

SANDY SPRING BANCORP INC  
Form 10-Q  
August 06, 2015

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

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2015**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland

52-1532952

(State of incorporation)

(I.R.S. Employer Identification Number)

17801 Georgia Avenue, Olney, Maryland

20832

(Address of principal executive office)

(Zip Code)

301-774-6400

(Registrant's telephone number, including area code)

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

Yes  No

—

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

Yes  No

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

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

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 August 3, 2015

**Common stock, \$1.00 par value – 24,566,838 shares**

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**SANDY SPRING BANCORP, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1. FINANCIAL STATEMENTS	
Condensed Consolidated Statements of Condition - Unaudited at June 30, 2015 and December 31, 2014	4
Condensed Consolidated Statements of Income - Unaudited for the Three and Six Months Ended June 30, 2015 and 2014	5
Condensed Consolidated Statements of Comprehensive Income – Unaudited for the Three and Six Months Ended June 30, 2015 and 2014	6
Condensed Consolidated Statements of Cash Flows – Unaudited for the Six Months Ended June 30, 2015 and 2014	7
Condensed Consolidated Statements of Changes in Stockholders’ Equity – Unaudited for the Six Months Ended June 30, 2015 and 2014	8
Notes to Condensed Consolidated Financial Statements	9
Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	35
Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	59
Item 4. CONTROLS AND PROCEDURES	59
<b>PART II - OTHER INFORMATION</b>	
Item 1. LEGAL PROCEEDINGS	59
Item 1A. RISK FACTORS	59
Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	59
Item 3. DEFAULTS UPON SENIOR SECURITIES	60
Item 4. MINE SAFETY DISCLOSURES	60
Item 5. OTHER INFORMATION	60
Item 6. EXHIBITS	60

SIGNATURES

2

61

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## Forward-Looking Statements

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

Forward-looking statements reflect our expectation or prediction of future conditions, events or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risk and uncertainties include, but are not limited to, the risks identified in Item 1A of the Company’s 2014 Annual Report on Form 10-K, Item 1A of Part II of this report and the following:

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

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

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

<i>(Dollars in thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
<b>Assets</b>		
Cash and due from banks	\$ 53,569	\$ 52,804
Federal funds sold	472	473
Interest-bearing deposits with banks	35,601	42,940
Cash and cash equivalents	89,642	96,217
Residential mortgage loans held for sale (at fair value)	19,445	10,512
Investments available-for-sale (at fair value)	625,819	672,209
Investments held-to-maturity -- fair value of \$217,880 and \$222,260 at June 30, 2015 and December 31, 2014, respectively	216,866	219,973
Other equity securities	35,599	41,437
Total loans and leases	3,288,865	3,127,392
Less: allowance for loan and lease losses	(38,713)	(37,802)
Net loans and leases	3,250,152	3,089,590
Premises and equipment, net	51,609	49,402
Other real estate owned	4,514	3,195
Accrued interest receivable	13,144	12,634
Goodwill	84,171	84,171
Other intangible assets, net	296	510
Other assets	116,110	117,282
<b>Total assets</b>	<b>\$ 4,507,367</b>	<b>\$ 4,397,132</b>
<b>Liabilities</b>		
Noninterest-bearing deposits	\$ 1,092,413	\$ 993,737
Interest-bearing deposits	2,154,933	2,072,772
Total deposits	3,247,346	3,066,509
Securities sold under retail repurchase agreements and federal funds purchased	111,817	74,432
Advances from FHLB	550,000	655,000
Subordinated debentures	35,000	35,000
Accrued interest payable and other liabilities	44,331	44,440
Total liabilities	3,988,494	3,875,381
<b>Stockholders' Equity</b>		
Common stock -- par value \$1.00; shares authorized 50,000,000; shares issued and outstanding 24,562,471 and 25,044,877 at June 30, 2015 and December 31, 2014, respectively	24,562	25,045
Additional paid in capital	181,504	194,647
Retained earnings	313,399	302,882
Accumulated other comprehensive loss	(592)	(823)
Total stockholders' equity	518,873	521,751
<b>Total liabilities and stockholders' equity</b>	<b>\$ 4,507,367</b>	<b>\$ 4,397,132</b>



The accompanying notes are an integral part of these statements

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<i>(Dollars in thousands, except per share data)</i>				
<b>Interest Income:</b>				
Interest and fees on loans and leases	\$ 33,031	\$ 30,706	\$ 65,170	\$ 60,440
Interest on loans held for sale	132	71	208	130
Interest on deposits with banks	22	22	44	42
Interest and dividends on investment securities:				
Taxable	3,850	3,876	7,427	7,992
Exempt from federal income taxes	1,814	2,316	4,072	4,637
Total interest income	38,849	36,991	76,921	73,241
<b>Interest Expense:</b>				
Interest on deposits	1,367	1,193	2,561	2,377
Interest on retail repurchase agreements and federal funds purchased	60	37	110	75
Interest on advances from FHLB	3,266	3,233	6,502	6,451
Interest on subordinated debt	223	219	442	437
Total interest expense	4,916	4,682	9,615	9,340
<b>Net interest income</b>	<b>33,933</b>	<b>32,309</b>	<b>67,306</b>	<b>63,901</b>
Provision (credit) for loan and lease losses	1,218	158	1,815	(824)
Net interest income after provision (credit) for loan and lease losses	<b>32,715</b>	<b>32,151</b>	<b>65,491</b>	<b>64,725</b>
<b>Non-interest Income:</b>				
Investment securities gains	19	-	19	-
Service charges on deposit accounts	1,839	2,089	3,721	4,061
Mortgage banking activities	822	570	2,000	886
Wealth management income	5,161	4,741	10,077	9,207
Insurance agency commissions	881	961	2,499	2,601
Income from bank owned life insurance	606	608	1,319	1,206
Visa check fees	1,220	1,169	2,277	2,147
Other income	1,561	1,556	3,356	2,835
Total non-interest income	<b>12,109</b>	<b>11,694</b>	<b>25,268</b>	<b>22,943</b>
<b>Non-interest Expenses:</b>				
Salaries and employee benefits	17,534	16,474	34,833	32,829
Occupancy expense of premises	3,173	3,274	6,662	6,746
Equipment expenses	1,490	1,262	2,863	2,518
Marketing	942	802	1,473	1,344
Outside data services	1,102	1,216	2,363	2,432
FDIC insurance	654	573	1,285	1,093
Amortization of intangible assets	106	224	213	594
Litigation expenses	162	6,128	362	6,128
Other expenses	4,314	4,188	8,667	8,006
Total non-interest expenses	<b>29,477</b>	<b>34,141</b>	<b>58,721</b>	<b>61,690</b>
Income before income taxes	<b>15,347</b>	<b>9,704</b>	<b>32,038</b>	<b>25,978</b>
Income tax expense	5,014	2,722	10,480	8,068
<b>Net income</b>	<b>\$ 10,333</b>	<b>\$ 6,982</b>	<b>\$ 21,558</b>	<b>\$ 17,910</b>

**Net Income Per Share Amounts:**

Basic net income per share	\$	<b>0.42</b>	\$	0.28	\$	<b>0.87</b>	\$	0.72
Diluted net income per share	\$	<b>0.42</b>	\$	0.28	\$	<b>0.87</b>	\$	0.71
Dividends declared per share	\$	<b>0.22</b>	\$	0.18	\$	<b>0.44</b>	\$	0.36

The accompanying notes are an integral part of these statements

5

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

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<b>2015</b>	2014	<b>2015</b>	2014
Net income	<b>\$ 10,333</b>	\$ 6,982	<b>\$ 21,558</b>	\$ 17,910
Other comprehensive income:				
Investments available-for-sale:				
Net change in unrealized gains (losses) on investments available-for-sale	<b>(4,819)</b>	6,361	<b>(185)</b>	13,493
Related income tax (expense) benefit	<b>1,915</b>	(2,522)	<b>74</b>	(5,345)
Net investment gains reclassified into earnings	<b>19</b>	-	<b>19</b>	-
Related income tax expense	<b>(8)</b>	-	<b>(8)</b>	-
Net effect on other comprehensive income (loss) for the period	<b>(2,893)</b>	3,839	<b>(100)</b>	8,148
Defined benefit pension plan:				
Recognition of unrealized gain	<b>259</b>	68	<b>551</b>	116
Related income tax expense	<b>(104)</b>	(24)	<b>(220)</b>	(61)
Net effect on other comprehensive income for the period	<b>155</b>	44	<b>331</b>	55
Total other comprehensive income (loss)	<b>(2,738)</b>	3,883	<b>231</b>	8,203
Comprehensive income	<b>\$ 7,595</b>	\$ 10,865	<b>\$ 21,789</b>	\$ 26,113

The accompanying notes are an integral part of these statements

6

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

<i>(Dollars in thousands)</i>	Six Months Ended June 30,	
	<b>2015</b>	2014
<b>Operating activities:</b>		
Net income	\$ 21,558	\$ 17,910
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,504	3,673
Provision (credit) for loan and lease losses	1,815	(824)
Share based compensation expense	941	853
Deferred income tax expense	116	1,029
Origination of loans held for sale	(109,045)	(59,566)
Proceeds from sales of loans held for sale	101,688	59,704
Gains on sales of loans held for sale	(1,576)	(815)
Loss on sales of other real estate owned	-	(2)
Investment securities gains	(19)	-
Net (increase) decrease in accrued interest receivable	(510)	261
Net increase in other assets	(65)	(4,580)
Net increase (decrease) in accrued expenses and other liabilities	(162)	4,472
Other – net	2,069	2,427
Net cash provided by operating activities	<b>20,314</b>	24,542
<b>Investing activities:</b>		
Purchases of investments held-to-maturity	(2,100)	-
Net proceeds from other equity securities	5,838	4,560
Proceeds from maturities, calls and principal payments of investments held-to-maturity	4,786	680
Proceeds from maturities, calls and principal payments of investments available-for-sale	45,249	42,228
Net increase in loans and leases	(163,717)	(127,333)
Proceeds from the sales of other real estate owned	-	32
Expenditures for premises and equipment	(4,559)	(1,795)
Net cash used in investing activities	<b>(114,503)</b>	(81,628)
<b>Financing activities:</b>		
Net increase in deposits	180,837	161,445
Net increase in retail repurchase agreements and federal funds purchased	37,385	19,075
Proceeds from advances from FHLB	1,174,000	980,000
Repayment of advances from FHLB	(1,279,000)	(1,058,000)
Proceeds from issuance of common stock	13	34
Tax benefits associated with share based compensation	335	-
Repurchase of common stock	(14,915)	-
Dividends paid	(11,041)	(9,094)
Net cash (used) provided by financing activities	<b>87,614</b>	93,460
Net increase (decrease) in cash and cash equivalents	<b>(6,575)</b>	36,374
Cash and cash equivalents at beginning of period	96,217	74,427
Cash and cash equivalents at end of period	\$ 89,642	\$ 110,801

**Supplemental Disclosures:**

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Interest payments	\$	<b>9,619</b>	\$	9,358
Income tax payments		<b>9,876</b>		10,151
Transfers from loans to other real estate owned		<b>1,340</b>		671

The accompanying notes are an integral part of these statements

7

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

	Common	Additional Paid-In	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
<i>(Dollars in thousands, except per share data)</i>	Stock	Capital	Earnings	(Loss)	Equity
<b>Balances at January 1, 2015</b>	<b>\$ 25,045</b>	<b>\$ 194,647</b>	<b>\$ 302,882</b>	<b>\$ (823)</b>	<b>\$ 521,751</b>
Net income	-	-	21,558	-	21,558
Other comprehensive income, net of tax	-	-	-	231	231
Common stock dividends - \$0.44 per share	-	-	(11,041)	-	(11,041)
Stock compensation expense	-	941	-	-	941
Common stock issued pursuant to:					
Stock option plan - 26,695 shares	26	365	-	-	391
Directors stock purchase plan - 837 shares	1	21	-	-	22
Employee stock purchase plan - 12,613 shares	12	264	-	-	276
Restricted stock - 52,921 shares	53	(394)	-	-	(341)
Purchase of treasury shares - 575,472 shares	(575)	(14,340)	-	-	(14,915)
<b>Balances at June 30, 2015</b>	<b>\$ 24,562</b>	<b>\$ 181,504</b>	<b>\$ 313,399</b>	<b>\$ (592)</b>	<b>\$ 518,873</b>
Balance at January 1, 2014	\$ 24,990	\$ 193,445	\$ 283,898	\$ (2,970)	\$ 499,363
Net income	-	-	17,910	-	17,910
Other comprehensive income, net of tax	-	-	-	8,203	8,203
Common stock dividends - \$0.36 per share	-	-	(9,094)	-	(9,094)
Stock compensation expense	-	853	-	-	853
Common stock issued pursuant to:					
Stock option plan - 13,721 shares	14	174	-	-	188
Employee stock purchase plan - 11,423 shares	11	229	-	-	240
Restricted stock - 54,535 shares	55	(449)	-	-	(394)
<b>Balances at June 30, 2014</b>	<b>\$ 25,070</b>	<b>\$ 194,252</b>	<b>\$ 292,714</b>	<b>\$ 5,233</b>	<b>\$ 517,269</b>



The accompanying notes are an integral part of these statements

8

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## **Sandy Spring Bancorp, Inc. and Subsidiaries**

### **Notes to the CONDENSED Consolidated Financial Statements - UNAUDITED**

#### **Note 1 – Significant Accounting Policies**

##### **Nature of Operations**

Sandy Spring Bancorp (the “Company”), a Maryland corporation, is the bank holding company for Sandy Spring Bank (the “Bank”), 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, general insurance, personal trust, and investment and wealth management services. The Company operates in the 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 Sandy Spring Insurance, and Neff & Associates, which are 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 three and six months ended June 30, 2015 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2015. In the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. Certain reclassifications have been made to prior period amounts, as necessary, to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

These statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s 2014 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 6, 2015. There have been no significant changes to the Company’s accounting policies as disclosed in the 2014 Annual Report on Form 10-K.

##### **Principles of Consolidation**

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

### **Use of Estimates**

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

### **Cash Flows**

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

## Pending Accounting Pronouncements

The FASB issued a standard in May 2014 that provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to customers. The guidance also provides for a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. This standard may affect an entity's financial statements, business processes and internal control over financial reporting. The guidance is effective for the first interim or annual period beginning after December 15, 2017. The guidance must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. The Company is assessing this guidance to determine its impact on the Company's financial position, results of operations and cash flows.

