**
Restricted stock - 49,648 shares	**49**	**(466)**	**-**	**-**	**(417)**
Purchase of treasury shares - 512,459 shares	**(512)**	**(12,761)**	**-**	**-**	**(13,273)**
Balances at September 30, 2016	**$ 23,887**	**$ 164,937**	**$ 343,366**	**$ 4,465**	**$ 536,655**
Balance at January 1, 2015	$ 25,045	$ 194,647	$ 302,882	$ (823)	$ 521,751
Net income	-	-	32,553	-	32,553
Other comprehensive income, net of tax	-	-	-	2,624	2,624
Common stock dividends - $0.66 per share	-	-	(16,496)	-	(16,496)
Stock compensation expense	-	1,450	-	-	1,450
Common stock issued pursuant to:					
Stock option plan - 35,039 shares	35	474	-	-	509
Director stock purchase plan - 837 shares	1	21	-	-	22
Employee stock purchase plan - 19,377 shares	19	412	-	-	431
Restricted stock - 53,746 shares	54	(435)	-	-	(381)
Purchase of treasury shares - 728,932 shares	(729)	(18,140)	-	-	(18,869)
Balances at September 30, 2015	$ 24,425	$ 178,429	$ 318,939	$ 1,801	$ 523,594

The accompanying notes are an integral part of these statements

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, 2016 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2016. 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 2015 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 4, 2016. There have been no significant changes to the Company’s accounting policies as disclosed in the 2015 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 and lease 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. 2014-09 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. This standard may affect an entity’s financial statements, business processes and internal control over financial reporting. 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 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. 2016-01 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. 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. 2016-02 in February 2016. Under this guidance lessees are required to record most leases on their balance sheets but recognize expenses in the income statement. 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. 2016-08 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. 2016-09 in March 2016. This guidance requires recognition of all income tax effects of stock awards in the income statement when such awards vest or are settled. In addition, it revises the existing guidance to allow employers to withhold more of an employee’s shares to satisfy the employer’s statutory withholding requirements and still qualify for equity accounting treatment. Finally, an entity will now be allowed to make an entity-wide accounting policy election to either estimate the number or awards that are expected to vest, as required in the current guidance, or account for forfeitures as they occur. For public entities, this guidance is effective for the first interim or annual period beginning after December 15, 2016. Early adoption is permitted. 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 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 a model to estimate expected losses on a forward-looking basis that will result in earlier recognition of loss allowances in most instances. Credit losses related to available-for-sale debt securities 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. 2016-15 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.

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, 2016** Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	December 31, 2015 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	**$ 54,742**	**$ 22**	**$ -**	**$ 54,764**	$109,602	$ 132	$(1,334)	$108,400
State and municipal	**284,830**	**12,987**	**(26)**	**297,791**	156,402	8,305	-	164,707
Mortgage-backed	**285,078**	**6,484**	**(67)**	**291,495**	312,846	6,396	(2,546)	316,696
Corporate debt	**9,100**	**246**	**-**	**9,346**	-	-	-	-
Trust preferred	**1,089**	**-**	**(66)**	**1,023**	1,089	-	(66)	1,023
Total debt securities	**634,839**	**19,739**	**(159)**	**654,419**	579,939	14,833	(3,946)	590,826
Marketable equity securities	**1,223**	**-**	**-**	**1,223**	1,223	-	-	1,223
Total investments available-for-sale	**$636,062**	**$ 19,739**	**$ (159)**	**$655,642**	$581,162	$14,833	$(3,946)	$592,049

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at September 30, 2016 are not the result of credit related events but due to changes in interest rates. These declines are considered temporary in nature and are expected to decline over time and recover as these securities approach maturity.

The mortgage-backed securities portfolio at September 30, 2016 is composed entirely of either the most senior tranches of GNMA, FNMA or FHLMC collateralized mortgage obligations ($111.1 million), or GNMA, FNMA or FHLMC mortgage-backed securities ($180.4 million). The Company does not currently intend to sell these securities and has sufficient liquidity to hold these securities for an adequate period of time, which may be maturity, to allow for any anticipated recovery in fair value.

During the first quarter of 2016, the Company transferred its investments held-to-maturity portfolio, which totaled $203.1 million, to the available-for-sale portfolio. At the time of the transfer, these investments had an unrealized gain of $4.6 million. The Company made this transfer to provide additional liquidity to fund future loan growth and other corporate activities.

At September 30, 2016 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, totals $1.1 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, 2016. The unrealized loss on this security that is recognized in other comprehensive income ("OCI") and is not expected to be sold and which the Company has the ability to hold until maturity, was $0.1 million at September 30, 2016.

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, 2015	$	531
Additions for credit losses not previously recognized		-
Cumulative credit losses on investment securities through September 30, 2016	$	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:

			September 30, 2016		
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of Securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
State and municipal	**4**	**$ 4,004**	**$ 1**	**$ 25**	**$ 26**
Mortgage-backed	**8**	**24,163**	**41**	**26**	**67**
Trust preferred	**1**	**1,023**	**-**	**66**	**66**
Total	**13**	**$ 29,190**	**$ 42**	**$ 117**	**$ 159**

			December 31, 2015		
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of Securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	7	$ 78,555	$ 1,020	$ 314	$ 1,334
Mortgage-backed	26	140,556	716	1,830	2,546
Trust preferred	1	1,023	-	66	66
Total	34	$ 220,134	$ 1,736	$ 2,210	$ 3,946

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.

	September 30, 2016		December 31, 2015	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	**$ 6,554**	**$ 6,631**	$ 301	$ 306
Due after one year through five years	**169,896**	**177,379**	157,710	160,257
Due after five years through ten years	**204,061**	**211,554**	168,136	174,677
Due after ten years	**254,328**	**258,855**	253,792	255,586
Total debt securities available for sale	**$ 634,839**	**$ 654,419**	$ 579,939	$ 590,826

At September 30, 2016 and December 31, 2015, investments available-for-sale with a book value of $464.2 million and $233.2 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, 2016 and December 31, 2015.

Investments held-to-maturity

The amortized cost and estimated fair values of investments held-to-maturity at the date indicated are presented in the following table:

	December 31, 2015			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 56,460	$ -	$ (733)	$ 55,727
State and municipal	149,537	4,297	(148)	153,686
Mortgage-backed	168	23	-	191
Corporate debt	2,100	-	-	2,100
Total investments held-to-maturity	$ 208,265	$ 4,320	$ (881)	$ 211,704

Gross unrealized losses and fair value by length of time that the individual held-to-maturity securities have been in a continuous unrealized loss position at the date indicated are presented in the following tables:

	December 31, 2015				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of Securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	6	$ 55,727	$ 456	$ 277	$ 733
State and municipal	11	12,369	23	125	148
Total	17	$ 68,096	$ 479	$ 402	$ 881

The amortized cost and estimated fair values of debt securities held-to-maturity by contractual maturity at the date indicated are reflected in the following table. Expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations with or without prepayment penalties.

	December 31, 2015	
(In thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 845	$ 853
Due after one year through five years	19,217	20,041
Due after five years through ten years	163,125	165,620
Due after ten years	25,078	25,190
Total debt securities held-to-maturity	$ 208,265	$ 211,704

At December 31, 2015, investments held-to-maturity with a book value of $194.3 million 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. Agency securities, exceeded ten percent of stockholders' equity at December 31, 2015.

Equity securities

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

(In thousands)	**September 30, 2016**	December 31, 2015
Federal Reserve Bank stock	**$ 8,269**	$ 8,269
Federal Home Loan Bank of Atlanta stock	**27,560**	33,067
Total equity securities	**$ 35,829**	$ 41,336

Note 3 – LOANS

Outstanding loan balances at September 30, 2016 and December 31, 2015 are net of unearned income including net deferred loan costs of $1.3 million and $1.1 million, respectively. The loan portfolio segment balances at the dates indicated are presented in the following table:

(In thousands)	**September 30, 2016**	December 31, 2015
Residential real estate:		
Residential mortgage	**$ 854,055**	$ 796,358
Residential construction	**144,998**	129,281
Commercial real estate:		
Commercial owner occupied real estate	**736,744**	678,027
Commercial investor real estate	**847,946**	719,084
Commercial acquisition, development and construction	**302,522**	255,980
Commercial business	**444,129**	465,765
Consumer	**450,113**	450,875
Total loans	**$ 3,780,507**	$ 3,495,370

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:

	Nine Months Ended September 30,	
(In thousands)	**2016**	2015
Balance at beginning of year	**$ 40,895**	$ 37,802
Provision for loan losses	**4,974**	3,521
Loan charge-offs	**(2,586)**	(2,753)
Loan recoveries	**659**	1,091
Net charge-offs	**(1,927)**	(1,662)
Balance at period end	**$ 43,942**	$ 39,661

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, 2016							
		Commercial Real Estate				Residential Real Estate		
	Commercial	Commercial	Commercial Investor	Commercial Owner Occupied		Residential	Residential	
(Dollars in thousands)	**Business**	**AD&C**	**R/E**	**R/E**	**Consumer**	**Mortgage**	**Construction**	**Total**
Balance at beginning of year	**$ 6,529**	**$ 4,691**	**$ 10,440**	**$ 7,984**	**$ 3,456**	**$ 6,901**	**$ 894**	**$ 40,895**
Provision (credit)	**635**	**456**	**1,435**	**253**	**81**	**2,132**	**(18)**	**4,974**
Charge-offs	**(289)**	**(48)**	**(197)**	**-**	**(674)**	**(1,378)**	**-**	**(2,586)**
Recoveries	**21**	**22**	**124**	**5**	**111**	**350**	**26**	**659**
Net charge-offs	**(268)**	**(26)**	**(73)**	**5**	**(563)**	**(1,028)**	**26**	**(1,927)**
Balance at end of period	**$ 6,896**	**$ 5,121**	**$ 11,802**	**$ 8,242**	**$ 2,974**	**$ 8,005**	**$ 902**	**$ 43,942**
Total loans and leases	**$444,129**	**$302,522**	**$847,946**	**$736,744**	**$450,113**	**$854,055**	**$144,998**	**$3,780,507**
Allowance for loans losses to total loans ratio	**1.55%**	**1.69%**	**1.39%**	**1.12%**	**0.66%**	**0.94%**	**0.62%**	**1.16%**
Balance of loans specifically evaluated for impairment	**$ 5,343**	**$ 137**	**$ 9,189**	**$ 6,336**	**$ na.**	**$ 3,292**	**$ -**	**$ 24,297**
Allowance for loans specifically evaluated for impairment	**$ 1,884**	**$ -**	**$ 1,256**	**$ 512**	**$ na.**	**$ -**	**$ -**	**$ 3,652**
Specific allowance to specific loans ratio	**35.26%**	**0.00%**	**13.67%**	**8.08%**	**na.**	**na.**	**na.**	**15.03%**
Balance of loans collectively evaluated	**$438,786**	**$302,385**	**$838,757**	**$730,408**	**$450,113**	**$850,763**	**$144,998**	**$3,756,210**
Allowance for loans collectively evaluated	**$ 5,012**	**$ 5,121**	**$ 10,546**	**$ 7,730**	**$ 2,974**	**$ 8,005**	**$ 902**	**$ 40,290**
Collective allowance to collective loans ratio	**1.14%**	**1.69%**	**1.26%**	**1.06%**	**0.66%**	**0.94%**	**0.62%**	**1.07%**

