

SANDY SPRING BANCORP INC  
Form 10-Q  
November 08, 2011

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

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2011

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  
(State of incorporation)

52-1532952  
(I.R.S. Employer Identification Number)

17801 Georgia Avenue, Olney, Maryland  
(Address of principal executive office)

20832  
(Zip Code)

301-774-6400  
(Registrant's telephone number, including area code)

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

Yes  No

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

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

Large accelerated filer  Accelerated filer  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

The number of outstanding shares of common stock outstanding as of November 2, 2011.

Common stock, \$1.00 par value – 24,083,640 shares

---

SANDY SPRING BANCORP, INC.  
TABLE OF CONTENTS

		Page
<b>PART I - FINANCIAL INFORMATION</b>		
<b>ITEM 1. FINANCIAL STATEMENTS</b>		
	Condensed Consolidated Statements of Condition - Unaudited at September 30, 2011 and December 31, 2010	2
	Condensed Consolidated Statements of Income - Unaudited for the Three and Nine Months Ended September 30, 2011 and 2010	3
	Condensed Consolidated Statements of Cash Flows – Unaudited for the Nine Months Ended September 30, 2011 and 2010	4
	Condensed Consolidated Statements of Changes in Stockholders' Equity – Unaudited for the Nine Months Ended September 30, 2011 and 2010	5
	Notes to Condensed Consolidated Financial Statements	6
<b>ITEM 2.</b>	<b>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</b>	<b>28</b>
<b>ITEM 3.</b>	<b>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</b>	<b>49</b>
<b>ITEM 4.</b>	<b>CONTROLS AND PROCEDURES</b>	<b>50</b>
<b>PART II - OTHER INFORMATION</b>		
<b>ITEM 1.</b>	<b>LEGAL PROCEEDINGS</b>	<b>51</b>
<b>ITEM 1A.</b>	<b>RISK FACTORS</b>	<b>51</b>
<b>ITEM 2.</b>	<b>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</b>	<b>51</b>
<b>ITEM 3.</b>	<b>DEFAULTS UPON SENIOR SECURITIES</b>	<b>51</b>
<b>ITEM 4.</b>	<b>[RESERVED]</b>	<b>51</b>
<b>ITEM 5.</b>	<b>OTHER INFORMATION</b>	<b>51</b>

ITEM 6.	EXHIBITS	51
SIGNATURES		52

2

---

## Forward-Looking Statements

This Quarterly Report 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 Annual Report Form 10-K filed on March 16, 2011 and the following:

- general business and economic conditions nationally or in the markets we serve 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. We do 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, 2011	December 31, 2010
<b>Assets</b>		
Cash and due from banks	\$ 43,132	\$ 44,696
Federal funds sold	1,146	1,813
Interest-bearing deposits with banks	26,535	16,608
Cash and cash equivalents	70,813	63,117
Residential mortgage loans held for sale (at fair value)	23,096	22,717
Investments available-for-sale (at fair value)	952,074	907,283
Investments held-to-maturity — fair value of \$193,432 and \$104,124 at September 30, 2011 and December 31, 2010, respectively	189,520	101,590
Other equity securities	32,586	34,070
Total loans and leases	2,145,403	2,156,232
Less: allowance for loan and lease losses	(49,720 )	(62,135 )
Net loans and leases	2,095,683	2,094,097
Premises and equipment, net	48,750	49,004
Other real estate owned	7,938	9,493
Accrued interest receivable	12,382	12,570
Goodwill	76,816	76,816
Other intangible assets, net	5,195	6,578
Other assets	111,190	142,053
<b>Total assets</b>	<b>\$ 3,626,043</b>	<b>\$ 3,519,388</b>
<b>Liabilities</b>		
Noninterest-bearing deposits	\$ 643,169	\$ 566,812
Interest-bearing deposits	1,997,155	1,983,060
Total deposits	2,640,324	2,549,872
Securities sold under retail repurchase agreements and federal funds purchased	79,529	96,243
Advances from FHLB	405,496	405,758
Subordinated debentures	35,000	35,000
Accrued interest payable and other liabilities	24,903	24,946
<b>Total liabilities</b>	<b>3,185,252</b>	<b>3,111,819</b>
<b>Stockholders' Equity</b>		
Common stock — par value \$1.00; shares authorized 50,000,000; shares issued and outstanding 24,079,204 and 24,046,627 at September 30, 2011 and December 31, 2010, respectively	24,079	24,047
Warrants	-	3,699
Additional paid in capital	177,451	177,344
Retained earnings	226,114	205,099
Accumulated other comprehensive income (loss)	13,147	(2,620 )
<b>Total stockholders' equity</b>	<b>440,791</b>	<b>407,569</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 3,626,043</b>	<b>\$ 3,519,388</b>

The accompanying notes are an integral part of these statements



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

(Dollars in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2011	2010	2011	2010
<b>Interest Income:</b>				
Interest and fees on loans and leases	\$26,791	\$29,084	\$80,597	\$87,742
Interest on loans held for sale	142	148	388	321
Interest on deposits with banks	23	61	62	158
<b>Interest and dividends on investment securities:</b>				
Taxable	5,693	6,336	16,782	18,640
Exempt from federal income taxes	2,355	1,737	6,932	5,372
Interest on federal funds sold	-	1	1	2
<b>Total interest income</b>	<b>35,004</b>	<b>37,367</b>	<b>104,762</b>	<b>112,235</b>
<b>Interest Expense:</b>				
Interest on deposits	2,773	3,883	8,673	13,741
Interest on retail repurchase agreements and federal funds purchased	49	61	155	198
Interest on advances from FHLB	3,628	3,676	10,769	10,949
Interest on subordinated debt	224	248	671	693
<b>Total interest expense</b>	<b>6,674</b>	<b>7,868</b>	<b>20,268</b>	<b>25,581</b>
Net interest income	28,330	29,499	84,494	86,654
Provision (credit) for loan and lease losses	(3,520 )	2,453	(854 )	23,585
Net interest income after provision (credit) for loan and lease losses	31,850	27,046	85,348	63,069
<b>Non-interest Income:</b>				
Investment securities gains	231	25	283	323
Total other-than-temporary impairment ("OTTI") losses	(76 )	(334 )	(178 )	(1,168 )
Portion of OTTI losses recognized in other comprehensive income, before taxes	-	(46 )	18	699
Net OTTI recognized in earnings	(76 )	(380 )	(160 )	(469 )
Service charges on deposit accounts	2,444	2,567	7,133	7,984
Mortgage banking activities	1,141	1,516	2,404	2,750
Fees on sales of investment products	905	782	2,768	2,464
Trust and investment management fees	3,032	2,505	8,837	7,488
Insurance agency commissions	1,044	978	3,177	3,895
Income from bank owned life insurance	662	709	1,962	2,105
Visa check fees	927	843	2,710	2,438
Other income	1,026	994	3,016	3,082
<b>Total non-interest income</b>	<b>11,336</b>	<b>10,539</b>	<b>32,130</b>	<b>32,060</b>
<b>Non-interest Expenses:</b>				
Salaries and employee benefits	14,892	13,841	44,192	41,393
Occupancy expense of premises	2,784	2,826	8,717	8,625
Equipment expenses	1,143	1,137	3,413	3,655
Marketing	468	589	1,662	1,678
Outside data services	1,073	966	3,067	3,007
FDIC insurance	709	1,056	2,489	3,383
Amortization of intangible assets	461	495	1,384	1,487

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

Other expenses	4,318	4,230	12,824	11,483
Total non-interest expenses	25,848	25,140	77,748	74,711
Income before income taxes	17,338	12,445	39,730	20,418
Income tax expense	6,081	3,961	12,886	5,174
Net income	\$11,257	\$8,484	\$26,844	\$15,244
Preferred stock dividends and discount accretion	-	2,074	-	4,477
Net income available to common stockholders	\$11,257	\$6,410	\$26,844	\$10,767
Net Income Per Share Amounts:				
Basic net income per share	\$0.47	\$0.35	\$1.11	\$0.70
Basic net income per common share	0.47	0.27	1.11	0.49
Diluted net income per share	\$0.47	\$0.35	\$1.11	\$0.70
Diluted net income per common share	0.47	0.27	1.11	0.49
Dividends declared per common share	\$0.08	\$0.01	\$0.24	\$0.03

The accompanying notes are an integral part of these statements

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

(Dollars in thousands)	Nine Months Ended September 30,	
	2011	2010
Operating activities:		
Net income	\$26,844	\$15,244
Adjustments to reconcile net income to net cash (used in ) provided by operating activities:		
Depreciation and amortization	5,566	5,816
Net OTTI recognized in earnings	160	469
Provision (credit) for loan and lease losses	(854 )	23,585
Share based compensation expense	942	791
Deferred income tax expense (benefit)	5,369	(1,911 )
Origination of loans held for sale	(155,965 )	(161,814 )
Proceeds from sales of loans held for sale	157,774	157,182
Gains on sales of loans held for sale	(2,188 )	(2,104 )
Loss on sales of other real estate owned	1,453	-
Investment securities gains	(283 )	(323 )
Loss (gains) on sales of premises and equipment	18	(92 )
Net decrease in accrued interest receivable	188	570
Net decrease in other assets	10,080	3,162
Net increase in accrued expenses and other liabilities	3,864	3,114
Other – net	5,656	4,495
Net cash provided by operating activities	58,624	48,184
Investing activities:		
Purchases of investments held-to-maturity	(121,767 )	-
Purchases of investments available-for-sale	(300,627 )	(600,295 )
Proceeds from redemption of FHLB stock	1,485	121
Proceeds from maturities, calls and principal payments of investments held-to-maturity	34,042	26,282
Proceeds from maturities, calls and principal payments of investments available-for-sale	277,035	512,503
Net (increase) decrease in loans and leases	(6,492 )	83,641
Proceeds from the sales of other real estate owned	5,338	5,294
Expenditures for premises and equipment	(3,087 )	(1,757 )
Net cash provided by (used in) investing activities	(114,073 )	25,789
Financing activities:		
Net increase (decrease) in deposits	90,452	(111,346 )
Net (decrease) increase in retail repurchase agreements and federal funds purchased	(16,714 )	8,822
Repayment of advances from FHLB	(262 )	(2,321 )
Redemption of stock warrant	(4,449 )	-
Redemption of preferred stock	-	(41,547 )
Repurchase of common stock	(334 )	-
Proceeds from issuance of common stock	205	95,961
Tax benefits associated with shared based compensation	76	15
Dividends paid	(5,829 )	(3,628 )
Net cash provided by financing activities	63,145	(54,044 )
Net increase in cash and cash equivalents	7,696	19,929

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

Cash and cash equivalents at beginning of period	63,117	59,796
Cash and cash equivalents at end of period	\$70,813	\$79,725

Supplemental Disclosures:

Interest payments	\$20,288	\$25,931
Income tax payments	6,140	181
Transfers from loans to other real estate owned	5,761	8,300

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

(Dollars in thousands, except per share data)	Preferred	Common		Additional	Retained	Accumulated	Total
	Stock	Stock	Warrants	Paid-In Capital	Earnings	Other Comprehensive Income (Loss)	Stockholders' Equity
Balances at December 31, 2010	\$ -	\$ 24,047	\$ 3,699	\$ 177,344	\$ 205,099	\$ (2,620 )	\$ 407,569
Comprehensive Income:							
Net income	-	-	-	-	26,844	-	26,844
Other comprehensive income, net of tax:							
Net unrealized gain on debt securities, net of reclassification adjustment	-	-	-	-	-	15,232	15,232
Change in funded status of defined benefit pension	-	-	-	-	-	535	535
Total Comprehensive Income							42,611
Common stock dividends - \$0.24 per share	-	-	-	-	(5,829 )	-	(5,829 )
Stock compensation expense	-	-	-	942	-	-	942
Stock warrant redemption	-	-	(3,699 )	(750 )	-	-	(4,449 )
Common stock issued pursuant to:							
Stock option plan - 1,765 shares	-	2	-	19	-	-	21
Employee stock purchase plan - 24,121 shares	-	24	-	352	-	-	376
Director stock purchase plan - 1,833 shares	-	2	-	30	-	-	32
Restricted stock - 28,450 shares	-	28	-	(176 )	-	-	(148 )
Purchase of treasury shares - 23,592 shares	-	(24 )	-	(310 )	-	-	(334 )
Balances at September 30, 2011	\$ -	\$ 24,079	\$ -	\$ 177,451	\$ 226,114	\$ 13,147	\$ 440,791
Balances at December 31, 2009	\$ 80,095	\$ 16,488	\$ 3,699	\$ 87,334	\$ 188,622	\$ (2,652 )	\$ 373,586
Comprehensive Income:							
Net income	-	-	-	-	15,244	-	15,244
Other comprehensive income, net of tax:							
	-	-	-	-	-	10,527	10,527

Net unrealized gain on debt securities, net of reclassification adjustment							
Change in funded status of defined benefit pension	-	-	-	-	-	509	509
Total Comprehensive Income							26,280
Redemption of preferred stock - 41,547 shares	(41,547)	-	-	-	-	-	(41,547)
Common stock dividends - \$0.03 per share	-	-	-	-	(652)	-	(652)
Preferred stock dividends - \$37.50 per share	-	-	-	-	(2,717)	-	(2,717)
Stock compensation expense	-	-	-	791	-	-	791
Discount accretion	1,760	-	-	-	(1,760)	-	-
Common stock issued pursuant to:							
Common stock issuance - 7,475,000 shares	-	7,475	-	88,159	-	-	95,634
Stock option plan - 2,216 shares	-	2	-	30	-	-	32
Employee stock purchase plan - 25,519 shares	-	26	-	276	-	-	302
Restricted stock - 12,247 shares	-	12	-	(79)	-	-	(67)
Director stock purchase plan - 3,709 shares	-	4	-	68	-	-	72
DRIP plan - 205 shares	-	-	-	3	-	-	3
Balances at September 30, 2010	\$ 40,308	\$ 24,007	\$ 3,699	\$ 176,582	\$ 198,737	\$ 8,384	\$ 451,717

The accompanying notes are an integral part of these statements

SANDY SPRING BANCORP, INC. AND SUBSIDIARIES  
NOTES TO THE 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”), which conducts a full-service commercial banking, mortgage banking and trust business. Services to individuals and businesses include accepting deposits, extending real estate, consumer and commercial loans and lines of credit, equipment leasing, general insurance, personal trust, and investment and wealth management services. The Company operates in the six Maryland counties of Anne Arundel, Carroll, Frederick, Howard, Montgomery, and Prince George's, and in Arlington, Fairfax and Loudoun counties in Virginia. The Company offers investment and wealth management services through the Bank's subsidiary, West Financial Services. Insurance products are available to clients through the agencies of Sandy Spring Insurance Corporation.

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 nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2011. 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 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 2010 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 16, 2011. There have been no significant changes to the Company's accounting policies as disclosed in the 2010 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 significant 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, potential impairment of goodwill or other intangible assets, valuation of investment securities and the determination of whether impaired securities are other-than-temporarily impaired, determination of impaired loans and the related measurement of impairment, 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 an original maturity of three months or less).

#### Adopted Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board (“FASB”) issued guidance regarding disclosures about the credit quality of financing receivables and the allowance for credit losses. This guidance is effective for interim and annual reporting periods ending on or after December 15, 2010. For disclosures about activity during a reporting period, those disclosures are effective for interim and annual reporting periods beginning on or after December 15, 2010. The purpose of the guidance is to enhance disclosures required on financing receivables and the allowance for credit losses. The disclosures provide enhanced information on the credit quality of a creditor’s financing receivables and the adequacy of its allowance for credit losses. This information is required to be presented on a disaggregated basis and includes the aging of the receivables, the nature and extent of any troubled debt restructurings and the effect on the allowance for credit losses. This guidance also requires disclosures of any significant purchases or sales of receivables. The application of this guidance did not have any material impact on the financial position, results of operations or cash flows of the Company, but increased the Company’s disclosures related to the credit quality of financing receivables and the allowance for loan and lease losses.



