SANDY SPRING BANCORP INC
Form 10-K
March 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2016

Commission File Number 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	**52-1532952**

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization)	Identification No.)

17801 Georgia Avenue, Olney, Maryland **20832**
(Address of principal executive offices) (Zip Code)
301-774-6400

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $1.00 per share	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

[ ] Yes [X] No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

[ ] Yes [X] No*

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 such filing requirements for the past 90 days. [X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 shorter period that the registrant was required to submit and post such files). [X] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). [ ] Yes [X] No

The aggregate market value of the voting common stock of the registrant held by non-affiliates on June 30, 2016, the last day of the registrant’s most recently completed second fiscal quarter was approximately $682 million, based on the closing sales price of $29.06 per share of the registrant's Common Stock on that date.

The number of outstanding shares of common stock outstanding as of March 1, 2017.

Common stock, $1.00 par value – 23,919,354 shares

Documents Incorporated By Reference

Part III: Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held on May 3, 2017 (the "Proxy Statement").

* The registrant is required to file reports pursuant to Section 13 of the Act.

SANDY SPRING BANCORP, INC.
Table of Contents

Forward-Looking Statements

This Annual Report Form 10-K, 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 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. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date of this report or to reflect the occurrence of unanticipated events except as required by federal securities laws.

PART I

Item 1. BUSINESS

General

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. Sandy Spring Bank traces its origin to 1868, making it among the oldest banking institutions in the region. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 44 community offices and 6 financial centers located in Central Maryland, Northern Virginia, and Washington D. C. The Bank is a state chartered bank subject to supervision and regulation by the Federal Reserve and the State of Maryland. The Bank's deposit accounts are insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum permitted by law. The Bank is a member of the Federal Reserve System and is an Equal Housing Lender. The Company, the Bank, and its other subsidiaries are Affirmative Action/Equal Opportunity Employers.

With $5.1 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.

The Company's and the Bank's principal executive office is located at 17801 Georgia Avenue, Olney, Maryland 20832, and its telephone number is 301-774-6400.

Availability of Information

This report is not part of the proxy materials; it is provided along with the annual proxy statement for convenience of use and as an expense control measure. The Company makes available through the Investor Relations area of the Company website, at *www.sandyspringbank.com*, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. Access to these reports is provided by means of a link to a third-party vendor that maintains a database of such filings. In general, the Company intends that these reports be available as soon as practicable after they are filed with or furnished to the Securities and Exchange Commission ("SEC"). Technical and other operational obstacles or delays caused by the vendor may delay their availability. The SEC maintains a website (www.sec.gov) where these filings also are available through the SEC's EDGAR system. There is no charge for access to these filings through either the Company's site or the SEC's site.

Market and Economic Overview

Sandy Spring Bank is headquartered in Montgomery County, Maryland and conducts business primarily in Central Maryland, Northern Virginia and Washington D.C. The Bank’s business footprint serves Greater Washington, which includes the District of Columbia proper, Northern Virginia and suburban Maryland, one of the country’s most economically successful regions. The region’s economic strength is due to the region’s significant federal government presence and its strong growth in the business and professional services sector. The proximity to numerous armed forces installations in Maryland, including the United States Cyber Command in Ft. Meade, Maryland, together with a strategic location between two of the country’s leading ports - the Port of Baltimore and the Port of Norfolk – has provided opportunities for growth in a variety of areas, including logistics and transportation.

The unemployment rate in the region has remained consistently below the national average for the last several years. Much of this success is due to the region’s highly trained and educated workforce. According to the U.S. Census Bureau, the region is home to six of the top ten most highly educated counties in the nation and five of the top ten most affluent counties, as measured by household income. The Company’s geographical location provides access to key neighboring markets such as Philadelphia, New York City, Pittsburgh and the Richmond/Norfolk, Virginia corridor.

The local economy that the Company operates in continues to show moderate improvement and management believes the regional economy will continue to strengthen and expand. While this economic improvement has resulted in many positive economic trends such as lower unemployment and increased housing starts, these have been offset by other concerns such as the lack of wage growth and the strength of the dollar, that in concert, have acted to suppress the pace of economic expansion. Additionally, the changes and declines in global economic markets and geo-political unrest continue to cause uncertainty and volatility in the financial markets. The additional potential for rising interest rates has further resulted in restrained confidence among individual consumers and small and mid-sized businesses. Despite this challenging economic environment, management believes that the regional economy will continue to improve and present growth opportunities for the Company.

Loan Products

The Company currently offers a complete menu of loan products primarily in our identified market footprint that are discussed in detail below and on the following pages. These following sections should be read in conjunction with the section "Credit Risk" on page 47 of this report.

Residential Real Estate Loans

The residential real estate category contains loans principally to consumers secured by residential real estate. The Company's residential real estate lending policy requires each loan to have viable repayment sources. Residential real estate loans are evaluated for the adequacy of these repayment sources at the time of approval, based upon measures including credit scores, debt-to-income ratios, and collateral values. Credit risk for residential real estate loans arises from borrowers lacking the ability or willingness to repay the loan or by a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default and subsequent liquidation of the real estate collateral. The residential real estate portfolio includes both conforming and non-conforming mortgage loans.

Conforming mortgage loans represent loans originated in accordance with underwriting standards set forth by the government-sponsored entities ("GSEs"), including the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"), which serve as the primary purchasers of loans sold in the secondary mortgage market by mortgage lenders. These loans are generally collateralized by one-to-four-family residential real estate, have loan-to-collateral value ratios of 80% or less or have mortgage insurance to insure down to 80%, and are made to borrowers in good credit standing. Substantially all fixed-rate conforming loans originated are sold in the secondary mortgage market. For any loans retained by the Company, title insurance insuring the priority of its mortgage lien, as well as fire and extended coverage casualty insurance protecting the properties securing the loans is required. Borrowers may be required to advance funds, with each monthly payment of principal and interest, to a loan escrow account from which the Company makes disbursements for items such as real estate taxes and mortgage insurance premiums. Appraisers approved by the Company appraise the properties securing substantially all of the Company's residential mortgage loans.

Non-conforming mortgage loans represent loans that generally are not saleable in the secondary market to the GSEs for inclusion in conventional mortgage-backed securities due to the credit characteristics of the borrower, the underlying documentation, the loan-to-value ratio, or the size of the loan, among other factors. The Company originates non-conforming loans for its own portfolio and for sale to third-party investors, usually large mortgage companies, under commitments by the mortgage company to purchase the loans subject to compliance with pre-established investor criteria. Non-conforming loans generated for sale include loans that may not be underwritten using customary underwriting standards. These loans typically are held after funding for thirty days or less, and are included in residential mortgages held for sale. The Company may sell both conforming and non-conforming loans on either a servicing released or servicing retained basis.

The Company makes residential real estate development and construction loans generally to provide interim financing on property during the development and construction period. Borrowers include builders, developers and persons who will ultimately occupy the single-family dwelling. Residential real estate development and construction loan funds are disbursed periodically as pre-specified stages of completion are attained based upon site inspections. Interest rates on these loans are usually adjustable. Loans to individuals for the construction of primary personal residences are typically secured by the property under construction, frequently include additional collateral (such as a second mortgage on the borrower's present home), and commonly have maturities of twelve to eighteen months. The Company attempts to obtain the permanent mortgage loan under terms, conditions and documentation standards that permit the sale of the mortgage loan in the secondary mortgage loan market.

Commercial Loans

Included in this category are commercial real estate loans, commercial construction loans and other commercial loans. Over the years, the Company's commercial loan clients have come to represent a diverse cross-section of small to mid-size local businesses within our market footprint, whose owners and employees are often established Bank customers. Such banking relationships are a natural business for the Company, with its long-standing community roots and extensive experience in serving and lending to this market segment.

Commercial loans are evaluated for the adequacy of repayment sources at the time of approval and are regularly reviewed for any possible deterioration in the ability of the borrower to repay the loan. Collateral generally is required to provide the Company with an additional source of repayment in the event of default by a commercial borrower. The structure of the collateral package, including the type and amount of the collateral, varies from loan to loan depending on the financial strength of the borrower, the amount and terms of the loan, and the collateral available to be pledged by the borrower, but generally may include real estate, accounts receivable, inventory, equipment or other assets. Loans also may be supported by personal guarantees from the principals of the commercial loan borrowers. The financial condition and cash flow of commercial borrowers are closely monitored by the submission of corporate financial statements, personal financial statements and income tax returns. The frequency of submissions of required information depends upon the size and complexity of the credit and the collateral that secures the loan. Credit risk for commercial loans arises from borrowers lacking the ability or willingness to repay the loan, and in the case of secured loans, by a shortfall in the collateral value in relation to the outstanding loan balance in the event of a default and subsequent liquidation of collateral. The Company has no commercial loans to borrowers in similar industries that exceed 10% of total loans.

Included in commercial loans are credits directly originated by the Company and, to a lesser extent, syndicated transactions or loan participations that are originated by other lenders. The Company's commercial lending policy requires each loan, regardless of whether it is directly originated or is purchased, to have viable repayment sources. The risks associated with syndicated loans or purchased participations are similar to those of directly originated commercial loans, although additional risk may arise from the limited ability to control actions of the primary lender. Shared National Credits (SNC), as defined by the banking regulatory agencies, represent syndicated lending arrangements with three or more participating financial institutions and credit exceeding $20.0 million in the aggregate. As of December 31, 2016, the Company had $11.8 million in SNC purchases outstanding and $25.2 million in SNC sold outstanding. During 2016, the Company's primary regulator completed its annual SNC examination. As a result of this review no action was required on the Company's SNC participations.

The Company sells participations in loans it originates to other financial institutions in order to build long-term customer relationships or limit loan concentration. The Company also purchases whole loans and loan participations as part of its asset/liability management strategy. Strict policies are in place governing the degree of risk assumed and volume of loans held. At December 31, 2016, other financial institutions had $25.4 million in outstanding commercial and commercial real estate loan participations sold by the Company, excluding SNC participations. In addition, the Company had $19.8 million in outstanding commercial and commercial real estate loan participations purchased from other lenders, excluding SNC participations.

The Company's commercial real estate loans consist of both loans secured by owner occupied properties and non-owner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. The commercial real estate category contains mortgage loans to developers and owners of commercial real estate. Commercial real estate loans are governed by the same lending policies and subject to credit risk as previously described for commercial loans. Commercial real estate loans secured by owner-occupied properties are based upon the borrower’s financial health and the ability of the borrower and the business to repay. The Company seeks to reduce the risks associated with commercial mortgage lending by generally lending in its market area, using conservative loan-to-value ratios and obtaining periodic financial statements and tax returns from borrowers to perform loan reviews. It is also the Company's general policy to obtain personal guarantees from the principals of the borrowers and to underwrite the business entity from a cash flow perspective. Interest rate risks are mitigated by using either floating interest rates or by fixing rates for a short period of time, generally less than three years. While loan amortizations may be approved for up to 300 months, each loan generally has a call provision (maturity date) of five to seven years or less.

The Company primarily lends for commercial construction in local markets that are familiar and understandable, works selectively with top-quality builders and developers, and requires substantial equity from its borrowers. The underwriting process is designed to confirm that the project will be economically feasible and financially viable; it is generally evaluated as though the Company will provide permanent financing. The Company's portfolio growth objectives do not include speculative commercial construction projects or projects lacking reasonable proportionate sharing of risk. Development and construction loans are secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely upon the value of the underlying collateral, the Company considers the financial condition and reputation of the borrower and any guarantors, the amount of the borrower's equity in the project, independent appraisals, cost estimates and pre-construction sales information. A risk rating system is used on the commercial loan portfolio to determine any exposures to losses.

Acquisition, development and construction loans (“AD&C loans”) to residential builders are generally made for the construction of residential homes for which a binding sales contract exists and the prospective buyers had been pre-qualified for permanent mortgage financing by either third-party lenders (mortgage companies or other financial institutions) or the Company. Loans for the development of residential land are extended when evidence is provided that the lots under development will be or have been sold to builders satisfactory to the Company. These loans are generally extended for a period of time sufficient to allow for the clearing and grading of the land and the installation of water, sewer and roads, which is typically a minimum of eighteen months to three years.