	For the Year Ended December 31,2015							
		Commercial Real Estate				Residential Real Estate		
	Commercial	Commercial	Commercial	Commercial Owner		Residential	Residential	

(Dollars in thousands)	Business	AD&C	Investor R/E	Occupied R/E	Leasing	Consumer	Mortgage	Construction	Total
Balance at beginning of year	$ 5,852	$ 4,267	$ 9,784	$ 7,143	$ 9	$ 3,592	$ 6,232	$ 923	$ 37,802
Provision (credit)	508	583	727	1,881	(5)	619	1,138	(80)	5,371
Charge-offs	(306)	(739)	(91)	(1,043)	(4)	(998)	(614)	-	(3,795)
Recoveries	475	580	20	3	-	243	145	51	1,517
Net charge-offs	169	(159)	(71)	(1,040)	(4)	(755)	(469)	51	(2,278)
Balance at end of period	$ 6,529	$ 4,691	$ 10,440	$ 7,984	$ -	$ 3,456	$ 6,901	$ 894	$ 40,895
Total loans and leases	$465,765	$255,980	$719,084	$678,027	$ -	$450,875	$796,358	$129,281	$3,495,370
Allowance for loan losses to total loans ratio	1.40%	1.83%	1.45%	1.18%	na.	0.77%	0.87%	0.69%	1.17%
Balance of loans specifically evaluated for impairment	$ 5,273	$ 194	$ 10,441	$ 6,580	$ na.	$ na.	$ 6,439	$ -	$ 28,927
Allowance for loans specifically evaluated for impairment	$ 1,318	$ 58	$ 1,489	$ 510	$ na.	$ na.	$ -	$ -	$ 3,375
Specific allowance to specific loans ratio	25.00%	29.90%	14.26%	7.75%	na.	na.	na.	na.	11.67%
Balance of loans collectively evaluated	$460,492	$255,786	$708,643	$671,447	$ na.	$450,875	$789,919	$129,281	$3,466,443
Allowance for loans collectively evaluated	$ 5,211	$ 4,633	$ 8,951	$ 7,474	$ na.	$ 3,456	$ 6,901	$ 894	$ 37,520
Collective allowance to collective loans ratio	1.13%	1.81%	1.26%	1.11%	na.	0.77%	0.87%	0.69%	1.08%

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

(In thousands)		**September 30, 2016**		December 31, 2015
Impaired loans with a specific allowance	**$**	**12,116**	$	14,208
Impaired loans without a specific allowance		**12,181**		14,719
Total impaired loans	**$**	**24,297**	$	28,927
Allowance for loan losses related to impaired loans	**$**	**3,652**	$	3,375
Allowance for loan losses related to loans collectively evaluated		**40,290**		37,520
Total allowance for loan losses	**$**	**43,942**	$	40,895
Average impaired loans for the period	**$**	**26,955**	$	29,828
Contractual interest income due on impaired loans during the period	**$**	**1,793**	$	2,527
Interest income on impaired loans recognized on a cash basis	**$**	**709**	$	961
Interest income on impaired loans recognized on an accrual basis	**$**	**153**	$	274

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:

	September 30, 2016					
		Commercial Real Estate				**Total Recorded Investment in Impaired**
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**All Other Loans**	**Loans**
Impaired loans with a specific allowance						
Non-accruing	**$ 1,507**	**$ -**	**$ 7,142**	**$ 1,911**	**$ -**	**$ 10,560**
Restructured accruing	**833**	**-**	**-**	**-**	**-**	**833**
Restructured non-accruing	**84**	**-**	**-**	**639**	**-**	**723**
Balance	**$ 2,424**	**$ -**	**$ 7,142**	**$ 2,550**	**$ -**	**$ 12,116**
Allowance	**$ 1,884**	**$ -**	**$ 1,256**	**$ 512**	**$ -**	**$ 3,652**
Impaired loans without a specific allowance						
Non-accruing	**$ 1,148**	**$ -**	**$ 525**	**$ 1,754**	**$ -**	**$ 3,427**
Restructured accruing	**370**	**-**	**-**	**745**	**564**	**1,679**
Restructured non-accruing	**1,401**	**137**	**1,522**	**1,287**	**2,728**	**7,075**
Balance	**$ 2,919**	**$ 137**	**$ 2,047**	**$ 3,786**	**$ 3,292**	**$ 12,181**
Total impaired loans						
Non-accruing	**$ 2,655**	**$ -**	**$ 7,667**	**$ 3,665**	**$ -**	**$ 13,987**

Restructured accruing	**1,203**	**-**	**-**	**745**	**564**	**2,512**
Restructured non-accruing	**1,485**	**137**	**1,522**	**1,926**	**2,728**	**7,798**
Balance	**$ 5,343**	**$ 137**	**$ 9,189**	**$ 6,336**	**$ 3,292**	**$ 24,297**
Unpaid principal balance in total impaired loans	**$ 7,262**	**$ 4,398**	**$ 13,864**	**$ 8,751**	**$ 3,984**	**$ 38,259**

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	September 30, 2016					
			Commercial Real Estate			Total Recorded Investment in Impaired Loans
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**All Other Loans**	
Average impaired loans for the period	**$ 5,303**	**$ 154**	**$ 9,823**	**$ 6,809**	**$ 4,866**	**$ 26,955**
Contractual interest income due on impaired loans during the period	**$ 418**	**$ 219**	**$ 578**	**$ 361**	**$ 217**	
Interest income on impaired loans recognized on a cash basis	**$ 114**	**$ -**	**$ 20**	**$ 471**	**$ 104**	
Interest income on impaired loans recognized on an accrual basis	**$ 93**	**$ -**	**$ -**	**$ 28**	**$ 32**	

	December 31, 2015					
			Commercial Real Estate			Total Recorded Investment in Impaired Loans
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	
Impaired loans with a specific allowance						
Non-accruing	$ 1,168	$ 58	$ 7,791	$ 3,519	$ -	$ 12,536
Restructured accruing	876	-	-	-	-	876
Restructured non-accruing	156	-	-	640	-	796
Balance	$ 2,200	$ 58	$ 7,791	$ 4,159	$ -	$ 14,208
Allowance	$ 1,318	$ 58	$ 1,489	$ 510	$ -	$ 3,375
Impaired loans without a specific allowance						
Non-accruing	$ 974	$ -	$ 518	$ 793	$ 2,750	$ 5,035
Restructured accruing	701	-	2,073	240	577	3,591
Restructured non-accruing	1,398	136	59	1,388	3,112	6,093
Balance	$ 3,073	$ 136	$ 2,650	$ 2,421	$ 6,439	$ 14,719
Total impaired loans						
Non-accruing	$ 2,142	$ 58	$ 8,309	$ 4,312	$ 2,750	$ 17,571
Restructured accruing	1,577	-	2,073	240	577	4,467
Restructured non-accruing	1,554	136	59	2,028	3,112	6,889
Balance	$ 5,273	$ 194	$ 10,441	$ 6,580	$ 6,439	$ 28,927
Unpaid principal balance in total impaired loans	$ 7,158	$ 4,456	$ 15,138	$ 8,555	$ 7,154	$ 42,461

December 31,

		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total Recorded Investment in Impaired Loans
Average impaired loans for the period	$ 4,714	$ 882	$ 11,145	$ 8,218	$ 4,869	$ 29,828
Contractual interest income due on impaired loans during the period	$ 450	$ 304	$ 918	$ 647	$ 208	
Interest income on impaired loans recognized on a cash basis	$ 273	$ 11	$ 226	$ 347	$ 104	
Interest income on impaired loans recognized on an accrual basis	$ 113	$ -	$ 107	$ 11	$ 43	

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Credit Quality

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

	September 30, 2016							
		Commercial Real Estate				Residential Real Estate		
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**Consumer**	**Residential Mortgage**	**Residential Construction**	**Total**
Non-performing loans and assets:								
Non-accrual loans	**$ 4,140**	**$ 137**	**$ 9,189**	**$ 5,591**	**$ 2,726**	**$ 7,321**	**$ 199**	**$29,303**
Loans 90 days past due	**163**	**-**	**-**	**-**	**-**	**-**	**-**	**163**
Restructured loans	**1,203**	**-**	**-**	**745**	**-**	**564**	**-**	**2,512**
Total non-performing loans	**5,506**	**137**	**9,189**	**6,336**	**2,726**	**7,885**	**199**	**31,978**
Other real estate owned	**39**	**365**	**395**	**-**	**-**	**475**	**-**	**1,274**
Total non-performing assets	**$ 5,545**	**$ 502**	**$ 9,584**	**$ 6,336**	**$ 2,726**	**$ 8,360**	**$ 199**	**$33,252**

	December 31, 2015							
		Commercial Real Estate				Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:								
Non-accrual loans	$ 3,696	$ 194	$ 8,368	$ 6,340	$ 2,193	$ 8,822	$ 418	$30,031
Loans 90 days past due	-	-	-	-	-	-	-	-
Restructured loans	1,577	-	2,073	240	-	577	-	4,467
Total non-performing loans	5,273	194	10,441	6,580	2,193	9,399	418	34,498
Other real estate owned	39	365	433	-	690	1,215	-	2,742
Total non-performing assets	$ 5,312	$ 559	$ 10,874	$ 6,580	$ 2,883	$10,614	$ 418	$37,240

	September 30, 2016							
		Commercial Real Estate				Residential Real Estate		
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**Consumer**	**Residential Mortgage**	**Residential Construction**	**Total**
<u>Past due loans</u>								
31-60 days	**$ 9,269**	**$ -**	**$ 156**	**$ 2,901**	**$ 1,590**	**$ 5,567**	**$ -**	**$ 19,483**