In April 2011, the FASB issued a standard that provides creditors guidance when analyzing modifications to the terms of receivables to determine if it meets criteria to be considered a troubled debt restructuring (TDR), both for purposes of recording impairment and disclosure of troubled debt restructurings. The new guidance also increases the qualitative and quantitative disclosures related to TDRs. This guidance may cause prior-period restructurings to be considered a TDR subsequent to the effective date of this guidance, in addition to producing significant changes to creditors' evaluation methods and their disclosures of TDRs. The guidance is effective for the first interim or annual period beginning on or after June 15, 2011. The application of this guidance did not have any material impact on the financial position, results of operations or cash flows of the Company.

The FASB issued guidance in September 2011 that provides for the optional application of a qualitative assessment to the goodwill impairment test. The guidance provides entities with the option to qualitatively determine whether they can bypass the two-step goodwill impairment test under current guidance. Under this guidance, if an entity chooses to perform a qualitative assessment and determine that it is more likely that not that the fair value of a reporting unit is less than its carrying amount, it would have to perform a Step 1 goodwill impairment test and, if necessary, proceed to the Step 2 process. If the fair value exceeds the carrying amount of goodwill, no further evaluation would be necessary. The decision to conduct a qualitative assessment must be made at the reporting unit level. Entities with multiple reporting units may utilize a mix of qualitative and quantitative tests for its various reporting units. The guidance is effective for interim and annual goodwill impairment testing performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company has opted to adopt this guidance early in the fourth quarter of 2011. This guidance will not have any impact on the financial position, results of operations or cash flows of the Company.

#### Pending Accounting Pronouncements

The FASB issued a standard in April 2011 that removed from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee, as the criterion is not a determining factor of effective control. This guidance is effective for the first interim or annual period beginning on or after December 15, 2011. This guidance is not expected to have a material impact on the financial position, results of operations or cash flows of the Company.

In May 2011, the FASB issued guidance on fair value that applies to all entities that measure assets, liabilities or instruments classified in stockholders' equity at fair value or provide fair value disclosures for items not recorded at fair value. The guidance clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risk and the concept of valuation premise and highest and best use, extends the prohibition of blockage factors to all three levels of the fair value hierarchy, and requires additional disclosures. This guidance is effective for interim and annual periods beginning after December 15, 2011. Differences in fair value measurement resulting from the application of the guidance will be recognized in income in the period of adoption as a change in estimate. Disclosure requirements will be recognized prospectively. Changes in valuation techniques and related inputs as a result of the application of the guidance in addition to an estimate of the total effect of the changes, if practicable, will be disclosed in the period of adoption. The application of this guidance is not expected to have a significant impact on the financial position, results of operations or cash flows of the Company.

In June 2011, the FASB issued a standard that requires comprehensive income to be reported in either a single statement or two consecutive statements reporting net income and other comprehensive income. The guidance does not alter the items that are reported in other comprehensive income or require reclassification of items from other comprehensive income to net income. This guidance should be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. This guidance will not have any impact on the financial position, results of operations or cash flows of the Company as it will only affect the presentation of the information in the financial statements.



## 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, 2011				December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	\$ 206,409	\$ 3,168	\$ (12 )	\$ 209,565	\$ 305,643	\$ 3,949	\$ (2,887)	\$ 306,705
State and municipal	158,196	8,450	(7 )	166,639	111,583	182	(4,228)	107,537
Mortgage-backed	549,836	20,282	(36 )	570,082	476,914	10,998	(951 )	486,961
Trust preferred	5,936	325	(573 )	5,688	6,783	190	(993 )	5,980
Total debt securities	920,377	32,225	(628 )	951,974	900,923	15,319	(9,059)	907,183
Marketable equity securities	100	-	-	100	100	-	-	100
Total investments available-for-sale	\$ 920,477	\$ 32,225	\$ (628 )	\$ 952,074	\$ 901,023	\$ 15,319	\$ (9,059)	\$ 907,283

At September 30, 2011, unrealized losses associated with U.S. Government Agencies and state and municipal securities have been caused by changes in interest rates and are not considered credit related as the contractual cash flows of these investments are either explicitly or implicitly backed by the full faith and credit of the U.S. government. The mortgage-backed portfolio at September 30, 2011 is composed entirely of either the most senior tranches of GNMA collateralized mortgage obligations (\$228.3 million), or GNMA, FNMA or FHLMC mortgage-backed securities (\$341.8 million). The Company does not 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. Unrealized losses that are related to the prevailing interest rate environment will decline over time and recover as these securities approach maturity.

At September 30, 2011, the trust preferred portfolio consisted of two securities totaling \$3.0 million, each backed by a single financial institution issuer. The fair value of this security was \$3.3 million as determined using broker quotations. The Company also owns one pooled trust preferred security backed by debt issued by banks and thrifts, which totals \$2.9 million, with a fair value of \$2.4 million. The fair value of this security was determined by a third party valuation specialist due to the limited trading activity for this security in the marketplace.

The specialist used an income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The methodology and significant assumptions employed by the specialist to determine fair value included:

- Evaluation of the structural terms as established in the indenture;
- Detailed credit and structural evaluation for each piece of collateral in the pool;
- Default, recovery and prepayment/amortization probabilities;
- Identification of adverse conditions specifically related to the security, industry and geographical area;
- Projection of estimated cash flows that incorporate default expectations and loss severities;
- Review of historical and implied volatility of the fair value of the security;
- Evaluation of credit risk concentrations;
- Evaluation of the length of time and the extent to which the fair value has been less than the amortized cost; and
-

A discount rate of 12.62% was established using credit adjusted financial institution spreads for comparably rated institutions and a liquidity adjustment that considered the previously noted characteristics.

As a result of this evaluation, it was determined that the pooled trust preferred security incurred credit-related other-than-temporary impairment (“OTTI”) of \$76 thousand, which was recognized in earnings for the quarter ended September 30, 2011. For the nine months ended September 30, 2011, credit-related OTTI incurred on this security amounted to \$160 thousand. Cumulative credit-related OTTI of \$422 thousand has been recognized in earnings through September 30, 2011. The non-credit related OTTI recognized in other comprehensive income (“OCI”) at September 30, 2011 was \$0.6 million. The security is not expected to be sold and the Company has the ability to hold the security until maturity.

The significant inputs used to measure the amount related to credit loss consisted of the following:

- Default rates were developed based on the financial condition of the trust preferred issuers in the pool and the payment or deferral status. Conditional default rates were estimated based on the payment characteristics of the security and the financial condition of the issuers in the pool. Near term and future defaults are estimated using third party industry data in addition to a review of key financial ratios and other pertinent data on the financial stability of the underlying issuer;
  - Loss severity is forecasted based on the type of impairment using research performed by third parties;
  - The security only contains one level of subordination below the senior tranche, with the senior tranche receiving the spread from the subordinate bonds. Given recent performance, it is not expected that the senior tranche will receive its full interest and principal at the bond’s maturity date;
- Credit ratings of the underlying issuers are reviewed in conjunction with the development of the default rates applied to determine the credit amounts related to the credit loss; and

- Potential prepayments are estimated based on terms and rates of the underlying trust preferred securities to determine the impact of excess spread on the credit enhancement, the removal of the strongest institutions from the underlying pool and any impact that prepayments might have on diversity and concentration.

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, 2010	\$ 262
Additions for credit losses not previously recognized	160
Cumulative credit losses on investment securities, through September 30, 2011	\$ 422

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:

At September 30, 2011

(Dollars in thousands)	Number of securities	Fair Value	Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
U.S. government agencies	2	\$ 14,990	\$ 12	\$ -	\$ 12
State and municipal	1	395	7	-	7
Mortgage-backed	5	20,623	35	1	36
Trust preferred	1	2,365	-	573	573
Total	9	\$ 38,373	\$ 54	\$ 574	\$ 628

At December 31, 2010

(Dollars in thousands)	Number of securities	Fair Value	Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
U.S. government agencies	13	\$ 115,829	\$ 2,887	\$ -	\$ 2,887
State and municipal	72	91,693	4,228	-	4,228
Mortgage-backed	11	139,899	949	2	951
Trust preferred	1	2,798	-	993	993
Total	97	\$ 350,219	\$ 8,064	\$ 995	\$ 9,059

The amortized cost and estimated fair values of investment 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.

(In thousands)	September 30, 2011		December 31, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 65,346	\$ 65,961	\$ 31,537	\$ 31,747
Due after one year through five years	76,513	78,689	167,190	170,292

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

Due after five years through ten years	345,192	354,617	258,107	255,700
Due after ten years	433,326	452,707	444,089	449,444
Total debt securities available for sale	\$ 920,377	\$ 951,974	\$ 900,923	\$ 907,183

At September 30, 2011 and December 31, 2010, investments available-for-sale with a book value of \$256.7 million and \$244.2 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, 2011 and December 31, 2010.

## Investments held-to-maturity

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

(In thousands)	September 30, 2011				December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	\$ 74,998	\$ 143	\$ (188 )	\$ 74,953	\$ -	\$ -	\$ -	\$ -
State and municipal	114,094	3,966	(61 )	117,999	101,091	2,530	(44 )	103,577
Mortgage-backed	428	52	-	480	499	48	-	547
Total investments held-to-maturity	\$ 189,520	\$ 4,161	\$ (249 )	\$ 193,432	\$ 101,590	\$ 2,578	\$ (44 )	\$ 104,124

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 dates indicated are presented in the following tables:

At September 30, 2011

(Dollars in thousands)	Number of securities	Fair Value	Continuous Unrealized Losses Existing for:		
			Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	4	\$ 44,812	\$ 188	\$ -	\$ 188
State and municipal	7	12,843	61	-	61
Total	11	\$ 57,655	\$ 249	\$ -	\$ 249

At December 31, 2010

(Dollars in thousands)	Number of securities	Fair Value	Continuous Unrealized Losses Existing for:		
			Less than 12 months	More than 12 months	Total Unrealized Losses
State and municipal	4	\$ 1,769	\$ 33	\$ 11	\$ 44
Total	4	\$ 1,769	\$ 33	\$ 11	\$ 44

The Company does not 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. Accordingly, the unrealized losses in the held-to-maturity portfolio are considered temporary in nature.

The amortized cost and estimated fair values of debt securities held-to-maturity by contractual maturity at the dates 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.

(In thousands)	September 30, 2011		December 31, 2010	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$24,047	\$24,516	\$26,238	\$26,750
Due after one year through five years	9,511	9,875	15,871	16,616

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

Due after five years through ten years	114,872	116,371	24,426	25,118
Due after ten years	41,090	42,670	35,055	35,640
Total debt securities held-to-maturity	\$189,520	\$193,432	\$101,590	\$104,124

At September 30, 2011 and December 31, 2010, investments held-to-maturity with a book value of \$61.4 million and \$85.8 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. Agency securities, exceeded ten percent of stockholders' equity at September 30, 2011 and December 31, 2010.



## Other Equity securities

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

(In thousands)	September 30, 2011	December 31, 2010
Federal Reserve Bank stock	\$ 7,530	\$ 7,530
Federal Home Loan Bank of Atlanta stock	24,981	26,465
Atlantic Central Bank stock	75	75
Total equity securities	\$ 32,586	\$ 34,070

## NOTE 3 – LOANS AND LEASES

The loan portfolio segment balances are presented in the following table at the dates indicated, net of unearned income and deferred fees of \$2.0 million and \$2.1 million, at September 30, 2011 and December 31, 2010, respectively:

(In thousands)	September 30, 2011	December 31, 2010
Residential real estate:		
Residential mortgage	\$ 440,606	\$ 436,534
Residential construction	90,727	91,273
Commercial real estate:		
Commercial owner occupied real estate	519,837	503,286
Commercial investor real estate	357,358	327,782
Commercial acquisition, development and construction	141,576	151,061
Commercial Business	226,528	250,255
Leases	8,484	15,551
Consumer	360,287	380,490
Total loans and leases	\$ 2,145,403	\$ 2,156,232

NOTE 4 – CREDIT QUALITY ASSESSMENT

Allowance for Loan and Lease Losses

Summary information on the allowance for loan and lease loss activity at the dates indicated ended is provided in the following table:

(In thousands)	Nine Months Ended	
	September 30, 2011	2010
Balance at beginning of year	\$62,135	\$64,559
Provision (credit) for loan and lease losses	(854 )	23,585
Loan and lease charge-offs	(12,612 )	(23,969 )
Loan and lease recoveries	1,051	3,107
Net charge-offs	(11,561 )	(20,862 )
Balance at period end	\$49,720	\$67,282

The following table provides information on the activity in the allowance for loan and lease losses by the respective loan portfolio segment for the period indicated:

(Dollars in thousands)	For the Nine Months Ended September 30, 2011									
	Commercial Real Estate					Residential Real Estate				
	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Commercial Leasing	Consumer	Residential Mortgage	Residential Construction	Other	Other
Balance at beginning of year	\$12,870	\$18,241	\$4,793	\$8,177	\$667	\$4,231	\$10,396	\$2,760	\$62,135	\$64,559
Provision (credit)	(3,328 )	(8,947 )	493	(647 )	1,042	3,229	4,967	2,337	(854 )	23,585
Charge-offs	(2,146 )	(840 )	(534 )	(158 )	(885 )	(2,320 )	(4,292 )	(1,437 )	(12,612 )	(23,969 )
Recoveries	190	573	4	-	12	141	127	4	1,051	3,107
Net charge-offs	(1,956 )	(267 )	(530 )	(158 )	(873 )	(2,179 )	(4,165 )	(1,433 )	(11,561 )	(20,862 )
Balance at period end	\$7,586	\$9,027	\$4,756	\$7,372	\$836	\$5,281	\$11,198	\$3,664	\$49,720	\$67,282
Total loans and leases	\$226,528	\$141,576	\$357,358	\$519,837	\$8,484	\$360,287	\$440,606	\$90,727	\$2,147,000	\$2,147,000
Allowance for loans and leases to total loans and leases ratio	3.35 %	6.38 %	1.33 %	1.42 %	9.85 %	1.47 %	2.54 %	4.04 %	2.31 %	2.31 %
Balance of loans specifically evaluated for impairment	\$9,949	\$24,481	\$16,118	\$12,556	na.	\$35	\$4,000	\$2,596	\$69,400	\$69,400
Allowance for loans specifically evaluated for impairment	\$1,234	\$836	\$137	\$1,175	na.	na.	\$597	\$1,053	\$5,000	\$5,000
Specific allowance to specific loans ratio	12.40 %	3.41 %	0.85 %	9.36 %	na.	na.	14.93 %	40.56 %	7.20 %	7.20 %
Balance of loans collectively evaluated	\$216,579	\$117,095	\$341,240	\$507,281	\$8,484	\$360,252	\$436,606	\$88,131	\$2,077,600	\$2,077,600
Allowance for loans collectively evaluated	\$6,352	\$8,191	\$4,619	\$6,197	\$836	\$5,281	\$10,601	\$2,611	\$44,720	\$44,720

Collective allowance to collective loans ratio	2.93	%	7.00	%	1.35	%	1.22	%	9.85	%	1.47	%	2.43	%	2.96	%	2.
--	------	---	------	---	------	---	------	---	------	---	------	---	------	---	------	---	----

The following table presents 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:

At September 30, 2011

(In thousands)	Commercial Real Estate					Total Recorded Investment in Impaired Loans
	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	
<b>Impaired loans with a specific allowance</b>						
Accruing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-accruing	1,644	2,790	464	2,610	1,178	8,686
Restructured accruing	1,375	-	-	709	3,433	5,517
Restructured non-accruing	482	6,608	785	3,311	392	11,578
Balance	\$ 3,501	\$ 9,398	\$ 1,249	\$ 6,630	\$ 5,003	\$ 25,781
<b>Allowance</b>						
	\$ 1,234	\$ 836	\$ 137	\$ 1,175	\$ 1,650	\$ 5,032
<b>Impaired loans without a specific allowance</b>						
Accruing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-accruing	3,654	10,035	14,192	5,039	-	32,920
Restructured accruing	536	-	-	-	35	571
Restructured non-accruing	2,258	5,048	677	887	1,593	10,463
Balance	\$ 6,448	\$ 15,083	\$ 14,869	\$ 5,926	\$ 1,628	\$ 43,954
<b>Total impaired loans</b>						
Accruing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-accruing	5,298	12,825	14,656	7,649	1,178	41,606
Restructured accruing	1,911	-	-	709	3,468	6,088
Restructured non-accruing	2,740	11,656	1,462	4,198	1,985	22,041
Balance	\$ 9,949	\$ 24,481	\$ 16,118	\$ 12,556	\$ 6,631	\$ 69,735
Unpaid principal balance in total impaired loans	\$ 12,312	\$ 43,804	\$ 16,372	\$ 13,266	\$ -	\$ 85,754

At December 31, 2010

(In thousands)	Commercial Real Estate					Total Recorded Investment in Impaired Loans
	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	
<b>Impaired loans with a specific allowance</b>						
Accruing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Non-accruing	4,755	4,792	1,175	3,060	-	13,782
Restructured accruing	-	-	-	-	-	-
Restructured non-accruing	627	2,664	-	1,873	-	5,164
Balance	\$ 5,382	\$ 7,456	\$ 1,175	\$ 4,933	\$ -	\$ 18,946
<b>Allowance</b>						
	\$ 2,507	\$ 289	\$ 274	\$ 775	\$ -	\$ 3,845

## Impaired loans without a specific allowance

Accruing	\$ -	\$6,383	\$ -	\$ -	\$ -	\$ 6,383
Non-accruing	916	12,076	578	6,119	-	19,689
Restructured accruing	209	4,545	3,878	710	1,229	10,571
Restructured non-accruing	1,640	10,885	-	729	771	14,025
Balance	\$ 2,765	\$33,889	\$ 4,456	\$ 7,558	\$2,000	\$ 50,668

## Total impaired loans

Accruing	\$ -	\$6,383	\$ -	\$ -	\$ -	\$ 6,383
Non-accruing	5,671	16,868	1,753	9,179	-	33,471
Restructured accruing	209	4,545	3,878	710	1,229	10,571
Restructured non-accruing	2,267	13,549	-	2,602	771	19,189
Balance	\$ 8,147	\$41,345	\$ 5,631	\$ 12,491	\$2,000	\$ 69,614

## Unpaid principal balance in total impaired loans

\$ 10,929	\$63,811	\$ 5,631	\$ 12,171	\$ -	\$ 92,542
-----------	----------	----------	-----------	------	-----------

The Company had commitments to lend \$2.5 million in additional funds on loans that have been restructured at September 30, 2011. At December 31, 2010, the Company had commitments to lend \$4.5 million in additional funds on loans that have been restructured.

The following table provides information regarding impaired loans for the period indicated:

For the Nine Months Ended September 30, 2011	Commercial Real Estate					Total
	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Recorded Investment in Impaired Loans
(In thousands)						
Average impaired loans for the period	\$9,564	\$32,666	\$8,576	\$13,211	\$4,871	\$68,887
Contractual interest income due on impaired loans during the period	\$479	\$1,496	\$445	\$682	\$690	
Interest income on impaired loans recognized on a cash basis	\$186	\$397	\$26	\$374	\$133	
Interest income on impaired loans recognized on an accrual basis	\$87	\$-	\$-	\$34	\$129	

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

(In thousands)	September 30, 2011	December 31, 2010
Impaired loans with a valuation allowance	\$ 25,781	\$ 18,946
Impaired loans without a valuation allowance	43,954	50,668
Total impaired loans	\$ 69,735	\$ 69,614
Allowance for loan and lease losses related to impaired loans	\$ 5,032	\$ 3,845
Allowance for loan and lease losses related to loans collectively evaluated	44,688	58,290
Total allowance for loan and lease losses	\$ 49,720	\$ 62,135

	Nine Months Ended September 30, 2011	Year Ended December 31, 2010
Average impaired loans for the period	\$ 68,887	\$ 75,556
Contractual interest income due on impaired loans during the period	\$ 3,792	\$ 6,651
Interest income on impaired loans recognized on a cash basis	\$ 1,116	\$ -
Interest income on impaired loans recognized on an accrual basis	\$ 250	\$ 524

Credit Quality

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

At September 30, 2011	Commercial Real Estate					Residential Real Estate			
	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Commercial Leasing	Residential Consumer Mortgage	Residential Construction	Total	
(In thousands)									
Non-performing loans and assets:									
Non-accrual loans and leases	\$ 8,038	\$ 24,481	\$ 16,118	\$ 11,847	\$ 956	\$ 1,478	\$ 6,081	\$ 5,034	\$ 74,033
Loans and leases 90 days past due	-	-	-	-	63	373	2,291	-	2,727
Restructured loans and leases (accruing)	1,911	-	-	709	-	35	2,788	645	6,088

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

Total non-performing loans and leases	9,949	24,481	16,118	12,556	1,019	1,886	11,160	5,679	82,848
Other real estate owned	-	400	462	-	-	-	5,458	1,618	7,938
Total non-performing assets	\$ 9,949	\$ 24,881	\$ 16,580	\$ 12,556	\$ 1,019	\$ 1,886	\$ 16,618	\$ 7,297	\$ 90,786

At December 31, 2010

(In thousands)	Commercial Real Estate					Residential Real Estate				Total
	Commercial	Commercial AD&C	Commercial Investor	Commercial Owner	Commercial Occupied R/E	Residential Consumer	Residential Mortgage	Residential Construction		
Non-performing loans and assets:										
Non-accrual loans and leases	\$ 7,938	\$ 30,417	\$ 1,753	\$ 11,781	\$ 1,887	\$ 300	\$ 3,946	\$ 5,305	\$ 63,327	
Loans and leases 90 days past due	19	-	-	-	407	182	9,871	3,675	14,154	
Restructured loans and leases (accruing)	209	4,545	3,878	710	-	37	1,192	-	10,571	
Total non-performing loans and leases	8,166	34,962	5,631	12,491	2,294	519	15,009	8,980	88,052	
Other real estate owned	-	1,172	-	-	-	-	6,799	1,522	9,493	
Other assets owned	-	-	-	-	-	200	-	-	200	
Total non-performing assets	\$ 8,166	\$ 36,134	\$ 5,631	\$ 12,491	\$ 2,294	\$ 719	\$ 21,808	\$ 10,502	\$ 97,745	

(In thousands)	Commercial Real Estate						Residential Real Estate		
	Commercial	AD&C	Commercial			Consumer	Mortgage	Construction	Total
			Investor	Owner	Occupied				
			R/E	R/E	Leasing				
<b>Past due loans and leases</b>									
31-60 days	\$1,132	\$-	\$568	\$2,608	\$224	\$790	\$4,090	\$1,219	\$10,631
61-90 days	254	-	6,513	-	47	184	655	-	7,653
> 90 days	-	-	-	-	63	373	2,291	-	2,727
<b>Total past due</b>	<b>1,386</b>	<b>-</b>	<b>7,081</b>	<b>2,608</b>	<b>334</b>	<b>1,347</b>	<b>7,036</b>	<b>1,219</b>	<b>21,011</b>
<b>Non-accrual loans and leases</b>	<b>8,038</b>	<b>24,481</b>	<b>16,118</b>	<b>11,847</b>	<b>956</b>	<b>1,478</b>	<b>6,081</b>	<b>5,034</b>	<b>74,033</b>
<b>Current loans</b>	<b>217,104</b>	<b>117,095</b>	<b>334,159</b>	<b>505,382</b>	<b>7,194</b>	<b>357,462</b>	<b>427,489</b>	<b>84,474</b>	<b>2,050,359</b>
<b>Total loans and leases</b>	<b>\$226,528</b>	<b>\$141,576</b>	<b>\$357,358</b>	<b>\$519,837</b>	<b>\$8,484</b>	<b>\$360,287</b>	<b>\$440,606</b>	<b>\$90,727</b>	<b>\$2,145,403</b>

(In thousands)	Commercial Real Estate						Residential Real Estate		
	Commercial	AD&C	Commercial			Consumer	Mortgage	Construction	Total
			Investor	Owner	Occupied				
			R/E	R/E	Leasing				
<b>Past due loans and leases</b>									
31-60 days	\$2,294	\$-	\$347	\$156	\$298	\$1,685	\$4,720	\$-	\$9,500
61-90 days	20	-	-	108	21	385	1,593	-	2,127
> 90 days	19	-	-	-	407	182	9,871	3,675	14,154
<b>Total past due</b>	<b>2,333</b>	<b>-</b>	<b>347</b>	<b>264</b>	<b>726</b>	<b>2,252</b>	<b>16,184</b>	<b>3,675</b>	<b>25,781</b>
<b>Non-accrual loans and leases</b>	<b>7,938</b>	<b>30,417</b>	<b>1,753</b>	<b>11,781</b>	<b>1,887</b>	<b>300</b>	<b>3,946</b>	<b>5,305</b>	<b>63,327</b>
<b>Current loans</b>	<b>239,984</b>	<b>120,644</b>	<b>325,682</b>	<b>491,241</b>	<b>12,938</b>	<b>377,938</b>	<b>416,404</b>	<b>82,293</b>	<b>2,067,124</b>
<b>Total loans and leases</b>	<b>\$250,255</b>	<b>\$151,061</b>	<b>\$327,782</b>	<b>\$503,286</b>	<b>\$15,551</b>	<b>\$380,490</b>	<b>\$436,534</b>	<b>\$91,273</b>	<b>\$2,156,232</b>

The Company evaluates its commercial credits under an internal loan risk rating system as a means of identifying problem or potential problem loans. The following table provides information by credit risk rating indicators for each segment of the commercial loan portfolio at the dates indicated:

(In thousands)	Commercial Real Estate					Total
	Commercial	AD&C	Commercial		Owner	
			Investor	R/E		
			R/E	R/E		
<b>Loan Classification:</b>						
<b>Risk Free to Marginally Acceptable</b>	<b>\$189,812</b>	<b>\$112,650</b>	<b>\$312,623</b>	<b>\$463,242</b>	<b>\$1,078,327</b>	
<b>Special Mention</b>	<b>7,456</b>	<b>1,366</b>	<b>17,529</b>	<b>27,136</b>	<b>53,487</b>	
<b>Substandard</b>	<b>27,499</b>	<b>27,560</b>	<b>27,206</b>	<b>29,459</b>	<b>111,724</b>	
<b>Doubtful</b>	<b>1,761</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,761</b>	
<b>Total</b>	<b>\$226,528</b>	<b>\$141,576</b>	<b>\$357,358</b>	<b>\$519,837</b>	<b>\$1,245,299</b>	



At December 31, 2010

(In thousands)	Commercial Real Estate				Total
	Commercial	AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	
<b>Loan Classification:</b>					
Risk Free to Marginally Acceptable	\$ 205,111	\$ 107,374	\$ 294,134	\$ 425,433	\$ 1,032,052
Special Mention	11,324	2,342	23,742	44,035	81,443
Substandard	30,330	39,546	9,906	33,497	113,279
Doubtful	3,490	1,799	-	321	5,610
Total	\$ 250,255	\$ 151,061	\$ 327,782	\$ 503,286	\$ 1,232,384

15

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

At September 30, 2011

(In thousands)	Leasing	Consumer	Residential Real Estate		Total
			Residential Mortgage	Residential Construction	
<b>Loan Classification:</b>					
Performing	\$7,465	\$358,401	\$429,446	\$85,048	\$880,360
<b>Non-performing:</b>					-
90 days past due	63	373	2,291	-	2,727
Non-accruing	956	1,478	6,081	5,034	13,549
Restructured loans and leases (accruing)	-	35	2,788	645	3,468
<b>Total</b>	<b>\$8,484</b>	<b>\$360,287</b>	<b>\$440,606</b>	<b>\$90,727</b>	<b>\$900,104</b>

At December 31, 2010

(In thousands)	Leasing	Consumer	Residential Real Estate		Total
			Residential Mortgage	Residential Construction	
<b>Loan Classification:</b>					
Performing	\$13,257	\$379,971	\$421,525	\$82,293	\$897,046
<b>Non-performing:</b>					
90 days past due	407	182	9,871	3,675	14,135
Non-accruing	1,887	300	3,946	5,305	11,438
Restructured loans and leases (accruing)	-	37	1,192	-	1,229
<b>Total</b>	<b>\$15,551</b>	<b>\$380,490</b>	<b>\$436,534</b>	<b>\$91,273</b>	<b>\$923,848</b>

During the first nine months ended September 30, 2011, the Company restructured \$6.9 million in loans. Modifications consisted principally of interest rate concessions. No modifications resulted in the reduction of the recorded investment 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 in the first nine months of 2011 have specific reserves of \$1.6 million at September 30, 2011. The following table provides information on restructured loans for specific segments of the loan portfolio at the date indicated:

For the Nine Months Ended September 30, 2011

(In thousands)	Commercial Real Estate				
	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans
<b>Troubled debt restructurings</b>					
Restructured accruing	\$1,730	\$-	\$-	\$-	\$2,751
Restructured non-accruing	-	-	676	1,320	382
<b>Balance</b>	<b>\$1,730</b>	<b>\$-</b>	<b>\$676</b>	<b>\$1,320</b>	<b>\$3,133</b>
<b>Specific allowance</b>	<b>\$292</b>	<b>\$-</b>	<b>\$-</b>	<b>\$537</b>	<b>\$818</b>
Restructured and subsequently defaulted	\$-	\$-	\$-	\$-	\$460



## Other Real Estate Owned

OREO is comprised of properties acquired by the Bank in partial or total satisfaction of problem loans. The properties are initially recorded at fair value on date of acquisition less estimated costs of disposal (net realizable value). Losses existing at the time of acquisition of such properties are charged against the allowance for loan and lease losses. Subsequent write-downs that may be required are expensed as incurred. Improvements to the properties may be capitalized if the improvements increase the overall value of the property. Amounts may not be capitalized in excess of the net realizable value of the property. Gains and losses realized from the sale of OREO, as well as valuation adjustments, are included in non-interest expense. Expenses of operation are included in non-interest expense. Other real estate owned totaled \$7.9 million and \$9.5 million at September 30, 2011 and December 31, 2010, respectively.

## NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS

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

	At September 30, 2011			Weighted Average Remaining Life	At December 31, 2010			Weighted Average Remaining Life
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
(Dollars in thousands)								
Amortized intangible assets:								
Core deposit intangibles	\$ 9,716	\$ (6,228 )	\$ 3,488	2.6 years	\$ 9,716	\$ (5,188 )	\$ 4,528	3.3 years
Other identifiable intangibles	8,301	(6,594 )	1,707	3.7 years	8,301	(6,251 )	2,050	4.5 years
Total amortized intangible assets	\$ 18,017	\$ (12,822)	\$ 5,195		\$ 18,017	\$ (11,439)	\$ 6,578	
Goodwill	\$ 76,816		\$ 76,816		\$ 76,816		\$ 76,816	

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

(In thousands)	Amount
2012	\$ 1,845
2013	1,778
2014	752
2015	303
Thereafter	55
Total amortizing intangibles	\$ 4,733

## NOTE 6 – DEPOSITS

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

(In thousands)	September 30, 2011	December 31, 2010
Noninterest-bearing deposits	\$ 643,169	\$ 566,812
Interest-bearing deposits:		

Demand	344,277	317,905
Money market savings	865,986	861,420
Regular savings	183,969	172,771
Time deposits of less than \$100,000	326,497	351,071
Time deposits of \$100,000 or more	276,426	279,893
Total interest-bearing deposits	1,997,155	1,983,060
Total deposits	\$ 2,640,324	\$ 2,549,872

#### NOTE 7 – STOCKHOLDERS’ EQUITY

On February 23, 2011, the Company completed the redemption of the warrant issued to the United States Department of the Treasury (the “Treasury”) in connection with the Company’s participation in the Troubled Asset Relief Program (“TARP”) Capital Purchase Program for \$4.5 million. The redemption of the warrant resulted in a net reduction of additional paid-in capital of \$0.8 million during the first quarter of 2011. The warrant was issued as part of the Securities Purchase Agreement under TARP Capital Purchase Program that the Company entered into with the Treasury pursuant to which the Company sold 83,094 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A with a liquidation preference of \$1,000 per share and a warrant to purchase 651,547 shares of the Company’s common stock, for \$83.1 million in cash. The preferred shares were redeemed in two transactions with one half of the shares redeemed in July 2010 and the remainder of the shares redeemed in December 2010.

The Company approved a stock repurchase program in August 2011 that permits the repurchase of up to 3% of the Company's outstanding shares of common stock or approximately 730,000 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 Company repurchased 23,592 shares of common stock at an average price of \$14.16 per share during the quarter ended September 30, 2011.

#### NOTE 8 – SHARE BASED COMPENSATION

At September 30, 2011, the Company had two share based compensation plans in existence, the 1999 Stock Option Plan (expired but having outstanding options that may still be exercised) and the 2005 Omnibus Stock Plan, which is described below.

The Company's 2005 Omnibus Stock Plan ("Omnibus Plan") provides for the granting of non-qualifying stock options to the Company's directors, and incentive and non-qualifying stock options, stock appreciation rights and restricted stock grants to selected key employees on a periodic basis at the discretion of the board. The Omnibus Plan authorizes the issuance of up to 1,800,000 shares of common stock of which 1,043,561 are available for issuance at September 30, 2011, 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 Stock Option 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. Options granted under the expired 1999 Stock Option Plan remain outstanding until exercised or they expire. 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 with the weighted-average assumptions for the periods shown are presented in the following table:

	Nine Months Ended			
	September 30,			
	2011	2010		
Dividend yield	1.72	0.27	%	%
Weighted average expected volatility	46.87	45.06	%	%
Weighted average risk-free interest rate	2.58	2.91	%	%
Weighted average expected lives (in years)	5.70	5.83		
Weighted average grant-date fair value	\$7.76	\$6.65		

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 \$0.3 million and \$0.3 million for the three months ended September 30, 2011 and 2010, respectively, related to the awards of stock options and restricted stock grants. The Company recognized compensation expense related to the awards of stock options and restricted stock grants of \$0.9 million and \$0.8 million for the nine months ended September 30, 2011 and 2010, respectively. Stock options exercised in the nine months ended September 30, 2011 and 2010, respectively, had immaterial intrinsic values. The total of unrecognized compensation cost related to stock options was approximately \$0.4 million as of

September 30, 2011. 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 \$2.9 million as of September 30, 2011. That cost is expected to be recognized over a weighted period of approximately 3.5 years. The fair value of the shares vested during the nine months ended September 30, 2011 and 2010, was \$0.3 million and \$0.2 million, respectively.

In the first quarter of 2011, 37,105 stock options were granted, subject to a three year vesting schedule with one third of the options vesting each year on the anniversary date of the grant. Additionally, 85,389 shares of restricted stock were granted, subject to a five year vesting schedule with one fifth of the shares vesting each year on the grant date anniversary. There were no additional stock options or shares of restricted stock granted in the second or third quarter of 2011.

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

(In thousands, except per share data):	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life(Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2011	722,367	\$32.47		\$ 310
Granted	37,105	\$18.69		-
Exercised	(1,765 )	\$12.01		(11 )
Forfeited or expired	(90,030 )	\$35.08		(5 )
Balance at September 30, 2011	667,677	\$31.40	2.7	296
Exercisable at September 30, 2011	587,493	\$33.51	2.3	\$ 181
Weighted average fair value of options granted during the year		\$7.76		

A summary of the activity for the Company's non-vested options for the period indicated is presented in the following table:

(In dollars, except share data):	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested options at January 1, 2011	106,185	\$4.78
Granted	37,105	\$7.76
Vested	(59,455 )	\$4.51
Forfeited or expired	(3,651 )	\$4.82
Non-vested options at September 30, 2011	80,184	\$6.35

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 Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2011	183,751	\$15.31
Granted	85,589	\$18.69
Vested	(43,335 )	\$14.92
Forfeited or expired	(14,921 )	\$15.74
Restricted stock at September 30, 2011	211,084	\$16.73

#### NOTE 9 – PENSION, PROFIT SHARING, AND OTHER EMPLOYEE BENEFIT PLANS

##### Defined Benefit Pension Plan

The Company has a qualified, noncontributory, defined benefit pension 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 future salary increases and additional years of service will 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 net periodic benefit cost for the periods indicated includes the following components:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest cost on projected benefit obligation	\$383	\$401	\$1,151	\$1,083
Expected return on plan assets	(267 )	(326 )	(801 )	(876 )
Recognized net actuarial loss	297	317	890	846
Net periodic benefit cost	\$413	\$392	\$1,240	\$1,053

#### 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. Given these uncertainties, management continues to monitor the funding level of the pension plan and may make contributions as necessary during 2011.

#### 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,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	\$11,257	\$8,484	\$26,844	\$15,244
Less: Dividends - preferred stock	-	2,074	-	4,477
Net income (loss) available to common stockholders	\$11,257	\$6,410	\$26,844	\$10,767
<b>Basic:</b>				
Basic weighted average EPS shares	24,099	24,004	24,081	21,772
Basic net income per share	\$0.47	\$0.35	\$1.11	\$0.70
Basic net income per common share	0.47	0.27	1.11	0.49
<b>Diluted:</b>				
Basic weighted average EPS shares	24,099	24,004	24,081	21,772
Dilutive common stock equivalents	43	98	47	40
Dilutive EPS shares	24,142	24,102	24,128	21,812
Diluted net income per share	\$0.47	\$0.35	\$1.11	\$0.70
Diluted net income per common share	0.47	0.27	1.11	0.49
Anti-dilutive shares	697	655	716	790

#### NOTE 11 – OTHER COMPREHENSIVE INCOME

Comprehensive income is defined as net income plus transactions and other occurrences that are the result of non-owner changes in equity. For financial statements presented for the Company, non-equity changes 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 components of other comprehensive

income and the related tax effects allocated to each component for the periods indicated are presented in the following table.

20

---

(In thousands)	Nine Months Ended September 30,	
	2011	2010
Net income	\$ 26,844	\$ 15,244
Investments available-for-sale:		
Net change in unrealized gains on investments available-for-sale	25,054	17,187
Related income tax expense	(9,992 )	(6,854 )
Net investment gains reclassified into earnings	283	323
Related income tax expense	(113 )	(129 )
Net effect on other comprehensive income for the period	15,232	10,527
Defined benefit pension plan:		
Recognition of unrealized gain	890	846
Related income tax expense	(355 )	(337 )
Net effect on other comprehensive income for the period	535	509
Total other comprehensive income	15,767	11,036
Comprehensive income	\$ 42,611	\$ 26,280

The following table presents net accumulated other comprehensive income (loss) for the periods indicated:

(In thousands)	Unrealized Gains (Losses) on Investments		Defined Benefit Pension Plan	Total
	Available-for-Sale			
Balance at December 31, 2010	\$ 3,764	\$ (6,384 )	\$ (2,620 )	
Period change, net of tax	15,232	535	\$ 15,767	
Balance at September 30, 2011	\$ 18,996	\$ (5,849 )	\$ 13,147	

(In thousands)	Unrealized Gains (Losses) on Investments		Defined Benefit Pension Plan	Total
	Available-for-Sale			
Balance at December 31, 2009	\$ 3,845	\$ (6,497 )	\$ (2,652 )	
Period change, net of tax	10,527	509	\$ 11,036	
Balance at September 30, 2010	\$ 14,372	\$ (5,988 )	\$ 8,384	

#### NOTE 12 – DERIVATIVE INSTRUMENTS

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. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The notional value of commercial loan swaps outstanding was \$56 million with a fair value of \$1.6 million as of September 30, 2011 compared to \$49 million with a fair value of \$1.1 million as of December 31, 2010. Since each position is netted these amounts represent both a gross asset and a gross liability on the condensed consolidated statements of condition. The offsetting nature of the swaps results in a neutral effect on the Company’s operations.



## NOTE 13 – 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 accounting for gains on sale of mortgage loans to more accurately reflect the timing and economics of the transaction.

The Company adopted the standards for fair value measurement which clarified that fair value is an exit price, representing the amount that would be received for sale of an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. 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.

### 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

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. For further information, refer to Note 3 – Investments. 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:

(In thousands)	At September 30, 2011			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>				
Residential mortgage loans held for sale	\$-	\$ 23,096	\$ -	\$23,096
<b>Investments available-for-sale:</b>				
U.S. government agencies	-	209,565	-	209,565
State and municipal	-	166,639	-	166,639
Mortgage-backed	-	570,082	-	570,082
Trust preferred	3,323	-	2,365	5,688
Marketable equity securities	-	100	-	100
Interest rate swap agreements	-	1,649	-	1,649
<b>Liabilities</b>				
Interest rate swap agreements	\$-	\$ (1,649 )	\$ -	\$(1,649 )

(In thousands)	At December 31, 2010			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>				
Residential mortgage loans held for sale	\$-	\$ 22,717	\$ -	\$22,717
<b>Investments available-for-sale:</b>				
U.S. government agencies	-	306,705	-	306,705
State and municipal	-	107,537	-	107,537
Mortgage-backed	-	486,961	-	486,961



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

Trust preferred	3,182	-	2,798	5,980
Marketable equity securities	-	100	-	100
Interest rate swap agreements	-	1,113	-	1,113
<b>Liabilities</b>				
Interest rate swap agreements	\$-	\$ (1,113 )	\$ -	\$(1,113 )

23

---

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 periods indicated:

(In thousands)	Significant Unobservable Inputs (Level 3)
<b>Investments available-for-sale:</b>	
Balance at December 31, 2010	\$ 2,798
Total OTTI included in earnings	(160 )
Principal redemption	(695 )
<b>Total unrealized losses included in other comprehensive income (loss)</b>	<b>422</b>
Balance at September 30, 2011	\$ 2,365

#### 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:

At September 30, 2011					
(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	\$ -	\$ -	\$ 64,703	\$ 64,703	\$ (1,424 )
Other real estate owned	-	-	7,938	7,938	(1,803 )
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 72,641</b>	<b>\$ 72,641</b>	<b>\$ (3,227 )</b>

At December 31, 2010					
(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	\$ -	\$ -	\$ 65,769	\$ 65,769	\$ (10,302 )
Other real estate owned	-	-	9,493	9,493	(203 )
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 75,262</b>	<b>\$ 75,262</b>	<b>\$ (10,505 )</b>

Impaired loans totaling \$69.7 million were written down to fair value of \$64.7 million at September 30, 2011 as a result of specific loan loss reserves of \$5.0 million associated with the impaired loans. At December 31, 2010, impaired loans totaling \$69.6 million were written down to fair value of \$65.8 million as a result of specific loan loss

reserves of \$3.8 million associated with the impaired loans which was included in the allowance for loan losses.

Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent and are classified at a level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable 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 same factors identified above.

The estimated fair value for other real estate owned included in Level 3 is determined by either 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.

### 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 are presented in the following table at the dates indicated:

(In thousands)	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets</b>				
Cash and temporary investments (1)	\$93,909	\$93,909	\$85,834	\$85,834
Investments available-for-sale	952,074	952,074	907,283	907,283
Investments held-to-maturity and other equity securities	222,106	226,018	135,660	138,194
Loans, net of allowance	2,095,683	1,976,860	2,094,097	1,983,242
Accrued interest receivable and other assets (2)	92,806	92,806	92,145	92,145
<b>Financial Liabilities</b>				
Deposits	\$2,640,324	\$2,645,484	\$2,549,872	\$2,554,327
Securities sold under retail repurchase agreements and federal funds purchased	79,529	79,529	96,243	96,243
Advances from FHLB	405,496	453,485	405,758	447,563
Subordinated debentures	35,000	9,204	35,000	8,091
Accrued interest payable and other liabilities (2)	2,664	2,664	3,765	3,765

(1) Temporary investments include federal funds sold, interest-bearing deposits with banks and residential mortgage loans held for sale.

(2) Only financial instruments as defined by GAAP are included in other assets and other liabilities.

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:

Cash and due from banks, federal funds sold and interest-bearing deposits with banks. The carrying amount approximated the fair value.

Residential mortgage loans held for sale. The fair value of residential mortgage loans held for sale was derived from secondary market quotations for similar instruments.

Investments: Fair value of U.S. Treasury, U.S. Agency, state and municipal, corporate debt and trust preferred securities was determined as using valuation methodologies outlined in the previous sections of this note.

Loans: The fair value was estimated by computing the discounted value of estimated cash flows, adjusted for potential loan and lease losses, for pools of loans having similar characteristics. The discount rate was based upon the current loan origination rate for a similar loan. Non-performing loans have an assumed interest rate of 0%.

Accrued interest receivable: The carrying amount approximated the fair value of accrued interest, considering the short-term nature of the receivable and its expected collection.

Other assets: The majority of the carrying amount approximated the fair value based on the surrender value of the cash surrender value life insurance contracts as determined by each insurance carrier. The remaining portion of the carrying amount approximated the fair value of interest rate swaps using quoted prices provided by the swap counterparty.

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.

The fair value of time deposits was based upon the discounted value of contractual cash flows at current rates for deposits of similar remaining maturity.

Short-term borrowings: The carrying amount approximated the fair value of repurchase agreements due to their variable interest rates. The fair value of Federal Home Loan Bank of Atlanta advances was estimated by computing the discounted value of contractual cash flows payable at current interest rates for obligations with similar remaining terms.

Long-term borrowings: The fair value of the Federal Home Loan Bank of Atlanta 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.

Accrued interest payable and other liabilities: The carrying amount approximated the fair value of accrued interest payable, accrued dividends and premiums payable, considering their short-term nature and expected payment.

#### NOTE 14 - 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 acquisition was retained. The accounting policies of the segments are the same as those described in Note 1 to the consolidated financial statements. 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 on sales of investment products and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Amortization of intangibles related to acquired entities amounted to non-cash charges of \$0.3 million for the three months ended September 30, 2011 and 2010, respectively. Non-cash charges associated with amortization of intangibles related to the acquired entities amounted to \$1.0 million for the nine months ended September 30, 2011 and 2010, 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 the 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 ended September 30, 2011 and 2010, respectively. Amortization of intangibles amounted to \$0.2 million for the nine months ended September 30, 2011 and 2010, 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 \$748 million 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 with respect to the results for the three months ended September 30, 2011 and 2010, respectively, were not significant. Amortization of intangibles amounted to \$0.2 million for the nine months ended September 30, 2011 and 2010, respectively.