## Note 2 – Investments

### Investments available-for-sale

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

(In thousands)	June 30, 2015				December 31, 2014			
	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	\$139,542	\$ 122	\$(1,684)	\$137,980	\$144,497	\$ -	\$(2,818)	\$141,679
State and municipal	153,769	8,185	(1)	161,953	157,603	9,453	(4)	167,052
Mortgage-backed	317,433	8,794	(2,082)	324,145	354,631	9,824	(2,936)	361,519
Trust preferred	1,111	-	(93)	1,018	1,348	-	(112)	1,236
Total debt securities	611,855	17,101	(3,860)	625,096	658,079	19,277	(5,870)	671,486
Marketable equity securities	723	-	-	723	723	-	-	723
Total investments available-for-sale	\$612,578	\$ 17,101	\$(3,860)	\$625,819	\$658,802	\$19,277	\$(5,870)	\$672,209

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at June 30, 2015 are not the result of credit related events but due to changes in interest rates. These declines are considered temporary in nature and are expected to decline over time and recover as these securities approach maturity.

The mortgage-backed securities portfolio at June 30, 2015 is composed entirely of either the most senior tranches of GNMA, FNMA or FHLMC collateralized mortgage obligations (\$150.6 million), or GNMA, FNMA or FHLMC mortgage-backed securities (\$173.5 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.

At June 30, 2015 the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security, which is backed by debt issued by banks and thrifts, totals \$1.1 million with a fair value of \$1.0 million. The fair value of this security was determined by management through the use of a third party valuation specialist due to the limited trading activity for this security.

The income valuation approach technique (present value) used 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 issuer collateral in the pool;
- Overall default (.61%), recovery and prepayment (2%)/amortization probabilities by issuers in the pool;
- 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 11.5% 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 had not incurred any credit-related other-than-temporary impairment (“OTTI”) for the quarter ended June 30, 2015. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was \$0.1 million at June 30, 2015. This non-credit related OTTI was recognized in other comprehensive income (“OCI”) at June 30, 2015.

The methodology and 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 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:

<i>(In thousands)</i>	OTTI Losses
Cumulative credit losses on investment securities, through December 31, 2014	\$ 531
Additions for credit losses not previously recognized	-
Cumulative credit losses on investment securities, through June 30, 2015	\$ 531

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

	<b>June 30, 2015</b>				
	<b>Continuous Unrealized Losses Existing for:</b>				
<i>(Dollars in thousands)</i>	<b>Number of securities</b>	<b>Fair Value</b>	<b>Less than 12 months</b>	<b>More than 12 months</b>	<b>Total Unrealized Losses</b>
U.S. government agencies	10	\$ 108,274	\$ 605	\$ 1,079	\$ 1,684
State and municipal	2	1,410	1	-	1
Mortgage-backed	22	111,424	250	1,832	2,082
Trust preferred	1	1,111	-	93	93
<b>Total</b>	<b>35</b>	<b>\$ 222,219</b>	<b>\$ 856</b>	<b>\$ 3,004</b>	<b>\$ 3,860</b>

	<b>December 31, 2014</b>				
	<b>Continuous Unrealized Losses Existing for:</b>				
<i>(Dollars in thousands)</i>	<b>Number of securities</b>	<b>Fair Value</b>	<b>Less than 12 months</b>	<b>More than 12 months</b>	<b>Total Unrealized Losses</b>
U.S. government agencies	14	\$ 141,679	\$ 60	\$ 2,758	\$ 2,818
State and municipal	2	1,409	4	-	4
Mortgage-backed	20	108,902	58	2,878	2,936
Trust preferred	1	1,236	-	112	112
<b>Total</b>	<b>37</b>	<b>\$ 253,226</b>	<b>\$ 122</b>	<b>\$ 5,748</b>	<b>\$ 5,870</b>

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

	<b>June 30, 2015</b>		<b>December 31, 2014</b>	
	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
<i>(In thousands)</i>				
Due in one year or less	\$ 690	\$ 701	\$ 691	\$ 714
Due after one year through five years	116,702	118,680	47,900	49,385
Due after five years through ten years	247,330	254,687	332,841	340,852
Due after ten years	247,133	251,028	276,647	280,535
<b>Total debt securities available for sale</b>	<b>\$ 611,855</b>	<b>\$ 625,096</b>	<b>\$ 658,079</b>	<b>\$ 671,486</b>

At June 30, 2015 and December 31, 2014, investments available-for-sale with a book value of \$229.0 million and \$212.9 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 June 30, 2015 and December 31, 2014.



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:

	June 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>(In thousands)</i>								
U.S. government agencies	\$ 64,515	\$ -	\$ (1,340)	\$ 63,175	\$ 64,512	\$ -	\$ (1,734)	\$ 62,778
State and municipal	150,069	3,454	(1,126)	152,397	155,261	4,321	(325)	159,257
Mortgage-backed	182	26	-	208	200	25	-	225
Corporate debt	2,100	-	-	2,100	-	-	-	-
Total investments held-to-maturity	\$ 216,866	\$ 3,480	\$ (2,466)	\$ 217,880	\$ 219,973	\$ 4,346	\$ (2,059)	\$ 222,260

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:

	Number of securities	Fair Value	June 30, 2015 Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
<i>(Dollars in thousands)</i>					
U.S. government agencies	8	\$ 63,175	\$ 533	\$ 807	\$ 1,340
State and municipal	63	55,987	874	252	1,126
Total	71	\$ 119,162	\$ 1,407	\$ 1,059	\$ 2,466

	Number of securities	Fair Value	December 31, 2014 Continuous Unrealized Losses Existing for:		Total Unrealized Losses
			Less than 12 months	More than 12 months	
<i>(Dollars in thousands)</i>					
U.S. government agencies	8	\$ 62,778	\$ -	\$ 1,734	\$ 1,734
State and municipal	41	32,027	18	307	325
Total	49	\$ 94,805	\$ 18	\$ 2,041	\$ 2,059

The Company intends to hold these securities until they reach maturity.

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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.

	June 30, 2015		December 31, 2014	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
<i>(In thousands)</i>				
Due in one year or less	\$ 846	\$ 865	\$ 1,690	\$ 1,694
Due after one year through five years	10,656	11,013	6,763	6,938
Due after five years through ten years	169,756	170,879	163,252	164,787
Due after ten years	35,608	35,123	48,268	48,841
Total debt securities held-to-maturity	\$ 216,866	\$ 217,880	\$ 219,973	\$ 222,260

At June 30, 2015 and December 31, 2014, investments held-to-maturity with a book value of \$193.3 million and \$202.4 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 June 30, 2015 and December 31, 2014.

### Equity securities

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

<i>(In thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Federal Reserve Bank stock	\$ 8,269	\$ 8,269
Federal Home Loan Bank of Atlanta stock	27,330	33,168
Total equity securities	\$ 35,599	\$ 41,437

### **Note 3 – Loans and Leases**

Outstanding loan balances at June 30, 2015 and December 31, 2014 are net of unearned income including net deferred loan costs of \$0.7 million and \$0.5 million, respectively. The loan portfolio segment balances at the dates indicated are presented in the following table:

<i>(In thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Residential real estate:		
Residential mortgage	\$ 744,195	\$ 717,886
Residential construction	137,134	136,741
Commercial real estate:		
Commercial owner occupied real estate	643,973	611,061
Commercial investor real estate	694,179	640,193
Commercial acquisition, development and construction	223,103	205,124
Commercial Business	409,795	390,781
Leases	21	54
Consumer	436,465	425,552
Total loans and leases	\$ 3,288,865	\$ 3,127,392

### **Note 4 – CREDIT QUALITY ASSESSMENT**

#### **Allowance for Loan and Lease Losses**

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

Six Months Ended June 30,

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<i>(In thousands)</i>	<b>2015</b>	2014
Balance at beginning of year	\$ <b>37,802</b>	\$ 38,766
Provision for loan and lease losses	<b>1,815</b>	(824)
Loan and lease charge-offs	<b>(1,837)</b>	(1,176)
Loan and lease recoveries	<b>933</b>	1,193
Net (charge-offs) recoveries	<b>(904)</b>	17
Balance at period end	\$ <b>38,713</b>	\$ 37,959

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

<i>(Dollars in thousands)</i>	For the Six Months Ended June 30, 2015									
	Commercial Real Estate					Residential Real Estate				
	Commercial		Commercial			Residential		Residential		
	Business	AD&C	Investor R/E	Owner Occupied R/E	Leasing	Consumer	Mortgage	Construction	Total	
Balance at beginning of year	\$ 5,852	\$ 4,267	\$ 9,784	\$ 7,143	\$ 9	\$ 3,592	\$ 6,232	\$ 923	\$ 37,802	
Provision (credit)	13	(336)	947	584	-	234	318	55	1,815	
Charge-offs	(181)	(739)	(90)	(212)	-	(537)	(78)	-	(1,837)	
Recoveries	197	580	10	1	-	99	31	15	933	
Net charge-offs	16	(159)	(80)	(211)	-	(438)	(47)	15	(904)	
Balance at end of period	\$ 5,881	\$ 3,772	\$ 10,651	\$ 7,516	\$ 9	\$ 3,388	\$ 6,503	\$ 993	\$ 38,713	
Total loans and leases	\$ 409,795	\$ 223,103	\$ 694,179	\$ 643,973	\$ 21	\$ 436,465	\$ 744,195	\$ 137,134	\$ 3,288,865	
Allowance for loans and leases to total loans and leases ratio	1.44%	1.69%	1.53%	1.17%	42.86%	0.78%	0.87%	0.72%	1.18%	
Balance of loans specifically evaluated for impairment	\$ 4,181	\$ 194	\$ 12,126	\$ 8,423	na.	na.	\$ 3,770	na.	\$ 28,694	
Allowance for loans specifically evaluated for impairment	\$ 1,047	\$ 58	\$ 715	\$ 1,066	na.	na.	-	na.	\$ 2,886	
Specific allowance to specific loans ratio	25.04%	29.90%	5.90%	12.66%	na.	na.	na.	na.	10.06%	
Balance of loans collectively evaluated	\$ 405,614	\$ 222,909	\$ 682,053	\$ 635,550	\$ 21	\$ 436,465	\$ 740,425	\$ 137,134	\$ 3,260,171	
Allowance for loans collectively evaluated	\$ 4,834	\$ 3,714	\$ 9,936	\$ 6,450	\$ 9	\$ 3,388	\$ 6,503	\$ 993	\$ 35,827	
Collective allowance to	1.19%	1.67%	1.46%	1.01%	42.86%	0.78%	0.88%	0.72%	1.10%	

**collective loans  
ratio**

For the Year Ended December 31, 2014

<i>(Dollars in thousands)</i>	Commercial Real Estate					Residential Real Estate				Total
	Commercial Business	Commercial AD&C	Commercial Owner		Leasing	Consumer	Residential			
			Investor R/E	Occupied R/E			Mortgage	Construction		
Balance at beginning of year	\$ 6,308	\$ 3,754	\$ 9,263	\$ 6,308	\$ 16	\$ 4,142	\$ 7,819	\$ 1,156	\$ 38,766	
Provision (credit)	(1,204)	1,042	486	1,094	(7)	119	(1,385)	(308)	(163)	
Charge-offs	(729)	(529)	(3)	(265)	-	(834)	(323)	(4)	(2,687)	
Recoveries	1,477	-	38	6	-	165	121	79	1,886	
Net charge-offs	748	(529)	35	(259)	-	(669)	(202)	75	(801)	
Balance at end of period	\$ 5,852	\$ 4,267	\$ 9,784	\$ 7,143	\$ 9	\$ 3,592	\$ 6,232	\$ 923	\$ 37,802	
Total loans and leases	\$390,781	\$205,124	\$640,193	\$611,061	\$ 54	\$425,552	\$717,886	\$136,741	\$3,127,392	
Allowance for loans and leases to total loans and leases ratio	1.50%	2.08%	1.53%	1.17%	16.80%	0.84%	0.87%	0.67%	1.21%	
Balance of loans specifically evaluated for impairment	\$ 3,894	\$ 2,464	\$ 10,279	\$ 8,941	\$ na.	\$ na.	\$ 3,535	\$ 306	\$ 29,419	
Allowance for loans specifically evaluated for impairment	\$ 788	\$ 741	\$ 541	\$ 824	\$ na.	\$ na.	\$ -	\$ -	\$ 2,894	
Specific allowance to specific loans ratio	20.24%	30.07%	5.26%	9.22%	na.	na.	na.	na.	9.84%	
Balance of loans collectively evaluated	\$386,887	\$202,660	\$629,914	\$602,120	\$ 54	\$425,552	\$714,351	\$136,435	\$3,097,973	
Allowance for loans collectively evaluated	\$ 5,064	\$ 3,526	\$ 9,243	\$ 6,319	\$ 9	\$ 3,592	\$ 6,232	\$ 923	\$ 34,908	
Collective allowance to collective loans ratio	1.31%	1.74%	1.47%	1.05%	16.80%	0.84%	0.87%	0.68%	1.13%	



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

<i>(In thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Impaired loans with a specific allowance	\$ 9,661	\$ 11,411
Impaired loans without a specific allowance	19,033	18,008
Total impaired loans	\$ 28,694	\$ 29,419
Allowance for loan and lease losses related to impaired loans	\$ 2,886	\$ 2,894
Allowance for loan and lease losses related to loans collectively evaluated	35,827	34,908
Total allowance for loan and lease losses	\$ 38,713	\$ 37,802
Average impaired loans for the period	\$ 28,769	\$ 34,331
Contractual interest income due on impaired loans during the period	\$ 1,326	\$ 2,339
Interest income on impaired loans recognized on a cash basis	\$ 324	\$ 773
Interest income on impaired loans recognized on an accrual basis	\$ 122	\$ 280

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

<i>(In thousands)</i>	<b>June 30, 2015</b>					<b>Total Recorded Investment in Impaired Loans</b>
	<b>Commercial Real Estate</b>					
	<b>Commercial</b>	<b>AD&amp;C</b>	<b>Commercial Investor R/E</b>	<b>Commercial Owner Occupied R/E</b>	<b>All Other Loans</b>	
<b>Impaired loans with a specific allowance</b>						
Non-accruing	\$ 659	\$ 57	\$ 2,589	\$ 4,561	\$ -	\$ 7,866
Restructured accruing	881	-	-	-	-	881
Restructured non-accruing	203	-	72	639	-	914
Balance	\$ 1,743	\$ 57	\$ 2,661	\$ 5,200	\$ -	\$ 9,661
Allowance	\$ 1,047	\$ 58	\$ 715	\$ 1,066	\$ -	\$ 2,886
<b>Impaired loans without a specific allowance</b>						
Non-accruing	\$ 1,013	\$ -	\$ 7,362	\$ 1,785	\$ -	\$ 10,160
Restructured accruing	15	-	2,103	-	2,621	4,739
Restructured non-accruing	1,410	137	-	1,438	1,149	4,134
Balance	\$ 2,438	\$ 137	\$ 9,465	\$ 3,223	\$ 3,770	\$ 19,033
<b>Total impaired loans</b>						