61-90 days	**381**	**-**	**-**	**291**	**221**	**1,924**	**-**	**2,817**
> 90 days	**163**	**-**	**-**	**-**	**-**	**-**	**-**	**163**
Total past due	**9,813**	**-**	**156**	**3,192**	**1,811**	**7,491**	**-**	**22,463**
Non-accrual loans	**4,140**	**137**	**9,189**	**5,591**	**2,726**	**7,321**	**199**	**29,303**
Loans acquired with deteriorated credit quality	**526**	**-**	**-**	**244**	**-**	**-**	**-**	**770**
Current loans	**429,650**	**302,385**	**838,601**	**727,717**	**445,576**	**839,243**	**144,799**	**3,727,971**
Total loans	**$444,129**	**$302,522**	**$847,946**	**$736,744**	**$450,113**	**$854,055**	**$144,998**	**$3,780,507**

December 31, 2015

		Commercial Real Estate				Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans								
31-60 days	$ 119	$ -	$ 616	$ 1,819	$ 1,642	$ 2,602	$ -	$ 6,798
61-90 days	404	-	2,200	849	550	986	-	4,989
> 90 days	-	-	-	-	-	-	-	-
Total past due	523	-	2,816	2,668	2,192	3,588	-	11,787
Non-accrual loans	3,696	194	8,368	6,340	2,193	8,822	418	30,031
Loans acquired with deteriorated credit quality	544	-	-	307	-	-	-	851
Current loans	461,002	255,786	707,900	668,712	446,490	783,948	128,863	3,452,701
Total loans	$465,765	$255,980	$719,084	$678,027	$450,875	$796,358	$129,281	$3,495,370

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

		September 30, 2016			
		Commercial Real Estate			
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**Total**
Pass	**$ 421,297**	**$ 302,385**	**$ 837,403**	**$ 720,150**	**$ 2,281,235**
Special Mention	**9,511**	**-**	**902**	**4,392**	**14,805**
Substandard	**13,321**	**137**	**9,641**	**12,202**	**35,301**
Doubtful	**-**	**-**	**-**	**-**	**-**
Total	**$ 444,129**	**$ 302,522**	**$ 847,946**	**$ 736,744**	**$ 2,331,341**

		December 31, 2015			
		Commercial Real Estate			
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	$ 447,439	$ 255,786	$ 706,623	$ 659,281	$ 2,069,129
Special Mention	797	-	1,509	3,356	5,662
Substandard	17,529	194	10,952	15,390	44,065
Doubtful	-	-	-	-	-
Total	$ 465,765	$ 255,980	$ 719,084	$ 678,027	$ 2,118,856

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, 2016		
		Residential Real Estate		
(In thousands)	**Consumer**	**Residential Mortgage**	**Residential Construction**	**Total**
Performing	**$ 447,387**	**$ 846,170**	**$ 144,799**	**$ 1,438,356**
Non-performing:				
90 days past due	**-**	**-**	**-**	**-**
Non-accruing	**2,726**	**7,321**	**199**	**10,246**
Restructured loans	**-**	**564**	**-**	**564**
Total	**$ 450,113**	**$ 854,055**	**$ 144,998**	**$ 1,449,166**

December 31, 2015

		Residential Real Estate		
(In thousands)	Consumer	Residential Mortgage	Residential Construction	Total
Performing	$ 448,682	$ 786,959	$ 128,863	$ 1,364,504
Non-performing:				
90 days past due	-	-	-	-
Non-accruing	2,193	8,822	418	11,433
Restructured loans	-	577	-	577
Total	$ 450,875	$ 796,358	$ 129,281	$ 1,376,514

During the nine months ended September 30, 2016, the Company restructured $0.6 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 2016 have specific reserves that were insignificant at September 30, 2016. For the year ended December 31, 2015, the Company restructured $1.9 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 2015 had specific reserves of $0.5 million at December 31, 2015. Commitments to lend additional funds on loans that have been restructured at September 30, 2016 and December 31, 2015 amounted to $0.1 million and $0.1 million, respectively.

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, 2016					
		Commercial Real Estate				
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**All Other Loans**	**Total**
Troubled debt restructurings						
Restructured accruing	**$ 42**	**$ -**	**$ -**	**$ 508**	**$ -**	**$ 550**
Restructured non-accruing	**20**	**-**	**-**	**-**	**-**	**20**
Balance	**$ 62**	**$ -**	**$ -**	**$ 508**	**$ -**	**$ 570**
Specific allowance	**$ 59**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 59**
Restructured and subsequently defaulted	**$ -**	**$ -**	**$ 479**	**$ -**	**$ -**	**$ 479**

	For the Year Ended December 31, 2015					
		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total
Troubled debt restructurings						
Restructured accruing	$ 1,003	$ -	$ -	$ 240	$ -	$ 1,243
Restructured non-accruing	-	-	-	639	-	639
Balance	$ 1,003	$ -	$ -	$ 879	$ -	$ 1,882
Specific allowance	$ 303	$ -	$ -	$ 149	$ -	$ 452
Restructured and subsequently defaulted	$ -	$ -	$ -	$ -	$ -	$ -

Other Real Estate Owned

Other real estate owned totaled $1.3 million and $2.7 million at September 30, 2016 and December 31, 2015, respectively.

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, 2016			**Weighted**	December 31, 2015			Weighted
	Gross		**Net**	**Average**	Gross		Net	Average
	Carrying	**Accumulated**	**Carrying**	**Remaining**	Carrying	Accumulated	Carrying	Remaining
(Dollars in thousands)	**Amount**	**Amortization**	**Amount**	**Life**	Amount	Amortization	Amount	Life
Amortizing intangible assets:								
Other identifiable intangibles	**$ 9,296**	**$ (8,580)**	**$ 716**	**13.8 years**	$ 8,623	$ (8,485)	$ 138	2.0 years
Total amortizing intangible assets	**$ 9,296**	**$ (8,580)**	**$ 716**		$ 8,623	$ (8,485)	$ 138	
Goodwill	**$ 85,768**		**$ 85,768**		$ 84,171		$ 84,171	

During the third quarter of 2016, a subsidiary of the Company acquired the operations and customer listing of an independent insurance agency, which resulted in the addition of $0.7 in other intangible assets and $1.6 million in goodwill.

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

(In thousands)	Amount
2016	$ 14
2017	16
2018	16
2019	11
Thereafter	659
Total amortizing intangible assets	$ 716

Note 6 – Deposits

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

(In thousands)	**September 30, 2016**	December 31, 2015
Noninterest-bearing deposits	**$ 1,154,227**	$ 1,001,841
Interest-bearing deposits:		
Demand	**574,761**	570,333
Money market savings	**928,992**	898,655
Regular savings	**302,461**	284,457
Time deposits of less than $100,000	**259,022**	248,172
Time deposits of $100,000 or more	**317,694**	260,272
Total interest-bearing deposits	**2,382,930**	2,261,889
Total deposits	**$ 3,537,157**	$ 3,263,730

Note 7 – Stockholders' Equity

The Company re-approved a stock repurchase program in August 2015 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1.2 million shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. During the first nine months of 2016, the Company repurchased 512,459 shares at an average cost of $25.90 per share or a total of $13.3 million.

Note 8 – Share Based Compensation

At September 30, 2016, 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 1,403,186 are available for issuance at September 30, 2016, 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,	
	2016	2015
Dividend yield	**3.48%**	3.40%
Weighted average expected volatility	**41.54%**	42.98%
Weighted average risk-free interest rate	**1.42%**	1.42%
Weighted average expected lives (in years)	**5.71**	5.42
Weighted average grant-date fair value	**$7.75**	$7.63

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, 2016 and 2015, respectively, related to the awards of stock options and restricted stock grants. Compensation expense of $1.4 million and $1.4 million was recognized for the nine months ended September 30, 2016 and 2015, respectively. The intrinsic value of stock options exercised in the nine months ended September 30, 2016 and 2015 was $0.4 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, 2016. 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 $4.4 million as of September 30, 2016. 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, 2016 and 2015, was not significant.

In the first quarter of 2016, 21,238 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 78,081 shares of restricted stock in the first quarter of 2016, 10,010 shares are subject to a three year vesting schedule with one third of the shares vesting each year and 59,298 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 8,773 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, 2016	134,131	$ 19.70		$ 974
Granted	21,238	$ 27.46		
Exercised	(34,646)	$ 15.44		$ 430
Forfeited or expired	(3,274)	$ 25.82		
Balance at September 30, 2016	117,449	$ 22.19	3.7	$ 974
Exercisable at September 30, 2016	78,093	$ 19.95	2.6	$ 831
Weighted average fair value of options granted during the year		$ 7.75		

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

(In dollars, except share data):	Number of Common Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2016	218,571	$ 23.30
Granted	78,081	$ 27.42
Vested	(73,975)	$ 22.04
Forfeited	(10,719)	$ 24.48
Restricted stock at September 30, 2016	211,958	$ 25.20

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") covering substantially all employees. 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2016**	2015	**2016**	2015
Interest cost on projected benefit obligation	**$ 416**	$ 406	**$ 1,242**	$ 1,223
Expected return on plan assets	**(404)**	(405)	**(1,151)**	(1,217)
Recognized net actuarial loss	**295**	240	**870**	791
Net periodic benefit cost	**$ 307**	$ 241	**$ 961**	$ 797

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 $5.8 million in the third quarter of 2016.

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:

(Dollars and amounts in thousands, except per share data)	Three Months Ended September 30, **2016**	2015	Nine Months Ended September 30, **2016**	2015
Net income	**$ 13,474**	$ 10,995	**$ 34,934**	$ 32,553
Basic:				
Basic weighted average EPS shares	**24,096**	24,526	**24,124**	24,692
Basic net income per share	**$ 0.56**	$ 0.45	**$ 1.45**	$ 1.32
Diluted:				
Basic weighted average EPS shares	**24,096**	24,526	**24,124**	24,692
Dilutive common stock equivalents	**27**	77	**27**	87
Dilutive EPS shares	**24,123**	24,603	**24,151**	24,779
Diluted net income per share	**$ 0.56**	$ 0.45	**$ 1.45**	$ 1.31
Anti-dilutive shares	**3**	7	**5**	8

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. These do not have an impact on the Company's net income. The following table presents the activity in net accumulated other comprehensive income (loss) and the components of the activity for the periods indicated:

(In thousands)	**Unrealized Gains (Losses) on Investments Available-for-Sale**	**Defined Benefit Pension Plan**	**Total**
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**

(In thousands)	Unrealized Gains (Losses) on Investments Available-for-Sale	Defined Benefit Pension Plan	Total
Balance at January 1, 2015	$ 8,078	$ (8,901)	$ (823)
Other comprehensive income before reclassification, net of tax	2,144	-	2,144
Reclassifications from accumulated other comprehensive income, net of tax	12	468	480
Current period change in other comprehensive income, net of tax	2,156	468	2,624
Balance at September 30,2015	$ 10,234	$ (8,433)	$ 1,801

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

(In thousands)	Nine Months Ended September 30, **2016**	2015
Unrealized gains/(losses) on investments available-for-sale		
Affected line item in the Statements of Income:		
Investment securities gains	**$ 1,919**	$ 20
Income before taxes	**1,919**	20
Tax expense	**765**	8
Net income	**$ 1,154**	$ 12
Amortization of defined benefit pension plan items		
Affected line item in the Statements of Income:		
Recognized actuarial loss (1)	**$ 870**	$ 791
Income before taxes	**870**	791
Tax expense	**339**	323
Net income	**$ 531**	$ 468

(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 $19.2 million with a fair value of $1.3 million as of September 30, 2016 compared to $19.9 million with a fair value of $1.3 million as of December 31, 2015. The offsetting nature of the swaps results in a neutral effect on the Company's operations. 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.