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

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:

(In thousands)	Three Months Ended September 30, 2011				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 35,008	\$ 1	\$ 2	\$ (7 )	\$ 35,004
Interest expense	6,681	-	-	(7 )	6,674
Provision (credit) for loan and lease losses	(3,520 )	-	-	-	(3,520 )
Noninterest income	9,084	1,136	1,319	(203 )	11,336
Noninterest expenses	24,198	1,054	799	(203 )	25,848
Income before income taxes	16,733	83	522	-	17,338
Income tax expense	5,843	35	203	-	6,081
Net income	\$ 10,890	\$ 48	\$ 319	\$ -	\$ 11,257
Assets	\$ 3,655,556	\$ 12,715	\$ 15,008	\$ (57,236 )	\$ 3,626,043

(In thousands)	Three Months Ended September 30, 2010				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 37,450	\$ 2	\$ 2	\$ (87 )	\$ 37,367
Interest expense	7,955	-	-	(87 )	7,868
Provision for loan and lease losses	2,453	-	-	-	2,453
Noninterest income	8,424	1,102	1,216	(203 )	10,539
Noninterest expenses	23,545	1,080	718	(203 )	25,140
Income before income taxes	11,921	24	500	-	12,445
Income tax expense	3,756	10	195	-	3,961
Net income	\$ 8,165	\$ 14	\$ 305	\$ -	\$ 8,484
Assets	\$ 3,631,840	\$ 12,764	\$ 13,079	\$ (51,066 )	\$ 3,606,617

(In thousands)	Nine Months Ended September 30, 2011				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 104,822	\$ 4	\$ 6	\$ (70 )	\$ 104,762
Interest expense	20,338	-	-	(70 )	20,268
Provision (credit) for loan and lease losses	(854 )	-	-	-	(854 )
Noninterest income	25,162	3,526	4,050	(608 )	32,130
Noninterest expenses	72,631	3,346	2,379	(608 )	77,748
Income before income taxes	37,869	184	1,677	-	39,730
Income tax expense	12,157	76	653	-	12,886
Net income	\$ 25,712	\$ 108	\$ 1,024	\$ -	\$ 26,844
Assets	\$ 3,655,556	\$ 12,715	\$ 15,008	\$ (57,236 )	\$ 3,626,043



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

(In thousands)	Nine Months Ended September 30, 2010				Total
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	
Interest income	\$ 112,554	\$ 6	\$ 4	\$ (329 )	\$ 112,235
Interest expense	25,910	-	-	(329 )	25,581
Provision for loan and lease losses	23,585	-	-	-	23,585
Noninterest income	24,609	4,348	3,711	(608 )	32,060
Noninterest expenses	69,586	3,396	2,337	(608 )	74,711
Income before income taxes	18,082	958	1,378	-	20,418
Income tax expense	4,250	387	537	-	5,174
Net income	\$ 13,832	\$ 571	\$ 841	\$ -	\$ 15,244
Assets	\$ 3,631,840	\$ 12,764	\$ 13,079	\$ (51,066 )	\$ 3,606,617

## 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 was founded in 1868 and is the oldest banking business based in Maryland. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 43 community offices located in Anne Arundel, Carroll, Frederick, Howard, Montgomery and Prince George's counties in Maryland, and Arlington, Fairfax and Loudoun counties in Virginia. 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.

### Overview

Net income for the Company for the third quarter of 2011 totaled \$11.3 million (\$0.47 per diluted share), compared to net income of \$8.5 million (\$0.35 per diluted share) for the third quarter of 2010. For the first nine months of 2011 net income totaled \$26.8 million (\$1.11 per diluted share) compared to net income of \$15.2 million (\$0.70 per diluted share) for the prior year period. These results reflect the following events:

- Total loans declined 2% compared to September 30, 2010 and remained virtually level compared to June 30, 2011. This trend was driven primarily by consumer loans, which decreased 8% compared to the prior year, while each of the three major loan categories (commercial, consumer and residential mortgage loans) remained relatively level compared to June 30, 2011.
- Deposits increased 2% compared to September 30, 2010 but declined 1% compared to June 30, 2011. The growth over September 30, 2010 was due primarily to a 13% increase in noninterest-bearing and interest-bearing checking accounts. The decrease compared to June 30, 2011 was due largely to a 2% decrease in certificates of deposit.
- Net interest income decreased 4% for the third quarter of 2011 compared to the third quarter of 2010 and increased 1% compared to the second quarter of 2011. For the year-to-date, net interest income decreased 2% for 2011 compared to the first nine months of 2010. This general downward trend was due primarily to a decline in average interest-earning assets as a result of new loan volume that was insufficient to offset increased loan payoffs.
- The provision for loan and lease losses was a credit of \$3.5 million for the third quarter of 2011 compared to a charge of \$2.5 million for the prior year period and a charge of \$1.2 million for the second quarter of 2011. For the first nine months of 2011, the provision for loan and lease losses decreased to a credit of \$.09 million compared to a charge of \$23.6 million for the first nine months of 2010. This declining trend was due mainly to a lower level of historical net charge-offs. Non-performing loans decreased to \$82.8 million at September 30, 2011 compared to \$93.3 million at September 30, 2010 and \$76.5 million at June 30, 2011. This increase compared to June 30, 2011 was due primarily to one commercial real estate credit totaling \$13.6 million which was placed on non-accrual during the third quarter of 2011.

The first nine months of 2011 reflected a stalled national economy together with struggling local economies as the equity markets declined over the third quarter from the positive trend shown earlier in the year. Significant volatility was evident in virtually every metric of the economy as concerns continued over the United States budget deficit and the financial stability of several countries in Europe. The depressed real estate market, continued high unemployment rates and municipal budget deficits continued to cause a high degree of economic uncertainty, particularly among

individual consumers and small and medium-sized businesses. This has constrained expansion as consumers and such businesses dealt with rising costs, tight credit and a lack of consumer confidence in the first nine months of 2011. Despite this challenging business environment, the Company has emphasized the fundamentals of community banking as it has maintained strong levels of liquidity and capital and overall credit quality has continued to improve.

Comparing September 30, 2011 balances to December 31, 2010, total assets remained level at \$3.6 billion. Loan balances decreased slightly compared to the prior year-end due primarily to a decrease of 5% in consumer loans, while commercial loans and residential mortgage and construction loans remained unchanged. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 3% compared to balances at December 31, 2010. This increase was due primarily to increases of 13% in noninterest-bearing deposits, 6% in regular savings accounts and 8% in interest bearing checking accounts. These increases were partially offset by declines of 4% in certificates of deposit while money market accounts remained level as the Company reduced rates on certificates of deposit and clients redeployed funds to emphasize liquidity. During the same period, stockholders' equity increased to \$440.8 million or 12% of total assets due to net income for the first nine months of the year, which was somewhat offset by the redemption in the first quarter of 2011 of the warrant issued under the TARP Capital Purchase Program.

Net interest income decreased 2% for the first nine months of 2011 compared to the prior year period. While the cost of interest-bearing liabilities decreased by 23 basis points, its positive effect on the interest margin was more than offset by the 20 basis point decline in the yield on average interest-earning assets. This was due to the fact that average interest-earning assets exceeded average interest-bearing liabilities by \$790 million for the period.

Non-interest income remained basically level for the first nine months of 2011 compared to the prior year period. Trust and investment management fees increased 18% over the prior year period primarily due to higher average assets under management due primarily to new client additions. Fees on sales of investment products increased 12% due to an increase in managed assets and higher sales of financial products while income from Visa check transactions increased 11% as the volume of such transactions continued to increase. These increases were largely offset by a decrease in insurance commissions of 18% brought about by a change in our estimate of collection timing which resulted in a non-recurring gain in the first quarter of 2010. In addition, service charges on deposits declined 11% as a result of the impact of recently enacted legislation on overdraft fees. Non-interest expenses increased 4% for the first nine months of 2011 compared to the first nine months of 2010 due largely to a 7% increase in salaries and benefits expenses. Other noninterest expenses increased 12% due primarily to losses on sales of other real estate owned and loan work out expenses.

Non-performing assets decreased to \$90.8 million at September 30, 2011 compared to \$97.7 million at December 31, 2010. Non-performing assets represented 2.50% of total assets at September 30, 2011 compared to 2.78% at December 31, 2010. The ratio of annualized net charge-offs to average loans and leases was .72% during the first nine months of 2011, compared to 1.24% for the first nine months of 2010.

#### Critical Accounting Policies

The Company's condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles ("GAAP") in the United States of America and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements may reflect different estimates, assumptions, and judgments. Certain policies inherently rely to a greater extent on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary for assets and liabilities that are required to be recorded at fair value. A decline in the assets required to be recorded at fair value will warrant an impairment write-down or valuation allowance to be established. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when readily available. The following accounting policies comprise those policies that management believes are the most critical to aid in fully understanding and evaluating our reported financial results:

- Allowance for loan and lease losses;
- Goodwill impairment;
- Accounting for income taxes;
- Fair value measurements, including assessment of other than temporary impairment;
- Defined benefit pension plan.

#### Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of the losses that are inherent in the loan and lease portfolio at the balance sheet date. The allowance is based on two basic principles of accounting: (1) the requirement that a loss

be accrued when it is probable that the loss has occurred at the date of the financial statements and the amount of the loss can be reasonably estimated and (2) the requirement that losses, if any, be accrued when it is probable that the Company will not collect all principal and interest payments according to the loan's or lease's contractual terms.

Management believes that the allowance is adequate. However, its determination requires significant judgment, and estimates of probable losses in the loan and lease portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions or reductions to the allowance may be necessary based on changes in the loans and leases comprising the portfolio and changes in the financial condition of borrowers, such as may result from changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Company, periodically review the loan and lease portfolio and the allowance. Such review may result in additional provisions based on their judgments of information available at the time of each examination.

The Company's allowance for loan and lease losses has two basic components: a general reserve reflecting historical losses by loan category, as adjusted by several factors whose effects are not reflected in historical loss ratios, and specific allowances for individually identified loans. Each of these components, and the allowance methodology used to establish them, are described in detail in Note 1 and Note 5 of the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The amount of the allowance is reviewed monthly by the Credit Risk Committee of the board of directors and formally approved quarterly by that same committee of the board.

General reserves are based upon historical loss experience by portfolio segment measured, over the prior eight quarters, weighted so that losses realized in the most recent quarters have the greatest effect. The historical loss experience is supplemented to address various risk characteristics of the Company's loan portfolio including:

- trends in delinquencies and other non-performing loans;
- changes in the risk profile related to large loans in the portfolio;
- changes in the categories of loans comprising the loan portfolio;
- concentrations of loans to specific industry segments;
- changes in economic conditions on both a local and national level;
- changes in the Company's credit administration and loan portfolio management processes; and
- quality of the Company's credit risk identification processes.

The general reserve comprised 90% of the total allowance at September 30, 2011 and 94% at December 31, 2010. The general reserve is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Reserves on loans considered to be "criticized" and "classified" under regulatory guidance are calculated separately from loans considered to be "pass" rated under the same guidance. This segregation allows the Company to monitor the reserves applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and ensure the sufficiency of reserves.

The portion of the reserve representing specific allowances is derived by accumulating the specific allowances established on individually impaired loans that have significant conditions or circumstances that indicate that a loss may be probable. Specific reserves are calculated on individually impaired loans and established based on the Company's calculation of the probable losses inherent in an individual loan. For loans on which the Company has not elected to use the collateral value as a basis to establish the measure of impairment, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. In determining the cash flows to be included in the discount calculation the Company considers a number of factors:

- the borrower's overall financial condition;
- resources and payment record;
- support available from financial guarantors; and
- the adequacy of collateral value and the ultimate realization of that value at liquidation.

These factors combine to estimate the probability and severity of potential losses. At September 30, 2011, the specific allowance accounted for 10% of the total allowance as compared to 6% at December 31, 2010. The severity of estimated losses on impaired loans can differ substantially from actual losses.

#### Goodwill Impairment

Goodwill represents the excess purchase price over the fair value of tangible and identifiable intangible assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Company's reporting units be compared to the carrying amount of its net assets, including goodwill. The Company's reporting units were identified based upon an analysis of each of its individual operating segments. Determining the fair value of a reporting unit requires the Company to use a high degree of subjectivity. If the fair values of the reporting units exceed their book values, no write-down of recorded goodwill is necessary. If the fair value of a reporting unit is less than book value, an expense may be required to write down the related goodwill to the proper carrying value. The Company tests for impairment of goodwill as of October 1 of each year, and again at any quarter-end if any triggering events occur during a quarter that may affect goodwill. Examples of such events include, but are not limited to adverse action by a regulator or a loss of key personnel. The Company engages a third-party valuation firm to determine the fair value of the reporting units to utilize in the "step one" test for potential goodwill impairment. At September 30, 2011 there was no evidence of impairment of goodwill or intangibles.

In September 2011, the FASB issued amended guidance that provides the Company with the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it is determined that the carrying value exceeds the fair value, then the first step, described above, of the two step process must be performed. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company will apply this guidance in performing its annual impairment testing as of October 1, 2011.

### Accounting for Income Taxes

The Company accounts for income taxes by recording deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods. The Company's accounting policy follows the prescribed authoritative guidance that a minimal probability threshold of a tax position must be met before a financial statement benefit is recognized. The Company recognized, when applicable, interest and penalties related to unrecognized tax benefits in other non-interest expenses in the Condensed Consolidated Statements of Income. Assessment of uncertain tax positions requires careful consideration of the technical merits of a position based on management's analysis of tax regulations and interpretations. Significant judgment may be involved in applying the applicable reporting and accounting requirements.

Management expects that the Company's adherence to the required accounting guidance may result in increased volatility in quarterly and annual effective income tax rates because of the requirement that any change in judgment or measurement of a tax position taken in a prior period be recognized as a discrete event in the period in which it occurs. Factors that could impact management's judgment include changes in income, tax laws and regulations, and tax planning strategies.

### Fair Value Measurements

The Company, in accordance with applicable accounting standards, measures certain financial assets and liabilities at fair value. Significant financial instruments measured at fair value on a recurring basis are investment securities available-for-sale, residential mortgages held for sale and commercial loan interest rate swap agreements. Loans with respect to which it is probable that the Company will not collect all principal and interest payments according to the contractual terms are considered impaired loans and are measured on a nonrecurring basis.

The Company conducts a review each quarter for all investment securities that reflect possible impairment to determine whether unrealized losses are other-than-temporary. Valuations for the investment portfolio are determined using quoted market prices, where available. If quoted market prices are not available, such valuation is based on pricing models, quotes for similar investment securities, and, where necessary, an income valuation approach based on the present value of expected cash flows. In addition, the Company considers the financial condition of the issuer, the receipt of principal and interest according to the contractual terms and the intent and ability of the Company to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

The above accounting policies with respect to fair value are discussed in further detail in "Note 13-Fair Value" to the Condensed Consolidated Financial Statements.

### Defined Benefit Pension Plan

The Company has a qualified, noncontributory, defined benefit pension plan covering substantially all employees. The plan was frozen for new and existing entrants after December 31, 2007 and all benefit accruals for employees were frozen as of December 31, 2007 based on past service. Future salary increases and additional years of service will no longer affect the defined benefit provided by the plan although additional vesting may continue to occur.

Several factors affect the net periodic benefit cost of the plan, including (1) the size and characteristics of the plan population, (2) the discount rate, (3) the expected long-term rate of return on plan assets and (4) other actuarial



assumptions. Pension cost is directly related to the number of employees covered by the plan and other factors including salary, age, years of employment, and the terms of the plan. As a result of the plan freeze, the characteristics of the plan population should not have a materially different effect in future years. The discount rate is used to determine the present value of future benefit obligations. The discount rate is determined by matching the expected cash flows of the plan to a yield curve based on long term, high quality fixed income debt instruments available as of the measurement date, which is December 31 of each year. The discount rate is adjusted each year on the measurement date to reflect current market conditions. The expected long-term rate of return on plan assets is based on a number of factors that include expectations of market performance and the target asset allocation adopted in the plan investment policy. Should actual asset returns deviate from the projected returns, this can affect the benefit plan expense recognized in the financial statements.