The Company makes commercial business loans. Commercial term loans are made to provide funds for equipment and general corporate needs. This loan category is designed to support borrowers who have a proven ability to service debt over a term generally not to exceed 84 months. The Company generally requires a first lien position on all collateral and requires guarantees from owners having at least a 10% interest in the involved business. Interest rates on commercial term loans are generally floating or fixed for a term not to exceed five years. Management monitors industry and collateral concentrations to avoid loan exposures to a large group of similar industries or similar collateral. Commercial business loans are evaluated for historical and projected cash flow attributes, balance sheet strength, and primary and alternate resources of personal guarantors. Commercial term loan documents require borrowers to forward regular financial information on both the business and personal guarantors. Loan covenants require at least annual submission of complete financial information and in certain cases this information is required monthly, quarterly or semi-annually depending on the degree to which the Company desires information resources for monitoring a borrower’s financial condition and compliance with loan covenants. Examples of properly margined collateral for loans, as required by bank policy, would be a 75% advance on the lesser of appraisal or recent sales price on commercial property, an 80% or less advance on eligible receivables, a 50% or less advance on eligible inventory and an 80% advance on appraised residential property. Collateral borrowing certificates may be required to monitor certain collateral categories on a monthly or quarterly basis. Loans may require personal guarantees. Key person life insurance may be required as appropriate and as necessary to mitigate the risk of loss of a primary owner or manager. Whenever appropriate and available, the Bank seeks governmental loan guarantees, such as the Small Business Administration loan programs, to reduce risks.

Commercial lines of credit are granted to finance a business borrower’s short-term credit needs and/or to finance a percentage of eligible receivables and inventory. In addition to the risks inherent in term loan facilities, line of credit borrowers typically require additional monitoring to protect the lender against increasing loan volumes and diminishing collateral values. Commercial lines of credit are generally revolving in nature and require close scrutiny. The Company generally requires at least an annual out of debt period (for seasonal borrowers) or regular financial information (monthly or quarterly financial statements, borrowing base certificates, etc.) for borrowers with more growth and greater permanent working capital financing needs. Advances against collateral value are limited. Lines of credit and term loans to the same borrowers generally are cross-defaulted and cross-collateralized. Interest rate charges on this group of loans generally float at a factor at or above the prime lending rate.

Consumer Loans

Consumer lending continues to be important to the Company's full-service, community banking business. This category of loans includes primarily home equity loans and lines, installment loans and personal lines of credit.

The home equity category consists mainly of revolving lines of credit to consumers that are secured by residential real estate. Home equity lines of credit and other home equity loans are originated by the Company for typically up to 85% of the appraised value, less the amount of any existing prior liens on the property. While home equity loans have maximum terms of up to twenty years and interest rates are generally fixed, home equity lines of credit have maximum terms of up to ten years for draws and thirty years for repayment, and interest rates are generally adjustable. The Company secures these loans with mortgages on the homes (typically a second mortgage). Purchase money second mortgage loans originated by the Company have maximum terms ranging from ten to thirty years. These loans generally carry a fixed rate of interest for a term of 15 or 20 years. ARM loans have a 30 year amortization period with a fixed rate of interest for the first five, seven or ten years, re-pricing annually thereafter at a predetermined spread to LIBOR. Home equity lines are generally governed by the same lending policies and subject to credit risk as described for residential real estate loans.

Other consumer loans include installment loans used by customers to purchase automobiles, boats and recreational vehicles. These consumer loans are generally governed by the same overall lending policies as described for residential real estate. Credit risk for consumer loans arises from borrowers lacking the ability or willingness to repay the loan, and in the case of secured loans, by a shortfall in the value of the collateral in relation to the outstanding loan balance in the event of a default and subsequent liquidation of collateral.

Consumer installment loans are generally offered for terms of up to six years at fixed interest rates. Automobile loans can be for up to 100% of the purchase price or the retail value listed by the National Automobile Dealers Association. The terms of the loans are determined by the age and condition of the collateral. Collision insurance policies are required on all these loans, unless the borrower has substantial other assets and income. The Company also makes other consumer loans, which may or may not be secured. The term of the loans usually depends on the collateral. The majority of unsecured loans usually do not exceed $50 thousand and have a term of no longer than 36 months.

Deposit Activities

Subject to the Company’s Asset/Liability Committee (the “ALCO”) policies and current business plan, the Treasury function works closely with the Company’s retail deposit operations to accomplish the objectives of maintaining deposit market share within the Company’s primary markets and managing funding costs to preserve the net interest margin.

One of the Company’s primary objectives as a community bank is to develop long-term, multi-product customer relationships from its comprehensive menu of financial products. To that end, the lead product to develop such relationships is typically a deposit product. The Company intends to rely on deposit growth to fund long-term loan growth.

Treasury Activities

The Treasury function manages the wholesale segments of the balance sheet, including investments, purchased funds and long-term debt, and is responsible for all facets of interest rate risk management for the Company, which includes the pricing of deposits consistent with conservative interest rate risk and liquidity practices. Management's objective is to achieve the maximum level of consistent earnings over the long term, while minimizing interest rate risk, credit risk and liquidity risk and optimizing capital utilization. In managing the investment portfolio under its stated objectives, the Company invests primarily in U.S. Treasury and Agency securities, U.S Agency mortgage-backed securities ("MBS"), U.S. Agency Collateralized Mortgage Obligations ("CMO"), municipal bonds and, to a minimal extent, trust preferred securities and corporate bonds. Treasury strategies and activities are overseen by the Risk Committee of the board of directors, ALCO and the Company's Investment Committee, which reviews all investment and funding transactions. The ALCO activities are summarized and reviewed quarterly with the Company's board of directors.

The primary objective of the investment portfolio is to provide the necessary liquidity consistent with anticipated levels of deposit funding and loan demand with a minimal level of risk. The overall average duration of 3.3 years of the investment portfolio together with the types of investments (97% of the portfolio is rated AA or above) is intended to provide sufficient cash flows to support the Company's lending goals. Liquidity is also provided by lines of credit maintained with the Federal Home Loan Bank of Atlanta ("FHLB"), the Federal Reserve, and to a lesser extent, bank lines of credit.

Borrowing Activities

Management utilizes a variety of sources to raise borrowed funds at competitive rates, including federal funds purchased, FHLB borrowings and retail repurchase agreements. FHLB borrowings typically carry rates at varying spreads from the LIBOR rate or treasury yield curve for the equivalent term because they may be secured with investments or high quality loans. Federal funds purchased, which are generally overnight borrowings, are typically purchased at the Federal Reserve target rate.

The Company’s borrowing activities are achieved through the use of the previously mentioned lines of credit to address overnight and short-term funding needs, match-fund loan activity and, when opportunities are present, to lock in attractive rates due to market conditions.

Employees

The Company and its subsidiaries employed 752 persons, including executive officers, loan and other banking and trust officers, branch personnel, and others at December 31, 2016. None of the Company's employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers its employee relations to be excellent.

Competition

The Bank's principal competitors for deposits are other financial institutions, including other banks, credit unions, and savings institutions located in the Bank’s primary market area of central Maryland, Northern Virginia and Washington D. C. Competition among these institutions is based primarily on interest rates and other terms offered, service charges imposed on deposit accounts, the quality of services rendered, and the convenience of banking facilities. Additional competition for depositors' funds comes from mutual funds, U.S. Government securities, and private issuers of debt obligations and suppliers of other investment alternatives for depositors such as securities firms. Competition from credit unions has intensified in recent years as historical federal limits on membership have been relaxed. Because federal law subsidizes credit unions by giving them a general exemption from federal income taxes, credit unions have a significant cost advantage over banks and savings associations, which are fully subject to federal income taxes. Credit unions may use this advantage to offer rates that are highly competitive with those offered by banks and thrifts.

The banking business in Central Maryland, Northern Virginia and Washington D. C. generally, and the Bank's primary service areas specifically, are highly competitive with respect to both loans and deposits. As noted above, the Bank competes with many larger banking organizations that have offices over a wide geographic area. These larger institutions have certain inherent advantages, such as the ability to finance wide-ranging advertising campaigns and promotions and to allocate their investment assets to regions offering the highest yield and demand. They also offer services, such as international banking, that are not offered directly by the Bank (but are available indirectly through correspondent institutions), and, by virtue of their larger total capitalization, such banks have substantially higher legal lending limits, which are based on bank capital, than does the Bank. The Bank can arrange loans in excess of its lending limit, or in excess of the level of risk it desires to take, by arranging participations with other banks. The primary factors in competing for loans are interest rates, loan origination fees, and the range of services offered by lenders. Competitors for loan originations include other commercial banks, mortgage bankers, mortgage brokers, savings associations, and insurance companies.

Sandy Spring Insurance Corporation ("SSIC"), a wholly owned subsidiary of the Bank, offers annuities as an alternative to traditional deposit accounts. SSIC operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff & Associates, an insurance agency located in Ocean City, Maryland. Both agencies face competition primarily from other insurance agencies and insurance companies. West Financial Services, Inc. ("WFS"), a wholly owned subsidiary of the Bank, is an asset management and financial planning company located in McLean, Virginia. The competition that WFS faces is primarily from other financial planners, banks, and financial management companies.

In addition to competing with other commercial banks, credit unions and savings associations, commercial banks such as the Bank compete with non-bank institutions for funds. For instance, yields on corporate and government debt and equity securities affect the ability of commercial banks to attract and hold deposits. Mutual funds also provide substantial competition to banks for deposits. Other entities, both governmental and in private industry, raise capital through the issuance and sale of debt and equity securities and indirectly compete with the Bank in the acquisition of deposits.

Financial holding companies may engage in banking as well as types of securities, insurance, and other financial activities. Banks with or without holding companies also may establish and operate financial subsidiaries that may engage in most financial activities in which financial holding companies may engage. Competition may increase as bank holding companies and other large financial services companies expand their operations to engage in new activities and provide a wider array of products.

Monetary Policy

The Company and the Bank are affected by fiscal and monetary policies of the federal government, including those of the Federal Reserve Board, which regulates the national money supply in order to mitigate recessionary and inflationary pressures. Among the techniques available to the Federal Reserve Board are engaging in open market transactions of U.S. Government securities, changing the discount rate and changing reserve requirements against bank deposits. These techniques are used in varying combinations to influence the overall growth of bank loans, investments and deposits. Their use may also affect interest rates charged on loans and paid on deposits. The effect of governmental policies on the earnings of the Company and the Bank cannot be predicted.

Regulation, Supervision, and Governmental Policy

The following is a brief summary of certain statutes and regulations that significantly affect the Company and the Bank. A number of other statutes and regulations may affect the Company and the Bank but are not discussed in the following paragraphs.

Bank Holding Company Regulation

The Company is registered as a bank holding company under the Holding Company Act and, as such, is subject to supervision and regulation by the Federal Reserve. As a bank holding company, the Company is required to furnish to the Federal Reserve annual and quarterly reports of its operations and additional information and reports. The Company is also subject to regular examination by the Federal Reserve.

Under the Holding Company Act, a bank holding company must obtain the prior approval of the Federal Reserve before (1) acquiring direct or indirect ownership or control of any class of voting securities of any bank or bank holding company if, after the acquisition, the bank holding company would directly or indirectly own or control more than 5% of the class; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company.

Prior to acquiring control of the Company or the Bank, any company must obtain approval of the Federal Reserve. For purposes of the Holding Company Act, "control" is defined as ownership of 25% or more of any class of voting securities of the Company or the Bank, the ability to control the election of a majority of the directors, or the exercise of a controlling influence over management or policies of the Company or the Bank.