Litigation expenses accrued in the first nine months of 2015 were related to an adverse jury verdict rendered in 2014 associated with the actions of an employee from an institution that was acquired in 2012. In the fourth quarter of 2015, as a result of a settlement of all claims, including claims for a contribution from its insurer relating to this litigation, the Company reversed $4.5 million in the previously accrued litigation expenses.

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, 2016			
(In thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
<u>Assets</u>				
Residential mortgage loans held for sale	**$ -**	**$ 15,822**	**$ -**	**$ 15,822**
Investments available-for-sale:				
U.S. government agencies	**-**	**54,764**	**-**	**54,764**
State and municipal	**-**	**297,791**	**-**	**297,791**
Mortgage-backed	**-**	**291,495**	**-**	**291,495**
Corporate debt	**-**	**-**	**9,346**	**9,346**
Trust preferred	**-**	**-**	**1,023**	**1,023**
Marketable equity securities	**-**	**1,223**	**-**	**1,223**
Interest rate swap agreements	**-**	**1,296**	**-**	**1,296**
<u>Liabilities</u>				
Interest rate swap agreements	**$ -**	**$ (1,296)**	**$ -**	**$ (1,296)**

	December 31, 2015			
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
<u>Assets</u>				
Residential mortgage loans held for sale	$ -	$ 15,457	$ -	$ 15,457
Investments available-for-sale:				
U.S. government agencies	-	108,400	-	108,400
State and municipal	-	164,707	-	164,707
Mortgage-backed	-	316,696	-	316,696
Trust preferred	-	-	1,023	1,023
Marketable equity securities	-	1,223	-	1,223
Interest rate swap agreements	-	1,312	-	1,312

Liabilities				
Interest rate swap agreements	$ -	$ (1,312)	$ -	$ (1,312)

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:

(In thousands)	Significant Unobservable Inputs (Level 3)
Investments available-for-sale:	
Balance at January 1, 2016	$ 1,023
Transfer into Level 3	2,116
Purchases of Level 3 assets	7,000
Total unrealized gains included in other comprehensive income (loss)	230
Balance at September 30, 2016	$ 10,369

The transfer was the result of the reclassification of the entire the held-to-maturity securities portfolio to the available-for-sale portfolio in the first quarter of 2016. The transfer into Level 3 was recognized as of the date of the reclassification of the securities portfolio. In August 2016, the Company purchased corporate debt that was determined to be a Level 3 asset as the inputs used to measure its fair value were significant and unobservable due to limited market activity.

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:

	September 30, 2016				
(In thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**	**Total Losses**
Impaired loans	**$ -**	**$ -**	**$ 9,052**	**$ 9,052**	**$ 10,291**
Other real estate owned	**-**	**-**	**1,274**	**1,274**	**(107)**
Total	**$ -**	**$ -**	**$ 10,326**	**$ 10,326**	**$ 10,184**

	December 31, 2015				
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Total Losses
Impaired loans	$ -	$ -	$ 9,349	$ 9,349	$ 10,348
Other real estate owned	-	-	2,742	2,742	(80)
Total	$ -	$ -	$ 12,091	$ 12,091	$ 10,268

At September 30, 2016, impaired loans totaling $24.3 million were written down to fair value of $20.6 million as a result of specific loan loss allowances of $3.7 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling $28.9 million were written down to fair value of $25.5 million at

December 31, 2015 as a result of specific loan loss allowances of $3.4 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.

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:

	September 30, 2016		Fair Value Measurements		
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets					
Other equity securities	**$ 35,829**	**$ 35,829**	**$ -**	**$ 35,829**	**$ -**
Loans, net of allowance	**3,736,565**	**3,769,922**	**-**	**-**	**3,769,922**
Other assets	**92,711**	**92,711**	**-**	**92,711**	**-**
Financial Liabilities					
Time deposits	**$ 576,716**	**$ 578,905**	**$ -**	**$ 578,905**	**$ -**
Securities sold under retail repurchase agreements and federal funds purchased	**124,205**	**124,205**	**-**	**124,205**	**-**
Advances from FHLB	**550,000**	**566,191**	**-**	**566,191**	**-**
Subordinated debentures	**30,000**	**14,505**	**-**	**-**	**14,505**

	December 31, 2015		Fair Value Measurements		
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets					
Investments held-to-maturity and other equity securities	$ 249,601	$ 253,040	$ -	$ 253,040	$ -
Loans, net of allowance	3,454,475	3,526,807	-	-	3,526,807
Other assets	90,866	90,866	-	90,866	-
Financial Liabilities					
Time deposits	$ 508,444	$ 508,000	$ -	$ 508,000	$ -
Securities sold under retail repurchase agreements and federal funds purchased	109,145	109,145	-	109,145	-

Advances from FHLB	685,000	704,410	-	704,410	-
Subordinated debentures	35,000	14,694	-	-	14,694

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, 2016 and December 31, 2015 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 related to the acquired entities was not significant for the three and nine months ended September 30, 2016 and 2015, 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 related to the acquired entities were not significant for the three and nine months ended September 30, 2016 and 2015, 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 $1.1 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 related to the acquired entities were not significant for the three and nine months ended September 30, 2016 and 2015, 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:

	Three Months Ended September 30, 2016				
(In thousands)	**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**
Noninterest income	**9,071**	**1,783**	**1,909**	**(179)**	**12,584**
Noninterest 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**

	Three Months Ended September 30, 2015				
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$ 40,318	$ -	$ 1	$ (2)	$ 40,317
Interest expense	5,203	-	-	(2)	5,201
Provision for loan losses	1,706	-	-	-	1,706
Non-interest income	9,106	1,716	1,749	(181)	12,390
Non-interest expense	27,318	1,480	1,013	(181)	29,630
Income before income taxes	15,197	236	737	-	16,170
Income tax expense	4,786	101	288	-	5,175
Net income	$ 10,411	$ 135	$ 449	$ -	$ 10,995
Assets	$ 4,612,413	$ 5,788	$ 11,135	$ (18,302)	$ 4,611,034

	Nine Months Ended September 30, 2016				
(In thousands)	**Community Banking**	**Insurance**	**Investment Mgmt.**	**Inter-Segment Elimination**	**Total**
Interest income	**$ 126,313**	**$ 2**	**$ 4**	**$ (6)**	**$ 126,313**
Interest expense	**15,734**	**-**	**-**	**(6)**	**15,728**
Provision for loan losses	**4,974**	**-**	**-**	**-**	**4,974**
Noninterest income	**29,426**	**4,186**	**5,621**	**(535)**	**38,698**
Noninterest 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**

	Nine Months Ended September 30, 2015				
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$ 117,238	$ 1	$ 4	$ (5)	$ 117,238
Interest expense	14,821	-	-	(5)	14,816
Provision for loan losses	3,521	-	-	-	3,521
Non-interest income	43,887	4,394	5,313	(15,936)	37,658
Non-interest expense	97,294	4,032	2,961	(15,936)	88,351
Income before income taxes	45,489	363	2,356	-	48,208
Income tax expense	14,583	153	919	-	15,655
Net income	$ 30,906	$ 210	$ 1,437	$ -	$ 32,553
Assets	$ 4,612,413	$ 5,788	$ 11,135	$ (18,302)	$ 4,611,034

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 independent, community oriented, and conducts a full-service commercial banking business 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.

With $4.8 billion in assets, the Company is a 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.

Overview

Net income for the Company for the third quarter of 2016 totaled $13.5 million ($0.56 per diluted share) as compared to net income of $11.0 million ($0.45 per diluted share) for the third quarter of 2015. For the first nine months of 2016, net income totaled $34.9 million ($1.45 per diluted share), compared to net income of $32.6 million ($1.31 per diluted share) for the first nine months of 2015. These results reflect the following events:

- The net interest margin was 3.50% for the third quarter of 2016, compared to 3.43% for the third quarter of 2015 and 3.51% for the second quarter of 2016.
- The Non-GAAP efficiency ratio was 56.33% for the current quarter as compared to 59.73% for the third quarter of 2015.
- Average total loans for the third quarter of 2016 increased 12% compared to the third quarter of 2015 due primarily to organic growth in the commercial and residential mortgage portfolio segments. Overall, the entire portfolio grew $387 million over the prior year period.
- Total deposits grew 8% to $3.5 billion at September 30, 2016 as compared to $3.3 billion at September 30, 2015.

The Mid-Atlantic region in which the Company operates showed moderate economic performance as many economic metrics reflected continued improvement throughout the year. International economic concerns have added to global uncertainty and affected both the regional and national economic outlook. Positive trends in housing, unemployment and particularly consumer spending in the United States have potentially offset such concerns. These international economic factors, combined with low oil prices and a lack of consistent high-paying jobs growth, have caused some uncertainty on the part of both large and small businesses, limiting business development and capital expenditures, effectively suppressing economic expansion. These concerns have caused enough economic uncertainty and market volatility to limit confidence and thus constrain the pace of domestic economic expansion and lending. The Company has emphasized the fundamentals of community banking in this challenging business environment and has maintained its overall credit quality and strong levels of liquidity and capital.

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.

The Company's non-performing assets decreased to $33.3 million at September 30, 2016 from $39.5 million at September 30, 2015. This decrease was due primarily to loan pay-offs. Non-performing assets represented 0.69% of total assets at September 30, 2016 compared to 0.86% at September 30, 2015. The ratio of net charge-offs to average loans and leases was 0.02% for the third quarter of 2016, compared to 0.09% for the prior year quarter.

Non-interest income increased 2% in the third quarter of 2016 compared to the third quarter of 2015. This increase was driven by an increase in income from mortgage banking activities due to a higher level of loan sales during the quarter and improved margins. This increase more than offset a decrease in wealth management income due primarily to a reduced level of assets under management as a result of the sale of a portion of the assets under management in the first quarter of 2016.