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<b>Non-accruing</b>	<b>\$ 1,672</b>	<b>\$ 57</b>	<b>\$ 9,951</b>	<b>\$ 6,346</b>	<b>\$ -</b>	<b>\$ 18,026</b>
<b>Restructured accruing</b>	<b>896</b>	<b>-</b>	<b>2,103</b>	<b>-</b>	<b>2,621</b>	<b>5,620</b>
<b>Restructured non-accruing</b>	<b>1,613</b>	<b>137</b>	<b>72</b>	<b>2,077</b>	<b>1,149</b>	<b>5,048</b>
<b>Balance</b>	<b>\$ 4,181</b>	<b>\$ 194</b>	<b>\$ 12,126</b>	<b>\$ 8,423</b>	<b>\$ 3,770</b>	<b>\$ 28,694</b>
<b>Unpaid principal balance in total impaired loans</b>	<b>\$ 5,646</b>	<b>\$ 4,456</b>	<b>\$ 16,878</b>	<b>\$ 10,271</b>	<b>\$ 4,086</b>	<b>\$ 41,337</b>

16

	June 30, 2015						Total Recorded Investment in Impaired Loans
	Commercial Real Estate						
	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	
	Investor	Owner	Other	Occupied	AD&C	R/E	
<i>(In thousands)</i>							
Average impaired loans for the period	\$ 4,013	\$ 1,340	\$ 10,829	\$ 8,779	\$ 3,808	\$ 28,769	
Contractual interest income due on impaired loans during the period	\$ 207	\$ 188	\$ 469	\$ 366	\$ 96		
Interest income on impaired loans recognized on a cash basis	\$ 93	\$ 11	\$ 15	\$ 185	\$ 20		
Interest income on impaired loans recognized on an accrual basis	\$ 29	\$ -	\$ 54	\$ -	\$ 39		

	December 31, 2014						Total Recorded Investment in Impaired Loans
	Commercial Real Estate						
	Commercial	Commercial	Commercial	Commercial	Commercial	Commercial	
	Investor	Owner	Other	Occupied	AD&C	R/E	
<i>(In thousands)</i>							
Impaired loans with a specific allowance							
Non-accruing	\$ 473	\$ 1,330	\$ 2,288	\$ 5,013	\$ -	\$ 9,104	
Restructured accruing	687	-	-	-	-	687	
Restructured non-accruing	308	-	76	1,236	-	1,620	
Balance	\$ 1,468	\$ 1,330	\$ 2,364	\$ 6,249	\$ -	\$ 11,411	
Allowance	\$ 788	\$ 741	\$ 541	\$ 824	\$ -	\$ 2,894	
Impaired loans without a specific allowance							
Non-accruing	\$ 1,115	\$ -	\$ 5,792	\$ 1,769	\$ -	\$ 8,676	
Restructured accruing	23	-	2,123	-	2,664	4,810	
Restructured non-accruing	1,288	1,134	-	923	1,177	4,522	
Balance	\$ 2,426	\$ 1,134	\$ 7,915	\$ 2,692	\$ 3,841	\$ 18,008	
Total impaired loans							
Non-accruing	\$ 1,588	\$ 1,330	\$ 8,080	\$ 6,782	\$ -	\$ 17,780	
Restructured accruing	710	-	2,123	-	2,664	5,497	
Restructured non-accruing	1,596	1,134	76	2,159	1,177	6,142	
Balance	\$ 3,894	\$ 2,464	\$ 10,279	\$ 8,941	\$ 3,841	\$ 29,419	
Unpaid principal balance in total impaired loans	\$ 5,360	\$ 7,044	\$ 14,926	\$ 10,729	\$ 4,126	\$ 42,185	

December 31, 2014

	Commercial Real Estate				Total Recorded Investment in	
	Commercial	Commercial	Commercial	Commercial	Other	Impaired
	Investor	AD&C	R/E	R/E	Loans	Loans
<i>(In thousands)</i>						
Average impaired loans for the period	\$ 5,308	\$ 3,651	\$ 9,327	\$ 8,963	\$ 7,082	\$ 34,331
Contractual interest income due on impaired loans during the period	\$ 311	\$ 352	\$ 730	\$ 859	\$ 87	
Interest income on impaired loans recognized on a cash basis	\$ 252	\$ 39	\$ 78	\$ 344	\$ 60	
Interest income on impaired loans recognized on an accrual basis	\$ 63	\$ -	\$ 111	\$ -	\$ 106	

## Credit Quality

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

<i>(In thousands)</i>	June 30, 2015								
	Commercial Real Estate					Residential Real Estate			
	Commercial			Commercial Owner		Residential		Residential	
	Commercial	AD&C	R/E	R/E Leasing	Investor Occupied	Consumer	Mortgage	Construction	Total
<b>Non-performing loans and assets:</b>									
Non-accrual loans and leases	\$ 3,285	\$ 194	\$ 10,023	\$ 8,423	\$ -	\$ 1,214	\$ 7,780	\$ 780	\$ 31,699
Loans and leases 90 days past due	-	-	-	-	2	7	-	-	9
Restructured loans and leases	896	-	2,103	-	-	-	2,621	-	5,620
<b>Total non-performing loans and leases</b>	<b>4,181</b>	<b>194</b>	<b>12,126</b>	<b>8,423</b>	<b>2</b>	<b>1,221</b>	<b>10,401</b>	<b>780</b>	<b>37,328</b>
Other real estate owned	39	789	-	-	-	690	1,613	1,383	4,514
<b>Total non-performing assets</b>	<b>\$ 4,220</b>	<b>\$ 983</b>	<b>\$ 12,126</b>	<b>\$ 8,423</b>	<b>\$ 2</b>	<b>\$ 1,911</b>	<b>\$ 12,014</b>	<b>\$ 2,163</b>	<b>\$ 41,842</b>

<i>(In thousands)</i>	December 31, 2014								
	Commercial Real Estate					Residential Real Estate			
	Commercial			Commercial Owner		Residential		Residential	
	Commercial	AD&C	R/E	R/E Leasing	Investor Occupied	Consumer	Mortgage	Construction	Total
<b>Non-performing loans and assets:</b>									
Non-accrual loans and leases	\$ 3,184	\$ 2,464	\$ 8,156	\$ 8,941	\$ -	\$ 1,668	\$ 3,012	\$ 1,105	\$ 28,530
Loans and leases 90 days past due	-	-	-	-	-	-	-	-	-
Restructured loans and leases	710	-	2,123	-	-	-	2,664	-	5,497
<b>Total non-performing loans and leases</b>	<b>3,894</b>	<b>2,464</b>	<b>10,279</b>	<b>8,941</b>	<b>-</b>	<b>1,668</b>	<b>5,676</b>	<b>1,105</b>	<b>34,027</b>
Other real estate owned	39	365	-	-	-	-	1,408	1,383	3,195
<b>Total non-performing assets</b>	<b>\$ 3,933</b>	<b>\$ 2,829</b>	<b>\$ 10,279</b>	<b>\$ 8,941</b>	<b>\$ -</b>	<b>\$ 1,668</b>	<b>\$ 7,084</b>	<b>\$ 2,488</b>	<b>\$ 37,222</b>

<i>(In thousands)</i>	June 30, 2015								
	Commercial Real Estate					Residential Real Estate			
	Commercial			Commercial Owner		Residential		Residential	
	Commercial	AD&C	R/E	R/E Leasing	Investor Occupied	Consumer	Mortgage	Construction	Total
<b>Past due loans and leases</b>									
31-60 days	\$ 61	\$ -	\$ 85	\$ 609	\$ -	\$ 1,307	\$ 3,772	\$ -	\$ 5,834

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<b>61-90 days</b>	-	-	<b>1,440</b>	<b>458</b>	-	<b>643</b>	<b>1,244</b>	-	<b>3,785</b>
<b>&gt; 90 days</b>	-	-	-	-	<b>2</b>	<b>7</b>	-	-	<b>9</b>
<b>Total past due</b>	<b>61</b>	-	<b>1,525</b>	<b>1,067</b>	<b>2</b>	<b>1,957</b>	<b>5,016</b>	-	<b>9,628</b>
<b>Non-accrual loans and leases</b>	<b>3,285</b>	<b>194</b>	<b>10,023</b>	<b>8,423</b>	-	<b>1,214</b>	<b>7,780</b>	<b>780</b>	<b>31,699</b>
<b>Loans acquired with deteriorated credit quality</b>	<b>1,198</b>	-	-	<b>1,053</b>	-	-	-	-	<b>2,251</b>
<b>Current loans</b>	<b>405,251</b>	<b>222,909</b>	<b>682,631</b>	<b>633,430</b>	<b>19</b>	<b>433,294</b>	<b>731,399</b>	<b>136,354</b>	<b>3,245,287</b>
<b>Total loans and leases</b>	<b>\$409,795</b>	<b>\$223,103</b>	<b>\$694,179</b>	<b>\$643,973</b>	<b>\$21</b>	<b>\$436,465</b>	<b>\$744,195</b>	<b>\$137,134</b>	<b>\$3,288,865</b>

December 31, 2014

<i>(In thousands)</i>	Commercial Real Estate					Residential Real Estate				Total
	Commercial		Commercial			Residential		Residential		
	Commercial	AD&C	Owner Occupied		Leasing	Consumer Mortgage	Construction			
			R/E	R/E						
<u>Past due loans and leases</u>										
31-60 days	\$ 759	\$ -	\$ 2,374	\$ 2,658	\$ 11	\$ 797	\$ 3,064	\$ -	\$ -	\$ 9,663
61-90 days	995	320	1,493	156	-	179	836	-	-	3,979
> 90 days	-	-	-	-	-	-	-	-	-	-
Total past due	1,754	320	3,867	2,814	11	976	3,900	-	-	13,642
Non-accrual loans and leases	3,184	2,464	8,156	8,941	-	1,668	3,012	1,105	-	28,530
Loans acquired with deteriorated credit quality	1,238	-	-	1,773	-	-	-	-	-	3,011
Current loans	384,605	202,340	628,170	597,533	43	422,908	710,974	135,636	-	3,082,209
Total loans and leases	\$ 390,781	\$ 205,124	\$ 640,193	\$ 611,061	\$ 54	\$ 425,552	\$ 717,886	\$ 136,741	\$ -	\$ 3,127,392

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

**June 30, 2015**  
**Commercial Real Estate**

<i>(In thousands)</i>	Commercial		Commercial		Commercial	Total
	Commercial	AD&C	Investor R/E	Owner Occupied R/E	Owner Occupied R/E	
Pass	\$ 384,562	\$ 220,747	\$ 679,253	\$ 616,435	\$ 1,900,997	
Special Mention	8,212	698	1,857	6,431	17,198	
Substandard	17,021	1,658	13,069	21,107	52,855	
Doubtful	-	-	-	-	-	
<b>Total</b>	<b>\$ 409,795</b>	<b>\$ 223,103</b>	<b>\$ 694,179</b>	<b>\$ 643,973</b>	<b>\$ 1,971,050</b>	

December 31, 2014  
Commercial Real Estate

<i>(In thousands)</i>	Commercial		Commercial		Commercial	Total
	Commercial	AD&C	Investor R/E	Owner Occupied R/E	Owner Occupied R/E	
Pass	\$ 366,367	\$ 201,642	\$ 621,511	\$ 581,575	\$ 1,771,095	
Special Mention	8,835	698	3,931	7,669	21,133	
Substandard	15,579	2,784	14,751	21,817	54,931	
Doubtful	-	-	-	-	-	
<b>Total</b>	<b>\$ 390,781</b>	<b>\$ 205,124</b>	<b>\$ 640,193</b>	<b>\$ 611,061</b>	<b>\$ 1,847,159</b>	



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

<i>(In thousands)</i>	<b>June 30, 2015</b>				
	<b>Residential Real Estate</b>				
	<b>Leasing</b>	<b>Consumer</b>	<b>Residential Mortgage</b>	<b>Residential Construction</b>	<b>Total</b>
<b>Performing</b>	<b>\$ 19</b>	<b>\$ 435,244</b>	<b>\$ 733,794</b>	<b>\$ 136,354</b>	<b>\$ 1,305,411</b>
<b>Non-performing:</b>					
<b>90 days past due</b>	<b>2</b>	<b>7</b>	<b>-</b>	<b>-</b>	<b>9</b>
<b>Non-accruing</b>	<b>-</b>	<b>1,214</b>	<b>7,780</b>	<b>780</b>	<b>9,774</b>
<b>Restructured loans and leases</b>	<b>-</b>	<b>-</b>	<b>2,621</b>	<b>-</b>	<b>2,621</b>
<b>Total</b>	<b>\$ 21</b>	<b>\$ 436,465</b>	<b>\$ 744,195</b>	<b>\$ 137,134</b>	<b>\$ 1,317,815</b>

<i>(In thousands)</i>	<b>December 31, 2014</b>				
	<b>Residential Real Estate</b>				
	<b>Leasing</b>	<b>Consumer</b>	<b>Residential Mortgage</b>	<b>Residential Construction</b>	<b>Total</b>
<b>Performing</b>	<b>\$ 54</b>	<b>\$ 423,884</b>	<b>\$ 712,210</b>	<b>\$ 135,636</b>	<b>\$ 1,271,784</b>
<b>Non-performing:</b>					
<b>90 days past due</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Non-accruing</b>	<b>-</b>	<b>1,668</b>	<b>3,012</b>	<b>1,105</b>	<b>5,785</b>
<b>Restructured loans and leases</b>	<b>-</b>	<b>-</b>	<b>2,664</b>	<b>-</b>	<b>2,664</b>
<b>Total</b>	<b>\$ 54</b>	<b>\$ 425,552</b>	<b>\$ 717,886</b>	<b>\$ 136,741</b>	<b>\$ 1,280,233</b>

During the six months ended June 30, 2015, the Company restructured \$0.9 million in loans. No modifications resulted in the reduction of the principal in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2015 have specific reserves of \$0.4 million at June 30, 2015. For the year ended December 31, 2014, the Company restructured \$1.6 million in loans. Modifications consisted principally of interest rate concessions and no modifications resulted in the reduction of the recorded investment in the associated loan balances. Loans restructured during 2014 had specific reserves of \$0.1 million at December 31, 2014. Commitments to lend additional funds on loans that have been restructured at June 30, 2015 and December 31, 2014 amounted to \$0.3 million and \$0.1 million, respectively.