The Holding Company Act also limits the investments and activities of bank holding companies. In general, a bank holding company is prohibited from acquiring direct or indirect ownership or control of more than 5% of the voting shares of a company that is not a bank or a bank holding company or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, providing services for its subsidiaries, non-bank activities that are closely related to banking, and other financially related activities. The activities of the Company are subject to these legal and regulatory limitations under the Holding Company Act and Federal Reserve regulations.

The Change in Bank Control Act and the related regulations of the Federal Reserve require any person or persons acting in concert (except for companies required to make application under the Holding Company Act) to file a written notice with the Federal Reserve before the person or persons acquire control of the Company or the Bank. The Change in Bank Control Act defines "control" as the direct or indirect power to vote 25% or more of any class of voting securities or to direct the management or policies of a bank holding company or an insured bank.

In general, bank holding companies that qualify as financial holding companies under federal banking law may engage in an expanded list of non-bank activities. Non-bank and financially related activities of bank holding companies, including companies that become financial holding companies, also may be subject to regulation and oversight by regulators other than the Federal Reserve. The Company is not a financial holding company, but may choose to become one in the future.

The Federal Reserve has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness, or stability of any bank subsidiary of that holding company.

The Federal Reserve has adopted guidelines regarding the capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See "Regulatory Capital Requirements."

The Federal Reserve has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company's capital needs, asset quality, and overall financial condition.

Bank Regulation

The Bank is a state chartered bank and trust company subject to supervision by the State of Maryland. As a member of the Federal Reserve System, the Bank is also subject to supervision by the Federal Reserve. Deposits of the Bank are insured by the FDIC to the legal maximum. Deposits, reserves, investments, loans, consumer law compliance, issuance of securities, payment of dividends, establishment of branches, mergers and acquisitions, corporate activities, changes in control, electronic funds transfers, responsiveness to community needs, management practices, compensation policies, and other aspects of operations are subject to regulation by the appropriate federal and state supervisory authorities. In addition, the Bank is subject to numerous federal, state and local laws and regulations which set forth specific restrictions and procedural requirements with respect to extensions of credit (including to insiders), credit practices, disclosure of credit terms and discrimination in credit transactions.

The Federal Reserve regularly examines the operations and condition of the Bank, including, but not limited to, its capital adequacy, reserves, loans, investments, and management practices. These examinations are for the protection of the Bank's depositors and the Deposit Insurance Fund. In addition, the Bank is required to furnish quarterly and annual reports to the Federal Reserve. The Federal Reserve's enforcement authority includes the power to remove officers and directors and the authority to issue cease-and-desist orders to prevent a bank from engaging in unsafe or unsound practices or violating laws or regulations governing its business.

The Federal Reserve has adopted regulations regarding capital adequacy, which require member banks to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See "Regulatory Capital Requirements." Federal Reserve and State regulations limit the amount of dividends that the Bank may pay to the Company. See “Note 11 –Stockholders’ Equity” in the Notes to the Consolidated Financial Statements.

The Bank is subject to restrictions imposed by federal law on extensions of credit to, and certain other transactions with, the Company and other affiliates, and on investments in their stock or other securities. These restrictions prevent the Company and the Bank's other affiliates from borrowing from the Bank unless the loans are secured by specified collateral, and require those transactions to have terms comparable to terms of arms-length transactions with third persons. In addition, secured loans and other transactions and investments by the Bank are generally limited in amount as to the Company and as to any other affiliate to 10% of the Bank's capital and surplus and as to the Company and all other affiliates together to an aggregate of 20% of the Bank's capital and surplus. Certain exemptions to these limitations apply to extensions of credit and other transactions between the Bank and its subsidiaries. These regulations and restrictions may limit the Company's ability to obtain funds from the Bank for its cash needs, including funds for acquisitions and for payment of dividends, interest, and operating expenses.

Under Federal Reserve regulations, banks must adopt and maintain written policies that establish appropriate limits and standards for extensions of credit secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards; prudent underwriting standards, including loan-to-value limits, that are clear and measurable; loan administration procedures; and documentation, approval, and reporting requirements. A bank's real estate lending policy must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies (the "Interagency Guidelines") adopted by the federal bank regulators. The Interagency Guidelines, among other things, call for internal loan-to-value limits for real estate loans that are not in excess of the limits specified in the Guidelines. The Interagency Guidelines state, however, that it may be appropriate in individual cases to originate or purchase loans with loan-to-value ratios in excess of the supervisory loan-to-value limits.

Sandy Spring Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. Under the Federal Deposit Insurance Corporation’s risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution’s assessment rate depends upon the category to which it is assigned. Assessment rates currently range from 2-1/2 to 45 basis points. No institution may pay a dividend if in default of the federal deposit insurance assessment. Deposit insurance assessments are based on total assets less tangible equity. The Federal Deposit Insurance Corporation has authority to increase insurance assessments. Management cannot predict what insurance assessment rates will be in the future.

Regulatory Capital Requirements

In December 2010, the Basel Committee on Banking Supervision (BCBS), an international forum for cooperation on banking supervisory matters, announced the "Basel III" capital standards, which substantially revised the existing capital requirements for banking organizations. Modest revisions were made in June 2011. On July 2, 2013, the Federal Reserve adopted a final rule for the Basel III capital framework. The requirements in the rule began to phase in on January 1, 2015 for the Company. The requirements in the rule will be fully phased in by January 1, 2019.

The rule imposes higher risk-based capital and leverage requirements than those currently in place. Specifically, the rule imposes the following minimum capital requirements: (1) a new common equity Tier 1 risk-based capital ratio of 4.5%; (2) a Tier 1 risk-based capital ratio of 6% (increased from the previous 4% requirement); (3) a total risk-based capital ratio of 8% (unchanged from the previous requirement); and (4) a leverage ratio of 4%.

Under the rule, Tier 1 capital has been redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as non-cumulative perpetual preferred stock. The rule permits bank holding companies with less than $15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that previously qualified in

Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. The new capital conservation buffer requirement began to phase in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. This buffer must consist solely of Tier 1 Common Equity and the buffer applies to all three measurements: Common Equity Tier 1, Tier 1 capital and total capital.

The previous capital rules required certain deductions from or adjustments to capital. The new rule retains many of these deductions and adjustments and also provides for new ones. As a result, deductions from Common Equity Tier 1 capital will be required for goodwill (net of associated deferred tax liabilities); intangible assets such as non-mortgage servicing assets and purchased credit card relationships (net of associated deferred tax liabilities); deferred tax assets that arise from net operating loss and tax credit carryforwards (net of any related valuation allowances and net of deferred tax liabilities); any gain on sale in connection with a securitization exposure; any defined benefit pension fund net asset (net of any associated deferred tax liabilities) held by a bank holding company (this provision does not apply to a bank or savings association); the aggregate amount of outstanding equity investments (including retained earnings) in financial subsidiaries; and identified losses.

Additionally, the new rule provides for the deduction of three categories of assets: (i) deferred tax assets arising from temporary differences that cannot be realized through net operating loss carrybacks (net of related valuation allowances and of deferred tax liabilities), (ii) mortgage servicing assets (net of associated deferred tax liabilities) and (iii) investments in more than 10% of the issued and outstanding common stock of unconsolidated financial institutions (net of associated deferred tax liabilities). The amount in each category that exceeds 10% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. The remaining, non-deducted amounts are then aggregated, and the amount by which this total amount exceeds 15% of Common Equity Tier 1 capital must be deducted from Common Equity Tier 1 capital. Amounts of minority investments in consolidated subsidiaries that exceed certain limits and investments in unconsolidated financial institutions may also have to be deducted from the category of capital to which such instruments belong.

Accumulated other comprehensive income (AOCI) is presumptively included in Common Equity Tier 1 capital and often would operate to reduce this category of capital. The new rule provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI and the Company has elected this option. The new rule also has the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

Supervision and Regulation of Mortgage Banking Operations

The Company's mortgage banking business is subject to the rules and regulations of the U.S. Department of Housing and Urban Development ("HUD"), the Federal Housing Administration ("FHA"), the Veterans' Administration ("VA") and Fannie Mae with respect to originating, processing, selling and servicing mortgage loans. Those rules and regulations, among other things, prohibit discrimination and establish underwriting guidelines, which include provisions for inspections and appraisals, require credit reports on prospective borrowers, and fix maximum loan amounts. Lenders such as the Company are required annually to submit audited financial statements to Fannie Mae, FHA and VA. Each of these regulatory entities has its own financial requirements. The Company's affairs are also subject to examination by the Federal Reserve, Fannie Mae, FHA and VA at all times to assure compliance with the applicable regulations, policies and procedures. Mortgage origination activities are subject to, among others, the Equal Credit Opportunity Act, Federal Truth-in-Lending Act, Fair Housing Act, Fair Credit Reporting Act, the National Flood Insurance Act and the Real Estate Settlement Procedures Act and related regulations that prohibit discrimination and require the disclosure of certain basic information to mortgagors concerning credit terms and settlement costs. The Company's mortgage banking operations also are affected by various state and local laws and regulations and the requirements of various private mortgage investors.

Community Reinvestment

Under the Community Reinvestment Act (“CRA”), a financial institution has a continuing and affirmative obligation to help meet the credit needs of the entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, or limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community. However, institutions are rated on their performance in meeting the needs of their communities. Performance is tested in three areas: (a) lending, to evaluate the institution's record of making loans in its assessment areas; (b) investment, to evaluate the institution's record of investing in community development projects, affordable housing, and programs benefiting low or moderate income individuals and businesses; and (c) service, to evaluate the institution's delivery of services through its branches, ATMs and other offices. The CRA requires each federal banking agency, in connection with its examination of a financial institution, to assess and assign one of four ratings to the institution's record of meeting the credit needs of the community and to take such record into account in its evaluation of certain applications by the institution, including applications for charters, branches and other deposit facilities, relocations, mergers, consolidations, acquisitions of assets or assumptions of liabilities, and savings and loan holding company acquisitions. The CRA also requires that all institutions make public, disclosure of their CRA ratings. The Bank was assigned a "satisfactory" rating as a result of its last CRA examination.

Bank Secrecy Act

Under the Bank Secrecy Act (“BSA”), a financial institution is required to have systems in place to detect certain transactions, based on the size and nature of the transaction. Financial institutions are generally required to report cash transactions involving more than $10,000 to the United States Treasury. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than $5,000 and which the financial institution knows, suspects, or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA, or has no lawful purpose. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act, commonly referred to as the "USA Patriot Act" or the "Patriot Act”, enacted prohibitions against specified financial transactions and account relationships, as well as enhanced due diligence standards intended to prevent the use of the United States financial system for money laundering and terrorist financing activities. The Patriot Act requires banks and other depository institutions, brokers, dealers and certain other businesses involved in the transfer of money to establish anti-money laundering programs, including employee training and independent audit requirements meeting minimum standards specified by the act, to follow standards for customer identification and maintenance of customer identification records, and to compare customer lists against lists of suspected terrorists, terrorist organizations and money launderers. The Patriot Act also requires federal bank regulators to evaluate the effectiveness of an applicant in combating money laundering in determining whether to approve a proposed bank acquisition.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) established a broad range of corporate governance and accounting measures intended to increase corporate responsibility and protect investors by improving the accuracy and reliability of disclosures under federal securities laws. The Company is subject to Sarbanes-Oxley because it is required to file periodic reports with the SEC under the Securities Exchange Act of 1934. Among other things, Sarbanes-Oxley, its implementing regulations and related Nasdaq Stock Market rules have established membership requirements and additional responsibilities for the Company’s audit committee, imposed restrictions on the relationship between the Company and its outside auditors (including restrictions on the types of non-audit services our auditors may provide to us), imposed additional financial statement certification responsibilities for the Company’s chief executive officer and chief financial officer, expanded the disclosure requirements for corporate insiders, required management to evaluate the Company’s disclosure controls and procedures and its internal control over financial reporting, and required the Company’s auditors to issue a report on our internal control over financial reporting.