Non-interest expenses decreased 1% in the third quarter of 2016 compared to the third quarter of 2015 due to lower other non-interest expenses.

Total assets at September 30, 2016 increased 3% compared to December 31, 2015. Loan balances increased 8% compared to the prior year end due to growth in commercial loans and residential mortgage loans while consumer loans remained even with the prior year end. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 9% compared to balances at December 31, 2015. The increase in customer funding sources was driven primarily by increases of 10% in noninterest-bearing and interest-bearing transaction accounts and 6% in regular savings accounts. Retail repurchase agreements increased 14% as the Company increased its emphasis on the sale of such cash management services. Certificates of deposit increased 13% compared to the balances at December 31, 2015 as the Company increased rates to fund loan growth. The Company proactively managed its net interest margin by the prepayment of FHLB advances during the first six months of 2016, coupled with the sale of relatively low yielding investment securities in the first quarter and the extinguishment of subordinated debentures in the second quarter. During the first nine months of 2016, stockholders' equity increased $12 million to $537 million due to the increase in accumulated other comprehensive income during the period.

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

	Nine Months Ended September 30,				
	2016			2015	
(Dollars in thousands and tax-equivalent)	**Average Balances**	**(1) Interest**	**Annualized Average Yield/Rate**	Average Balances	(1) Interest
Assets					
Residential mortgage loans	**$ 818,599**	**$ 21,010**	**3.42%**	$ 737,655	$ 18,625
Residential construction loans	**141,743**	**3,804**	**3.59**	134,714	3,729
Total mortgage loans	**960,342**	**24,814**	**3.45**	872,369	22,354
Commercial AD&C loans	**273,922**	**9,511**	**4.64**	217,409	7,464
Commercial investor real estate loans	**790,864**	**27,087**	**4.57**	672,920	23,703
Commercial owner occupied real estate loans	**693,442**	**24,946**	**4.81**	630,985	23,266
Commercial business loans	**453,468**	**14,819**	**4.37**	398,418	13,107
Leasing	**-**	**-**	**-**	30	1
Total commercial loans	**2,211,696**	**76,363**	**4.61**	1,919,762	67,541
Consumer loans	**450,280**	**11,691**	**3.49**	433,788	10,807
Total loans (2)	**3,622,318**	**112,868**	**4.16**	3,225,919	100,702
Loans held for sale	**10,854**	**294**	**3.61**	14,118	422
Taxable securities	**470,987**	**9,073**	**2.57**	605,719	11,464
Tax-exempt securities (3)	**281,938**	**8,912**	**4.21**	291,868	9,396
Total investment securities	**752,925**	**17,985**	**3.19**	897,587	20,860
Interest-bearing deposits with banks	**41,433**	**156**	**0.50**	36,688	69
Federal funds sold	**688**	**3**	**0.48**	473	1
Total interest-earning assets	**4,428,218**	**131,306**	**3.96**	4,174,785	122,054
Less: allowance for loan losses	**(42,215)**			(38,256)	
Cash and due from banks	**46,255**			46,067	
Premises and equipment, net	**53,318**			51,500	
Other assets	**214,284**			216,105	
Total assets	**$4,699,860**			$4,450,201	
Liabilities and Stockholders' Equity					
Interest-bearing demand deposits	**$ 578,473**	**335**	**0.08%**	$ 528,683	312
Regular savings deposits	**297,944**	**137**	**0.06**	275,433	108
Money market savings deposits	**914,499**	**1,446**	**0.21**	849,469	983
Time deposits	**550,195**	**4,088**	**0.99**	472,065	2,790
Total interest-bearing deposits	**2,341,111**	**6,006**	**0.34**	2,125,650	4,193
Other borrowings	**118,105**	**212**	**0.24**	105,945	179
Advances from FHLB	**565,493**	**8,812**	**2.08**	592,509	9,774
Subordinated debentures	**31,989**	**698**	**2.91**	35,000	670
Total interest-bearing liabilities	**3,056,698**	**15,728**	**0.69**	2,859,104	14,816
Noninterest-bearing demand deposits	**1,078,851**			1,024,692	
Other liabilities	**38,981**			47,447	
Stockholders' equity	**525,330**			518,958	
Total liabilities and stockholders' equity	**$4,699,860**			$4,450,201	

Net interest income and spread	**115,578**	**3.27%**	107,238
Less: tax-equivalent adjustment	**4,993**		4,816
Net interest income	**$110,585**		$102,422
Interest income/earning assets		**3.96%**	
Interest expense/earning assets		**0.47**	
Net interest margin		**3.49%**	

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2016 and 2015. annualized taxable-equivalent
adjustments utilized in the above table to compute yields aggregated to $5.0 million and $4.8 million in 2016 and 2015, 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, 2016 Compared to the Nine Months Ended September 30, 2015

Net income for the Company for the first nine months of 2016 totaled $34.9 million ($1.45 per diluted share) compared to net income of $32.6 million ($1.31 per diluted share) for the first nine months of 2015.

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 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 2016 was $110.6 million compared to $102.4 million for the first nine months of 2015. On a tax-equivalent basis, net interest income for the first nine months of 2016 was $115.6 million compared to $107.2 million for the first nine months of 2015, an increase of 8%. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that has increased to 3.49% for the first nine months of 2016 compared to 3.43% for the first nine months of 2015. Average interest-earning assets increased by 6% while average interest-bearing liabilities increased 7% in the first nine months of 2016 compared to the first nine months of 2015. Average noninterest-bearing deposits increased 5% in the first nine months of 2016 as the percentage of average noninterest-bearing deposits to total deposits declined slightly to 32% in the first nine months of 2016 compared to 33% in the first nine months of 2015. The higher net interest margin was driven by an increase in the yield on interest-earning assets as a result of loan growth and the migration of assets from lower-yielding investment securities into higher-yielding loans.

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:

	2016 vs. 2015			2015 vs. 2014		
	Increase Or	**Due to Change In Average:***		Increase Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	**(Decrease)**	**Volume**	**Rate**	(Decrease)	Volume	Rate
Interest income from earning assets:						
Residential mortgage loans	**$ 2,385**	**$ 2,101**	**$ 284**	$ 1,751	$ 2,101	$ (350)
Residential construction loans	**75**	**189**	**(114)**	(259)	(217)	(42)
Commercial AD&C loans	**2,047**	**1,965**	**82**	1,014	1,655	(641)
Commercial investor real estate loans	**3,384**	**4,099**	**(715)**	2,822	3,656	(834)
Commercial owner occupied real estate loans	**1,680**	**2,258**	**(578)**	1,962	2,335	(373)
Commercial business loans	**1,712**	**1,802**	**(90)**	839	1,446	(607)
Leasing	**(1)**	**(1)**	**-**	(15)	(10)	(5)
Consumer loans	**884**	**420**	**464**	1,118	1,088	30
Loans held for sale	**(128)**	**(91)**	**(37)**	211	227	(16)
Taxable securities	**(2,391)**	**(2,612)**	**221**	(1,322)	(1,526)	204
Tax exempt securities	**(484)**	**(313)**	**(171)**	(371)	(326)	(45)
Interest-bearing deposits with banks	**87**	**10**	**77**	3	3	-
Federal funds sold	**2**	**1**	**1**	1	1	-
Total interest income	**9,252**	**9,828**	**(576)**	7,754	10,433	(2,679)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	**23**	**23**	**-**	6	40	(34)
Regular savings deposits	**29**	**8**	**21**	(23)	9	(32)
Money market savings deposits	**463**	**74**	**389**	144	(21)	165
Time deposits	**1,298**	**513**	**785**	481	59	422
Other borrowings	**33**	**24**	**9**	62	64	(2)
Advances from FHLB	**(962)**	**(420)**	**(542)**	65	602	(537)
Subordinated debentures	**28**	**(61)**	**89**	11	-	11
Total interest expense	**912**	**161**	**751**	746	753	(7)
Net interest income	**$ 8,340**	**$ 9,667**	**$ (1,327)**	$ 7,008	$ 9,680	$ (2,672)

* 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.

Interest Income

The Company's total tax-equivalent interest income increased 8% for the first nine months of 2016 compared to the prior year period. The previous table shows that, in 2016, the increase in average loans and leases more than offset the decline in earning asset yields with respect to the loan portfolio.

The average balance of the loan portfolio increased 12% for the first nine months of 2016 compared to the first nine months of 2015. This growth occurred in the residential mortgage portfolio and all segments of the commercial loan portfolio. These increases were driven by organic loan growth as the regional economy improved. The yield on average loans and leases decreased by 1 basis point as fewer higher rate loans were paid off and new loans were originated at comparatively lower rates compared to prior periods. The decline in the portfolio yield was driven primarily by a decrease of 9 basis points in the yield on the commercial loan portfolio.

The average yield on total investment securities increased 9 basis points while the average balance of the portfolio decreased 16% for the first nine months of 2016 compared to the first nine months of 2015. The increase in the yield on investments was due primarily to a decline in the relative size of the lower-yielding mortgage-backed securities portfolio due in large part to the sale of $40 million of such securities to fund the prepayment of Federal Home Loan Bank advances in the first half of 2016. An effect of this sale was an increase in the relative size of the higher yielding state and municipal portfolio as the size of the overall portfolio declined.

Interest Expense

Interest expense increased 6% in the first nine months of 2016 compared to the first nine months of 2015. The cost of interest-bearing deposits increased as the Company increased rates to maintain deposit relationships and to provide funding for loan growth. Both the average balance and average rate paid on Federal Home Loan Bank advances decreased due to the prepayments mentioned previously and a reduced need for borrowings due to the growth in deposits. Average deposits increased 9% in the first nine months of 2016 compared to the first nine months of 2015. This increase was primarily due to increases of $104 million or 7% in average noninterest-bearing and interest-bearing checking accounts together with increases of $78 million or 17% in certificates of deposit and $65 million or 8% in money market accounts as the Company increased rates on these products.