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

<b>For the Six Months Ended June 30, 2015</b>			
<b>Commercial Real Estate</b>			
	<b>Commercial</b>	<b>Commercial</b>	<b>All</b>
	<b>Commercial</b>	<b>Owner</b>	<b>Other</b>



<i>(In thousands)</i>	Commercial	AD&C	Investor R/E	Occupied R/E	Loans	Total
<b>Troubled debt restructurings</b>						
<b>Restructured accruing</b>	\$ 275	\$ -	\$ -	\$ -	\$ -	\$ 275
<b>Restructured non-accruing</b>	-	-	-	639	-	639
<b>Balance</b>	\$ 275	\$ -	\$ -	\$ 639	\$ -	\$ 914
<b>Specific allowance</b>	\$ 275	\$ -	\$ -	\$ 149	\$ -	\$ 424
<b>Restructured and subsequently defaulted</b>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

For the Year Ended December 31, 2014

Commercial Real Estate

<i>(In thousands)</i>	Commercial		Commercial	Commercial	Commercial	All	Total
	Commercial	AD&C	Investor R/E	Owner Occupied R/E	Loans	Other	
Troubled debt restructurings							
Restructured accruing	\$ 75	\$ -	\$ 1,284	\$ -	\$ -	\$ -	\$ 1,359
Restructured non-accruing	92	192	-	-	-	-	284
Balance	\$ 167	\$ 192	\$ 1,284	\$ -	\$ -	\$ -	\$ 1,643
Specific allowance	\$ 99	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 99
Restructured and subsequently defaulted	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

**Other Real Estate Owned**

Other real estate owned totaled \$4.5 million and \$3.2 million at June 30, 2015 and December 31, 2014, respectively.

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

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

<i>(Dollars in thousands)</i>	June 30, 2015		Weighted Average Remaining Life	December 31, 2014		Weighted Average Remaining Life
	Gross Carrying Amount	Net Carrying Amount		Gross Carrying Amount	Net Carrying Amount	
Amortizing intangible assets:						
Other identifiable intangibles	\$ 8,623	\$ (8,327)	1.6 years	\$ 8,623	\$ (8,113)	1.7 years
Total amortizing intangible assets	\$ 8,623	\$ (8,327)		\$ 8,623	\$ (8,113)	
Goodwill	\$ 84,171	\$ 84,171		\$ 84,171	\$ 84,171	

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

<i>(In thousands)</i>	Amount
2015	\$ 158
2016	94
	42

2017			16
2018			16
Thereafter			12
	Total amortizing intangible assets	\$	296

**Note 6 – Deposits**

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

<i>(In thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Noninterest-bearing deposits	\$ 1,092,413	\$ 993,737
Interest-bearing deposits:		
Demand	525,584	534,605
Money market savings	860,315	828,494
Regular savings	280,143	264,751
Time deposits of less than \$100,000	245,347	239,857
Time deposits of \$100,000 or more	243,544	205,065
Total interest-bearing deposits	2,154,933	2,072,772
Total deposits	\$ 3,247,346	\$ 3,066,509

**Note 7 – Stockholders' Equity**

The Company re-approved a stock repurchase program in August 2013 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock at the date the plan was approved or approximately 1.3 million shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. During the first six months of 2015, the Company repurchased 575,472 shares at an average cost of \$25.92 per share or a total of \$14.9 million.

**Note 8 – Share Based Compensation**

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

The Company's Omnibus Incentive Plan was approved on May 6, 2015 and provides for the granting of non-qualifying stock options to the Company's directors, and incentive and non-qualifying stock options, stock appreciation rights, restricted stock grants, RSU's and performance awards to selected key employees on a periodic basis at the discretion of the board. The Omnibus Incentive Plan authorizes the issuance of up to 1,500,000 shares of common stock, all of which are available for issuance at June 30, 2015, 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 ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The board committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. The Company generally issues authorized but previously unissued shares to satisfy option exercises. At June 30, 2015, no stock options or awards had been granted from this plan.

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:

	Six Months Ended June 30,	
	2015	2014
Dividend yield	<b>3.40%</b>	3.04%
Weighted average expected volatility	<b>42.98%</b>	46.78%
Weighted average risk-free interest rate	<b>1.42%</b>	1.56%
Weighted average expected lives (in years)	<b>5.42</b>	5.08
Weighted average grant-date fair value	<b>\$7.63</b>	\$8.05

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 \$0.4 million and \$0.4 million for the three months ended June 30, 2015 and 2014, respectively, related to the awards of stock options and restricted stock grants. Compensation expense of \$0.9 million and \$0.8 million was recognized for the six months ended June 30, 2015 and 2014, respectively. The intrinsic value of stock options exercised in the six months ended June 30, 2015 and 2014 was \$0.3 million and \$0.1 million, respectively. The total of unrecognized compensation cost related to stock options was approximately \$0.3 million as of June 30, 2015. That cost is expected to be recognized over a weighted average period of approximately 2.2 years. The total of unrecognized compensation cost related to restricted stock was approximately \$4.8 million as of June 30, 2015. That cost is expected to be recognized over a weighted average period of approximately 3.5 years. The fair value of the options vested during the six months ended June 30, 2015 and 2014, was \$0.2 million and \$0.2 million, respectively.

In the first quarter of 2015, 21,245 stock options were granted, subject to a three year vesting schedule with one third of the options vesting on April 1<sup>st</sup> of each year. Additionally, 79,860 shares of restricted stock were granted, subject to a five year vesting schedule with one fifth of the shares vesting on April 1<sup>st</sup> of each year.

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

	Number of Common Shares	Weighted Average Exercise Share Price	Average Contractual Remaining Life(Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2015	224,381	\$ 20.88		\$ 1,300
Granted	21,245	\$ 26.20		
Exercised	(26,695)	\$ 14.68		\$ 308
Forfeited or expired	(71,708)	\$ 27.96		
Balance at June 30, 2015	147,223	\$ 19.37	3.7	\$ 1,268
Exercisable at June 30, 2015	105,984	\$ 17.26	2.7	\$ 1,137
Weighted average fair value of options granted during the year		\$ 7.63		

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

	Number of Common Shares	Weighted Average Grant-Date Fair Value
<i>(In dollars, except share data):</i>		
Restricted stock at January 1, 2015	226,871	\$ 21.07
Granted	79,860	\$ 26.20
Vested	(78,565)	\$ 19.79
Forfeited	(3,317)	\$ 22.80

Restricted stock at June 30, 2015	224,849	\$ 23.31
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**Note 9 – Pension, Profit Sharing, and Other Employee Benefit Plans****Defined Benefit Pension Plan**

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

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

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

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest cost on projected benefit obligation	\$ 407	\$ 403	\$ 817	\$ 794
Expected return on plan assets	(406)	(493)	(812)	(987)
Recognized net actuarial loss	259	68	551	116
Net periodic benefit cost	\$ 260	\$ (22)	\$ 556	\$ (77)

### 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 2015.

### Note 10 – Net Income per Common Share

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

<i>(Dollars and amounts in thousands, except per share data)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$ 10,333	\$ 6,982	\$ 21,558	\$ 17,910
<u>Basic:</u>				
Basic weighted average EPS shares	24,626	25,062	24,776	25,031
Basic net income per share	\$ 0.42	\$ 0.28	\$ 0.87	\$ 0.72

### Diluted:



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Basic weighted average EPS shares	<b>24,626</b>	25,062	<b>24,776</b>	25,031
Dilutive common stock equivalents	<b>64</b>	65	<b>92</b>	95
Dilutive EPS shares	<b>24,690</b>	25,127	<b>24,868</b>	25,126
Diluted net income per share	\$ <b>0.42</b>	\$ 0.28	\$ <b>0.87</b>	\$ 0.71
Anti-dilutive shares	<b>8</b>	65	<b>8</b>	56

24

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**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 condensed financial statements presented for the Company, non-owner 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 following table presents the activity in net accumulated other comprehensive income (loss) and the components of the activity for the periods indicated:

<i>(In thousands)</i>	Unrealized Gains (Losses) on		Defined Benefit Pension	Total
	Available-for-Sale	Plan		
<b>Balance at January 1, 2015</b>	<b>\$ 8,078</b>	<b>\$ (8,901)</b>		<b>\$ (823)</b>
<b>Other comprehensive income before reclassification, net of tax</b>	<b>(100)</b>	<b>-</b>		<b>(100)</b>
<b>Reclassifications from accumulated other comprehensive income, net of tax</b>	<b>-</b>	<b>331</b>		<b>331</b>
<b>Current period change in other comprehensive income, net of tax</b>	<b>(100)</b>	<b>331</b>		<b>231</b>
<b>Balance at June 30, 2015</b>	<b>\$ 7,978</b>	<b>\$ (8,570)</b>		<b>\$ (592)</b>

<i>(In thousands)</i>	Unrealized Gains (Losses) on		Defined Benefit Pension	Total
	Available-for-Sale	Plan		
<b>Balance at January 1, 2014</b>	<b>\$ 358</b>	<b>\$ (3,328)</b>		<b>\$ (2,970)</b>
<b>Other comprehensive income before reclassification, net of tax</b>	<b>8,148</b>	<b>-</b>		<b>8,148</b>
<b>Reclassifications from accumulated other comprehensive income, net of tax</b>	<b>-</b>	<b>55</b>		<b>55</b>
<b>Current period change in other comprehensive income, net of tax</b>	<b>8,148</b>	<b>55</b>		<b>8,203</b>
<b>Balance at June 30, 2014</b>	<b>\$ 8,506</b>	<b>\$ (3,273)</b>		<b>\$ 5,233</b>

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

<i>(In thousands)</i>	For the Six Months Ended June 30,	
	<b>2015</b>	2014

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Unrealized gains/(losses) on investments available-for-sale			
Affected line item in the Statements of Income:			
Investment securities gains	\$	<b>19</b>	\$ -
Income before taxes		<b>19</b>	-
Tax expense		<b>8</b>	-
Net income	\$	<b>11</b>	\$ -
Amortization of defined benefit pension plan items			
Affected line item in the Statements of Income:			
Recognized actuarial loss (1)	\$	<b>551</b>	\$ 116
Income before taxes		<b>551</b>	116
Tax expense		<b>220</b>	61
Net income	\$	<b>331</b>	\$ 55

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

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

The Company has entered into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk. The notional value of commercial loan swaps outstanding was \$20.4 million with a fair value of \$1.4 million as of June 30, 2015 compared to \$20.9 million with a fair value of \$1.5 million as of December 31, 2014. The offsetting nature of the swaps results in a neutral effect on the Company’s operations. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The associated net gains and losses on the swaps are recorded in other non-interest income.

### **Note 13 – Litigation**

The Company and its subsidiaries are subject in the ordinary course of business to various pending or threatened legal proceedings in which claims for monetary damages are asserted. During 2014, the Company accrued \$6.5 million for litigation expenses as a result of an adverse jury verdict rendered in the second quarter of 2014 associated with the actions of a former employee of CommerceFirst Bank, which was acquired in 2012. The Company is currently in the process of appealing the decision. As a result of the appeal process, an additional \$0.4 million in legal expenses have been accrued in the first six months of 2015.

After consultation with legal counsel, management does not anticipate that the ultimate liability, if any, arising out of any other legal matters will have a material adverse effect on the Company's financial condition, operating results or liquidity.

### **Note 14 – Fair Value**

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

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

**Basis of Fair Value Measurement:**

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

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

Level 3- Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity). Changes to interest rates may result in changes in the cash flows due to prepayments or extinguishments. Accordingly, this could result in higher or lower measurements of the fair values.

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, mortgage-backed securities and corporate debt

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 2 – 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:

	<b>June 30, 2015</b>				<b>Total</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>		
<i>(In thousands)</i>					
<b><u>Assets</u></b>					
<b>Residential mortgage loans held for sale</b>	\$ -	\$ 19,445	\$ -		\$ 19,445
<b>Investments available-for-sale:</b>					
U.S. government agencies	-	137,980	-		137,980
State and municipal	-	161,953	-		161,953
Mortgage-backed	-	324,145	-		324,145
Trust preferred	-	-	1,018		1,018
Marketable equity securities	-	723	-		723
<b>Interest rate swap agreements</b>	-	1,390	-		1,390
<b><u>Liabilities</u></b>					
<b>Interest rate swap agreements</b>	\$ -	\$ (1,390)	\$ -		\$ (1,390)

	<b>December 31, 2014</b>				<b>Total</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>		
<i>(In thousands)</i>					
<b><u>Assets</u></b>					
<b>Residential mortgage loans held for sale</b>	\$ -	\$ 10,512	\$ -		\$ 10,512
<b>Investments available-for-sale:</b>					
U.S. government agencies	-	141,679	-		141,679
State and municipal	-	167,052	-		167,052
Mortgage-backed	-	361,519	-		361,519
Trust preferred	-	-	1,236		1,236
Marketable equity securities	-	723	-		723
<b>Interest rate swap agreements</b>	-	1,501	-		1,501



Liabilities

Interest rate swap agreements	\$	-	\$	(1,501)	\$	-	\$	(1,501)
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28

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

<i>(In thousands)</i>	Significant Unobservable Inputs (Level 3)
Investments available-for-sale:	
Balance at January 1, 2015	\$ 1,236
Principal redemption	(218)
Balance at June 30, 2015	\$ 1,018

### Assets Measured at Fair Value on a Nonrecurring Basis

The following table sets forth the Company's financial assets subject to fair value adjustments (impairment) on a nonrecurring basis at the date indicated that are valued at the lower of cost or market. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

<i>(In thousands)</i>	June 30, 2015				Total	Total Losses
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total		
Impaired loans	\$ -	\$ -	\$ 6,913	\$ 6,913	\$ 10,304	
Other real estate owned	-	-	4,514	4,514	(268)	
Total	\$ -	\$ -	\$ 11,427	\$ 11,427	\$ 10,036	

<i>(In thousands)</i>	December 31, 2014				Total	Total Losses
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total		
Impaired loans	\$ -	\$ -	\$ 7,819	\$ 7,819	\$ 13,893	
Other real estate owned	-	-	3,195	3,195	(247)	
Total	\$ -	\$ -	\$ 11,014	\$ 11,014	\$ 13,646	

At June 30, 2015, impaired loans totaling \$28.7 million were written down to fair value of \$25.8 million as a result of specific loan loss allowances of \$2.9 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling \$29.4 million were written down to fair value of \$26.5 million at December 31, 2014 as a result of specific loan loss allowances of \$2.9 million associated with the impaired loans.

Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable collateral is based on net book value on the business' financial statements and, if necessary, discounted based on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the factors identified above. Valuation techniques are consistent with those techniques applied in prior periods.

Other real estate owned (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. The estimated fair value for other real estate owned included in Level 3 is determined by independent market based appraisals and other available market information, less cost to sell, that may be reduced further based on market expectations or an executed sales agreement. If the fair value of the collateral deteriorates subsequent to initial recognition, the Company records the OREO as a non-recurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

### **Fair Value of Financial Instruments**

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

Quoted market prices, where available, are shown as estimates of fair market values. Because no quoted market prices are available for a significant portion of the Company's financial instruments, the fair value of such instruments has been derived based on the amount and timing of future cash flows and estimated discount rates.

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

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

	Fair Value Measurements				
	June 30, 2015		Quoted Prices in Active Markets	Significant Other Observable Inputs	Significant Unobservable Inputs
	Carrying Amount	Fair Value	Estimated for Identical Assets (Level 1)	(Level 2)	(Level 3)
<i>(In thousands)</i>					
<b>Financial Assets</b>					
Investments held-to-maturity and other equity securities	\$ 252,465	\$ 253,479	\$ -	\$ 253,479	\$ -
Loans, net of allowance	3,250,152	3,279,656	-	-	3,279,656
Other assets	89,617	89,617	-	89,617	-
<b>Financial Liabilities</b>					
Time Deposits	\$ 488,891	\$ 489,419	\$ -	\$ 489,419	\$ -
Securities sold under retail repurchase agreements and federal funds purchased	111,817	111,817	-	111,817	-
Advances from FHLB	550,000	572,615	-	572,615	-
Subordinated debentures	35,000	13,108	-	-	13,108

	Fair Value Measurements				
	December 31, 2014		Quoted Prices in Active Markets	Significant Other Observable Inputs	Significant Unobservable Inputs
	Carrying Amount	Fair Value	Estimated for Identical Assets (Level 1)	(Level 2)	(Level 3)
<i>(In thousands)</i>					
<b>Financial Assets</b>					
Investments held-to-maturity and other equity securities	\$ 261,410	\$ 263,697	\$ -	\$ 263,697	\$ -
Loans, net of allowance	3,089,590	3,118,635	-	-	3,118,635
Other assets	88,657	88,657	-	88,657	-
<b>Financial Liabilities</b>					
Time Deposits	\$ 444,921	\$ 444,729	\$ -	\$ 444,729	\$ -
Securities sold under retail repurchase agreements and federal funds purchased	74,432	74,432	-	74,432	-

Advances from FHLB	655,000	679,163	-	679,163	-
Subordinated debentures	35,000	13,276	-	-	13,276

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

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

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

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

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

**Other assets:** The investment in bank-owned life insurance represents the cash surrender value of the policies at June 30, 2015 and December 31, 2014 as determined by the each insurance carrier. The carrying value of accrued interest receivable approximates fair values due to the short-term duration.

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

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

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

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

#### **Note 15 - Segment Reporting**

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

The Community Banking segment is conducted through Sandy Spring Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. Parent company income is included in the Community Banking segment, as the majority of effort of these functions is related to this segment. Major revenue sources include net interest income, gains on sales of mortgage loans, trust income, fees on sales of investment products and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three and six ended June 30, 2015 and 2014, respectively.

The Insurance segment is conducted through Sandy Spring Insurance Corporation, a subsidiary of the Bank, and offers annuities as an alternative to traditional deposit accounts. Sandy Spring Insurance Corporation operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff and Associates, located in Ocean City, Maryland. Major sources of revenue are insurance commissions from commercial lines, personal lines, and medical liability lines. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three and six ended June 30, 2015 and 2014, respectively.

The Investment Management segment is conducted through West Financial Services, Inc., a subsidiary of the Bank. This asset management and financial planning firm, located in McLean, Virginia, provides comprehensive investment management and financial planning to individuals, families, small businesses and associations including cash flow analysis, investment review, tax planning, retirement planning, insurance analysis and estate planning. West Financial currently has approximately \$1.1 billion in assets under management. Major revenue sources include non-interest income earned on the above services. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three and six ended June 30, 2015 and 2014, respectively.



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

<i>(In thousands)</i>	Three Months Ended June 30, 2015				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 38,849	\$ -	\$ 2	\$ (2)	\$ 38,849
Interest expense	4,918	-	-	(2)	4,916
Provision for loan and lease losses	1,218	-	-	-	1,218
Noninterest income	24,945	984	1,754	(15,574)	12,109
Noninterest expenses	42,958	1,169	924	(15,574)	29,477
Income before income taxes	14,700	(185)	832	-	15,347
Income tax expense	4,763	(74)	325	-	5,014
Net income	\$ 9,937	\$ (111)	\$ 507	\$ -	\$ 10,333
Assets	\$ 4,508,858	\$ 5,647	\$ 10,672	\$ (17,810)	\$ 4,507,367

<i>(In thousands)</i>	Three Months Ended June 30, 2014				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 36,991	\$ 3	\$ 5	\$ (8)	\$ 36,991
Interest expense	4,690	-	-	(8)	4,682
Provision for loan and lease losses	158	-	-	-	158
Non-interest income	12,108	1,045	1,717	(3,176)	11,694
Non-interest expenses	35,305	1,125	887	(3,176)	34,141
Income before income taxes	8,946	(77)	835	-	9,704
Income tax expense	2,427	(30)	325	-	2,722
Net income	\$ 6,519	\$ (47)	\$ 510	\$ -	\$ 6,982
Assets	\$ 4,257,129	\$ 6,025	\$ 10,927	\$ (39,739)	\$ 4,234,342

<i>(In thousands)</i>	Six Months Ended June 30, 2015				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 76,920	\$ 1	\$ 3	\$ (3)	\$ 76,921
Interest expense	9,618	-	-	(3)	9,615
Provision for loan and lease losses	1,815	-	-	-	1,815
Noninterest income	34,781	2,678	3,564	(15,755)	25,268
Noninterest expenses	69,975	2,552	1,949	(15,755)	58,721
Income before income taxes	30,293	127	1,618	-	32,038
Income tax expense	9,797	52	631	-	10,480

<b>Net income</b>	<b>\$ 20,496</b>	<b>\$ 75</b>	<b>\$ 987</b>	<b>\$ -</b>	<b>\$ 21,558</b>
<b>Assets</b>	<b>\$ 4,508,858</b>	<b>\$ 5,647</b>	<b>\$ 10,672</b>	<b>\$ (17,810)</b>	<b>\$ 4,507,367</b>

## Six Months Ended June 30, 2014

<i>(In thousands)</i>	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 73,241	\$ 5	\$ 9	\$ (14)	\$ 73,241
Interest expense	9,354	-	-	(14)	9,340
Provision (credit) for loan and lease losses	(824)	-	-	-	(824)
Non-interest income	20,123	2,776	3,395	(3,351)	22,943
Non-interest expenses	60,917	2,317	1,807	(3,351)	61,690
Income before income taxes	23,917	464	1,597	-	25,978
Income tax expense	7,258	188	622	-	8,068
Net income	\$ 16,659	\$ 276	\$ 975	\$ -	\$ 17,910
Assets	\$ 4,257,129	\$ 6,025	\$ 10,927	\$ (39,739)	\$ 4,234,342

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

### The Company

Sandy Spring Bancorp, Inc. (the "Company") is the bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. The Bank traces its origin to 1868, making it among the oldest institutions in the region. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 44 community offices located in Central Maryland and Northern 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.

With \$4.5 billion in assets, the Company is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank offers a comprehensive menu of insurance and investment management services.

### Overview

Net income for the Company for the second quarter of 2015 totaled \$10.3 million (\$0.42 per diluted share) as compared to net income of \$7.0 million (\$0.28 per diluted share) for the second quarter of 2014. For the first six months of 2015, net income totaled \$21.6 million (\$0.87 per diluted share), compared to net income of \$17.9 million (\$0.71 per diluted share), for the first six months of 2014. During the second quarter of 2014, the Company recognized accrued litigation expenses of \$6.1 million due to an adverse jury verdict. These results reflect the following events:

- Average total loans for the second quarter of 2015 increased 12% compared to the second quarter of 2014 due to organic growth in each of the three major portfolio segments.
- Combined noninterest-bearing and interest-bearing transaction account balances increased 11% to \$1.6 billion at June 30, 2015 as compared to \$1.5 billion at June 30, 2014.
- The provision for loan and lease losses was a charge of \$1.2 million for the second quarter of 2015 as compared to a charge of \$0.2 million for the second quarter of 2014 and a charge of \$0.6 million for the first quarter of 2015. The increase in the provision for the second quarter of 2015 was driven primarily by loan growth over the prior year period.

- The net interest margin was 3.42% in the second quarter of 2015, compared to 3.48% for the second quarter of 2014 and 3.44% for the first quarter of 2015. The decrease compared to the prior year's quarter was the result of declining loan yields, primarily in the commercial loan portfolio.
- Non-interest income increased \$0.4 million or 4% for the second quarter of 2015 compared to the second quarter of 2014 due largely to increases in wealth management income and income from mortgage banking activities.
- During the first six months of 2015, the Company repurchased 575,472 shares of its common stock at an average price of \$25.92 per share as part of its existing share repurchase program.

In the first six months of 2015, the Mid-Atlantic region in which the Company operates continued to show economic improvement. While the national economy improved during the first half of the year, international economic concerns together with volatile oil prices impeded both the regional and national economic outlook. Positive trends in housing, consumer spending and unemployment have been offset by concerns over a lack of wage growth and the strength of the dollar compared to other major currencies. These factors have caused uncertainty on the part of both large and small businesses and have thus restricted economic expansion. Slowing economic growth and stock market declines in China together with continuing default concerns in Greece and Puerto Rico have served as underlying volatility factors in financial markets. Together with state and municipal budget challenges across the country, these factors have caused enough economic uncertainty, particularly among individual consumers and small and medium-sized businesses, to suppress confidence and thus constrain the pace of economic expansion. Despite this challenging business environment, the Company has emphasized the fundamentals of community banking as it has maintained strong levels of liquidity and capital while overall credit quality has continued to improve.

Liquidity remained strong due to the borrowing lines with the Federal Home Loan Bank of Atlanta and the Federal Reserve and the size and composition of the investment portfolio.

The Company's non-performing assets decreased to \$41.8 million at June 30, 2015 from \$43.7 million at June 30, 2014. This decrease was due primarily to problem loan pay-offs and a reduction in restructured loans. Non-performing assets represented 0.93% of total assets at June 30, 2015 compared to 1.03% at June 30, 2014. The ratio of net charge-offs to average loans and leases was insignificant for the second quarter of 2015, compared to 0.03% for the prior year quarter.

Non-interest income increased 4% in the second quarter of 2015 compared to the second quarter of 2014. This increase was driven by a 9% increase in wealth management income due primarily to higher assets under management. Income from mortgage banking activities increased 44% for the quarter due primarily to higher volumes of loan originations.

Non-interest expenses decreased 14% in the second quarter of 2015 compared to the prior year quarter due mainly to litigation expenses incurred in the second quarter of 2014. Excluding such expenses, non-interest expenses increased 5% due to higher salaries and benefits and other non-interest expenses.

Total assets at June 30, 2015 increased 3% compared to December 31, 2014. Loan balances increased 5% compared to the prior year end due to growth of 7% in commercial loans while both consumer and residential mortgage loans increased 3% compared to the prior year end. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 7% compared to balances at December 31, 2014. The increase in customer funding sources was driven primarily by increases of 10% in certificates of deposit, 6% in noninterest-bearing and interest-bearing transaction accounts and 6% in regular savings accounts. Retail repurchase agreements also increased 50% as the Company increased its emphasis on the sale of cash management services. The Company continued to manage its net interest margin, primarily by utilizing short-term FHLB borrowings, deposit growth and retail repurchase agreements to fund loans during this extended period of historically low interest rates. During the same period, stockholders' equity decreased \$3 million to \$519 million as the payment of dividends and repurchases of stock under the Company's share repurchase program exceeded net income during the period.

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

	2015			Six Months Ended June 30,		
	Average Balances	(1) Interest	Annualized Average Yield/Rate	Average Balances	(1) Interest	2014 Average Yield/Rate
<i>(Dollars in thousands and tax-equivalent)</i>						
<b>Assets</b>						
Residential mortgage loans	\$ 729,343	\$12,279	3.37%	\$ 640,155	\$11,061	
Residential construction loans	134,849	2,489	3.72	140,147	2,612	
Commercial ADC loans	212,257	4,862	4.62	165,319	4,253	
Commercial investor real estate loans	657,088	15,350	4.71	566,275	13,872	
Commercial owner occupied real estate loans	618,100	15,200	4.96	582,042	14,213	
Commercial business loans	390,853	8,507	4.39	349,162	8,091	
Leasing	36	1	3.76	459	12	
Consumer loans	429,746	7,106	3.35	383,983	6,326	
Total loans and leases (2)	3,172,272	65,794	4.18	2,827,542	60,440	
Loans held for sale	10,583	208	3.94	6,083	130	
Taxable securities	617,861	7,722	2.50	699,460	8,715	
Tax-exempt securities (3)	294,024	6,305	4.29	302,398	6,527	
Interest-bearing deposits with banks	35,273	44	0.25	33,853	42	
Federal funds sold	473	1	0.22	475	-	
Total interest-earning assets	4,130,486	80,074	3.90	3,869,811	75,854	
Less: allowance for loan and lease losses	(37,833)			(38,864)		
Cash and due from banks	46,663			45,268		
Premises and equipment, net	51,127			45,787		
Other assets	215,567			209,535		
Total assets	\$4,406,010			\$4,131,537		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing demand deposits	\$ 525,692	207	0.08%	\$ 468,677	194	
Regular savings deposits	274,220	71	0.05	255,667	97	
Money market savings deposits	832,549	590	0.14	871,464	546	
Time deposits	455,147	1,693	0.75	462,591	1,540	
Total interest-bearing deposits	2,087,608	2,561	0.25	2,058,399	2,377	
Other borrowings	98,228	110	0.23	65,889	75	
Advances from FHLB	614,254	6,502	2.13	573,619	6,451	
Subordinated debentures	35,000	442	2.53	35,000	437	
Total interest-bearing liabilities	2,835,090	9,615	0.68	2,732,907	9,340	
Noninterest-bearing demand deposits	1,004,965			862,830		
Other liabilities	46,824			27,984		
Stockholders' equity	519,131			507,816		
Total liabilities and stockholders' equity	\$4,406,010			\$4,131,537		
Net interest income and spread		\$70,459	3.22%		\$66,514	
Less: tax-equivalent adjustment		3,153			2,613	

Net interest income	<b>\$67,306</b>	\$63,901
Interest income/earning assets	<b>3.90%</b>	
Interest expense/earning assets	<b>0.47</b>	
Net interest margin	<b>3.43%</b>	

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2015 and 2014. annualized taxable-equivalent

adjustments utilized in the above table to compute yields aggregated to \$3.2 million and \$2.6 million in 2015 and 2014, respectively.