Regulatory Restructuring Legislation

The Dodd-Frank Act, enacted in 2010, implements significant changes to the regulation of depository institutions. The Dodd-Frank Act created the Consumer Financial Protection Bureau, as an independent bureau of the Federal Reserve, to take over the implementation of federal consumer financial protection and fair lending laws from the depository institution regulators. However, institutions of $10 billion or fewer in assets continue to be examined for compliance with such laws and regulations by, and to be subject to the primary enforcement authority of, their primary federal regulator. In addition, the Dodd-Frank Act, among other things, requires changes in the way that institutions are assessed for deposit insurance, requires that originators of securitized loans retain a percentage of the risk for the transferred loans, directs the Federal Reserve to regulate pricing of certain debit card interchange fees, and contains a number of reforms related to mortgage originations. Many of the provisions of the Dodd-Frank Act contain delayed effective dates and/or require the issuance of regulations. As a result, it will be some time before their impact on operations can be assessed by management. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in an increased regulatory burden and higher compliance, operating, and possibly, interest costs for the Company and the Bank.

Other Laws and Regulations

Some of the aspects of the lending and deposit business of the Bank that are subject to regulation by the Federal Reserve and the FDIC include reserve requirements and disclosure requirements in connection with personal and mortgage loans and deposit accounts. In addition, the Bank is subject to numerous federal and state laws and regulations that include specific restrictions and procedural requirements with respect to the establishment of branches, investments, interest rates on loans, credit practices, the disclosure of credit terms, and discrimination in credit transactions.

Enforcement Actions

Federal statutes and regulations provide financial institution regulatory agencies with great flexibility to undertake an enforcement action against an institution that fails to comply with regulatory requirements. Possible enforcement actions range from the imposition of a capital plan and capital directive to civil money penalties, cease-and-desist orders, receivership, conservatorship, or the termination of the deposit insurance.

Executive Officers

The following listing sets forth the name, age (as of February 28, 2017), principal position and recent business experience of each executive officer:

R. Louis Caceres, 54, Executive Vice President of the Bank. Mr. Caceres was made Executive Vice President of the Bank in 2002. Prior to that, Mr. Caceres was a Senior Vice President of the Bank.

Ronald E. Kuykendall, 64, became Executive Vice President, General Counsel and Secretary of the Company and the Bank in 2002. Prior to that, Mr. Kuykendall was General Counsel and Secretary of the Company and Senior Vice President of the Bank.

Philip J. Mantua, CPA, 58, became Executive Vice President and Chief Financial Officer of the Company and the Bank in 2004. Prior to that, Mr. Mantua was Senior Vice President of Managerial Accounting.

Ronda M. McDowell, 52, became an Executive Vice President and Chief Credit Officer of the Bank in 2013. Prior to that, Ms. McDowell served as a Senior Vice President, Loan Administration and Retail Senior Credit Officer of the Bank.

Joseph J. O'Brien, Jr., 53, became Executive Vice President for Commercial and Retail Banking on January 1, 2011. Mr. O'Brien joined the Bank in July 2007 as Executive Vice President for Commercial Banking.

John D. Sadowski, 53, became Executive Vice President and Chief Information Officer of the Bank on February 1, 2011. Prior to that, Mr. Sadowski served as a Senior Vice President of the Bank.

Daniel J. Schrider, 52, became President of the Company and the Bank effective March 26, 2008 and Chief Executive Officer effective January 1, 2009. Prior to that, Mr. Schrider served as an Executive Vice President and Chief Revenue Officer of the Bank.

Item 1A. RISK FACTORS

Investing in the Company's common stock involves risks. The investor should carefully consider the following risk factors before deciding to make an investment decision regarding the Company's stock. The risk factors may cause future earnings to be lower or the financial condition to be less favorable than expected. In addition, other risks that the Company is not aware of, or which are not believed to be material, may cause earnings to be lower, or may deteriorate the financial condition of the Company. Consideration should also be given to the other information in this Annual Report on Form 10-K, as well as in the documents incorporated by reference into this Form 10-K.

Changes in U.S. or regional economic conditions could have an adverse effect on the Company's business, financial condition or results of operations.

The Company's business activities and earnings are affected by general business conditions in the United States and in the local market area. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and in the Company's market area in particular. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters; or a combination of these or other factors. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and savings habits. A return to elevated levels of unemployment, declines in the values of real estate, or other events that affect household and/or corporate incomes could impair the ability of the Company's borrowers to repay their loans in accordance with their terms and reduce demand for banking products and services.

The geographic concentration of our operations makes the Company susceptible to downturns in local economic conditions.

The Company's commercial and commercial real estate lending operations are concentrated in central Maryland, Northern Virginia and Washington D. C. The Company's success depends in part upon economic conditions in these markets. Adverse changes in economic conditions in these markets could limit growth in loans and deposits, impair the Company's ability to collect amounts due on loans, increase problem loans and charge-offs and otherwise negatively affect performance and financial condition. Declines in real estate values could cause some of the residential and commercial real estate loans to be inadequately collateralized, which would expose the Company to a greater risk of loss in the event that the recovery on amounts due on defaulted loans is resolved by selling the real estate collateral.

The Company's allowance for loan losses may not be adequate to cover our actual loan losses, which could adversely affect the Company's financial condition and results of operations.

An allowance for loan losses is maintained in an amount that is believed to be adequate to provide for probable losses inherent in the portfolio. The Company has an aggressive program to monitor credit quality and to identify loans that may become non-performing, however, at any time there are loans included in the portfolio that will result in losses, but that have not been identified as non-performing or potential problem credits. There can be no assurance that the ability exists to identify all deteriorating credits prior to them becoming non-performing assets, or that the Company will have the ability to limit losses on those loans that are identified. As a result, future additions to the allowance may be necessary. Additionally, future additions may be required based on changes in the loans comprising the portfolio and changes in the financial condition of borrowers, or as a result of assumptions by management in determining the allowance. Additionally, banking regulators, as an integral part of their supervisory function, periodically review the Company's allowance for loan losses. These regulatory agencies may require an increase in the provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from the Company's. Any increase in the allowance for loan losses could have a negative effect on the financial condition and results of operations of the Company.

If non-performing assets increase, earnings will be adversely impacted.

At December 31, 2016, non-performing assets, which are comprised of non-accrual loans, 90 days past due loans and other real estate owned, totaled $33.8 million, or 0.66%, of total assets, compared to non-performing assets of $37.2 million, or 0.80% of total assets at December 31, 2015. Non-performing assets adversely affect net income in various ways. Interest income is not recorded on non-accrual loans or other real estate owned. The Company must record a reserve for probable losses on loans, which is established through a current period charge to the provision for loan losses, and from time to time must write-down the value of properties in the Company's other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to other real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activity. Finally, if the estimate for the recorded allowance for loan losses proves to be incorrect and the allowance is inadequate, the allowance will have to be increased and, as a result, Company earnings would be adversely affected. A downturn in the Company's market areas could increase credit risk associated with the loan portfolio, as it could have a material adverse effect on both the ability of borrowers to repay loans as well as the value of the real property or other property held as collateral for such loans. There can be no assurance that non-performing loans will not increase in the future, or that the Company's non-performing assets will not result in further losses in the future.

The Company may be subject to certain risks related to originating and selling mortgage loans.

When mortgage loans are sold, it is customary to make representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Whole loan sale agreements require the repurchase or substitution of mortgage loans in the event the Company breaches any of these representations or warranties. In addition, there may be a requirement to repurchase mortgage loans as a result of borrower fraud or in the event of early payment default of the borrower on a mortgage loan. The Company receives a limited number of repurchase and indemnity demands from purchasers as a result of borrower fraud and early payment default of the borrower on mortgage loans. The Company has enhanced its underwriting policies and procedures, however, these steps may not be effective or reduce the risk associated with loans sold in the past. If repurchase and indemnity demands increase materially, the Company's results of operations could be adversely affected.

Any delays in the Company's ability to foreclose on delinquent mortgage loans may negatively impact the Company's business.

The origination of mortgage loans occurs with the expectation that if the borrower defaults then the ultimate loss is mitigated by the value of the collateral that secures the mortgage loan. The ability to mitigate the losses on defaulted loans depends upon the ability to promptly foreclose upon the collateral after an appropriate cure period. In some states, the large number of mortgage foreclosures that have occurred has resulted in delays in foreclosing. Any delay in the foreclosure process will adversely affect the Company by increasing the expenses related to carrying such assets, such as taxes, insurance, and other carrying costs, and exposes the Company to losses as a result of potential additional declines in the value of such collateral.

Changes in interest rates may adversely affect earnings and financial condition.

The Company’s net income depends to a great extent upon the level of net interest income. Changes in interest rates can increase or decrease net interest income and net income. Net interest income is the difference between the interest income earned on loans, investments, and other interest-earning assets, and the interest paid on interest-bearing liabilities, such as deposits and borrowings. Net interest income is affected by changes in market interest rates, because different types of assets and liabilities may react differently, and at different times, to market interest rate changes. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a period, an increase in market rates of interest could reduce net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could reduce net interest income.

Changes in market interest rates are affected by many factors beyond the Company’s control, including inflation, unemployment, money supply, international events, and events in world financial markets. The Company attempts to manage its risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest-earning assets and interest-bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on the net interest margin and results of operations. Changes in the market interest rates for types of products and services in various markets also may vary significantly from location to location and over time based upon competition and local or regional economic factors. At December 31, 2016, the Company’s interest rate sensitivity simulation model projected that net interest income would decrease by 2.84% if interest rates immediately rose by 200 basis points. The results of an interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that the Company will be able to successfully manage interest rate risk.

The Company’s investment securities portfolio is subject to credit risk, market risk, and liquidity risk.

The investment securities portfolio has risk factors beyond the Company’s control that may significantly influence its fair value. These risk factors include, but are not limited to, rating agency downgrades of the securities, defaults of the issuers of the securities, lack of market pricing of the securities, and instability in the credit markets. Lack of market activity with respect to some securities has, in certain circumstances, required the Company to base its fair market valuation on unobservable inputs. Any changes in these risk factors, in current accounting principles or interpretations of these principles could impact the Company’s assessment of fair value and thus the determination of other-than-temporary impairment of the securities in the investment securities portfolio. Investment securities that previously were determined to be other-than-temporarily impaired could require further write-downs due to continued erosion of the creditworthiness of the issuer. Write-downs of investment securities would negatively affect the Company’s earnings and regulatory capital ratios.

The Company is subject to liquidity risks.

Market conditions could negatively affect the level or cost of available liquidity, which would affect the Company's ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, and fund asset growth and new business transactions at a reasonable cost, in a timely manner, and without adverse consequences. Core deposits and Federal Home Loan Bank advances are the Company's primary source of funding. A significant decrease in the core deposits, an inability to renew Federal Home Loan Bank advances, an inability to obtain alternative funding to core deposits or Federal Home Loan Bank advances, or a substantial, unexpected, or prolonged change in the level or cost of liquidity could have a negative effect on the Company's business, financial condition and results of operations.

Impairment in the carrying value of goodwill could negatively impact the Company's earnings.

At December 31, 2016, goodwill totaled $85.8 million. Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. Goodwill is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. There could be a requirement to evaluate the recoverability of goodwill prior to the normal annual assessment if there is a disruption in the Company's business, unexpected significant declines in operating results, or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill impairment charges in the future, which would adversely affect the results of operations. A goodwill impairment charge does not adversely affect regulatory capital ratios or tangible capital. Based on an analysis, it was determined that the fair value of the Company's reporting units exceeded the carrying value of their assets and liabilities and, therefore, goodwill was not considered impaired at December 31, 2016.

The Company depends on its executive officers and key personnel to continue the implementation of its long-term business strategy and could be harmed by the loss of their services.