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

(Dollars in thousands and tax-equivalent)	Nine Months Ended September 30,						Annualized Average	Annualized Average
	2011			2010				
	Average Balances	(1) Interest	Annualized Average Yield/Rate	Average Balances	(1) Interest	Annualized Average Yield/Rate		
<b>Assets</b>								
Residential mortgage loans (3)	\$455,909	\$16,747	4.89 %	\$465,393	\$18,989	5.44 %		
Residential construction loans	86,399	2,448	3.79	87,616	3,044	4.65		
Commercial ADC loans	148,215	4,813	4.34	157,253	4,587	3.90		
Commercial investor real estate loans	347,926	15,236	5.94	337,127	15,241	6.04		
Commercial owner occupied real estate loans	508,478	22,686	6.05	515,119	23,288	6.04		
Commercial business loans	229,168	8,493	4.95	272,435	10,249	5.03		
Leasing	11,460	576	6.70	22,071	1,185	7.16		
Consumer loans	363,388	9,986	3.70	395,835	11,480	3.90		
Total loans and leases (2)	2,150,943	80,985	5.03	2,252,849	88,063	5.22		
Taxable securities	879,230	17,810	2.70	855,243	19,227	3.02		
Tax-exempt securities (4)	236,113	10,058	5.68	159,281	8,269	6.92		
Interest-bearing deposits with banks	32,257	62	0.25	83,351	158	0.25		
Federal funds sold	1,408	1	0.14	1,814	2	0.17		
Total interest-earning assets	3,299,951	108,916	4.41	3,352,538	115,719	4.61		
Less: allowance for loan and lease losses	(58,672 )			(70,145 )				
Cash and due from banks	45,587			44,633				
Premises and equipment, net	49,130			48,876				
Other assets	223,506			243,100				
Total assets	\$3,559,502			\$3,619,002				
<b>Liabilities and Stockholders' Equity</b>								
Interest-bearing demand deposits	\$336,020	278	0.11 %	\$288,637	256	0.12 %		
Regular savings deposits	182,424	142	0.10	163,687	128	0.10		
Money market savings deposits	855,458	2,865	0.45	892,838	4,006	0.60		
Time deposits	618,250	5,388	1.17	727,980	9,351	1.72		
Total interest-bearing deposits	1,992,152	8,673	0.58	2,073,142	13,741	0.89		
Other borrowings	77,135	155	0.27	87,881	198	0.30		
Advances from FHLB	405,621	10,769	3.55	410,523	10,949	3.57		
Subordinated debentures	35,000	671	2.55	35,000	693	2.64		
Total interest-bearing liabilities	2,509,908	20,268	1.08	2,606,546	25,581	1.31		
Noninterest-bearing demand deposits	607,087			546,961				

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

Other liabilities	25,714			26,006		
Stockholders' equity	416,793			439,489		
Total liabilities and stockholders' equity	\$3,559,502			\$3,619,002		
Net interest income and spread	\$88,648	3.33	%	\$90,138	3.30	%
Less: tax-equivalent adjustment	4,154			3,484		
Net interest income	\$84,494			\$86,654		
Interest income/earning assets		4.41	%		4.61	%
Interest expense/earning assets		0.82			1.02	
Net interest margin		3.59	%		3.59	%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2011 and 2010. The annualized taxable-equivalent adjustments utilized in the above table to compute yields aggregated to \$4.2 million and \$3.5 million in 2011 and 2010, respectively.

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

(3) Includes residential mortgage loans held for sale. Home equity loans and lines are classified as consumer loans.

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

## Results of Operations

For the Nine Months Ended September 30, 2011 Compared to the Nine Months Ended September 30, 2010

Net income for the Company for the first nine months of 2011 totaled \$26.8 million (\$1.11 per diluted share) compared to net income of \$15.2 million (\$0.70 per diluted share) for the first nine months of 2010.

## 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 on the preceding table.

Net interest income for the first nine months of 2011 was \$84.5 million compared to \$86.7 million for the same period of 2010. On a tax-equivalent basis, net interest income decreased by 2% in the first nine months of 2011 to \$88.6 million from \$90.1 million in the first nine months of 2010. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that remained level at 3.59% for both the nine months ended September 30, 2011 and 2010. Average interest-earning assets decreased by 2% while average interest-bearing liabilities decreased 4% from the first nine months of 2010 compared to the first nine months of 2011. Average noninterest-bearing deposits increased 11% in the first nine months of 2011 while the percentage of average noninterest-bearing deposits to total deposits also increased to 23% in the first nine months of 2011 compared to 21% in the first nine months of 2010.

## Effect of Volume and Rate Changes on Net Interest Income

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

	Nine Months Ended September 30,					
	2011 vs. 2010			2010 vs. 2009		
	Increase Or (Decrease)	Due to Change In Average:*		Increase Or (Decrease)	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)		Volume	Rate		Volume	Rate
<b>Interest income from earning assets:</b>						
Loans and leases	\$(7,078 )	\$(3,931 )	\$(3,147 )	\$(9,170 )	\$(7,598 )	\$(1,572 )
Securities	372	2,693	(2,321 )	4,800	7,165	(2,365 )
Other earning assets	(97 )	(98 )	1	45	48	(3 )
<b>Total interest income</b>	<b>(6,803 )</b>	<b>(1,336 )</b>	<b>(5,467 )</b>	<b>(4,325 )</b>	<b>(385 )</b>	<b>(3,940 )</b>
<b>Interest expense on funding of earning assets:</b>						
<b>Interest-bearing demand deposits</b>	<b>22</b>	<b>48</b>	<b>(26 )</b>	<b>(70 )</b>	<b>40</b>	<b>(110 )</b>
<b>Regular savings deposits</b>	<b>14</b>	<b>10</b>	<b>4</b>	<b>(49 )</b>	<b>14</b>	<b>(63 )</b>
<b>Money market savings deposits</b>	<b>(1,141 )</b>	<b>(161 )</b>	<b>(980 )</b>	<b>(4,684 )</b>	<b>824</b>	<b>(5,508 )</b>
<b>Time deposits</b>	<b>(3,963 )</b>	<b>(1,262 )</b>	<b>(2,701 )</b>	<b>(9,574 )</b>	<b>(2,171 )</b>	<b>(7,403 )</b>

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

Total borrowings	(245 )	(341 )	96	(748 )	(9 )	(739 )
Total interest expense	(5,313 )	(1,706 )	(3,607 )	(15,125 )	(1,302 )	(13,823 )
Net interest income	\$(1,490 )	\$370	\$(1,860 )	\$10,800	\$917	\$9,883

\*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 decreased by \$6.8 million or 6% in the first nine months of 2011 compared to the first nine months of 2010. The previous table shows that, in 2011, the decrease in interest income resulted primarily from declines in both the earning asset yields and average interest-earning assets, particularly average loans and leases.

For the first nine months of 2011, the yield on average loans and leases decreased by 19 basis points due to the continued prevailing low interest rate environment as relatively higher rate loans were paid off and new loans were originated at comparatively lower rates. In addition, the average balance of the loan portfolio declined 5% for the first nine months of 2011 compared to the prior year period as the volume of quality loan demand remained low due to the struggling economy. The decline in the portfolio yield was driven primarily by decreases in the yields on the consumer and residential mortgage loan portfolios. These decreases were somewhat offset by an increase of 44 basis points in commercial ADC loans due mainly to loans placed on non-accrual status during the first quarter of 2010. The decrease in the average balance of the loan portfolio was driven by declines in several segments of the portfolio, particularly commercial business loans, due to soft market demand, and consumer loans, due to pay downs of second mortgage equity lines of credit.

The average yield on investment securities decreased 30 basis points while the average balance of the portfolio increased 10% or \$101 million for the nine months ended September 30, 2011 compared to the prior year period. The growth in investments was due to liquidity provided primarily by the decline in loan balances mentioned above. The decrease in the yield on investments was due to the fact that a significant portion of the portfolio is invested in amortizing securities which were replaced by lower yielding investments as a result of lower overall market rates.

#### Interest Expense

Interest expense decreased by \$5.3 million or 21% in the first nine months of 2011 compared to the year ago period, primarily as a result of a 23 basis point decrease in the average rate paid on deposits and borrowings, which decreased to 1.08% from 1.31%. Deposit activity during the first nine months of 2011 continued to be affected by a somewhat stalled economy due to a depressed real estate market, equity market volatility and a lack of confidence on the part of consumers and small and medium-sized businesses. Average deposits decreased due largely to a decline of \$110 million or 15% in average certificates of deposit. In addition, average balances of money market accounts experienced a decrease of \$37 million or 4%. These decreases were somewhat offset by an increase of \$108 million or 13% in noninterest-bearing and interest-bearing checking accounts as clients redeployed funds into short-term instruments to preserve liquidity. During the first nine months of 2011, the Company continued to preserve its net interest margin in the face of reduced loan volumes as it reduced rates on higher cost certificates of deposit thus prompting growth in noninterest-bearing checking accounts. Much of this decrease, particularly in time deposits, was incurred with single product clients, and thus did not significantly affect clients with multiple product relationships.

#### 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,			
	2011	2010	2011/2010 \$ Change	2011/2010 % Change
Securities gains	\$283	323	\$(40)	(12.4)%
Total other-than-temporary impairment ("OTTI") losses	(178)	(1,168)	990	(84.8)
Portion of OTTI losses recognized in other comprehensive income before taxes	18	699	(681)	(97.4)
Net OTTI recognized in earnings	(160)	(469)	309	(65.9)
Service charges on deposit accounts	7,133	7,984	(851)	(10.7)
Mortgage banking activities	2,404	2,750	(346)	(12.6)
Fees on sales of investment products	2,768	2,464	304	12.3
Trust and investment management fees	8,837	7,488	1,349	18.0
Insurance agency commissions	3,177	3,895	(718)	(18.4)
Income from bank owned life insurance	1,962	2,105	(143)	(6.8)
Visa check fees	2,710	2,438	272	11.2
Other income	3,016	3,082	(66)	(2.1)
<b>Total non-interest income</b>	<b>\$32,130</b>	<b>\$32,060</b>	<b>\$70</b>	<b>0.2</b>

Total non-interest income was \$32.1 million for the first nine months of 2011, remaining virtually level compared to the first nine months of 2010. As shown in the table above, deposit service charges decreased as a result of the impact of recently enacted legislation on overdraft fees. Insurance agency commission revenue decreased due mainly to a change in the timing of the recognition of renewal premiums that was implemented in the first quarter of 2010 while mortgage banking activities also decreased due to a lower volume of refinancing activity compared to the prior year period. Offsetting the above decreases, wealth management revenues, comprised of trust and investment management fees and fees on sales of investment products, increased \$1.7 million or 17% due largely to growth in assets under management resulting from new client additions. In addition, Visa check fees increased due to growth in the volume

of electronic transactions.

34

---

## Non-interest Expense

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

(Dollars in thousands)	Nine Months Ended September 30,			
	2011	2010	2011/2010 \$ Change	2011/2010 % Change
Salaries and employee benefits	\$44,192	\$41,393	\$2,799	6.8 %
Occupancy expense of premises	8,717	8,625	92	1.1
Equipment expenses	3,413	3,655	(242)	(6.6)
Marketing	1,662	1,678	(16)	(1.0)
Outside data services	3,067	3,007	60	2.0
FDIC insurance	2,489	3,383	(894)	(26.4)
Amortization of intangible assets	1,384	1,487	(103)	(6.9)
Professional fees	3,528	3,744	(216)	(5.8)
Other real estate owned expenses	1,808	533	1,275	-
Other expenses	7,488	7,206	282	3.9
Total non-interest expense	\$77,748	\$74,711	\$3,037	4.1

Non-interest expenses totaled \$77.7 million in the first nine months of 2011 compared to \$74.7 million in the prior year period, an increase of \$3.0 million or 4%. This growth in expenses was due primarily to an increase in salaries and benefits expenses resulting from higher salary and incentive compensation expenses. This increase was primarily the result of specific targeted staff additions, merit increases and higher incentive compensation as a result of earnings growth from the prior year. Other real estate owned expenses increased due to losses on sales of other real estate owned and loan work out expenses. These increases were partially offset by a reduction in FDIC expenses due primarily to a regulatory change in the calculation of such premiums which was effective with the second quarter of 2011.

## Income Taxes

The Company had income tax expense of \$12.9 million in the first nine months of 2011, compared to expense of \$5.2 million in the first nine months of 2010. This increase was due primarily to higher income before taxes in 2011 that was taxed at the full statutory rate together with an income tax benefit on a loss before income taxes in the first quarter of 2010. The Company's effective tax rate was 32% for the first nine months of 2011 compared to 25% for the first nine months of 2010.

## Results of Operations

For the Quarter Ended September 30, 2011 Compared to the Quarter Ended September 30, 2010

Net income for the third quarter of 2011 totaled \$11.3 million (\$0.47 per diluted share) compared to net income of \$8.5 million (\$0.35 per diluted share) for the third quarter of 2010.

## Net Interest Income

Net interest income for the third quarter of 2011 was \$28.3 million compared to \$29.5 million for the third quarter of 2010. On a tax-equivalent basis, net interest income decreased by 3% in the third quarter of 2011 compared to the third quarter of 2010. The net interest margin was 3.53% for the third quarter of 2011 compared with 3.64% for the third quarter of 2010, a decrease of 11 basis points. The yield on interest-earning assets for the quarter decreased 25 basis points compared to the prior year quarter while the rates paid on interest-bearing liabilities decreased 16 basis points for the third quarter of 2011 compared to the third quarter of 2010. The decrease in the yield on interest-earning assets was due primarily to a decline of \$72 million in the average balance of the higher-earning loan portfolio in the third quarter of 2011 compared to the third quarter of 2010 while the average balance of the



lower-yielding investment portfolio increased by \$111 million. The yield on the Company's loan portfolio decreased in the third quarter of 2011 compared to 2010 due to declines in the yields on virtually all segments of the portfolio. These trends reflect the overall effect of a basically stalled economy as quality loan demand remained soft and higher rate loans were paid down. The yield on the investment portfolio decreased by 26 basis points in the third quarter of 2011 compared to the prior year quarter as amortizing or called securities were replaced at lower prevailing rates. The decrease in the rates paid on interest-bearing liabilities was driven by a decline in the rates paid on certificates of deposit which produced an 11% decrease in such balances as the Company managed its net interest margin.

### Interest Income

The Company's total tax-equivalent interest income decreased by \$2.3 million or 6% in the third quarter of 2011 compared to the third quarter of 2010. The decrease in interest income resulted primarily from declines in both earning asset yields and average interest-earning assets, primarily loans and leases.

For the third quarter of 2011, average loans and leases decreased 3% with a yield of 4.98% versus 5.23% for the third quarter of 2010. The average residential real estate portfolio decreased 2% due mainly to a decrease in residential mortgage loans while the average commercial loan portfolio decreased 4% due largely to decreases of 11% in commercial business loans and 6% commercial ADC loans, which were somewhat offset by growth of 5% in commercial investor real estate loans. The average consumer loan portfolio decreased 8% due to declines of 29% in installment loans and 42% in conventional second mortgage loans. The decline in conventional second mortgage loans was due largely to a reclassification of \$11 million of such loans to the residential permanent mortgage portfolio early in 2011. The decreases in virtually every segment of the loan portfolio reflect the lingering effects of an uneven economic recovery. The increase in commercial investor real estate loans during the quarter was due largely to advances on existing loan commitments and several new loan credits during the first quarter of 2011. In the quarter ended September 30, 2011, average loans and leases comprised 64% of average interest-earning assets compared to a ratio of 66% for the quarter ended September 30, 2010. Average total investment securities, yielding 3.24% in the third quarter of 2011 versus 3.50% in third quarter of the prior year, increased 10% to \$1.2 billion. Average total investment securities comprised 35% of average interest-earning assets in 2011 compared to 31% in 2010.