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

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



## Results of Operations

### For the Six Months Ended June 30, 2015 Compared to the Six Months Ended June 30, 2014

Net income for the Company for the first six months of 2015 totaled \$21.6 million (\$0.87 per diluted share) compared to net income of \$17.9 million (\$0.71 per diluted share) for the first six months of 2014.

### Net Interest Income

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

Net interest income for the first six months of 2015 was \$67.3 million compared to \$63.9 million for the first six months of 2014. On a tax-equivalent basis, net interest income for the first six months of 2015 was \$70.5 million compared to \$66.5 million for the first six months of 2014, an increase of 6%. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that decreased to 3.43% for the first six months of 2015 compared to 3.48% for the prior year period. Year-to-date 2015 average interest-earning assets increased by 7% while average interest-bearing liabilities increased 4% compared to the year ago period. Average noninterest-bearing deposits increased 16% in the first six months of 2015 while the percentage of average noninterest-bearing deposits to total deposits increased to 32% for the first six months of 2015 compared to 30% for the first six months of 2014. The decrease in the net interest margin was caused by the effect of lower rates on interest-earning assets that exceeded the benefit of lower rates on interest-bearing deposits and borrowings and the increase in noninterest-bearing deposits.

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

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

	2015 vs. 2014			2014 vs. 2013		
	Increase Or (Decrease)	Due to Change In Average:*		Increase Or (Decrease)	Due to Change In Average:*	
		Volume	Rate		Volume	Rate
<i>(Dollars in thousands and tax equivalent)</i>						
Interest income from earning assets:						

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Loans and leases	\$ 5,354	\$ 7,598	\$ (2,244)	\$ 1,582	\$ 5,680	\$ (4,098)
Loans held for sale	78	89	(11)	(532)	(681)	149
Securities	(1,215)	(1,382)	167	124	(700)	824
Other earning assets	3	3	-	(1)	(1)	-
Total interest income	4,220	6,308	(2,088)	1,173	4,298	(3,125)

Interest expense on funding of earning assets:

Interest-bearing demand deposits	13	15	(2)	11	21	(10)
Regular savings deposits	(26)	8	(34)	(9)	8	(17)
Money market savings deposits	44	(21)	65	(243)	(11)	(232)
Time deposits	153	(26)	179	(233)	(140)	(93)
Total borrowings	91	721	(630)	14	1,333	(1,319)
Total interest expense	275	697	(422)	(460)	1,211	(1,671)
Net interest income	\$ 3,945	\$ 5,611	\$ (1,666)	\$ 1,633	\$ 3,087	\$ (1,454)

\* 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 for the first six months of 2015 increased 6% compared to the first six months of 2014. The previous table shows that, in 2015, the increase in average loans and leases more than offset the decline in earning asset yields with respect to the loan portfolio.

The average balance of the loan portfolio increased 12% for the first six months of 2015 compared to the prior year period. This growth was primarily in the commercial investor real estate and residential mortgage portfolios. These increases were driven by organic loan growth as the regional economy improved. The yield on average loans and leases decreased by 16 basis points due to the pay-off of higher rate loans and the origination of new loans at comparatively lower rates. The decline in the portfolio yield was driven primarily by a decrease of 24 basis points in the yield on the commercial loan portfolio together with a decrease of 9 basis points in the yield in the residential mortgage portfolio.

The average yield on total investment securities increased 4 basis points while the average balance of the portfolio decreased 9% for the first six months of 2015 compared to the first six months of 2014. The increase in the yield on investments was due primarily to a change in the mix of the overall portfolio as principal amortization reduced the relative size of the lower-yielding mortgage-backed securities while the balance of tax-exempt securities remained essentially unchanged.

## Interest Expense

Interest expense increased 3% in the first six months of 2015 compared to the first half of 2014. The increase in the expense was due to the cost of interest-bearing deposits increasing primarily due to growth in the average balances at relatively the same rates, while the increase in the average balances of Federal Home Loan Bank advances was largely offset by a 14 basis point decrease in the average rates paid. Average deposits increased 6% in the first six months of 2015 compared to the prior year period. This increase was primarily due to increases of \$199 million or 15% in average noninterest-bearing and interest-bearing checking accounts together with an increase of \$19 million or 7% in regular savings accounts as clients kept funds in short-term instruments to preserve liquidity. This growth was partially offset by a decrease in average certificates of deposit of \$7 million or 2% in the first six months of 2015 compared to the prior year-to-date. Average balances of money market accounts decreased 4% in the first six months of 2015 compared to the first six months of 2014 as clients generally maintained liquidity.

## Non-interest Income

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

<i>(Dollars in thousands)</i>	Six Months Ended June 30,		2015/2014	2015/2014
	<b>2015</b>	2014	\$ Change	% Change

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Securities gains	\$	<b>19</b>	\$	-	\$	19	-
Service charges on deposit accounts		<b>3,721</b>		4,061		(340)	(8.4) %
Mortgage banking activities		<b>2,000</b>		886		1,114	125.7
Wealth management income		<b>10,077</b>		9,207		870	9.4
Insurance agency commissions		<b>2,499</b>		2,601		(102)	(3.9)
Income from bank owned life insurance		<b>1,319</b>		1,206		113	9.4
Bank card fees		<b>2,277</b>		2,147		130	6.1
Other income		<b>3,356</b>		2,835		521	18.4
Total non-interest income	\$	<b>25,268</b>	\$	22,943	\$	2,325	10.1
		39					

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Total non-interest income was \$25.3 million for the first six months of 2015 compared to \$22.9 million for the first six months of 2014. The primary drivers of non-interest income for the first six months of 2015 were increases in wealth management income, income from mortgage banking activities and other non-interest income. Further detail by type of non-interest income follows:

- Wealth management income is comprised of income from trust and estate services, investment management fees earned by West Financial Services, the Company's investment management subsidiary, and fees on sales on investment products and services. Trust services fees increased 15% for the first six months of 2015 compared to the prior year period due to an increase in assets under management and one-time estate fees. Investment management fees in West Financial Services increased 5% in 2015 compared to the first six months of 2014, also due to higher assets under management. Fees on sales of investment products increased 5% for the first six months of 2015 compared to the prior year period, due to higher assets under management. Overall total assets under management increased to \$2.9 billion at June 30, 2015 compared to \$2.7 billion at June 30, 2014 as a result of positive market movements and additions from new and existing clients.
- Income from mortgage banking activities increased in 2015 compared to 2014 due primarily to higher loan origination volumes from refinancing activity as mortgage rates remained at historic lows.
- Other non-interest income increased during 2015 compared to 2014 due mainly to increases in loan prepayment fees and gains on sales of SBA loans.
- Income from bank owned life insurance increased in the first six months of 2015 compared to the first half of 2014 due primarily to policy proceeds recognized during 2015.
- Income from service charges on deposits decreased due to a decrease in return check charges for 2015 compared to the prior year period.
- Insurance agency commissions decreased due primarily to a decline in annual contingency commissions based on policy performance.
- Income from bank card fees increased 6% due to a higher volume of electronic transactions.

## Non-interest Expense

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

<i>(Dollars in thousands)</i>	<b>Six Months Ended June 30,</b>		2015/2014	2015/2014
	<b>2015</b>	2014	<b>\$ Change</b>	<b>% Change</b>
Salaries and employee benefits	\$ <b>34,833</b>	\$ 32,829	\$ 2,004	6.1 %
Occupancy expense of premises	<b>6,662</b>	6,746	(84)	(1.2)
Equipment expenses	<b>2,863</b>	2,518	345	13.7
Marketing	<b>1,473</b>	1,344	129	9.6
Outside data services	<b>2,363</b>	2,432	(69)	(2.8)
FDIC insurance	<b>1,285</b>	1,093	192	17.6
Amortization of intangible assets	<b>213</b>	594	(381)	(64.1)

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Litigation Expenses	<b>362</b>	6,128	(5,766)	(94.1)
Professional fees	<b>2,408</b>	2,206	202	9.2
Other real estate owned	<b>14</b>	9	5	55.6
Other expenses	<b>6,245</b>	5,791	454	7.8
Total non-interest expense	<b>\$ 58,721</b>	\$ 61,690	\$ (2,969)	(4.8)

Non-interest expenses totaled \$58.7 million in the first six months of 2015 compared to \$61.7 million in the first six months of 2014, a decrease of 5%. Excluding the litigation expenses from both years, non-interest expenses increased 5% compared to the prior year period. This increase in expenses was driven primarily by higher salaries and benefits and other non-interest expenses, which were partially offset by a decrease in intangibles amortization. Further detail by category of non-interest expense follows:

- Salaries and employee benefits, the largest component of non-interest expenses, increased in the first six months of 2015 due primarily to higher compensation expenses as a result of merit increases and increased health insurance expenses. In addition, pension expense increased over the first six months of 2014 due to a change in actuarial assumptions. The average number of full-time equivalent employees was 718 in the first six months of 2015 compared to 722 in the prior year period.
- Equipment expenses increased in 2015 compared to 2014 due to higher software amortization expense.
- FDIC expenses increased in 2015 compared to 2014 due to growth in assets.

- Intangibles amortization decreased in 2015 due to the costs of prior year acquisitions being fully amortized during the period.
- Other non-interest expenses increased in 2015 compared to the prior year-to-date due mainly to an increase in fraudulent bankcard activity.
- Marketing expenses increased in 2015 due to increases in targeted advertising initiatives.

### **Income Taxes**

The Company had income tax expense of \$10.5 million in the first six months of 2015, compared to income tax expense of \$8.1 million in the first six months of 2014. The resulting effective tax rates were 33% for the first six months of 2015 compared to 31% for the first six months of 2014. The effective rate increased in 2015 compared to 2014 due to tax exempt income comprising a lower proportion of income before taxes.

## Results of Operations

### For the Three Months Ended June 30, 2015 Compared to the Three Months Ended June 30, 2014

Net income for the Company for the second quarter of 2015 totaled \$10.3 million (\$0.42 per diluted share) compared to net income of \$7.0 million (\$0.28 per diluted share) for the second quarter of 2014.

## Net Interest Income

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

Net interest income for the second quarter of 2015 was \$33.9 million compared to \$32.3 million for the second quarter of 2014. On a tax-equivalent basis, net interest income for the second quarter of 2015 was \$35.5 million compared to \$33.6 million for the second quarter of 2014, an increase of 6%. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that decreased to 3.42% for the second quarter of 2015 compared to 3.48% for the prior year period. Quarterly average interest-earning assets increased by 7% and average interest-bearing liabilities increased 5% compared to the second quarter of 2014. Average noninterest-bearing deposits increased 14% for the quarter compared to the same quarter of the prior year. The percentage of average noninterest-bearing deposits to total deposits increased to 33% for the second quarter of 2015 compared to 30% for the second quarter of 2014. The decrease in the net interest margin was caused by the effect of lower rates on interest-earning assets that exceeded the benefit of lower rates on interest-bearing deposits and borrowings and the increase in noninterest-bearing deposits.



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

	Three Months Ended June 30,					
	2015			2014		
	Average	(1)	Annualized	Average	(1)	Annualized
<i>(Dollars in thousands and tax-equivalent)</i>	Balances	Interest	Yield/Rate	Balances	Interest	Yield/Rate
<b>Assets</b>						
Residential mortgage loans	\$ 734,382	\$ 6,155	3.35%	\$ 652,232	\$ 5,614	3.44%
Residential construction loans	137,216	1,268	3.71	145,968	1,359	3.73
Commercial ADC loans	218,341	2,525	4.64	168,063	2,180	5.20
Commercial investor real estate loans	668,883	7,771	4.66	575,283	7,139	4.98
Commercial owner occupied real estate loans	624,407	7,669	4.93	579,953	7,146	5.09
Commercial business loans	398,510	4,369	4.40	348,597	4,054	4.69
Leasing	28	-	1.49	352	6	6.30
Consumer loans	434,011	3,606	3.35	390,076	3,208	3.32
Total loans and leases (2)	3,215,778	33,363	4.16	2,860,524	30,706	4.34
Loans held for sale	14,075	132	3.76	6,940	71	4.12
Taxable securities	606,581	3,786	2.50	688,793	4,263	2.48
Tax-exempt securities (3)	291,656	3,135	4.30	302,342	3,260	4.32
Interest-bearing deposits with banks	34,400	22	0.25	34,770	22	0.25
Federal funds sold	473	-	0.22	474	-	0.22
Total interest-earning assets	4,162,963	40,438	3.89	3,893,843	38,322	3.97
Less: allowance for loan and lease losses	(38,217)			(38,342)		
Cash and due from banks	46,894			44,987		
Premises and equipment, net	51,591			45,696		
Other assets	215,439			211,375		
Total assets	\$4,438,670			\$4,157,559		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing demand deposits	\$ 527,307	101	0.08%	\$ 477,018	102	0.09%
Regular savings deposits	278,199	37	0.05%	262,078	49	0.07%
Money market savings deposits	833,382	317	0.15%	865,134	273	0.13%
Time deposits	466,632	912	0.78%	461,812	769	0.67%
Total interest-bearing deposits	2,105,520	1,367	0.26%	2,066,042	1,193	0.23%
Other borrowings	106,180	60	0.23%	68,880	37	0.22%
Advances from FHLB	605,714	3,266	2.16%	546,615	3,233	2.37%
Subordinated debentures	35,000	223	2.55%	35,000	219	2.50%
Total interest-bearing liabilities	2,852,414	4,916	0.69%	2,716,537	4,682	0.69%
Noninterest-bearing demand deposits	1,023,042			899,287		
Other liabilities	46,274			29,997		
Stockholders' equity	516,940			511,738		
Total liabilities and stockholders' equity	\$4,438,670			\$4,157,559		
Net interest income and spread		\$35,522	3.20%		\$33,640	3.28%
Less: tax-equivalent adjustment		1,589			1,331	

Net interest income	<b>\$33,933</b>	\$32,309
Interest income/earning assets	<b>3.89%</b>	3.97%
Interest expense/earning assets	<b>0.47</b>	0.49
Net interest margin	<b>3.42%</b>	3.48%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2015 and 2014. The annualized taxable-equivalent

adjustments utilized in the above table to compute yields aggregated to \$1.6 million and \$1.3 million in 2015 and 2014, respectively.