The Company believes that its continued growth and future success will depend in large part on the skills of its management team and its ability to motivate and retain these individuals and other key personnel. In particular, the Company relies on the leadership of its Chief Executive Officer, Daniel J. Schrider. The loss of service of Mr. Schrider or one or more of the Company's other executive officers or key personnel could reduce the Company's ability to successfully implement its long-term business strategy, its business could suffer and the value of the Company's common stock could be materially adversely affected. Leadership changes will occur from time to time and the Company cannot predict whether significant resignations will occur or whether the Company will be able to recruit additional qualified personnel. The Company believes its management team possesses valuable knowledge about the banking industry and the Company's markets and that their knowledge and relationships would be very difficult to replicate. Although the Chief Executive Officer and Chief Financial Officer have entered into employment agreements with the Company, it is possible that they may not complete the term of their employment agreements or renew them upon expiration. The Company's success also depends on the experience of its branch managers and lending officers and on their relationships with the customers and communities they serve. The loss of these key personnel could negatively impact the Company's banking operations. The loss of key personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on the Company's business, financial condition or operating results.

The market price for the Company's stock may be volatile.

The market price for the Company's common stock has fluctuated, ranging between $24.36 and $40.64 per share during the 12 months ended December 31, 2016. The overall market and the price of the Company's common stock may experience volatility. There may be a significant impact on the market price for the common stock due to, among other things:

- past and future dividend practice;
- financial condition, performance, creditworthiness and prospects;
- quarterly variations in operating results or the quality of the Company's assets;
- operating results that vary from the expectations of management, securities analysts and investors;

- changes in expectations as to the future financial performance;
- announcements of innovations, new products, strategic developments, significant contracts, acquisitions and other material events by the Company or its competitors;
- the operating and securities price performance of other companies that investors believe are comparable to the Company;
- future sales of the Company’s equity or equity-related securities;
- the credit, mortgage and housing markets, the markets for securities relating to mortgages or housing, and developments with respect to financial institutions generally; and
- changes in global financial markets and global economies and general market conditions, such as interest or foreign exchange rates, stock, commodity or real estate valuations or volatility or other geopolitical, regulatory or judicial events.

There can be no assurance that a more active or consistent trading market in the Company’s common stock will develop. As a result, relatively small trades could have a significant impact on the price of the Company’s common stock.

The cost savings that the Company estimates for mergers and acquisitions may not be realized.

The success of the Company's mergers and acquisitions may depend, in part, on the ability to realize the estimated cost savings from combining the acquired businesses with the Company's existing operations. It is possible that the potential cost savings could turn out to be more difficult to achieve than anticipated. The cost savings estimates also depend on the ability to combine the businesses in a manner that permits those cost savings to be realized. If the estimates turn out to be incorrect or there is an inability to combine successfully, the anticipated cost savings may not be realized fully or at all, or may take longer to realize than expected.

Combining acquired businesses with the Company may be more difficult, costly, or time-consuming than expected, or could result in the loss of customers.

It is possible that the process of merger integration of acquired companies could result in the loss of key employees, the disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger or acquisition. There also may be disruptions that cause the Company to lose customers or cause customers to withdraw their deposits. Customers may not readily accept changes to their banking arrangements or other customer relationships after the merger or acquisition.

Market competition may decrease the Company's growth or profits.

The Company competes for loans, deposits, and investment dollars with other banks and other financial institutions and enterprises, such as securities firms, insurance companies, savings associations, credit unions, mortgage brokers, and private lenders, many of which have substantially greater resources than possessed by the Company. Credit unions have federal tax exemptions, which may allow them to offer lower rates on loans and higher rates on deposits than taxpaying financial institutions such as commercial banks. In addition, non-depository institution competitors are generally not subject to the extensive regulation applicable to institutions that offer federally insured deposits. Other institutions may have other competitive advantages in particular markets or may be willing to accept lower profit margins on certain products. These differences in resources, regulation, competitive advantages, and business strategy may decrease the Company's net interest margin, increase the Company's operating costs, and may make it harder to compete profitably.

The Company operates in a highly regulated industry, and compliance with, or changes to, the laws and regulations that govern its operations may adversely affect the Company.

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. Sandy Spring Bank is subject to regulation and supervision by the Board of Governors of the Federal Reserve System and by Maryland banking authorities. Sandy Spring Bancorp is subject to regulation and supervision by the Board of Governors of the Federal Reserve System. The burdens imposed by federal and state regulations put banks at a competitive disadvantage compared to less regulated competitors such as finance companies, mortgage banking companies, and leasing companies. Changes in the laws, regulations, and regulatory practices affecting the banking industry may increase the cost of doing business or otherwise adversely affect the Company and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and the Company cannot predict the ultimate effect of these changes, which could have a material adverse effect on the Company's results of operations or financial condition. Federal economic and monetary policy may also affect the Company’s ability to attract deposits and other funding sources, make loans and investments, and achieve satisfactory interest spreads.

The Company’s ability to pay dividends is limited by law.

The ability to pay dividends to shareholders largely depends on Sandy Spring Bancorp’s receipt of dividends from Sandy Spring Bank. The amount of dividends that Sandy Spring Bank may pay to Sandy Spring Bancorp is limited by federal laws and regulations. The ability of Sandy Spring Bank to pay dividends is also subject to its profitability, financial condition and cash flow requirements. There is no assurance that Sandy Spring Bank will be able to pay dividends to Sandy Spring Bancorp in the future. The decision may be made to limit the payment of dividends even when the legal ability to pay them exists, in order to retain earnings for other uses.

Restrictions on unfriendly acquisitions could prevent a takeover of the Company.

The Company’s articles of incorporation and bylaws contain provisions that could discourage takeover attempts that are not approved by the board of directors. The Maryland General Corporation Law includes provisions that make an acquisition of the Company more difficult. These provisions may prevent a future takeover attempt in which the shareholders otherwise might receive a substantial premium for their shares over then-current market prices.

These provisions include supermajority provisions for the approval of certain business combinations and certain provisions relating to meetings of shareholders. The Company’s articles of incorporation also authorize the issuance of additional shares without shareholder approval on terms or in circumstances that could deter a future takeover attempt.

Future sales of the Company’s common stock or other securities may dilute the value and adversely affect the market price of the Company’s common stock.

In many situations, the board of directors has the authority, without any vote of the Company’s shareholders, to issue shares of authorized but unissued stock, including shares authorized and unissued under the Company’s equity incentive plans. In the future, additional securities may be issued, through public or private offerings, in order to raise additional capital. Any such issuance would dilute the percentage of ownership interest of existing shareholders and may dilute the per share book value of the Company’s common stock. In addition, option holders may exercise their options at a time when the Company would otherwise be able to obtain additional equity capital on more favorable terms.

Any changes in the Federal or State tax laws may negatively impact the Company’s financial performance.

The Company is subject to changes in tax law that could increase the effective tax rate payable to the state or federal government. These law changes may be retroactive to previous periods and as a result, could negatively affect the current and future financial performance of the Company.

Changes in accounting standards or interpretation of new or existing standards may affect how the Company reports its financial condition and results of operations.

From time to time the Financial Accounting Standards Board (“FASB”) and the SEC change accounting regulations and reporting standards that govern the preparation of the Company’s financial statements. In addition, the FASB, SEC, bank regulators and the

outside independent auditors may revise their previous interpretations regarding existing accounting regulations and the application of these accounting standards. These changes can be hard to predict and can materially impact how to record and report the Company’s financial condition and results of operations. In some cases, there could be a requirement to apply a new or revised accounting standard retroactively, resulting in the restatement of prior period financial statements.

New capital rules that became effective in 2015 and 2016 generally require insured depository institutions and their holding companies to hold more capital.

On July 2, 2013, the Federal Reserve adopted a final rule for the Basel III capital framework. These rules substantially amend the regulatory risk-based capital rules applicable to us. The rules phase in over time beginning in 2015 and will become fully effective in 2019. The rules apply to the Company as well as to Sandy Spring Bank. Beginning in 2015, our minimum capital requirements are (i) a common Tier 1 equity ratio of 4.5%, (ii) a Tier 1 capital (common Tier 1 capital plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement remains at the 4% level previously required. Beginning in 2016, a capital conservation buffer began to phase in over three years, ultimately resulting in a requirement of 2.5% on top of the common Tier 1, Tier 1 and total capital requirements, resulting in a required common Tier 1 equity ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

The Company faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

The Company’s accounting estimates and risk management processes rely on analytical and forecasting models.

The processes that the Company uses to estimate its inherent loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on its financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models that the Company uses for interest rate risk and asset-liability management are inadequate, the Company may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models that the Company uses for determining its probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models that the Company uses to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Company could realize upon sale or settlement of such financial instruments. Any such failure in the Company’s analytical or forecasting models could have a material adverse effect on its business, financial condition and results of operations.

The Company continually encounters technological change.

The financial services industry is undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company’s future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company’s operations. Many of the Company’s competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse effect on the Company’s business, financial condition and results of operations.

The Company's information systems may experience an interruption or security breach.

We rely heavily on communications and information systems to conduct our business. We, our customers, and other financial institutions with which we interact, are subject to ongoing, continuous attempts to penetrate key systems by individual hackers, organized criminals, and in some cases, state-sponsored organizations. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems, misappropriation of funds, and theft of proprietary Company or customer data. While we have policies and procedures designed to prevent or limit the effect of the possible failure, interruption or security breach of our information systems, there can be no assurance that any such failure, interruption or security breach will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failure, interruption or security breach of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties, disrupt our operations and the services we provide to customers, damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our business, revenues and competitive position.

The reliance of the Company on third party vendors could expose it to additional cyber risk and liability.

The operation of our business involves outsourcing of certain business functions and reliance on third-party providers, which may result in transmission and maintenance of personal, confidential, and proprietary information to and by such vendors. Although we require third-party providers to maintain certain levels of information security, such providers remain vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious attacks that could ultimately compromise sensitive information possessed by our company. Although we contract to limit our liability in connection with attacks against third-party providers, the company remains exposed to risk of loss associated with such vendors.

The Company outsources certain aspects of its data processing to certain third-party providers which may expose it to additional risk.

We outsource certain key aspects of our data processing to certain third-party providers. While we have selected these third-party providers carefully, we cannot control their actions. If our third-party providers encounter difficulties, including those which result from their failure to provide services for any reason or their poor performance of services, or if we have difficulty in communicating with them, our ability to adequately process and account for customer transactions could be affected, and our business operations could be adversely impacted. Replacing these third-party providers could also entail significant delay and expense.

Our third-party providers may be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. Threats to information security also exist in the processing of customer information through various other third-party providers and their personnel. We may be required to expend significant additional resources to protect against the threat of such security breaches and computer viruses, or to alleviate problems caused by such security breaches or viruses. To the extent that the activities of our third-party providers or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities.

The Company is dependent on its information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on its financial condition and results of operations.

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. We outsource many of our major systems, such as data processing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

In addition, we provide our customers the ability to bank remotely, including online over the Internet. The secure transmission of confidential information is a critical element of remote banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. Further, we outsource some of the data processing functions used for remote banking, and accordingly we are dependent on the expertise and performance of our third-party providers. To the extent that our activities, the activities of our customers, or the activities of our third-party service providers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation, results of operations and ability to attract and maintain customers and businesses. In addition, a security breach could also subject us to additional regulatory scrutiny, expose us to civil litigation and possible financial liability and cause reputational damage.

Item 1B. Unresolved Staff Comments

None.

Item 2. PROPERTIES

The Company’s headquarters is located in Olney, Maryland. As of December 31, 2016, Sandy Spring Bank owned 13 of its 44 full-service community banking centers and leased the remaining banking centers. See Note 6–Premises and Equipment to the Notes to the Consolidated Financial Statements for additional information.

Item 3. 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 out of these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Listing

Common shares of Sandy Spring Bancorp, Inc. are listed on the NASDAQ Global Select Market under the symbol “SASR”. At February 25, 2017 there were approximately 2,300 holders of record of the Company’s common stock.