### Interest Expense

Interest expense decreased by 15% or \$1.2 million in the third quarter of 2011 compared to the third quarter of 2010, primarily as a result of a 16 basis point decrease in the average rate paid on deposits and borrowings, which decreased to 1.05% from 1.21%. Deposit and borrowing activity during the third quarter of 2011 continued to be driven by challenging market conditions as clients relied on short-term instruments to preserve liquidity and safety until interest rates begin to rise. During the third quarter of 2011, the Company continued to manage its net interest margin in the face of reduced loan volumes by a strategic decline in deposits by adjusting rates, primarily on certificates of deposit and money market accounts. Much of the decreases in both of these deposit categories was due to the attrition of single product clients, and thus did not significantly affect clients with multiple product relationships. The above decreases were somewhat offset by an 11% increase in average noninterest-bearing deposits.

### Non-interest Income

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

(Dollars in thousands)	Three Months Ended September 30,			
	2011	2010	2011/2010 \$ Change	2011/2010 % Change
Securities gains	\$231	\$25	\$206	-
Total other-than-temporary impairment ("OTTI") losses	(76 )	(334 )	258	(77.2 )
Portion of OTTI losses recognized in other comprehensive income before taxes	-	(46 )	46	-
Net OTTI recognized in earnings	(76 )	(380 )	304	(80.0 )
Service charges on deposit accounts	2,444	2,567	(123 )	(4.8 )
Mortgage banking activities	1,141	1,516	(375 )	(24.7 )
Fees on sales of investment products	905	782	123	15.7
Trust and investment management fees	3,032	2,505	527	21.0
Insurance agency commissions	1,044	978	66	6.7
Income from bank owned life insurance	662	709	(47 )	(6.6 )

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

Visa check fees	927	843	84	10.0
Other income	1,026	994	32	3.2
Total non-interest income	\$11,336	\$10,539	\$797	7.6

Total non-interest income was \$11.3 million for the third quarter of 2011 compared to \$10.5 million for the third quarter of 2010. This increase was primarily driven by increases in trust and investment management fees and fees on sales of investment products which together increased 20% due primarily to growth in assets under management as a result of new client additions. This increase was somewhat offset by a decrease in deposit service charges as a result of the impact of recently enacted legislation on overdraft fees. Income from mortgage banking activities decreased due to a lower volume of refinancing activity. All other segments of noninterest income remained essentially level with the prior year quarter as can be seen from the above table.

## Non-interest Expense

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

(Dollars in thousands)	Three Months Ended September 30,			
	2011	2010	2011/2010 \$ Change	2011/2010 % Change
Salaries and employee benefits	\$ 14,892	\$ 13,841	\$ 1,051	7.6 %
Occupancy expense of premises	2,784	2,826	(42 )	(1.5 )
Equipment expenses	1,143	1,137	6	0.5
Marketing	468	589	(121 )	(20.5 )
Outside data services	1,073	966	107	11.1
FDIC insurance	709	1,056	(347 )	(32.9 )
Amortization of intangible assets	461	495	(34 )	(6.9 )
Professional fees	1,314	1,337	(23 )	(1.7 )
Other real estate owned expenses	383	236	147	62.3
Other expenses	2,621	2,657	(36 )	(1.4 )
<b>Total non-interest expense</b>	<b>\$ 25,848</b>	<b>\$ 25,140</b>	<b>\$ 708</b>	<b>2.8</b>

Non-interest expenses totaled \$25.8 million in the third quarter of 2011 compared to \$25.1 million in the third quarter of 2010, an increase of \$0.7 million or 3%. This growth in expenses was due primarily to an increase in salaries and benefits expenses resulting from higher salary and incentive compensation expenses. This increase was primarily the result of specific targeted staff additions, merit increases and higher incentive compensation as a result of earnings growth from the prior year. Other real estate owned expense increased due largely to losses on sales of other real estate owned and loan work out expenses. These increases were partially offset by a reduction in FDIC expenses due to a regulatory change in the calculation of such premiums.

## Income Taxes

The Company had income tax expense of \$6.1 million in the third quarter of 2011, compared with an income tax expense of \$4.0 million in the third quarter of 2010. The Company's effective tax rate was 35% for the third quarter of 2011 compared to an effective rate of 32% for the third quarter of 2010. The increase in the effective tax rate in the third quarter of 2011 was due to a higher level of income before taxes that was taxed at a full statutory rate.

## 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 Measure

The Company has for many years used 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 Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. Both efficiency ratios increased in 2011 as a result of increasing non-interest expenses and a decline in net interest income, which increased in 2011 compared to 2010 while net interest income declined.

## GAAP and Non-GAAP Efficiency Ratios

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>GAAP efficiency ratio:</b>				
Non-interest expenses	\$ 25,848	\$ 25,140	\$ 77,748	\$ 74,711
Net interest income plus non-interest income	\$ 39,666	\$ 40,038	\$ 116,624	\$ 118,714
<b>Efficiency ratio—GAAP</b>	<b>65.16 %</b>	<b>62.79 %</b>	<b>66.67 %</b>	<b>62.93 %</b>
<b>Non-GAAP efficiency ratio:</b>				
Non-interest expenses	\$ 25,848	\$ 25,140	\$ 77,748	\$ 74,711
<b>Less non-GAAP adjustment:</b>				
Amortization of intangible assets	461	495	1,384	1,487
Non-interest expenses as adjusted	\$ 25,387	\$ 24,645	\$ 76,364	\$ 73,224
Net interest income plus non-interest income	\$ 39,666	\$ 40,038	\$ 116,624	\$ 118,714
<b>Plus non-GAAP adjustment:</b>				
Tax-equivalent income	1,420	1,321	4,154	3,484
<b>Less non-GAAP adjustments:</b>				
Securities gains	231	25	283	323
OTTI recognized in earnings	(76 )	(380 )	(160 )	(469 )
Net interest income plus non-interest income - as adjusted	\$ 40,931	\$ 41,714	\$ 120,655	\$ 122,344
<b>Efficiency ratio—Non-GAAP</b>	<b>62.02 %</b>	<b>59.08 %</b>	<b>63.29 %</b>	<b>59.85 %</b>

## FINANCIAL CONDITION

The Company's total assets were \$3.6 billion at September 30, 2011, increasing \$106.7 million or 3% during the first nine months of 2011. Interest-earning assets increased \$130.0 million to \$3.4 billion at September 30, 2011 compared to December 31, 2010. Asset growth, which is primarily due to growth in the investment portfolio, was funded by increases in customer deposits.

## Loans and Leases

Total loans and leases, excluding loans held for sale, remained virtually level during the first nine months of 2011. The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans reflected a slight increase to \$531.3 million at September 30, 2011 from \$527.8 million at December 31, 2010. Permanent residential mortgages, most of which are 1-4 family, increased \$4.1 million to \$440.6 million due to higher loan origination volumes. The Company generally retains adjustable rate mortgages in its portfolio and sells the fixed rate mortgages that it originates in the secondary mortgage market. Residential construction loans decreased \$0.5 million to \$90.7 million during the first nine months of 2011.

The commercial loan portfolio increased by \$5.8 million to \$1.3 billion at September 30, 2011. Soft loan demand resulting from weak market conditions in both the national and regional economies have continued to play a role in limiting growth in commercial loan balances as pay-offs of performing credits have outpaced new originations. Activity in the commercial loan portfolio reflects the current slow but uneven recovery in the regional economy in which the Company operates. The small overall increase in commercial loans for the nine months was due primarily to an increase of \$29.6 million or 9% in commercial investor real estate loans while commercial owner occupied real

estate loans reflected a more limited increase of \$16.6 million or 3% for the period. Somewhat offsetting these increases, commercial business loans decreased \$23.7 million or 9% for the nine months. Commercial ADC loans decreased \$9.5 million or 6% for the nine months compared to December 31, 2010.

The consumer loan portfolio decreased 5% or \$20.2 million, to \$360.3 million at September 30, 2011. This decline was driven largely by a decrease of \$19.1 million or 37% in conventional second mortgage loans during the nine months resulting in a balance of \$32.4 million at September 30, 2011 due to weak consumer demand and the reclassification of \$11 million of loans to the residential mortgage portfolio in early 2011.

## Analysis of Loans and Leases

The following table presents the trends in the composition of the loan and lease portfolio at the dates indicated:

(In thousands)	September 30, 2011		December 31, 2010		Period-to-Period Change	
	Amount	%	Amount	%	\$ Change	% Change
<b>Residential real estate:</b>						
Residential mortgage	\$440,606	20.5	% \$436,534	20.3	% \$4,072	0.9
Residential construction	90,727	4.2	91,273	4.2	(546 )	(0.6 )
<b>Commercial real estate:</b>						
<b>Commercial owner occupied</b>						
real estate	519,837	24.2	503,286	23.4	16,551	3.3
Commercial investor real estate	357,358	16.7	327,782	15.2	29,576	9.0
Commercial acquisition, development and construction	141,576	6.6	151,061	7.0	(9,485 )	(6.3 )
Commercial Business	226,528	10.6	250,255	11.6	(23,727 )	(9.5 )
Leases	8,484	0.4	15,551	0.7	(7,067 )	(45.4 )
Consumer	360,287	16.8	380,490	17.6	(20,203 )	(5.3 )
<b>Total loans and leases</b>	<b>\$2,145,403</b>	<b>100.0</b>	<b>% \$2,156,232</b>	<b>100.0</b>	<b>% \$(10,829 )</b>	<b>(0.5 )</b>

## Investment Securities

The investment portfolio, consisting of available-for-sale, held-to-maturity and other equity securities, showed an increase of 13% or \$131.2 million to \$1.2 billion at September 30, 2011, from \$1.0 billion at December 31, 2010.

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 has remained virtually the same at an average of 3.2 years at both September 30, 2011 and December 31, 2010. The Company considers the duration of the portfolio to be reasonable for liquidity purposes. This investment strategy has resulted in a portfolio with minimal risk and thus will provide needed liquidity should loan demand increase in the coming year. 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 due diligence of economic projections and analysis.

At September 30, 2011, the trust preferred portfolio included one \$3.0 million security backed by a single financial institution issuer. The fair value of this security was \$3.3 million as determined using broker quotations. The Company also owns one pooled trust preferred security backed by debt issued by banks and thrifts, which totals \$2.9 million, with a fair value of \$2.4 million. The fair value of this security was determined by a third party valuation specialist due to the limited trading activity for this security in the marketplace. The specialist used an income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The methodology, observable inputs and significant assumptions employed by the specialist to determine fair value are provided in Note 2 – Investment Securities in the Notes to the Condensed Consolidated Financial Statements.

As a result of this valuation, it was determined that the pooled trust preferred security did incur credit-related OTTI of \$76 thousand which was recognized in earnings for the quarter ended September 30, 2011. For the nine months ended September 30, 2011, credit-related other-than-temporary impairment (“OTTI”) incurred on this security amounted to \$160 thousand. Cumulative credit-related OTTI of \$422 thousand has been recognized in earnings through September 30, 2011. Non-credit related OTTI on this security, which is not expected to be sold and that the Company has the ability to hold until maturity, was \$0.6 million at September 30, 2011. This non-credit related OTTI was recognized



in other comprehensive income (“OCI”) at September 30, 2011.

39

---

## Investment Securities

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

(In thousands)	September 30, 2011		December 31, 2010		Period-to-Period Change	
	Amount	%	Amount	%	\$ Change	% change
<b>Available-for-Sale:</b>						
U.S. government agencies and corporations	\$ 209,565	17.8 %	\$ 306,705	29.4 %	\$ (97,140 )	(31.7 )%
State and municipal	166,639	14.2	107,537	10.3	59,102	55.0
Mortgage-backed	570,082	48.6	486,961	46.7	83,121	17.1
Trust preferred	5,688	0.5	5,980	0.6	(292 )	(4.9 )
Marketable equity securities	100	-	100	-	-	-
Total available-for-sale	952,074	81.1	907,283	87.0	44,791	4.9
<b>Held-to-Maturity and Other Equity</b>						
U.S. government agencies and corporations	74,998	6.4	-	-	74,998	-
State and municipal	114,094	9.7	101,091	9.7	13,003	12.9
Mortgage-backed	428	-	499	-	(71 )	(14.2 )
Other equity securities	32,586	2.8	34,070	3.3	(1,484 )	(4.4 )
Total held-to-maturity and other equity	222,106	18.9	135,660	13.0	86,446	63.7
Total securities	\$ 1,174,180	100.0 %	\$ 1,042,943	100.0 %	\$ 131,237	12.6

## Other Earning Assets

Residential mortgage loans held for sale increased \$0.4 million to \$23.1 million as of September 30, 2011 from \$22.7 million as of December 31, 2010. The aggregate of federal funds sold and interest-bearing deposits with banks increased \$9.3 million to \$27.7 million in the first nine months of 2011.

## Deposits

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

(In thousands)	September 30, 2011		December 31, 2010		Period-to-Period Change	
	Amount	%	Amount	%	\$ Change	% change
Noninterest-bearing deposits	\$ 643,169	24.4 %	\$ 566,812	22.2 %	\$ 76,357	13.5 %
<b>Interest-bearing deposits:</b>						
Demand	344,277	13.0	317,905	12.4	26,372	8.3
Money market savings	865,986	32.8	861,420	33.8	4,566	0.5
Regular savings	183,969	7.0	172,771	6.8	11,198	6.5
Time deposits of less than \$100,000	326,497	12.3	351,071	13.8	(24,574 )	(7.0 )
Time deposits of \$100,000 or more	276,426	10.5	279,893	11.0	(3,467 )	(1.2 )
Total interest-bearing deposits	1,997,155	75.6	1,983,060	77.8	14,095	0.7
Total deposits	\$ 2,640,324	100.0 %	\$ 2,549,872	100.0 %	\$ 90,452	3.5

## Deposits and Borrowings

Total deposits were \$2.6 billion at September 30, 2011, increasing \$90.5 million or 4% from \$2.5 billion at December 31, 2010. This growth in deposits was driven primarily by a 12% increase in noninterest-bearing and interest-bearing checking accounts and, to a lesser extent, a 6% increase in regular savings accounts at September 30, 2011 compared to balances at December 31, 2010. Money market accounts remained virtually level compared to the prior year end. The activity in these deposit products can be attributed primarily to clients' emphasis on safety and liquidity considering the current low interest rates and the volatility of alternative investments. Certificates of deposit decreased 4% over the first nine months of the year as the Company managed its net interest margin. Total borrowings decreased \$17.0 million or 3% to \$520.0 million at September 30, 2011 compared to December 31, 2010 due to a decline in retail repurchase agreements.

#### 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. During the first nine months of 2011, total stockholders' equity increased \$33.2 million to \$440.8 million at September 30, 2011, from \$407.6 million at December 31, 2010. This increase was due primarily to net income during the period, together with an increase of \$15.8 million in other comprehensive income resulting from unrealized gains on available for sale investments. These increases were partially offset by the redemption in the first quarter of 2011 for \$4.5 million of the warrant that was issued to the Treasury in connection with the Company's participation in the TARP Capital Purchase Program.

The ratio of average equity to average assets was 11.71% for the first nine months of 2011, as compared to 12.14% for the first nine months of 2010.

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
	September 30,	December 31,	Regulatory
	2011	2010	Requirements
Total Capital to risk-weighted assets	16.21%	15.37%	8.00%
Tier 1 Capital to risk-weighted assets	14.96%	14.11%	4.00%
Tier 1 Leverage	10.79%	10.30%	3.00%

Tier 1 capital of \$380.7 million and total qualifying capital of \$412.7 million each included \$35.0 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, 2011, 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.