Non-interest Income

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

(Dollars in thousands)	Nine Months Ended September 30, **2016**	2015	2016/2015 $ Change	2016/2015 % Change
Securities gains	**$ 1,919**	$ 20	$ 1,899	-%
Service charges on deposit accounts	**5,894**	5,657	237	4.2
Mortgage banking activities	**2,770**	2,566	204	8.0
Wealth management income	**13,200**	15,040	(1,840)	(12.2)
Insurance agency commissions	**4,180**	4,147	33	0.8
Income from bank owned life insurance	**1,846**	1,937	(91)	(4.7)
Bank card fees	**3,498**	3,475	23	0.7
Other income	**5,391**	4,816	575	11.9
Total non-interest income	**$ 38,698**	$ 37,658	$ 1,040	2.8

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Total non-interest income was $38.7 million for the first nine months of 2016 compared to $37.7 million for the first nine months of 2015. The first nine months of 2016 includes $1.9 million in gains on sales and calls of investment securities and a gain of $1.2 million on the extinguishment of $5 million in subordinated debentures. Excluding these gains, non-interest income decreased 5% due to a decrease in income from wealth management resulting from the sale of a portion of the assets under management in the first quarter of 2016. Further detail by type of non-interest income follows:

- Investment securities gains increased for the first nine months compared to the prior year period due to the sale of mortgage-backed ARM securities and the call of a U. S. Agency security during the first quarter. The proceeds of these transactions were applied to prepay FHLB advances in the first quarter of 2016.

- Income from mortgage banking activities increased in the first nine months of 2016 compared to the first nine months of 2015 due primarily to higher margins on loan sales compared to the prior year period.

- Wealth management income is comprised of income from trust and estate services and investment management fees earned by West Financial Services, the Company’s investment management subsidiary. Trust services fees remained level for the first nine months of 2016 compared to the prior year period. Investment management fees in West Financial Services increased 5% for the first nine months of 2016 compared to the same period of 2015, due to an increase in assets under management. Fees on sales of investment products declined for the first nine months of 2016 compared to the prior year period as the Company sold a portion of its portfolio of assets under management in the first quarter of 2016. Overall total assets under management decreased to $2.4 billion at September 30, 2016 compared to $2.8 billion at September 30, 2015 primarily as a result of the previously mentioned sale.

- Income from bank owned life insurance decreased due to policy proceeds recognized during the first quarter of 2015.

- Other non-interest income increased due mainly to a $1.2 million gain on the extinguishment of subordinated debentures in the second quarter of 2016. Excluding this gain, other non-interest income decreased for the period due to declines in loan prepayment fees and gains on sales of SBA loans.

Non-interest Expense

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

	Nine Months Ended September 30,		2016/2015	2016/2015
(Dollars in thousands)	**2016**	2015	$ Change	% Change
Salaries and employee benefits	**$ 53,299**	$ 52,566	$ 733	1.4 %
Occupancy expense of premises	**9,765**	9,748	17	0.2
Equipment expenses	**5,102**	4,463	639	14.3
Marketing	**1,971**	2,161	(190)	(8.8)
Outside data services	**4,067**	3,692	375	10.2
FDIC insurance	**2,012**	1,850	162	8.8

Amortization of intangible assets		**94**		320	(226)	(70.6)
Litigation expense		**-**		517	(517)	(100.0)
Professional fees		**3,572**		3,497	75	2.1
Other real estate owned		**17**		62	(45)	(72.6)
Other expense		**12,615**		9,475	3,140	33.1
Total non-interest expense	**$**	**92,514**	$	88,351	$ 4,163	4.7

Non-interest expenses totaled $92.5 million in the first nine months of 2016 compared to $88.4 million in the first nine months of 2015, an increase of 5%. This increase in expenses was driven primarily by $3.2 million in penalties due to the prepayment of FHLB advances during the first and second quarters. Excluding such penalties, non-interest expenses increased 1% due to higher salaries and benefits. 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 2016 due primarily to higher compensation expenses as a result of merit increases, a larger staff and increased benefit expenses. The average number of full-time equivalent employees was 727 in the first nine months of 2016 compared to 719 in the first nine months of 2015.

- Equipment expenses increased in 2016 compared to 2015 due to higher software amortization expense related to new systems.

- Outside data services expenses increased in 2016 compared to the prior year period due primarily to implementation of new systems and the issuance of new chip enabled debit cards.

- Intangibles amortization decreased in 2016 due to the costs of prior year acquisitions being fully amortized during the period.

- Litigation expense decreased compared to the prior year due to the settlement of litigation in the fourth quarter of 2015.

- Other non-interest expenses increased in the first nine months of 2016 compared to the prior year period due to penalties related to the prepayment of FHLB advances mentioned previously. Excluding this expense, other non-interest expenses remained level 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 2016 compared to the first nine months of 2015 due primarily to the increase in net interest income discussed previously and expense control discipline.

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 (subtracting) the provision (credit) for loan and lease losses, and the provision for income taxes back to net income. This metric increased in the first nine months of 2016 compared to the first nine months of 2015 due primarily to the increase in net interest income.

GAAP and Non-GAAP Efficiency Ratios

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	**2016**	2015	**2016**	2015
Pre-tax pre-provision income:				
Net income	**$ 13,474**	$ 10,995	**$ 34,934**	$ 32,553
Plus non-GAAP adjustment:				
Litigation expense	**-**	155	**-**	517
Income taxes	**6,734**	5,175	**16,861**	15,655
Provision for loan losses	**781**	1,706	**4,974**	3,521
Pre-tax pre-provision income	**$ 20,989**	$ 18,031	**$ 56,769**	$ 52,246
Efficiency ratio - GAAP basis:				
Non-interest expense	**$ 29,326**	$ 29,630	**$ 92,514**	$ 88,351
Net interest income plus non-interest income	**$ 50,315**	$ 47,506	**$ 149,283**	$ 140,080
Efficiency ratio - GAAP basis	**58.28%**	62.37%	**61.97%**	63.07%
Efficiency ratio - Non-GAAP basis:				
Non-interest expense	**$ 29,326**	$ 29,630	**$ 92,514**	$ 88,351
Less non-GAAP adjustment:				
Amortization of intangible assets	**34**	107	**94**	320
Loss on FHLB redemption	**-**	-	**3,167**	-
Litigation expense	**-**	155	**-**	517
Non-interest expenses - as adjusted	**$ 29,292**	$ 29,368	**$ 89,253**	$ 87,514
Net interest income plus non-interest income	**$ 50,315**	$ 47,506	**$ 149,283**	$ 140,080
Plus non-GAAP adjustment:				
Tax-equivalent income	**1,688**	1,663	**4,993**	4,816
Less non-GAAP adjustments:				
Securities gains	**-**	1	**1,919**	20
Gain on redemption of subordinated debentures	**-**	-	**1,200**	-
Net interest income plus non-interest income - as adjusted	**$ 52,003**	$ 49,168	**$ 151,157**	$ 144,876
Efficiency ratio - Non-GAAP basis	**56.33%**	59.73%	**59.05%**	60.41%

Income Taxes

The Company had income tax expense of $16.9 million in the first nine months of 2016, compared to income tax expense of $15.7 million in the first nine months of 2015. The resulting effective tax rates were 33% for the first nine months of 2016 and 32% for the first nine months of 2015. This 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, 2016 Compared to the Three Months Ended September 30, 2015

Net income for the Company for the third quarter of 2016 totaled $13.5 million ($0.56 per diluted share) compared to net income of $11.0 million ($0.45 per diluted share) for the third quarter of 2015.

Net Interest Income

Net interest income for the third quarter of 2016 was $37.7 million compared to $35.1 million for the third quarter of 2015. On a tax-equivalent basis, net interest income for the third quarter of 2016 was $39.4 million compared to $36.8 million for the third quarter of 2015, an increase of 7%. The following table provides an analysis of net interest income performance that reflects a net interest margin that has increased to 3.50% for the third quarter of 2016 compared to 3.43% for the third quarter of 2015. Average interest-earning assets increased by 5% while average interest-bearing liabilities increased 5% in the third quarter of 2016 compared to the third quarter of 2015. Average noninterest-bearing deposits increased 6% in the third quarter of 2016 while the percentage of average noninterest-bearing deposits to total deposits decreased to 32% in the current quarter compared to 33% in the third quarter of 2015. During the quarter the net interest margin was driven by an increase in the yield on interest-earning assets and reduced cost of borrowing due to the prepayment of FHLB advances earlier in the year. These trends were somewhat offset by an increase in the cost of deposits as the Company increased rates on certificates of deposit 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,					
	2016			2015		
(Dollars in thousands and tax-equivalent)	**Average Balances**	**(1) Interest**	**Annualized Average Yield/Rate**	Average Balances	(1) Interest	An A Yi
Assets						
Residential mortgage loans	**$ 836,452**	**$ 7,208**	**3.45%**	$ 754,007	$ 6,346	
Residential construction loans	**147,602**	**1,341**	**3.62**	134,448	1,240	
Total mortgage loans	**984,054**	**8,549**	**3.47**	888,455	7,586	
Commercial AD&C loans	**287,836**	**3,398**	**4.70**	227,545	2,602	
Commercial investor real estate loans	**832,529**	**9,487**	**4.53**	704,068	8,353	
Commercial owner occupied real estate loans	**717,371**	**8,581**	**4.76**	656,337	8,065	
Commercial business loans	**446,123**	**4,863**	**4.34**	413,300	4,600	
Leasing	**-**	**-**	**-**	19	-	
Total commercial loans	**2,283,859**	**26,329**	**4.59**	2,001,269	23,620	
Consumer loans	**450,171**	**3,916**	**3.48**	441,740	3,701	
Total loans (2)	**3,718,084**	**38,794**	**4.16**	3,331,464	34,907	
Loans held for sale	**10,207**	**96**	**3.75**	21,070	214	
Taxable securities	**432,706**	**2,717**	**2.51**	581,832	3,742	
Tax-exempt securities (3)	**276,821**	**2,888**	**4.17**	287,629	3,091	
Total investment securities	**709,527**	**5,605**	**3.16**	869,461	6,833	
Interest-bearing deposits with banks	**38,773**	**49**	**0.51**	39,472	25	
Federal funds sold	**847**	**1**	**0.49**	472	1	
Total interest-earning assets	**4,477,438**	**44,545**	**3.96**	4,261,939	41,980	
Less: allowance for loan losses	**(43,498)**			(39,090)		
Cash and due from banks	**45,210**			44,893		
Premises and equipment, net	**53,162**			52,233		
Other assets	**214,708**			217,167		
Total assets	**$4,747,020**			$4,537,142		
Liabilities and Stockholders' Equity						
Interest-bearing demand deposits	**$ 579,863**	**112**	**0.08%**	$ 534,568	105	
Regular savings deposits	**305,077**	**48**	**0.06**	277,819	37	
Money market savings deposits	**938,528**	**514**	**0.22**	882,755	393	
Time deposits	**573,458**	**1,454**	**1.01**	505,351	1,097	
Total interest-bearing deposits	**2,396,926**	**2,128**	**0.35**	2,200,493	1,632	
Other borrowings	**120,702**	**74**	**0.24**	121,127	69	
Advances from FHLB	**498,370**	**2,699**	**2.15**	549,728	3,272	
Subordinated debentures	**30,000**	**225**	**3.00**	35,000	228	
Total interest-bearing liabilities	**3,045,998**	**5,126**	**0.67**	2,906,348	5,201	
Noninterest-bearing demand deposits	**1,131,739**			1,063,500		
Other liabilities	**39,042**			48,675		
Stockholders' equity	**530,241**			518,619		
Total liabilities and stockholders' equity	**$4,747,020**			$4,537,142		

Net interest income and spread	**39,419**	**3.29%**	36,779
Less: tax-equivalent adjustment	**1,688**		1,663
Net interest income	**$37,731**		$35,116
Interest income/earning assets		**3.96%**	
Interest expense/earning assets		**0.46**	
Net interest margin		**3.50%**	

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2016 and 2015.
annualized taxable-equivalent
adjustments utilized in the above table to compute yields aggregated to $1.7 million and $1.7 million in 2016 and 2015, 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 6% for the third quarter of 2016 compared to the prior year quarter. The previous table shows that this increase was driven by the redeployment of earning assets from the investment portfolio into higher yielding loans.