Transfer Agent and Registrar

Computershare Shareholder Services, P.O. Box 30170, College Station, TX 77842-3170

Dividends

The dividend amount is established by the board of directors each quarter. In making its decision on dividends, the board considers operating results, financial condition, capital adequacy, regulatory requirements, shareholder returns, and other factors. Shareholders received quarterly cash common dividends totaling $23.7 million in 2016, $22.4 million in 2015, $19.2 million in 2014, $16.1 million in 2013 and $11.9 million in 2012. Dividends have increased from 2012 through 2016 due to the Company’s improved operating results.

Share Transactions with Employees

Shares issued under the employee stock purchase plan, which was authorized on July 1, 2011, totaled 23,779 in 2016 and 25,136 in 2015, while issuances pursuant to exercises of stock options and grants of restricted stock were 93,535 and 95,571 in the respective years. Shares issued under the director stock purchase plan in 2016 and 2015 were not significant.

Quarterly Stock Information

The following table provides stock price activity and dividend payment information for the periods indicated:

	2016			2015		
	Stock Price Range		**Per Share**	Stock Price Range		Per Share
Quarter	**Low**	**High**	**Dividend**	Low	High	Dividend
1st	**$ 24.36**	**$ 27.43**	**$ 0.24**	**$** 23.75	$ 25.84	$ 0.22
2nd	**$ 26.03**	**$ 29.47**	**0.24**	**$** 25.21	$ 28.27	0.22
3rd	**$ 27.74**	**$ 31.28**	**0.24**	**$** 24.41	$ 28.18	0.22
4th	**$ 29.51**	**$ 40.64**	**0.26**	**$** 25.37	$ 29.43	0.24
Total			**$ 0.98**			$ 0.90

Issuer Purchases of Equity Securities

The Company re-approved the stock repurchase program in August 2015 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1,200,000 shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. The Company repurchased 512,459 shares of common stock at an average price of $25.90 per share during the year ended December 31, 2016 and 870,450 shares of common stock at an average price of $25.99 per share during the year ended December 31, 2015.

Shares repurchased pursuant to the stock repurchase program during the fourth quarter of 2016 were as follows:

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
October 1, 2016 through October 31, 2016	-	N/A	-	463,861
November 1, 2016 through November 30, 2016	-	N/A	-	463,861
December 1, 2016 through				

December 31, 2016	-	N/A	-	463,861

Total Return Comparison

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the Standard and Poor's 500 Index or "S&P 500"), and a narrower index of Mid-Atlantic bank holding company peers with assets of $2 billion to $7 billion. The cumulative total return on the stock or the index equals the total increase in value since December 31, 2010, assuming reinvestment of all dividends paid into the stock or the index. The graph and table were prepared assuming that $100 was invested on December 31, 2010, in the common stock and the securities included in the indexes.

24

The Peer Group Index includes twenty publicly traded bank holding companies, other than the Company, headquartered in the Mid-Atlantic region and with assets of $2 billion to $7 billion. The companies included in this index are: Bancorp, Inc. (DE); BNC Bancorp (NC); Bryn Mawr Bank Corporation (PA); Burke & Herbert Bank & Trust Company (VA); Cardinal Financial Corporation (VA); Carter Bank & Trust (VA); City Holding Company (WV); CNB Financial Corporation (PA); CommunityOne Bancorp (NC); ConnectOne Bancorp, Inc. (NJ); Customers Bancorp, Inc. (PA); Eagle Bancorp, Inc. (MD); First Bancorp (NC); First Commonwealth Financial Corp. (PA), First Community Bancshares, Inc. (VA); Hampton Roads Bankshares, Inc (VA); HomeTrust Bancshares, Inc. (NC); Lakeland Bancorp, Inc. (NJ); Metro Bancorp, Inc. (PA); NewBridge Bancorp (NC); Park Sterling Corporation (NC); Peapack-Gladstone Financial Corporation (NJ); Peoples Bancorp Inc. (OH); S&T Bancorp, Inc. (PA); Southern Bancshares, Inc. (NC); Square 1 Financial, Inc. (NC); Sun Bancorp, Inc. (NJ); Towne Bank (VA); TriState Capital Holdings, Inc. (PA); Univest Company of Pennsylvania (PA); WesBanco, Inc. (WV) and Yadkin Financial Corp. (NC). Returns are weighted according to the issuer’s stock market capitalization at the beginning of each year shown.

Equity Compensation Plans

The following table presents the number of shares available for issuance under the Company's equity compensation plans at December 31, 2016.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	108,503	$22.46	1,403,186
Equity compensation plans not approved by security holders	-	-	-
Total	108,503	$22.46	1,403,186

26

Item 6. SELECTED FINANCIAL DATA

Consolidated Summary of Financial Results *(Dollars in thousands, except per share data)*	**2016**	2015	2014	2013	2012
Results of Operations:					
Tax-equivalent interest income	**$ 177,267**	$ 164,790	$ 153,558	$ 154,639	$ 149,244
Interest expense	**21,004**	20,113	18,818	19,433	22,651
Tax-equivalent net interest income	**156,263**	144,677	134,740	135,206	126,593
Tax-equivalent adjustment	**6,711**	6,478	5,192	5,292	5,374
Provision (credit) for loan losses	**5,546**	5,371	(163)	(1,084)	3,649
Net interest income after provision (credit) for loan losses	**144,006**	132,828	129,711	130,998	117,570
Non-interest income	**51,042**	49,901	46,871	47,511	46,956
Non-interest expenses	**123,058**	115,347	120,800	111,524	109,927
Income before taxes	**71,990**	67,382	55,782	66,985	54,599
Income tax expense	**23,740**	22,027	17,582	22,563	18,045
Net income	**48,250**	45,355	38,200	44,422	36,554
Per Share Data:					
Net income - basic per share	**$ 2.00**	$ 1.84	$ 1.53	$ 1.78	$ 1.49
Net income - diluted per share	**2.00**	1.84	1.52	1.77	1.48
Dividends declared per common share	**0.98**	0.90	0.76	0.64	0.48
Book value per common share	**22.32**	21.58	20.83	19.98	19.41
Dividends declared to diluted net income per common share	**49.00%**	48.91%	50.00%	36.16%	32.43%
Period End Balances:					
Assets	**$5,091,383**	$4,655,380	$4,397,132	$4,106,100	$3,955,206
Investment securities	**779,648**	841,650	933,619	1,016,609	1,075,032
Loans	**3,927,808**	3,495,370	3,127,392	2,784,266	2,531,128
Deposits	**3,577,544**	3,263,730	3,066,509	2,877,225	2,913,034
Borrowings	**945,119**	829,145	764,432	703,842	526,987
Stockholders' equity	**533,572**	524,427	521,751	499,363	483,512
Average Balances:					
Assets	**$4,743,375**	$4,486,453	$4,194,206	$4,007,411	$3,780,084
Investment securities	**740,519**	883,143	977,730	1,063,247	1,062,377
Loans	**3,677,662**	3,276,610	2,917,514	2,642,872	2,415,459
Deposits	**3,460,804**	3,184,359	2,986,213	2,889,875	2,777,098

Borrowings	**717,542**	735,474	662,111	595,842	510,704
Stockholders' equity	**527,524**	519,671	514,207	487,836	465,719
Performance Ratios:					
Return on average assets	**1.02%**	1.01%	0.91%	1.11%	0.97%
Return on average common equity	**9.15**	8.73	7.43	9.11	7.85
Yield on average interest-earning assets	**3.96**	3.91	3.93	4.15	4.24
Rate on average interest-bearing liabilities	**0.68**	0.70	0.69	0.74	0.89
Net interest spread	**3.28**	3.21	3.24	3.41	3.35
Net interest margin	**3.49**	3.44	3.45	3.63	3.60
Efficiency ratio – GAAP(1)	**61.35**	61.32	68.47	62.86	65.36
Efficiency ratio – Non-GAAP (1)	**58.66**	61.09	62.48	60.06	60.94
Capital Ratios:					
Tier 1 leverage	**10.14%**	10.60%	11.26%	11.32%	10.98%
Common equity tier 1 capital to risk-weighted assets	**11.01**	12.17	n.a	n.a	n.a
Tier 1 capital to risk-weighted assets	**11.74**	13.13	13.95	14.42	14.15
Total regulatory capital to risk-weighted assets	**12.80**	14.25	15.06	15.65	15.40
Tangible common equity to tangible assets - Non-GAAP (2)	**9.07**	9.66	10.15	10.37	9.94
Average equity to average assets	**11.12**	11.58	12.26	12.17	12.32
Credit Quality Ratios:					
Allowance for loan losses to loans	**1.12%**	1.17%	1.21%	1.39%	1.70%
Non-performing loans to total loans	**0.81**	0.99	1.09	1.44	2.29
Non-performing assets to total assets	**0.66**	0.80	0.85	1.01	1.61
Net charge-offs to average loans	**0.06**	0.07	0.03	0.12	0.42

(1) See the discussion of the efficiency ratio in the section of Management's Discussion and Analysis of Financial Condition and Results of Operations entitled "Operating Expense Performance."

(2) See the discussion of tangible common equity in the section of Management's Discussion and Analysis of Financial Condition and Results of Operations entitled "Tangible Common Equity."

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Net income for Sandy Spring Bancorp, Inc. and subsidiaries (the "Company") for the year ended December 31, 2016 totaled $48.3 million ($2.00 per diluted share), compared to net income of $45.4 million ($1.84 per diluted share) for the prior year. These results reflect the following events:

- Total loans at December 31, 2016 increased 12% compared to the balance at December 31, 2015 due primarily to a 17% increase in commercial loans. Overall the entire portfolio grew $432 million over the prior year.

- The net interest margin increased to 3.49% in 2016 compared to 3.44% in 2015.

- Combined noninterest-bearing and interest-bearing transaction account balances increased 12% to $1.8 billion at December 31, 2016 as compared to $1.6 billion at December 31, 2015.

- The provision for loan losses was a charge of $5.5 million for 2016 compared to a charge of $5.4 million for 2015. The provision for 2016 reflects the effect of loan growth during the year that was offset by the impact of the decline in non-performing loans and continued improvement in loan quality.

- Non-interest income increased 2% for 2016 compared to 2015 due to $1.9 million in gains on sales and calls of investment securities and a gain of $1.2 million on the extinguishment of $5 million in subordinated debentures. Excluding these gains, non-interest income decreased 4% due to a decrease in income from wealth management resulting from the sale of a portion of the assets under management.

- Non-interest expenses increased 7% for 2016 compared to the prior year. This increase was a product of $3.2 million in penalties due to the prepayment of FHLB advances in 2016 and a $1 million charitable contribution to the Sandy Spring Foundation along with the recapture of $4.5 million in litigation expenses resulting from the settlement of litigation related to an adverse jury verdict in 2015. Excluding these transactions, non-interest expenses for the year ended December 31, 2016 increased 1% over the prior year due to higher software and outside data services expenses.

In 2016, the Mid-Atlantic region in which the Company operates showed moderate economic performance. While the national economy slowly improved throughout the year, international economic concerns together with volatile stock 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 suppressed economic activity. Slowing economic growth and stock market declines in China together with continuing unrest in the Middle East and the pending exit of Great Britain from the European Union have served as underlying volatility factors in financial markets. Together with the prospect of rising interest rates, 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 experienced healthy loan growth while maintaining strong levels of liquidity, capital and credit quality.

The net interest margin increased to 3.49% in 2016 compared to 3.44% for 2015. Average loans increased 12%, compared to the prior year, while average total deposits increased 9% compared to 2015. Liquidity remained strong due to borrowing lines with the Federal Home Loan Bank of Atlanta and the Federal Reserve and the size and composition of the investment portfolio.

At December 31, 2016, the Bank remained above all "well-capitalized" regulatory requirement levels. In addition, tangible book value per common share increased 4% to $18.98 from $18.17 at December 31, 2015.

The Company's credit quality remained strong as non-performing assets totaled $33.8 million at December 31, 2016 compared to $37.2 million at December 31, 2015 as an increase in non-performing commercial loans was more than offset by a decline in non-performing residential mortgage loans. Non-performing assets represented 0.66% of total assets at December 31, 2016 compared to 0.80% at December 31, 2015. The ratio of net charge-offs to average loans was 0.06% for 2016, compared to 0.07% for the prior year.