#### Tangible Common Equity

Tangible equity and tangible assets are non-GAAP financial measures calculated using GAAP amounts. We calculate tangible equity by excluding the balance of goodwill and other intangible assets from our calculation of stockholders’ equity. We calculate tangible assets by excluding the balance of goodwill and other intangible assets from our calculation of total assets. We believe that this non-GAAP financial measure provides information to investors that may 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 is provided in the following table.

#### Tangible Common Equity Ratio – Non-GAAP

(Dollars in thousands)	September 30, 2011		December 31, 2010	
<b>Tangible common equity ratio:</b>				
Total stockholders' equity	\$	440,791	\$	407,569
Accumulated other comprehensive income (loss)		(13,147 )		2,620
Goodwill		(76,816 )		(76,816 )
Other intangible assets, net		(5,195 )		(6,578 )
Tangible common equity	\$	345,633	\$	326,795
Total assets	\$	3,626,043	\$	3,519,388
Goodwill		(76,816 )		(76,816 )
Other intangible assets, net		(5,195 )		(6,578 )
Tangible assets	\$	3,544,032	\$	3,435,994

Tangible common equity ratio	9.75	%	9.51	%
------------------------------	------	---	------	---

### 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 and lease 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. Declining economic conditions have an adverse affect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

Current economic data has shown that while the Mid-Atlantic region is outperforming most other markets in the nation, the Company is continuing to deal with the lingering impact from the economic pressures that are continuing to be experienced by its borrowers. Although total non-performing loans decreased compared to the balance at December 31, 2010, such balances increased compared to June 30, 2011 due primarily to one commercial real estate credit totaling \$13.6 million which was placed on non-accrual during the third quarter of 2011. Management considers this loan as fully collateralized. Excluding the effect of this one loan, the balance of non-performing loans at September 30, 2011 would have reflected the same improving trend evident in prior quarters. 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 non-performing loan levels may continue to be influenced by the current slow and uncertain economic recovery on both a regional and national level.

To control and manage credit risk, management has a credit process in place to ensure credit standards are maintained along with a robust in-house loan administration accompanied by strong 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 and lease losses (the "allowance") to absorb estimated and probable losses in the loan and lease portfolio. The allowance is based on consistent, continuous review and evaluation of the loan and lease portfolio, along with ongoing, monthly assessments of the probable losses and problem credits in each portfolio.

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

The methodology for assessing the appropriateness of the allowance includes: (1) the general allowance reflects historical losses, as adjusted, by credit category, and (2) the specific allowance for impaired credits on an individual or portfolio basis. This systematic allowance methodology is further described in the section entitled “Critical Accounting Policies” and in “Note 1 – Significant Accounting Policies” of the Notes to the Consolidated Financial Statements of the Company’s 2010 Form 10-K. The amount of the allowance is reviewed and approved quarterly by the Credit 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. However, not all impaired loans are in non-accrual status because they may be current with regard to the payment terms. Their determination as an impaired loan is based on some inherent weakness in the credit that may, if certain circumstances occur or arise, result in an inability to comply with the loan agreement’s contractual terms. Impaired loans exclude large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment such as leases, residential real estate and consumer loans. All payments received on non-accrual loans are applied to the remaining principal balance of the loan(s). Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific reserve on an impaired loan is warranted and, when losses are confirmed, a charge-off is taken that is at least in the amount of the collateral deficiency as determined by an independent third party appraisal. Any further collateral deterioration results in either further specific reserves 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 is usually obtained if the appraisal on file is more than 12 months old. 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 reserve or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific reserve or charge-off between monthly credit committee meetings to insure 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, resources and payment record, the sufficiency of collateral 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 will consider the existence of guarantees and the financial strength and wherewithal of the guarantors involved in any loan relationship and it considers such guarantees only as a secondary source of repayment. Guarantors are evaluated to determine their 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 reserve 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 reserve 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. 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 reserve or partial charge-off, and it is less than the initial appraisal used in the initial charge-off, an additional specific reserve 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 may have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief to a borrower experiencing financial difficulty. All restructured loans 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 the restructured category in the year subsequent to the restructuring if their revised loans terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk.

The Company generally follows a policy of not extending maturities on non-performing loans under existing terms. The Company may extend the maturity of a performing or current loan that may have some inherent weakness associated with the loan. Maturity date extensions only occur under terms that clearly place the Company in a



position to increase 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, but the Company does not extend loans based solely on guarantees. 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. Then a specific amount of impairment is established based on the Company's calculation of the probable loss inherent in the individual loan. The actual occurrence and severity of losses involving impaired credits can differ substantially from estimates.

Management believes that it uses relevant information available to make determinations about whether a loan is impaired in accordance with accounting principles generally accepted in the United States ("US GAAP"). However, the determination of impairment requires significant judgment, and estimates of probable losses in the loan and lease portfolio can vary significantly from the amounts actually observed. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Company, periodically review the loan and lease portfolio. These reviews may result in additional loans being considered impaired based on management's judgments of information available at the time of each examination.

The Company makes provisions for loan and lease losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology discussed above. Provisions amounted to a credit of \$0.9 million in the first nine months of 2011 compared to a provision of \$23.6 million in the prior year period. The provision for the third quarter of 2011 was a credit of \$3.5 million. This reduction in the provision was due primarily to a consistently declining level of historical net charge-offs which is a principal component in the application of the Company's allowance methodology. Net charge-offs totaled \$11.6 million in the first nine months of 2011 compared to \$20.9 million in the first nine months of 2010. This resulted in a ratio of annualized net charge-offs to average loans and leases of 0.72% in the first nine months of 2011 compared to 1.24% for the first nine months of 2010. At September 30, 2011, the allowance for loan and lease losses was \$49.7 million, or 2.32% of total loans and leases, compared to \$67.3 million, or 3.08% of total loans and leases, at September 30, 2010.

Management believes that the allowance is adequate. However, its determination requires significant judgment, and estimates of probable losses in the loan and lease 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 and lease portfolio and the allowance. Such reviews may result in adjustments to the provision based upon their analysis of the information available at the time of each examination.

Substantially all of the fixed-rate conforming residential mortgage loans originated by the Company are sold in the secondary mortgage market. Concurrent with such sales, the Company is required to make customary representations and warranties to the purchasers about the mortgage loans and the manner in which they were originated. The related sale agreements grant the purchasers recourse back to the Company, which could require the Company to repurchase loans or to share in any losses incurred by the purchasers. This recourse exposure typically extends for a period of six to eighteen months after the sale of the loan. 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 \$0.3 million for possible losses due to repurchases. Given its lack of history as to losses of this type, the Company believes that this reserve is adequate.

#### Allowance for Loan and Lease Losses

During the first nine months of 2011, there were no changes in the Company's systematic methodology for assessing the appropriateness of the allowance for loan and lease losses from the prior year period. Variations can occur over time in the methodology's estimation of the adequacy of the allowance as a result of the credit performance of borrowers. There was no unallocated allowance at September 30, 2011 or December 31, 2010, when measured

against the total allowance.

At September 30, 2011, total non-performing loans and leases were \$82.8 million, or 3.86% of total loans and leases, compared to \$88.1 million, or 4.08% of total loans and leases, at December 31, 2010. Timely aggressive recognition and management of problem credits has significantly limited the migration of these loans into non-accrual status during this period. As previously mentioned, the increase in non-performing loans and leases at September 30, 2011 was due primarily to one commercial real estate loan totaling \$13.6 million which was placed on non-accrual status during the third quarter of 2011. Management considers this loan to be adequately collateralized and thus no additional specific reserves were required. Total non-performing loans and leases, excluding this particular loan would have totaled \$69.2 million at September 30, 2011 compared to \$76.5 million at June 30, 2011 reflecting a continued improvement in this credit metrics trend. Also included in non-performing loans were four commercial relationships which included net charge-offs of \$0.1 million and net pay downs of \$7.1 million for the first nine months of 2011. These relationships currently encompass 10 loans in the commercial construction, commercial real estate and commercial business loan categories. None of these loans have had their maturities extended. Credit issues for home builders have been identified, workout strategies have been developed and the Company continues to monitor the performance of the underlying collateral, and to update appraisals, as necessary, given the context of market environment expectations. The allowance represented 60% of non-performing loans and leases at September 30, 2011 and 71% at December 31, 2010. This decrease in the coverage ratio is due primarily to a 6% reduction in non-performing loans and leases noted above as the Company continues to aggressively workout existing problem credits by a combination of charge-offs and pay downs while the migration of new credits to non-performing status has significantly declined. Continued analysis of the actual loss history on the problem credits in 2010 and in the first nine months of 2011 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, lower inflow in criticized loans and the significant decline in early stage delinquencies. The improvement in these credit metrics support management's outlook for continued improved credit quality performance.

The balance of impaired loans was \$69.7 million, with specific reserves of \$5.0 million against those loans at September 30, 2011, as compared to \$69.6 million with reserves of \$3.8 million, at December 31, 2010.

The Company's borrowers are concentrated in six counties in Maryland, three counties in Virginia and in Washington D. C. Commercial and residential mortgages, including home equity loans and lines, represented 77% of total loans and leases at September 30, 2011 and at December 31, 2010. 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. The Company originates option adjustable-rate mortgages infrequently and sells all of them in the secondary market.

## Loan and Lease Loss Experience

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

(Dollars in thousands)	Nine Months Ended September 30, 2011	Year Ended December 31, 2010		
<b>Analysis of Allowance for Loan Losses:</b>				
Balance, January 1	\$ 62,135	\$ 64,559		
Provision (credit) for loan and lease losses	(854 )	25,908		
<b>Charge-offs:</b>				
Commercial business	(2,146 )	(7,144 )		
<b>Commercial real estate:</b>				
Commercial acquisition, development and construction	(840 )	(13,545 )		
Commercial investor real estate	(534 )	(232 )		
Commercial owner occupied real estate	(158 )	(1,692 )		
Leasing	(885 )	(109 )		
Consumer	(2,320 )	(3,493 )		
<b>Residential real estate:</b>				
Residential mortgage	(4,292 )	(5,724 )		
Residential construction	(1,437 )	(677 )		
Total charge-offs	(12,612 )	(32,616 )		
<b>Recoveries:</b>				
Commercial business	190	2,954		
<b>Commercial real estate:</b>				
Commercial acquisition, development and construction	573	1,062		
Commercial investor real estate	4	2		
Commercial owner occupied real estate	-	5		
Leasing	12	6		
Consumer	141	222		
<b>Residential real estate:</b>				
Residential mortgage	127	32		
Residential construction	4	1		
Total recoveries	1,051	4,284		
Net charge-offs	(11,561 )	(28,332 )		
Balance at end of period	\$ 49,720	\$ 62,135		
Allowance for loan losses to loans	2.32	%	2.88	%
Net charge-offs in quarter to average loans	0.72	%	1.27	%

## Analysis of Credit Risk

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

(Dollars in thousands)	September 30, 2011	December 31, 2010		
<b>Non-Performing Assets:</b>				
Loans and leases 90 days past due:				
Commercial business	\$ -	\$ 19		
Commercial real estate:				
Commercial AD&C	-	-		
Commercial investor real estate	-	-		
Commercial owner occupied real estate	-	-		
Leasing	63	407		
Consumer	373	182		
Residential real estate:				
Residential mortgage	2,291	9,871		
Residential construction	-	3,675		
Total loans and leases 90 days past due	2,727	14,154		
Non-accrual loans and leases:				
Commercial business	8,038	7,938		
Commercial real estate:				
Commercial AD&C	24,481	30,417		
Commercial investor real estate	16,118	1,753		
Commercial owner occupied real estate	11,847	11,781		
Leasing	956	1,887		
Consumer	1,478	300		
Residential real estate:				
Residential mortgage	6,081	3,946		
Residential construction	5,034	5,305		
Total non-accrual loans and lease	74,033	63,327		
Total restructured loans - accruing	6,088	10,571		
Total non-performing loans and leases	82,848	88,052		
Other assets and real estate owned (OREO)	7,938	9,493		
Other assets owned	-	200		
Total non-performing assets	\$ 90,786	\$ 97,745		
Non-performing loans to total loans	3.86	%	4.08	%
Non-performing assets to total assets	2.50	%	2.78	%
Allowance for loan losses to non-performing loans	60.01	%	70.57	%

## 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 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. 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, 2011	(5.76 )%	(2.93 )%	(1.03 )%	(0.03 )%	N/A	N/A	N/A	N/A
December 31, 2010	(3.64 )%	(1.28 )%	(0.15 )%	(0.06 )%	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk increased moderately from December 31, 2010 at all interest rate shock levels except the +100bp level which remained virtually level. All measures remained well within prescribed policy limits.

The risk position increased moderately in the upper shock scenarios. The major contributor to the increased risk was the loan portfolio. Longer durations in the loan portfolio limit the potential increase to net interest income in a rising rate environment due to the fact fewer dollars are available to reprice as rates increase during the time horizon



involved.

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, 2011	(7.27 )%	(4.67 )%	(0.52 )%	1.75 %	N/A	N/A	N/A	N/A
December 31, 2010	(12.49 )%	(9.78 )%	(5.69 )%	(2.68 )%	N/A	N/A	N/A	N/A

Measures of the economic value of equity ("EVE") at risk decreased compared to year-end 2010 in all rising interest rate shock levels due primarily to longer durations in deposits and borrowings. The Company is retaining more low cost core deposits for longer lengths of time and as rates rise, the Company thus experiences a benefit in such market values.

### 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, 2011. Management considers core deposits, defined to include all deposits other than time deposits of \$100 thousand or more, to be a relatively stable funding source. Core deposits equaled 70% of total interest-earning assets at September 30, 2011. 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, 2011, show short-term investments exceeding short-term borrowings by \$32.1 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 \$1.1 billion, of which \$486.3 million was available for borrowing based on pledged collateral, with \$405.5 million borrowed against it as of September 30, 2011. The line of credit at the Federal Reserve totaled \$285.8 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of September 30, 2011. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled \$55.0 million at September 30, 2011, against which there were no outstanding borrowings. In addition, the Company had a secured line of credit with a correspondent bank of \$20.0 million as of September 30, 2011. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at September 30, 2011.

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, 2011, the Bank could have declared a dividend of \$34.3 million to Bancorp. At September 30, 2011, Bancorp had liquid assets of \$8.0 million.

Arrangements to fund credit products or guarantee financing take the form of loans 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 September 30, 2011 were as follows:

(In thousands)	September 30, 2011	December 31, 2010
Commercial	\$ 72,447	\$ 72,324
Real estate-development and construction	87,355	53,511
Real estate-residential mortgage	36,429	25,054
Lines of credit, principally home equity and business lines	621,830	586,816
Standby letters of credit	64,170	68,057
Total Commitments to extend credit and available credit lines	\$ 882,231	\$ 805,762

### 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, 2011, 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 2010 Annual Report on Form 10-K.

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

The Company approved a stock repurchase program in August 2011 that permits the repurchase of up to 3% of the Company's outstanding shares of common stock or approximately 730,000 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, 2011.

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 of Shares that May Yet Be Purchased under the Plans or Programs
July 2011	-	N/A	-	730,000
August 2011	-	N/A	-	730,000
September 2011	23,592	\$ 14.16	-	706,408

## Item 3. Defaults Upon Senior Securities – None

## Item 4. (Removed and Reserved)

## 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 June 30, 2011 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 Cash Flows; (iv) The Condensed Consolidated Statements of Changes in Stockholders' Equity; (v) 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 8, 2011

By: /s/ Philip J. Mantua  
Philip J. Mantua  
Executive Vice President and Chief Financial Officer

Date: November 8, 2011

---