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

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

## Interest Income

The Company's total tax-equivalent interest income increased 6% for the second quarter of 2015 compared to the prior year quarter. The previous table shows that, in 2015, the increase in average loans and leases more than offset the decline in earning asset yields with respect to the loan portfolio.

The average balance of the loan portfolio increased 12% for the second quarter of 2015 compared to the second quarter of 2014. This growth was primarily in the commercial investor real estate and residential mortgage portfolios. These increases were driven by organic loan growth, as the regional economy improved, together with the possibility of Federal Reserve action to increase interest rates by the end of 2015. The yield on average loans and leases decreased by 18 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. The decline in the portfolio yield was driven primarily by a decrease of 29 basis points in the yield on the commercial loan portfolio together with a decrease of 9 basis points in the yield in the residential mortgage portfolio.

The average yield on total investment securities increased 5 basis points while the average balance of the portfolio decreased 9% for the second quarter of 2015 compared to the second quarter of 2014. The increase in the yield on investments was due primarily to a change in the mix of the overall portfolio as principal amortization reduced the relative size of the lower-yielding mortgage-backed securities while the balance of tax-exempt securities remained essentially unchanged.

## Interest Expense

Interest expense increased \$0.2 million or 5% in the second quarter of 2015 compared to the second quarter of 2014 primarily due to growth in interest-bearing deposits together with an increase of 3 basis points in the cost of such deposits. Higher average balances of Federal Home Loan Bank advances was largely offset by a 21 basis point decrease in the average rates paid. Average deposits increased 6% in the second quarter of 2015 compared to the prior year quarter. This increase was primarily due to increases of \$174 million or 13% in average noninterest-bearing and interest-bearing checking accounts together with an increase of \$16 million or 6% in regular savings accounts. Average certificates of deposit increased 1% in the second quarter of 2015 compared to the prior year quarter as the Company increased rates offered on selected products in response to a rise in rates paid as part of the Company's liquidity management program. Average balances of money market accounts decreased 4% in the second quarter of 2015 compared to the second quarter of 2014 as clients generally maintained liquidity.

## Non-interest Income

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

	2015/2014	2015/2014
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Three Months Ended June  
30,

<i>(Dollars in thousands)</i>	<b>2015</b>	2014	\$ Change	% Change
Securities gains	\$ <b>19</b>	\$ -	\$ 19	- %
Service charges on deposit accounts	<b>1,839</b>	2,089	(250)	(12.0)
Mortgage banking activities	<b>822</b>	570	252	44.2
Wealth management income	<b>5,161</b>	4,741	420	8.9
Insurance agency commissions	<b>881</b>	961	(80)	(8.3)
Income from bank owned life insurance	<b>606</b>	608	(2)	(0.3)
Bank card fees	<b>1,220</b>	1,169	51	4.4
Other income	<b>1,561</b>	1,556	5	0.3
Total non-interest income	\$ <b>12,109</b>	\$ 11,694	\$ 415	3.5

44

Total non-interest income was \$12.1 million for the second quarter of 2015 compared to \$11.7 million for the second quarter of 2014. The primary drivers of non-interest income for the second quarter of 2015 were increases in wealth management income and income from mortgage banking activities. Further detail by type of non-interest income follows:

- Wealth management income is comprised of income from trust and estate services, investment management fees earned by West Financial Services, the Company's investment management subsidiary, and fees on sales on investment products and services. Trust services fees increased 13% for the second quarter compared to the prior year period due to an increase in assets under management and one-time estate fees. Investment management fees in West Financial Services increased 2% for the second quarter of 2015 compared to the second quarter of 2014, as higher assets under management were somewhat offset by lower average fees. Fees on sales of investment products increased 11% for the second quarter compared to the prior year quarter, also due to growth in assets under management. Overall total assets under management increased to \$2.9 billion at June 30, 2015 compared to \$2.7 billion at June 30, 2014 as a result of positive market movements and additions from new and existing clients.
- Income from mortgage banking activities increased in 2015 compared 2014 due primarily to higher loan origination volumes as mortgage rates remained at historic lows.
- Other non-interest income increased during 2015 compared to 2014 due mainly to increases in loan prepayment fees and gains on sales of SBA loans.
- Income from service charges on deposits decreased 12% in 2015 compared to 2014 due to a decline in return check charges.
- Bank card fees increased 4% over the prior year quarter due to an increased volume of electronic transactions.

## Non-interest Expense

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

<i>(Dollars in thousands)</i>	<b>Three Months Ended June</b>		2015/2014 \$ Change	2015/2014 % Change
	<b>2015</b>	<b>2014</b>		
Salaries and employee benefits	\$ 17,534	\$ 16,474	\$ 1,060	6.4 %
Occupancy expense of premises	3,173	3,274	(101)	(3.1)
Equipment expenses	1,490	1,262	228	18.1
Marketing	942	802	140	17.5
Outside data services	1,102	1,216	(114)	(9.4)
FDIC insurance	654	573	81	14.1
Amortization of intangible assets	106	224	(118)	(52.7)
Litigation expenses	162	6,128	(5,966)	(97.4)
Professional fees	1,199	1,292	(93)	(7.2)
Other real estate owned	4	9	(5)	(55.6)
Other expenses	3,111	2,887	224	7.8
Total non-interest expense	\$ 29,477	\$ 34,141	\$ (4,664)	(13.7)

Non-interest expenses totaled \$29.5 million in the second quarter of 2015 compared to \$34.1 million in the second quarter of 2014, a decrease of 14%. This decrease in expenses was due to \$6.1 million in litigation expenses resulting from an adverse jury verdict in the second quarter of 2014. Excluding such expenses, non-interest expenses for the second quarter increased 5% over the prior year quarter. This increase was driven primarily by higher salaries and benefits, equipment and marketing expenses. Further detail by category of non-interest expense follows:

- Salaries and employee benefits, the largest component of non-interest expenses, increased in 2015 due primarily to higher compensation expenses as a result of merit increases and increased health insurance expenses. In addition, pension expense increased over 2014 due to a change in actuarial assumptions. The average number of full-time equivalent employees was 722 in the second quarter of 2015 compared to 723 in the second quarter of 2014.
- Equipment expenses increased in 2015 compared to 2014 due to higher software amortization expense.
- FDIC expenses increased in 2015 compared to 2014 due to growth in assets.
- Intangibles amortization decreased in 2015 due to the costs of prior year acquisitions being fully amortized during the period.
- Marketing expenses increased in 2015 due to increases in targeted advertising initiatives.

## **Operating Expense Performance**

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

## **Non-GAAP Financial Measures**

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

In general, the efficiency ratio is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation of the non-GAAP efficiency ratio exclude goodwill impairment losses, the amortization of intangibles, and non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. The GAAP efficiency ratio improved in the second of 2015 compared to the second of the 2014 due to the litigation expenses mentioned previously. The non-GAAP efficiency ratio remained essentially the same in the second quarter of 2015 compared to the second quarter of 2014.

In addition, the Company uses pre-tax, pre-provision income as a measure of the level of recurring income before taxes. Management believes this provides financial statement users with a useful metric of the run-rate of revenues and expenses which is readily comparable to other financial institutions. This measure is calculated by adding (subtracting) the provision (credit) for loan and lease losses, and the provision for income taxes back to net income.

**GAAP and Non-GAAP Efficiency Ratios**

<i>(Dollars in thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	<b>2015</b>	2014	<b>2015</b>	2014
<b>Pre-tax pre-provision income:</b>				
Net income	\$ 10,333	\$ 6,982	\$ 21,558	\$ 17,910
Plus non-GAAP adjustment:				
Litigation expenses	162	6,128	362	6,128
Income taxes	5,014	2,722	10,480	8,068
Provision (credit) for loan and lease losses	1,218	158	1,815	(824)
Pre-tax pre-provision income	\$ 16,727	\$ 15,990	\$ 34,215	\$ 31,282
<b>Efficiency ratio - GAAP basis:</b>				
Non-interest expenses	\$ 29,477	\$ 34,141	\$ 58,721	\$ 61,690
Net interest income plus non-interest income	\$ 46,042	\$ 44,003	\$ 92,574	\$ 86,844
Efficiency ratio - GAAP basis:	64.02%	77.59%	63.43%	71.04%
<b>Efficiency ratio - Non-GAAP basis:</b>				
Non-interest expenses	\$ 29,477	\$ 34,141	\$ 58,721	\$ 61,690
Less non-GAAP adjustment:				
Amortization of intangible assets	106	224	213	594
Litigation expenses	162	6,128	362	6,128
Non-interest expenses - as adjusted	\$ 29,209	\$ 27,789	\$ 58,146	\$ 54,968
Net interest income plus non-interest income	\$ 46,042	\$ 44,003	\$ 92,574	\$ 86,844
Plus non-GAAP adjustment:				
Tax-equivalent income	1,589	1,331	3,153	2,613
Less non-GAAP adjustments:				
Securities gains	19	-	-	-
Net interest income plus non-interest income - as adjusted	\$ 47,612	\$ 45,334	\$ 95,727	\$ 89,457
Non-GAAP efficiency ratio	61.35%	61.30%	60.74%	61.45%

**Income Taxes**

The Company had income tax expense of \$5.0 million in the second quarter of 2015, compared to income tax expense of \$2.7 million in the second quarter of 2014. The resulting effective tax rate was 33% for the second quarter of 2015 and 28% for the second quarter of 2014. The effective rate increased in 2015 compared to 2014 due to tax exempt income comprising a lower proportion of income before taxes.



**FINANCIAL CONDITION**

The Company's total assets were \$4.5 billion at June 30, 2015, an increase of \$110 million or 3% compared to December 31, 2014. Total loans increased 5% compared to the fourth quarter of 2014. This increase was funded by a 6% decrease in the investment portfolio and a 6% increase in deposits.

### Analysis of Loans and Leases

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

	June 30, 2015		December 31, 2014		Period-to-Period Change	
	Amount	%	Amount	%	\$ Change	% Change
<i>(Dollars in thousands)</i>						
Residential real estate:						
Residential mortgage	\$ 744,195	22.6%	\$ 717,886	22.9%	\$ 26,309	3.7%
Residential construction	137,134	4.2	136,741	4.4	393	0.3
Commercial real estate:						
Commercial owner occupied real estate	643,973	19.6	611,061	19.5	32,912	5.4
Commercial investor real estate	694,179	21.1	640,193	20.5	53,986	8.4
Commercial acquisition, development and construction	223,103	6.8	205,124	6.6	17,979	8.8
Commercial Business	409,795	12.4	390,781	12.5	19,014	4.9
Leases	21	-	54	-	(33)	(61.1)
Consumer	436,465	13.3	425,552	13.6	10,913	2.6
Total loans and leases	\$3,288,865	100.0%	\$3,127,392	100.0%	\$161,473	5.2

Total loans and leases, excluding loans held for sale, increased 5% at June 30, 2015 compared to December 31, 2014. The commercial loan portfolio increased 7% at June 30, 2015 compared to the prior year end due primarily to increases in all categories of commercial lending.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, increased 3% at June 30, 2015 compared to December 31, 2014. This increase was due to a 4% increase in permanent residential mortgages, most of which are loans on 1-4 family dwellings.

The consumer loan portfolio increased 3% at June 30, 2015 compared to December 31, 2014, primarily due to growth in home equity lines of credit.

### Analysis of Investment Securities

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

June 30, 2015	December 31, 2014
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(Dollars in thousands)

		Amount	%	Amount	%
<b>Available-for-Sale:</b>					
	U.S. government agencies and				
U.S. government agencies and corporations	corporations	\$137,980	15.7%	\$141,679	15.2
State and municipal	State and municipal	161,953	18.5	167,052	17.9
Mortgage-backed	Mortgage-backed	324,145	37.0	361,519	38.7
Trust preferred	Trust preferred	1,018	0.1	1,236	0.1
Marketable equity securities	Marketable equity securities	723	-	723	0.1
	Total available-for-sale securities	625,819	71.3	672,209	72.0
<b>Held-to-Maturity and Other Equity</b>					
	U.S. government agencies and				
U.S. government agencies and corporations	corporations	64,515	7.3	64,512	6.9
State and municipal	State and municipal	150,069	17.1	155,261	16.6
Mortgage-backed	Mortgage-backed	182	-	200	-
	Corporate debt	2,100	0.2	-	-
Other equity securities	Other equity securities	35,599	4.1	41,437	4.5
	Total held-to-maturity and other equity	252,465	28.7	261,410	28.0
<b>Total Securities</b>		<b>\$878,284</b>	<b>100.0%</b>	<b>\$933,619</b>	<b>100.0%</b>

Available-for-sale securities decreased 7% at June 30, 2015 compared to December 31, 2014 due to amortization of mortgage-backed securities and calls, while held-to-maturity and other equity securities decreased 3% due to calls and maturities and the redemption of FHLB stock.

The investment portfolio consists primarily of U.S. Agency securities, U.S. Agency mortgage-backed securities, U.S. Agency collateralized mortgage obligations and state and municipal securities. The duration of the portfolio was 3.2 years at June 30, 2015 and 3.4 years at December 31, 2014. The Company considers the duration of the portfolio to be adequate for liquidity purposes. This investment strategy has resulted in a portfolio with low credit risk that would provide the required liquidity needed to meet increased loan demand. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis.

At June 30, 2015, the trust preferred portfolio included one pooled trust preferred security backed by debt issued by banks and thrifts, which totaled \$1.1 million, with a fair value of \$1.0 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) 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 – Investments in the Notes to the Condensed Consolidated Financial Statements.

As a result of this valuation, it was determined that the pooled trust preferred security had not incurred any credit-related OTTI for the three months ended June 30, 2015. Cumulative credit-related OTTI of \$0.5 million has been recognized in earnings through June 30, 2015. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was \$0.1 million at June 30, 2015. This non-credit related OTTI was recognized in accumulated other comprehensive income (“OCI”) at June 30, 2015.

### Other Earning Assets

Residential mortgage loans held for sale increased \$8 million to \$19 million as of June 30, 2015 from \$11 million as of December 31, 2014 due to higher mortgage loan origination volumes resulting from low market interest rates. The aggregate of federal funds sold and interest-bearing deposits with banks decreased \$7 million to \$36 million at June 30, 2015 compared to December 31, 2014.