Total assets at December 31, 2016 increased 9% compared to December 31, 2015. Loan balances increased 12% compared to the prior year end due to increases of 7% in residential mortgage and construction loans, 17% in commercial loans and 1% in consumer loans. The growth in commercial loans was driven by double digit increases in ADC, owner-occupied real estate and investor real estate loans while the increase in mortgage loans was due primarily to growth in conventional fixed rate mortgage loans. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 10% compared to balances at December 31, 2015. The increase in customer funding sources was driven primarily by increases of 15% in certificates of deposit and 12% in checking accounts. The Company continued to manage its net interest margin, by utilizing less costly short-term FHLB borrowings during this extended period of historically low interest rates. This effect on the net interest margin was somewhat offset by increased rates offered on certificates of deposit and money market accounts to retain these deposit relationships in the expectation of higher interest rates. During the same period, stockholders' equity increased to $534 million due to net income in 2016 which effect was somewhat offset by dividends paid to stockholders and stock repurchases during 2016.

Net interest income increased 8% compared to the prior year due to the effects of 6% growth in average interest-earning assets and an increase of 5 basis points in the net interest margin.

Non-interest income increased 2% in 2016 compared to 2015. The primary drivers of non-interest income in 2016 compared to 2015 were $1.9 million in gains on sales and calls of investment securities and a gain of $1.2 million on the extinguishment of $5 million in subordinated debentures. Excluding these gains, non-interest income decreased 4% due to a decrease in wealth management income resulting from the sale of a portion of the assets under management in 2016.

Non-interest expenses increased 7% in 2016 compared to the prior year due primarily to $3.2 million in penalties due to the prepayment of FHLB advances in 2016 and the recapture of $4.5 million in litigation expenses and a $1 million charitable contribution in 2015. Excluding these transactions, non-interest expenses increased 1% over 2015. This increase was driven primarily by higher software and outside data services expenses.

Critical Accounting Policies

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

- Allowance for loan losses;
- Goodwill and other intangible asset impairment;
- Accounting for income taxes;
- Fair value measurements;
- Defined benefit pension plan.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the probable losses that are inherent in the loan portfolio at the balance sheet date. The allowance is based on the basic principle that a loss be accrued when it is probable that the loss has occurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

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

The Company's allowance for loan losses has two basic components: a general allowance (ASC 450 reserves) reflecting historical losses by loan category, as adjusted by several factors whose effects are not reflected in historical loss ratios, and specific allowances (ASC 310 reserves) for individually identified loans. Each of these components, and the allowance methodology used to establish them, are described in detail in Note 1 of the Notes to the Consolidated Financial Statements included in this report. The amount of the allowance is reviewed monthly by the Risk Committee of the board of directors and formally approved quarterly by that same committee of the board.

General allowances are based upon historical loss experience by portfolio segment measured over the prior eight quarters and weighted equally. The historical loss experience is supplemented to address various risk characteristics of the Company's loan portfolio including:

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

The general allowance comprised 89% of the total allowance at December 31, 2016 and 92% at December 31, 2015. The general allowance is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Allowances on loans considered to be "criticized" and "classified" under regulatory guidance are calculated separately from loans considered to be "pass" rated under the same guidance. This segregation allows the Company to monitor the allowance applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and ensure the sufficiency of the allowance for loan losses.

The portion of the allowance representing specific allowances is established on individually impaired loans. As a practical expedient, for collateral dependent loans, the Company measures impairment based on fair value of the collateral less costs to sell the underlying collateral. For loans on which the Company has not elected to use a practical expedient to measure impairment, the Company will measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. In determining the cash flows to be included in the discount calculation the Company considers the following factors that combine to estimate the probability and severity of potential losses:

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

The specific allowance accounted for 11% of the total allowance at December 31, 2016 and 8% at December 31, 2015. The estimated losses on impaired loans can differ substantially from actual losses.

Goodwill and Other Intangible Asset Impairment

Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. Goodwill is not amortized but is assessed for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment assessment requires that the fair value of each of the Company's reporting units be compared to the carrying amount of the reporting unit's net assets, including goodwill. The Company's reporting units were identified based upon an analysis of each of its individual operating segments. If the fair values of the reporting units exceed their book values, no write-down of recorded goodwill is required. If the fair value of a reporting unit is less than book value, an expense may be required to write-down the related goodwill to the proper carrying value. The Company assesses for impairment of goodwill as of October 1 of each year using September 30 data and again at any quarter-end if any triggering events occur during a quarter that may affect goodwill. Examples of such events include, but are not limited to, a significant deterioration in future operating results, adverse action by a regulator or a loss of key personnel. Determining the fair value of a reporting unit requires the Company to use a degree of subjectivity.

Under current accounting guidance, the Company has the option to assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it appears that the carrying value exceeds the fair value based on the qualitative assessment, the first step of the two-step process must be performed. The Company has elected this accounting guidance with respect to its Community Banking, Investment Management and Insurance segments. At September 30, 2016 there was no evidence of impairment of goodwill or intangibles in any of the Company's reporting units.

Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Other intangible assets have finite lives and are reviewed for impairment annually. These assets are amortized over their estimated useful lives on a straight-line or sum-of-the-years basis over varying periods that initially did not exceed 15 years.

Accounting for Income Taxes

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

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

Fair Value Measurements

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

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

The above accounting policies with respect to fair value are discussed in further detail in “Note 20-Fair Value” to the Consolidated Financial Statements.

Defined Benefit Pension Plan

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

Several factors affect the net periodic benefit cost of the plan, including (1) the size and characteristics of the plan population, (2) the discount rate, (3) the expected long-term rate of return on plan assets and (4) other actuarial assumptions. Pension cost is directly related to the number of employees covered by the plan and other factors including salary, age, years of employment, and the terms of the plan. As a result of the plan freeze, the characteristics of the plan population should not have a materially different effect in future years. The discount rate is used to determine the present value of future benefit obligations. The discount rate is determined by matching the expected cash flows of the plan to a yield curve based on long term, high quality fixed income debt instruments available as of the measurement date, which is December 31 of each year. The discount rate is adjusted each year on the measurement date to reflect current market conditions. The expected long-term rate of return on plan assets is based on a number of factors that include expectations of market performance and the target asset allocation adopted in the plan investment policy. Should actual asset returns deviate from the projected returns, this can affect the benefit plan expense recognized in the financial statements.

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

				Year Ended December 31,		
		2016			2015	
(Dollars in thousands and tax-equivalent)	**Average Balances**	**(1) Interest**	**Annualized Average Yield/Rate**	Average Balances	(1) Interest	Annualized Average Yield/Rate
Assets						
Residential mortgage loans	**$ 826,089**	**$ 28,331**	**3.43%**	$ 748,584	$ 25,251	3.37%
Residential construction loans	**143,378**	**5,169**	**3.61**	134,486	4,970	3.70
Total mortgage loans	**969,467**	**33,500**	**3.46**	883,070	30,221	3.42
Commercial AD&C loans	**283,018**	**13,199**	**4.66**	225,022	10,299	4.58
Commercial investor real estate loans	**812,896**	**37,110**	**4.57**	684,218	32,073	4.69
Commercial owner occupied real estate loans	**707,830**	**33,837**	**4.78**	641,798	31,508	4.91
Commercial business loans	**453,148**	**19,750**	**4.36**	404,994	17,926	4.43
Leasing	**-**	**-**	**-**	27	1	2.50
Total commercial loans	**2,256,892**	**103,896**	**4.60**	1,956,059	91,807	4.69
Consumer loans	**451,303**	**15,596**	**3.48**	437,481	14,624	3.37
Total loans (2)	**3,677,662**	**152,992**	**4.16**	3,276,610	136,652	4.17
Loans held for sale	**11,256**	**387**	**3.44**	13,571	544	4.01
Taxable securities	**461,973**	**11,923**	**2.58**	592,153	15,016	2.54
Tax-exempt securities (3)	**278,546**	**11,747**	**4.22**	290,990	12,479	4.29
Total investment securities	**740,519**	**23,670**	**3.20**	883,143	27,495	3.11
Interest-bearing deposits with banks	**40,940**	**213**	**0.52**	37,761	98	0.26
Federal funds sold	**876**	**5**	**0.50**	473	1	0.23
Total interest-earning assets	**4,471,253**	**177,267**	**3.96**	4,211,558	164,790	3.91
Less: allowance for loan losses	**(42,487)**			(38,732)		
Cash and due from banks	**47,219**			46,719		
Premises and equipment, net	**53,386**			51,804		
Other assets	**214,004**			215,104		
Total assets	**$4,743,375**			$4,486,453		
Liabilities and Stockholders' Equity						
Interest-bearing demand deposits	**$ 581,185**	**446**	**0.08%**	$ 532,578	418	0.08%
Regular savings deposits	**300,035**	**182**	**0.06**	276,873	146	0.05
Money market savings deposits	**920,125**	**1,951**	**0.21**	860,399	1,364	0.16
Time deposits	**558,355**	**5,582**	**1.00**	481,368	3,950	0.82
Total interest-bearing deposits	**2,359,700**	**8,161**	**0.35**	2,151,218	5,878	0.27
Other borrowings	**120,711**	**290**	**0.24**	110,899	255	0.23
Advances from FHLB	**565,342**	**11,610**	**2.05**	589,575	13,081	2.22
Subordinated debentures	**31,489**	**943**	**3.00**	35,000	899	2.57
Total interest-bearing liabilities	**3,077,242**	**21,004**	**0.68**	2,886,692	20,113	0.70
Noninterest-bearing demand deposits	**1,101,104**			1,033,141		
Other liabilities	**37,505**			46,949		
Stockholders' equity	**527,524**			519,671		
Total liabilities and stockholders' equity	**$4,743,375**			$4,486,453		
Net interest income and spread		**$156,263**	**3.28%**		$144,677	3.21%

Less: tax-equivalent adjustment	**6,711**		6,478	
Net interest income	**$149,552**		$138,199	
Interest income/earning assets		**3.96%**		3.91%
Interest expense/earning assets		**0.47**		0.47
Net interest margin		**3.49%**		3.44%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2016, 2015 and taxable-equivalent adjustments utilized in
the above table to compute yields aggregated to $6.7 million, $6.5 million and $5.2 million in 2016, 2015 and 2014, respect
(2) Non-accrual loans are included in the average balances.
(3) Includes only investments that are exempt from federal taxes.

33

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-advantaged loans and 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.

2016 vs. 2015

Net interest income for 2016 was $149.6 million compared to $138.2 million for 2015. On a tax-equivalent basis, net interest income for 2016 was $156.3 million compared to $144.7 million for 2015. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.49% for 2016 compared to 3.44% for 2015. Average interest-earning assets increased by 6% while average interest-bearing liabilities increased 7% in 2016. Average noninterest-bearing deposits increased 7% in 2016 while the percentage of average noninterest-bearing deposits to total deposits remained at 32% for 2016 compared to 2015.

2015 vs. 2014

Net interest income for 2015 was $138.2 million compared to $129.5 million for 2014. On a tax-equivalent basis, net interest income for 2015 was $144.7 million compared to $134.7 million for 2014. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that decreased to 3.44% for 2015 compared to 3.45% for 2014. Average interest-earning assets increased by 7% while average interest-bearing liabilities increased 6% in 2015. Average noninterest-bearing deposits increased 12% in 2015 while the percentage of average noninterest-bearing deposits to total deposits also increased to 32% for 2015 compared to 31% for 2014.