The average balance of the loan portfolio increased 12% for the third quarter of 2016 compared to the prior year period. This growth was primarily in the commercial investor real estate, commercial owner occupied real estate, commercial ADC and residential mortgage portfolios. These increases were driven by organic loan growth due to the strength of the regional economy. The yield on average loans and leases remained level with the prior year quarter due to a 9 basis point decline in the yield on commercial loans that was offset by increases in the yield on mortgage and consumer portfolios.

The average yield on total investment securities increased 2 basis points while the average balance of the portfolio decreased 18% for the third quarter of 2016 compared to the third quarter of 2015. The increase in the yield on investments was due primarily to a decline in the relative size of the lower-yielding mortgage-backed securities portfolio due in large part to the sale of $40 million of such securities in the first quarter of 2016 to fund the previously mentioned prepayment of Federal Home Loan Bank advances. In addition, the relative size of the higher yielding state and municipal portfolio increased as a proportion of the overall portfolio.

Interest Expense

Interest expense decreased 1% in the third quarter of 2016 compared to the third quarter of 2015. The cost of interest-bearing deposits increased as the Company increased rates to maintain deposit relationships and fund loan growth. This increase was more than offset as average balances of Federal Home Loan Bank advances decreased and the average rate paid on such advances also decreased 21 basis points due to the prepayment of such advances during the first and second quarters. Average deposits increased 8% in the third quarter of 2016 compared to the third quarter of 2015. This increase was primarily due to increases of $114 million or 7% in average noninterest-bearing and interest-bearing checking accounts together with increases of $68 million or 13% in certificates of deposit and $56 million or 6% in money market accounts as the Company increased rates on these products.

Non-interest Income

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

	Three Months Ended September 30,	2016/2015	2016/2015

(Dollars in thousands)	**2016**	2015	$ Change	% Change
Securities gains	**$ -**	$ 1	$ (1)	(100.0)
Service charges on deposit accounts	**2,035**	1,936	99	5.1 %
Mortgage banking activities	**1,129**	566	563	99.5
Wealth management income	**4,347**	4,963	(616)	(12.4)
Insurance agency commissions	**1,786**	1,648	138	8.4
Income from bank owned life insurance	**616**	618	(2)	(0.3)
Bank card fees	**1,189**	1,198	(9)	(0.8)
Other income	**1,482**	1,460	22	1.5
Total non-interest income	**$ 12,584**	$ 12,390	$ 194	1.6

Total non-interest income was $12.6 million for the third quarter of 2016 compared to $12.4 million for the third quarter of 2015, an increase of 2%. This increase was due primarily to higher mortgage banking income from increased loan sales volume that more than offset a decline in income from wealth management due to the sale of a portion of the assets under management in the first quarter. Further detail by type of non-interest income follows:

- Service charges on deposit accounts increased in the current quarter compared to the prior year quarter due to higher return check charges and commercial analysis fees.

- Income from mortgage banking activities increased in the third quarter of 2016 compared to the third quarter of 2015 due to a higher volume of loan sales and increased margins on such sales during the quarter.

- With respect to wealth management income, trust services fees were level for the third quarter compared to the prior year quarter. Investment management fees in West Financial Services increased 9% for the third quarter of 2016 compared to the third quarter of 2015, due to an increase in assets under management. Fees on sales of investment products declined for the third quarter compared to the prior year quarter as the Company sold a portion of its portfolio of assets under management in the first quarter of 2016. Overall total assets under management decreased to $2.4 billion at September 30, 2016 compared to $2.8 billion at September 30, 2015 primarily as a result of the previously mentioned sale.

- Insurance agency commissions increased in the current quarter due to growth in income from commercial and personal insurance lines and bond fees which offset a decline in income from physicians' liability policies.

- Other non-interest income remained stable during the third quarter of 2016 compared to the third quarter of 2015 as higher letter of credit fees were offset by decreases in gains on sales of SBA loans and loan prepayment fees.

Non-interest Expense

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

	Three Months Ended September 30,		2016/2015	2016/2015
(Dollars in thousands)	**2016**	2015	$ Change	% Change
Salaries and employee benefits	**$ 17,848**	$ 17,733	$ 115	0.6 %
Occupancy expense of premises	**3,130**	3,086	44	1.4
Equipment expenses	**1,745**	1,600	145	9.1
Marketing	**628**	688	(60)	(8.7)
Outside data services	**1,349**	1,329	20	1.5
FDIC insurance	**726**	565	161	28.5
Amortization of intangible assets	**34**	107	(73)	(68.2)
Litigation expense	**-**	155	(155)	(100.0)
Professional fees	**987**	1,089	(102)	(9.4)

Other real estate owned		**5**		48	(43)	(89.6)
Other expense		**2,874**		3,230	(356)	(11.0)
Total non-interest expense	**$**	**29,326**	$	29,630 $	(304)	(1.0)

Non-interest expenses totaled $29.3 million in the third quarter of 2016 compared to $29.6 million in the third quarter of 2015, due to a decrease in other non-interest expenses as a result of reduced losses on sales of OREO included in other expense in the above table. 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 2016 due primarily to an increase in compensation expenses as a result of staff additions and merit increases. The average number of full-time equivalent employees was 729 in the third quarter of 2016 compared to 720 in the third quarter of 2015.

- Equipment expenses increased in 2016 compared to 2015 due to higher software amortization expense.

- FDIC insurance expense increased due to growth in the commercial loan portfolio.

- Litigation expense decreased compared to the prior year quarter due to the settlement of litigation in the fourth quarter of 2015.

- Professional fees decreased in the third quarter of 2016 due to decreases in legal and consulting fees.

- Other non-interest expenses decreased in the third quarter of 2016 compared to the prior year quarter due to lower EFT losses and losses on sales of OREO.

Income Taxes

The Company had income tax expense of $6.7 million in the third quarter of 2016, compared to income tax expense of $5.2 million in the third quarter of 2015. The resulting effective tax rates were 33% for the third quarter of 2016 and 32% for the third quarter of 2015. This increase in the effective tax rate was due to the decline in tax advantaged interest income in proportion to total interest income.

FINANCIAL CONDITION

The Company's total assets were $4.8 billion at September 30, 2016, an increase of $155 million or 3% compared to December 31, 2015. Total loans increased 8% compared to the previous year end. This increase was partially offset by a 18% decrease in the investment portfolio.

Analysis of Loans and Leases

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

	September 30, 2016		December 31, 2015		Period-to-Period Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$	%
Residential real estate:						
Residential mortgage	**$ 854,055**	**22.6%**	$ 796,358	22.8%	$ 57,697	7.2%
Residential construction	**144,998**	**3.8**	129,281	3.7	15,717	12.2
Commercial real estate:						
Commercial owner occupied real estate	**736,744**	**19.5**	678,027	19.4	58,717	8.7
Commercial investor real estate	**847,946**	**22.4**	719,084	20.6	128,862	17.9
Commercial acquisition, development and construction	**302,522**	**8.0**	255,980	7.3	46,542	18.2
Commercial business	**444,129**	**11.8**	465,765	13.3	(21,636)	(4.6)
Consumer	**450,113**	**11.9**	450,875	12.9	(762)	(0.2)
Total loans	**$3,780,507**	**100.0%**	$3,495,370	100.0%	$ 285,137	8.2

Total loans, excluding loans held for sale, increased 8% at September 30, 2016 compared to December 31, 2015. The commercial loan portfolio increased 10% at September 30, 2016 driven by increases of 18% in both investor real estate loans and ADC loans and 9% in owner occupied real estate loans. These increases were somewhat offset by a 5% decrease in commercial business loans.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, increased 8% at September 30, 2016 compared to December 31, 2015. Permanent residential mortgages, most of which are 1-4 family, reflected an increase of 7% while residential construction loans increased 12% during the third quarter.

The consumer loan portfolio remained level at September 30, 2016 compared to December 31, 2015.

Analysis of Investment Securities

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

	September 30, 2016		December 31, 2015		Period-to-Period Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$	%

Investments available-for-sale:						
U.S. government agencies and corporations	**$ 54,764**	**7.9%**	$ 108,400	12.9%	$ (53,636)	(49.5)%
State and municipal	**297,791**	**43.1**	164,707	19.6	133,084	80.8
Mortgage-backed	**291,495**	**42.2**	316,696	37.6	(25,201)	(8.0)
Corporate debt	**9,346**	**1.4**	-	-	9,346	-
Trust preferred	**1,023**	**0.1**	1,023	0.1	-	-
Marketable equity securities	**1,223**	**0.1**	1,223	0.1	-	-
Total available-for-sale securities	**655,642**	**94.8**	592,049	70.3	63,593	10.7
Investments held-to-maturity and other equity:						
U.S. government agencies and corporations	**-**	**-**	56,460	6.7	(56,460)	(100.0)
State and municipal	**-**	**-**	149,537	17.8	(149,537)	(100.0)
Mortgage-backed	**-**	**-**	168	-	(168)	(100.0)
Corporate debt	**-**	**-**	2,100	0.3	(2,100)	(100.0)
Other equity securities	**35,829**	**5.2**	41,336	4.9	(5,507)	(13.3)
Total held-to-maturity and other equity	**35,829**	**5.2**	249,601	29.7	(213,772)	(85.6)
Total securities	**$ 691,471**	**100.0%**	$ 841,650	100.0%	$ (150,179)	(17.8)

The investment portfolio decreased 18% at September 30, 2016 compared to December 31, 2015, as a result of calls of agency securities and amortization of mortgage-backed securities throughout the period in addition to the sale of $40 million in mortgage-backed securities in the first quarter. These proceeds were used in combination to prepay FHLB borrowings.