### Deposits

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

	June 30, 2015		December 31, 2014		Period-to-Period Change	
	Amount	%	Amount	%	\$ Change	% Change
<i>(Dollars in thousands)</i>						

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Noninterest-bearing deposits	<b>\$ 1,092,413</b>	<b>33.6%</b>	\$ 993,737	32.4%	\$ 98,676	9.9%
Interest-bearing deposits:						
Demand	<b>525,584</b>	<b>16.2</b>	534,605	17.4	(9,021)	(1.7)
Money market savings	<b>860,315</b>	<b>26.5</b>	828,494	27.0	31,821	3.8
Regular savings	<b>280,143</b>	<b>8.6</b>	264,751	8.6	15,392	5.8
Time deposits of less than \$100,000	<b>245,347</b>	<b>7.6</b>	239,857	7.8	5,490	2.3
Time deposits of \$100,000 or more	<b>243,544</b>	<b>7.5</b>	205,065	6.8	38,479	18.8
Total interest-bearing deposits	<b>2,154,933</b>	<b>66.4</b>	2,072,772	67.6	82,161	4.0
Total deposits	<b>\$ 3,247,346</b>	<b>100.0%</b>	\$ 3,066,509	100.0%	\$ 180,837	5.9

### Deposits and Borrowings

Total deposits increased \$181 million or 6% at June 30, 2015 compared to December 31, 2014. This increase was due primarily to a 10% increase in noninterest-bearing checking accounts compared to the prior year end. In addition, certificates of deposit also increased 10% compared to December 31, 2014. Money market accounts increased 4% and regular savings accounts increased 6% compared to December 31, 2014. The activity in these deposit products can be attributed primarily to clients' emphasis on safety and liquidity considering the current extended period of low interest rates. Total borrowings decreased 9% at June 30, 2015 compared to December 31, 2014.

## 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 six months of 2015, total stockholders' equity decreased to \$519 million at June 30, 2015 compared to \$522 million at December 31, 2014 as the payment of dividends and stock repurchases exceeded net income during the period. The ratio of average equity to average assets was 11.78% for the first six months of 2015, as compared to 12.29% for the first six months of 2014.

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

	<b>June 30, 2015</b>	Ratios at December 31, 2014	Minimum Regulatory Requirements
Total Capital to risk-weighted assets	<b>14.65%</b>	15.06%	8.00%
Tier 1 Capital to risk-weighted assets	<b>13.54%</b>	13.95%	6.00%
Common Equity Tier 1 Capital	<b>12.53%</b>	n.a.	4.50%
Tier 1 Leverage	<b>10.83%</b>	11.26%	4.00%

Tier 1 capital of \$472 million and total qualifying capital of \$510 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 June 30, 2015, the most recent notification from the Bank's primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

In July 2013, the Federal Reserve Board approved revisions to its capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of the Dodd-Frank Act. The rules include new risk-based capital and leverage ratios, which were effective January 1, 2015, and revise the definition of what constitutes "capital" for calculating those ratios. The new minimum capital level requirements applicable to the Company and the Bank are: (1) a new common equity Tier 1 capital ratio of 4.5%; (2) a Tier 1 capital ratio of 6% (increased from 4%); (3) a total capital ratio of 8% (unchanged from current rules); and (4) a Tier 1 leverage ratio of 4%. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May

19, 2010 are grandfathered for companies with consolidated assets of \$15 billion or less. The rules also establish a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses to executive officers if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such action.

### **Tangible Common Equity**

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

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

<i>(Dollars in thousands, except per share data)</i>	<b>June 30, 2015</b>	December 31, 2014
<b>Tangible common equity ratio:</b>		
Total stockholders' equity	\$ 518,873	\$ 521,751
Accumulated other comprehensive income (loss)	592	823
Goodwill	(84,171)	(84,171)
Other intangible assets, net	(296)	(510)
Tangible common equity	\$ 434,998	\$ 437,893
Total assets	\$ 4,507,367	\$ 4,397,132
Goodwill	(84,171)	(84,171)
Other intangible assets, net	(296)	(510)
Tangible assets	\$ 4,422,900	\$ 4,312,451
Tangible common equity ratio	9.84%	10.15%
Tangible book value per share	\$ 17.71	\$ 17.48

**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. Inconsistent economic conditions may have an adverse effect 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 remains one of the stronger markets in the nation, the Company is continuing to deal with the challenging economy and its resulting effects on its borrowers, particularly in the real estate sector. Total non-performing loans increased 10% to \$37 million at June 30, 2015



compared to the balance at December 31, 2014. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by the volatility being experienced in various business sectors of the economy on both a regional and national level.

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

The allowance 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 an adequate allowance for loan losses. Determination of the allowance is inherently subjective and requires significant estimates, including estimated losses on pools of homogeneous loans 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) a general allowance that reflects historical losses, as adjusted, by credit category, and (2) a specific allowance for impaired credits on an individual or portfolio basis. This methodology is further described in “Note 1 – Significant Accounting Policies” of the Notes to the Consolidated Financial Statements included in the Company’s 2014 Annual Report on Form 10-K. The amount of the allowance is reviewed monthly and approved quarterly by the Risk Committee of the board of directors.

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

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

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

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

- Upon receipt of the updated appraisal (or based on an updated internal financial evaluation) the loan balance is compared to the appraisal and a specific allowance is decided upon for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal net of closing costs. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

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

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

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

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

The determination of the allowance requires significant judgment, and estimates of probable losses in the loan 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 allowance based upon their analysis of the 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 previously discussed. The provision for loan and lease losses was a charge of \$1.8 million for the first six months of 2015 compared to a credit of \$0.8 million for the first six months of 2014. Historical net charge-offs represent a principal component in the application of the Company's allowance methodology. The charge to the provision in the first six months of 2015 was driven primarily by growth in the loan portfolio. The credit to the provision in the first six months of 2014 was driven by a decline in historical losses, improvement in the overall credit quality of the loan portfolio and problem loan resolutions and recoveries whose impact more than offset the effect of loan growth.

Substantially all of the fixed-rate 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 nine to eighteen months after the sale of the loan although the time frame for repurchase requests can extend for an indefinite period. Such transactions could be due to a number of causes including borrower fraud or early payment default. The Company has seen a very limited number of repurchase and indemnity demands from purchasers for such events and routinely monitors its exposure in this regard. The Company maintains a liability of \$0.5 million for probable losses due to repurchases. The Company believes that this reserve is adequate.

### **Allowance for Loan and Lease Losses**

During the second quarter of 2015, there were no changes in the Company's methodology for assessing the appropriateness of the allowance for loan and lease losses from the prior year. Variations can occur over time in the estimation of the allowance as a result of the credit performance of borrowers. No portion of the allowance was unallocated at June 30, 2015 or December 31, 2014.

At June 30, 2015, total non-performing loans and leases were \$37.3 million, or 1.13% of total loans and leases, compared to \$34.0 million, or 1.09% of total loans and leases, at December 31, 2014. The allowance represented 104% of non-performing loans and leases at June 30, 2015 as compared to 111% at December 31, 2014. The allowance for loan and lease losses as a percent of total loans and leases was 1.18% at June 30, 2015 as compared to 1.21% at December 31, 2014.

Continued analysis of the actual loss history on the problem credits in 2014 and 2015 provided an indication that the coverage of the inherent losses on the problem credits was adequate. The Company continues to monitor the impact of the economic conditions on our commercial customers, the reduced inflow of non-accruals and criticized loans in addition to the significant decline in early stage delinquencies. The improvement in these credit metrics supports management's outlook for continued improved credit quality performance.

The balance of impaired loans was \$28.7 million, with specific allowances of \$2.9 million against those loans at June 30, 2015, as compared to \$29.4 million with allowances of \$2.9 million, at December 31, 2014.

The Company's borrowers are concentrated in nine counties in Maryland, three counties in Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 76% of total loans and leases at June 30, 2015 and at December 31, 2014. Certain loan terms may create concentrations of credit risk and increase the Company's exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases

in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

**Summary of Loan and Lease Loss Experience**

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

<i>(Dollars in thousands)</i>	<b>Six Months Ended June 30, 2015</b>	<b>Year Ended December 31, 2014</b>
Balance, January 1	\$ 37,802	\$ 38,766
Provision for loan and lease losses	1,815	(163)
Loan charge-offs:		
Residential real estate:		
Residential mortgage	(78)	(323)
Residential construction	-	(4)
Commercial real estate:		
Commercial investor	(90)	(3)
Commercial owner occupied	(212)	(265)
Commercial AD&C	(739)	(529)
Commercial business	(181)	(729)
Leases	-	-
Consumer	(537)	(834)
Total charge-offs	(1,837)	(2,687)
Loan recoveries:		
Residential real estate:		
Residential mortgage	31	121
Residential construction	15	79
Commercial real estate:		
Commercial investor	10	38
Commercial owner occupied	1	6
Commercial AD&C	580	-
Commercial business	197	1,477
Leases	-	-
Consumer	99	165
Total recoveries	933	1,886
Net charge-offs	(904)	(801)
Balance, period end	\$ 38,713	\$ 37,802
Net charge-offs to average loans and leases	<b>0.06%</b>	0.03%
Allowance for loan losses to loans	<b>1.18%</b>	1.21%



**Analysis of Credit Risk**

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

<i>(Dollars in thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Non-accrual loans and leases:		
Residential real estate:		
Residential mortgage	\$ 7,780	\$ 3,012
Residential construction	780	1,105
Commercial real estate:		
Commercial investor	10,023	8,156
Commercial owner occupied	8,423	8,941
Commercial AD&C	194	2,464
Commercial business	3,285	3,184
Leases	-	-
Consumer	1,214	1,668
Total non-accrual loans and leases	<b>31,699</b>	28,530
Loans and leases 90 days past due		
Residential real estate:		
Residential mortgage	-	-
Residential construction	-	-
Commercial real estate:		
Commercial investor	-	-
Commercial owner occupied	-	-
Commercial AD&C	-	-
Commercial business	-	-
Leases	2	-
Consumer	7	-
Total 90 days past due loans and leases	<b>9</b>	-
Restructured loans and leases (accruing)	5,620	5,497
Total non-performing loans and leases	<b>37,328</b>	34,027
Other real estate owned, net	4,514	3,195
Total non-performing assets	<b>\$ 41,842</b>	\$ 37,222

**Market Risk Management**

The Company's net income is largely dependent on its net interest income. Net interest income is susceptible to interest rate risk to the extent that interest-bearing liabilities mature or re-price on a different basis than interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest

rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and stockholders' equity.

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

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

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

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

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

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

#### **Estimated Changes in Net Interest Income**

Change in Interest Rates:      + 400 bp   + 300 bp   + 200 bp   + 100 bp   - 100 bp   - 200 bp   -300 bp   -400 bp

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Policy Limit	23.50%	17.50%	15.00%	10.00%	10.00%	15.00%	17.50%	23.50%
<b>June 30, 2015</b>	<b>(2.37%)</b>	<b>(0.74%)</b>	<b>0.47%</b>	<b>0.17%</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
December 31, 2014	(5.12%)	(2.62%)	(0.89%)	(0.52%)	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk improved from December 31, 2014 at all rising interest rate shock levels. All measures remained well within prescribed policy limits.

The decrease in the risk position with respect to net interest income from December 31, 2014 to June 30, 2015 was the result of a decline in short-term FHLB borrowings which will reduce the Company's exposure to increases in interest rates. The decline in short-term borrowings was partially offset by an increase in repurchase agreements.

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%
<b>June 30, 2015</b>	<b>(8.47%)</b>	<b>(5.91%)</b>	<b>(3.07%)</b>	<b>(1.81%)</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>	<b>N/A</b>
December 31, 2014	(9.97%)	(6.75%)	(4.17%)	(1.97%)	N/A	N/A	N/A	N/A

Measures of the economic value of equity (“EVE”) at risk improved from December 31, 2014 to June 30, 2015 in all rising shock scenarios. The positive impact in EVE was driven by longer durations on several deposit categories, especially noninterest-bearing and interest-bearing checking accounts and time deposits, resulting in higher market value premiums should rates increase.

**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 June 30, 2015. Management considers core deposits, defined to include all deposits other than time deposits of \$100 thousand or more, to be a relatively stable funding source. Core deposits equaled 71% of total interest-earning assets at June 30, 2015. 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 June 30, 2015, show short-term investments exceeding short-term borrowings by \$24 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 \$1.3 billion, of which \$1.2 billion was available for borrowing based on pledged collateral, with \$550 million borrowed against it as of June 30, 2015. The line of credit at the Federal Reserve totaled \$335 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of June 30, 2015. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled \$55 million at June 30,

2015, against which there were no outstanding borrowings. In addition, the Company had a secured line of credit with a correspondent bank of \$20 million as of June 30, 2015. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at June 30, 2015.

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 funding stock repurchases and 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 June 30, 2015, the Bank could have declared a dividend of \$39 million to Bancorp. At June 30, 2015, Bancorp had liquid assets of \$15 million.

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

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

<i>(In thousands)</i>	<b>June 30, 2015</b>	December 31, 2014
Commercial	<b>\$ 234,223</b>	\$ 212,628
Real estate-development and construction	<b>81,817</b>	100,264
Real estate-residential mortgage	<b>30,529</b>	12,667
Lines of credit, principally home equity and business lines	<b>857,704</b>	810,552
Standby letters of credit	<b>60,073</b>	58,144
Total Commitments to extend credit and available credit lines	<b>\$ 1,264,346</b>	\$ 1,194,255

### **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 June 30, 2015, 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 2014 Annual Report on Form 10-K.

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

The Company re-approved a stock repurchase program in August 2013 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1,260,000 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 June 30, 2015.



Period	Total Number of Shares Purchased	Average Price Paid per Share	Total number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number that May Yet Be Purchased Under the Plans or Programs
April 1, 2015 through April 30, 2015	100,576	\$26.25	100,576	759,008
May 1, 2015 through May 31, 2015	110,302	\$26.19	110,302	648,706
June 1, 2015 through June 30, 2015	13,225	\$26.37	13,225	635,481

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

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

Exhibit 101                      The following materials from the Sandy Spring Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter end June 30, 2015 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Condition; (ii) The Condensed Consolidated Statements of Income; (iii) The Condensed Consolidated Statements of Comprehensive Income; (iv) The Condensed Consolidated Statements of Cash Flows; (v) The Condensed Consolidated Statements of Changes in Stockholders' Equity; (vi) related notes.

**Signatures**

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

SANDY SPRING BANCORP, INC.

(Registrant)

By: /s/ Daniel J. Schrider

Daniel J. Schrider

President and Chief Executive Officer

Date: August 6, 2015

By: /s/ Philip J. Mantua

Philip J. Mantua

Executive Vice President and Chief Financial Officer

Date: August 6, 2015