Available-for-sale securities increased 11% at September 30, 2016 compared to December 31, 2015 due to the Company's designation of the held-to-maturity investment portfolio as available-for-sale during the first quarter. This transfer was made to provide for additional liquidity for the Company to fund loan growth.

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 2.9 years at September 30, 2016 and 3.3 years at December 31, 2015. 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 required liquidity needed to meet increased 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 increased to $16 million at September 30, 2016 compared to $15 million at December 31, 2015. The aggregate of federal funds sold and interest-bearing deposits with banks increased $24 million to $50 million at September 30, 2016 compared to December 31, 2015 due to the timing of cash flows.

Deposits

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

	September 30, 2016		December 31, 2015		Period-to-Period Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$	%
Noninterest-bearing deposits	**$ 1,154,227**	**32.6%**	$ 1,001,841	30.7%	$ 152,386	15.2%
Interest-bearing deposits:						
Demand	**574,761**	**16.2**	570,333	17.5	4,428	0.8
Money market savings	**928,992**	**26.3**	898,655	27.5	30,337	3.4
Regular savings	**302,461**	**8.6**	284,457	8.7	18,004	6.3
Time deposits of less than $100,000	**259,022**	**7.3**	248,172	7.6	10,850	4.4
Time deposits of $100,000 or more	**317,694**	**9.0**	260,272	8.0	57,422	22.1
Total interest-bearing deposits	**2,382,930**	**67.4**	2,261,889	69.3	121,041	5.4
Total deposits	**$ 3,537,157**	**100.0%**	$ 3,263,730	100.0%	$ 273,427	8.4

Deposits and Borrowings

Total deposits increased $273 million or 8% at September 30, 2016 compared to December 31, 2015. This increase was due primarily to increases of 15% in noninterest-bearing checking accounts and 13% in certificates of deposit compared to the prior year end. In addition, regular savings accounts increased 6% compared to December 31, 2015. The increase in these products occurred as the Company raised rates to maintain client relationships and to fund loan growth in addition to clients' emphasis on safety and liquidity in the face of volatile equity markets. Total borrowings decreased 15% at September 30, 2016 compared to December 31, 2015 due to a combination of deposit growth, the prepayment of $75 million in FHLB advances and the extinguishment of $5 million in subordinated debentures during the first nine months of 2016.

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 $537 million at September 30, 2016 compared to $524 million at December 31, 2015 as net income during the period exceeded the payment of dividends and stock repurchases. The ratio of average equity to average assets was 11.18% for the first nine months of 2016, as compared to 11.66% for the first nine months of 2015.

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, in addition to the ratios required to be categorized as "well capitalized", are summarized for the Company in the following table.

Risk-Based Capital Ratios

	Ratios at		Minimum Regulatory Requirements
	September 30, 2016	December 31, 2015	
Total capital to risk-weighted assets	**13.29%**	14.25%	8.00%
Tier 1 capital to risk-weighted assets	**12.17%**	13.13%	6.00%
Common equity tier 1 capital	**11.41%**	12.17%	4.50%
Tier 1 leverage	**10.25%**	10.60%	4.00%

At September 30, 2016, Tier 1 capital of $478 million and total qualifying capital of $522 million each included $30.0 million in trust preferred securities that are considered regulatory capital for purposes of determining the Company's Tier 1 capital ratio. As of September 30, 2016, 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% (increased from 4%); (3) a total capital ratio of 8% (unchanged from prior rules); 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.

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Tangible Common Equity Ratio – Non-GAAP

(Dollars in thousands, except per share data)	**September 30, 2016**	December 31, 2015
Tangible common equity ratio:		
Total stockholders' equity	**$ 536,655**	$ 524,427
Accumulated other comprehensive income (loss)	**(4,465)**	1,297
Goodwill	**(85,768)**	(84,171)
Other intangible assets, net	**(716)**	(138)
Tangible common equity	**$ 445,706**	$ 441,415
Total assets	**$ 4,810,611**	$ 4,655,380
Goodwill	**(85,768)**	(84,171)
Other intangible assets, net	**(716)**	(138)
Tangible assets	**$ 4,724,127**	$ 4,571,071
Tangible common equity ratio	**9.43%**	9.66%
Tangible book value per share	**$ 18.66**	$ 18.17

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. Home 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 7% to $32.0 million at September 30, 2016 compared to the balance at December 31, 2015. 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 volatility 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 aggressive 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 and 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 monthly 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 applied to the remaining principal balance of the loans. 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. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

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 charge-off, 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 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 an impaired loan 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 a charge of $5.0 million in the first nine months of 2016 compared to a charge of $3.5 million in the first nine months of 2015. The increase in the provision in the first nine months of 2016 was driven primarily by growth in the loan portfolio.

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 nine to eighteen 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 believes that this reserve is adequate.

Allowance for Loan Losses

During the third quarter of 2016, 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, 2016, total non-performing loans were $32.0 million, or 0.85% of total loans, compared to $34.5 million, or 0.99% of total loans, at December 31, 2015. The allowance represented 137% of non-performing loans at September 30, 2016 as compared to 119% at December 31, 2015. The allowance for loan losses as a percent of total loans was 1.16% at September 30, 2016 as compared to 1.17% at December 31, 2015.

Continued analysis of the actual loss history on the problem credits in 2015 and 2016 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, the reduced inflow of non-accruals and criticized loans in addition to the significant decline in early stage delinquencies. The improvement in these credit metrics supports management's outlook for continued improved credit quality performance.

The balance of impaired loans was $24.3 million, with specific allowances of $3.7 million against those loans at September 30, 2016, as compared to $28.9 million with allowances of $3.4 million, at December 31, 2015.

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 80% of total loans and leases at both September 30, 2016 and December 31, 2015. 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

(Dollars in thousands)	**Nine Months Ended September 30, 2016**	Year Ended December 31, 2015
Balance, January 1	**$ 40,895**	$ 37,802
Provision for loan losses	**4,974**	5,371
Loan charge-offs:		
Residential real estate:		
Residential mortgage	**(1,378)**	(614)
Residential construction	**-**	-
Commercial real estate:		
Commercial investor	**(197)**	(91)
Commercial owner occupied	**-**	(1,043)
Commercial AD&C	**(48)**	(739)
Commercial business	**(289)**	(306)
Leases	**-**	(4)
Consumer	**(674)**	(998)
Total charge-offs	**(2,586)**	(3,795)
Loan recoveries:		
Residential real estate:		
Residential mortgage	**350**	145
Residential construction	**26**	51
Commercial real estate:		
Commercial investor	**124**	20
Commercial owner occupied	**5**	3
Commercial AD&C	**22**	580
Commercial business	**21**	475
Leases	**-**	-
Consumer	**111**	243
Total recoveries	**659**	1,517
Net charge-offs	**(1,927)**	(2,278)
Balance, period end	**$ 43,942**	$ 40,895
Net charge-offs to average loans	**0.07%**	0.07%
Allowance for loan losses to loans	**1.16%**	1.17%

Analysis of Credit Risk

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

(Dollars in thousands)	**September 30, 2016**	December 31, 2015
Non-accrual loans:		
Residential real estate:		
Residential mortgage	**$ 7,321**	$ 8,822
Residential construction	**199**	418
Commercial real estate:		
Commercial investor	**9,189**	8,368
Commercial owner occupied	**5,591**	6,340
Commercial AD&C	**137**	194
Commercial business	**4,140**	3,696
Leases	**-**	-
Consumer	**2,726**	2,193
Total non-accrual loans	**29,303**	30,031
Loans 90 days past due		
Residential real estate:		
Residential mortgage	**-**	-
Residential construction	**-**	-
Commercial real estate:		
Commercial investor	**-**	-
Commercial owner occupied	**-**	-
Commercial AD&C	**-**	-
Commercial business	**163**	-
Leases	**-**	-
Consumer	**-**	-
Total 90 days past due loans	**163**	-
Restructured loans (accruing)	**2,512**	4,467
Total non-performing loans	**31,978**	34,498
Other real estate owned, net	**1,274**	2,742
Total non-performing assets	**$ 33,252**	$ 37,240

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 imbedded 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, 2016	**(4.14%)**	**(2.47%)**	**(0.68%)**	**(0.24%)**	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2015	(5.99%)	(3.63%)	(1.52%)	(0.68%)	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk improved from December 31, 2015 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, 2015 to September 30, 2016 at all shock levels was the result of a decline in both short-term and long-term FHLB borrowings which will reduce the Company’s exposure to 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, 2016	**(4.38%)**	**(2.10%)**	**0.10%**	**0.64%**	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2015	(8.24%)	(5.50%)	(2.72%)	(1.28%)	N/A	N/A	N/A	N/A

Measures of the economic value of equity ("EVE") at risk improved from December 31, 2015 to September 30, 2016 in all rising shock scenarios. The positive impact in EVE was driven by the decrease in FHLB advances, higher balances of noninterest-bearing checking accounts and longer durations on deposits.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan and lease 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, 2016. 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 71% of total interest-earning assets at September 30, 2016. In addition, loan and lease 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, 2016, 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 $1.4 billion, of which $1.4 billion was available for borrowing based on pledged collateral, with $550 million borrowed against it as of September 30, 2016. The line of credit at the Federal Reserve totaled $375 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of September 30, 2016. 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, 2016, 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, 2016. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at September 30, 2016.

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, 2016, the Bank could have declared a dividend of $20 million to Bancorp. At September 30, 2016, Bancorp had liquid assets of $11million.

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:

(In thousands)		September 30, 2016		December 31, 2015
Commercial	$	**332,467**	$	234,552
Real estate-development and construction		**95,498**		80,935
Real estate-residential mortgage		**38,622**		23,375
Lines of credit, principally home equity and business lines		**950,912**		879,326
Standby letters of credit		**70,139**		66,012
Total commitments to extend credit and available credit lines	$	**1,487,638**	$	1,284,200

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, 2016 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 2015 Annual Report on Form 10-K.

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

The Company re-approved a stock repurchase program in August 2015 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1,200,000 shares. Repurchases which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. The following table provides information regarding repurchase transactions executed during the quarter ended September 30, 2016.

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, 2016 through July 31, 2016	-	-	-	463,861
August 1, 2016 through August 31, 2016	-	-	-	463,861
September 1, 2016 through September 30, 2016	-	-	-	463,861

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, 2016 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 4, 2016

By: /s/ Philip J. Mantua___________

Philip J. Mantua

Executive Vice President and Chief Financial Officer

Date: November 4, 2016