Effect of Volume and Rate Changes on Net Interest Income

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

	2016 vs. 2015			2015 vs. 2014		
	Increase Or	**Due to Change In Average:***		Increase Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	**(Decrease)**	**Volume**	**Rate**	(Decrease)	Volume	Rate
Interest income from earning assets:						
Residential mortgage loans	**$ 3,080**	**$ 2,628**	**$ 452**	$ 2,392	$ 2,711	$ (319)
Residential construction loans	**199**	**322**	**(123)**	(346)	(297)	(49)
Commercial AD&C loans	**2,900**	**2,716**	**184**	1,485	2,188	(703)
Commercial investor real estate loans	**5,037**	**5,879**	**(842)**	3,872	4,959	(1,087)
Commercial owner occupied real estate loans	**2,329**	**3,179**	**(850)**	2,922	3,500	(578)
Commercial business loans	**1,824**	**2,111**	**(287)**	1,526	2,118	(592)
Leasing	**(1)**	**(1)**	**-**	(16)	(10)	(6)
Consumer loans	**972**	**455**	**517**	1,448	1,346	102
Loans held for sale	**(157)**	**(86)**	**(71)**	232	247	(15)
Taxable securities	**(3,093)**	**(3,328)**	**235**	(1,801)	(2,110)	309
Tax-exempt securities	**(732)**	**(530)**	**(202)**	(495)	(459)	(36)
Interest-bearing deposits with banks	**115**	**9**	**106**	13	10	3
Federal funds sold	**4**	**2**	**2**	-	-	-
Total interest income	**12,477**	**13,356**	**(879)**	11,232	14,203	(2,971)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	**28**	**28**	**-**	(7)	46	(53)
Regular savings deposits	**36**	**10**	**26**	(19)	7	(26)
Money market savings deposits	**587**	**107**	**480**	248	(5)	253
Time deposits	**1,632**	**688**	**944**	865	161	704
Other borrowings	**35**	**23**	**12**	91	91	-
Advances from FHLB	**(1,471)**	**(514)**	**(957)**	99	745	(646)
Subordinated debentures	**44**	**(97)**	**141**	18	-	18
Total interest expense	**891**	**245**	**646**	1,295	1,045	250
Net interest income	**$ 11,586**	**$ 13,111**	**$ (1,525)**	$ 9,937	$ 13,158	$ (3,221)

* 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.

35

Interest Income

2016 vs. 2015

The Company's total tax-equivalent interest income increased 8% for 2016 compared to the prior year. The previous table shows that the increase in average loans more than offset the decrease in earning asset yields with respect to the loan portfolio.

In 2016, the average balance of the loan portfolio increased 12% compared to the prior year. This growth was primarily in the commercial investor real estate, commercial ADC and residential mortgage portfolios. These increases were driven by organic loan growth as the regional economy improved. The yield on average loans decreased by 1 basis point compared to the prior year due to lower yields on commercial loans.

The average yield on total investment securities increased 9 basis points while the average balance of the portfolio decreased 16% in 2016 compared to 2015. The increase in the yield on investments was due primarily to a decline in the relative size of the lower-yielding mortgage-backed securities portfolio due in large part to the sale of $40 million of such securities to fund the prepayment of FHLB advances in the 2016. The average balance of the higher-yielding state and municipal portfolio reflected a much smaller decline due to calls during the year. This resulted in an increase to the relative size of this portfolio as a percentage of the overall portfolio.

2015 vs. 2014

The Company's total tax-equivalent interest income decreased 7% for 2015 compared to the prior year. The previous table shows that the increase in average loans more than offset a continued slowing decline in earning asset yields with respect to the loan portfolio.

In 2015, the average balance of the loan portfolio increased 13% compared to the prior year. 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 decreased by 10 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 combined decrease of 19 basis points in the yield on the commercial loan portfolio.

The average yield on total investment securities increased 6 basis points while the average balance of the portfolio decreased 10% in 2015 compared to 2014. The increase in the yield on investments was due primarily to a 5 basis point increase in the yield on the much larger taxable securities portfolio due to amortization and calls.

Interest Expense

2016 vs. 2015

Interest expense increased by $0.9 million or 4% in 2016 compared to 2015. The increase in expense was due to the cost of interest-bearing deposits increasing primarily due to higher rates offered on certificates of deposit together with growth in the average balances, while the average balances of Federal Home Loan Bank advances declined 4% and the average rates paid decreased 17 basis points due to the redemption of high-rate advances early in 2016. Average deposits increased 9% in 2016 compared to 2015. This increase was primarily due to increases of $117 million or 7% in average noninterest-bearing and interest-bearing checking accounts together with an increase of $77 million or 16% in certificates of deposit as the Company offered higher rates on certificates of deposit to fund loan growth. Average balances of regular savings accounts increased $23 million or 8% and average balances of money market accounts increased $60 million or 7% in 2016 compared to 2015.

2015 vs. 2014

Interest expense increased by $1.3 million or 7% in 2015 compared to 2014. The increase in expense was due to the cost of interest-bearing deposits increasing primarily due to higher rates offered on certificates of deposit together with growth in the average balances, while the increase in the average balances of Federal Home Loan Bank advances was largely offset by an 11 basis point decrease in the average rates paid. Average deposits increased 7% in 2015 compared to 2014. This increase was primarily due to increases of $160 million or 11% in average noninterest-bearing and interest-bearing checking accounts together with an increase of $18 million or 7% in regular savings accounts and $24 million or 5% in certificates of deposit as the Company offered higher rates on certificates of deposit to fund loan growth. Average balances of money market accounts remained virtually level in 2015 compared to 2014.

Interest Rate Performance

2016 vs. 2015

The Company's net interest margin increased to 3.49% for 2016 compared to 3.44% for 2015 while the net interest spread increased to 3.28% in 2016 compared to 3.21% in 2015. This increase was driven by an increase in the yield on interest-earning assets as a result of loan growth and the migration of assets from lower-yielding investment securities into higher-yielding loans.

2015 vs. 2014

The Company's net interest margin decreased to 3.44% for 2016 compared to 3.45% for 2015 while the net interest spread decreased to 3.21% in 2016 compared to 3.24% in 2015. This decrease was due to the effect of lower rates on interest-earning assets which more than offset the effect of loan growth. In addition, the cost of interest-bearing liabilities increased due primarily to the higher cost of deposits as the Company raised rates to maintain deposit balances to fund loan growth.

Non-interest Income

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

(Dollars in thousands)		**2016**	2015	2014	**2016/2015 $ Change**	**2016/2015 % Change**	2015/2 $ Chan
	Securities gains	**$ 1,932**	$ 36	$ 5	**$ 1,896**	**-** %	$
	Service charges on deposit accounts	**7,953**	7,607	8,422	**346**	**4.5**	(81
	Mortgage banking activities	**4,049**	3,114	1,994	**935**	**30.0**	1,1
Service charges on deposit accounts	Wealth management income	**17,805**	19,931	19,086	**(2,126)**	**(10.7)**	8
Mortgage banking activities	Insurance agency commissions	**5,408**	5,176	4,996	**232**	**4.5**	1
	Income from bank owned life insurance	**2,462**	2,571	2,444	**(109)**	**(4.2)**	1
	Visa check fees	**4,674**	4,652	4,439	**22**	**0.5**	2
	Letter of credit fees	**888**	790	706	**98**	**12.4**	
	Extension fees	**559**	503	560	**56**	**11.1**	(5
	Other income	**5,312**	5,521	4,219	**(209)**	**(3.8)**	1,3
	Total non-interest income	**$ 51,042**	$ 49,901	$ 46,871	**$ 1,141**	**2.3**	$ 3,0

2016 vs. 2015

Total non-interest income was $51.0 million for 2016 compared to $49.9 million for 2015. The primary drivers of non-interest income for 2016 were increases in securities gains and mortgage banking income.

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

Service charges on deposits increased in 2016 compared to 2015 due to increases in commercial analysis fees and return check charges.

Income from mortgage banking activities increased in 2016 compared to 2015 due primarily to higher volumes and margins on loan sales compared to the prior year.

Wealth management income is comprised of income from trust and estate services and investment management fees earned by West Financial Services, the Company's investment management subsidiary. Trust services fees increased 4% compared to the prior year, due to higher one-time fees while assets under management increased 4% over the prior year. Investment management fees in West Financial Services increased 6% for 2016 compared to 2015, due primarily to a 12% increase in assets under management due to new client acquisitions and market activity. Fees on sales of investment products and services declined in 2016 compared to the prior year as the company sold a portion of its portfolio of assets under management in 2016. Overall total assets under management decreased to $2.4 billion at December 31, 2016 compared to $2.8 billion at December 31, 2015.

Insurance agency commissions increased in 2016 compared to 2015 due primarily to higher income from commercial lines and contingency fees that more than offset a reduction in income from physicians' liability policies.

Income from bank owned life insurance decreased in 2016 compared to the prior year due to policy proceeds recognized in 2015. The Company invests in bank owned life insurance products in order to manage the cost of employee benefit plans. Investments totaled $93.3 million at December 31, 2016 and $90.9 million at December 31, 2015 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 4.44% for 2016 compared to 4.76% for the prior year.

Other non-interest income increased during the current year compared to the prior year due mainly to $1.9 million in gains on sales and calls of investment securities and a gain of $1.2 million on the extinguishment of $5 million in subordinated debentures.

2015 vs. 2014

Total non-interest income was $49.9 million for 2015 compared to $46.9 million for 2014. The primary drivers of non-interest income for 2015 were increases in wealth management income, income from mortgage banking activities and other non-interest income. Income from mortgage banking activities increased in 2015 compared to 2014 due primarily to higher loan origination volumes from refinancing activity. Other non-interest income also increased during the current year compared to the prior year due mainly to gains on sales of SBA loans and loan prepayment fees. Wealth management income increased over the prior year due to higher one-time fees and additions from new and existing clients. Insurance agency commissions increased in 2015 compared to 2014 due primarily to higher income from physicians' liability policies. Service charges on deposits decreased in 2015 compared to 2014 due primarily to a decline in overdraft fees. Income from bank owned life insurance increased in 2015 compared to the prior year due to policy proceeds recognized in the current year. No net OTTI losses were recognized in earnings in 2015 and 2014. The Company recognized net securities gains, which resulted primarily from securities calls during the period.

Non-interest Expense

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

(Dollars in thousands)	**2016**	2015	2014	**2016/2015 $ Change**	**2016/2015 % Change**	2015/2014 $ Change	2015/2014 % Change
Salaries and employee benefits	**$ 71,354**	$ 71,003	$ 66,387	**$ 351**	**0.5** %	$ 4,616	7.0 %
Occupancy expense of premises	**12,960**	12,809	13,692	**151**	**1.2**	(883)	(6.4)
Equipment expenses	**6,883**	6,071	5,188	**812**	**13.4**	883	17.0
Marketing	**2,851**	2,896	2,926	**(45)**	**(1.6)**	(30)	(1.0)
Outside data services	**5,377**	5,023	4,947	**354**	**7.0**	76	1.5
FDIC insurance	**2,741**	2,491	2,302	**250**	**10.0**	189	8.2
Amortization of intangible assets	**130**	372	821	**(242)**	**(65.1)**	(449)	(54.7)
Litigation expenses	**-**	(3,869)	6,519	**3,869**	**(100.0)**	(10,388)	(159.3)
Professional fees	**4,840**	4,819	4,544	**21**	**0.4**	275	6.1
Other real estate owned	**19**	76	100	**(57)**	**(75.0)**	(24)	(24.0)
Postage and delivery	**1,155**	1,173	1,286	**(18)**	**(1.5)**	(113)	(8.8)
Communications	**1,583**	1,587	1,507	**(4)**	**(0.3)**	80	5.3
Loss on FHLB redemption	**3,167**	-	-	**3,167**	**100.0**	-	-
Other expenses	**9,998**	10,896	10,581	**(898)**	**(8.2)**	315	3.0
Total non-interest expense	**$ 123,058**	$ 115,347	$ 120,800	**$ 7,711**	**6.7**	$ (5,453)	(4.5)

2016 vs. 2015

Non-interest expenses totaled $123.1 million in 2016 compared to $115.3 million in 2015. This increase in expenses was driven primarily by prepayment penalties of $3.2 million in 2016 for the early payoff of $75 million of FHLB advances together with the recapture in 2015 of $3.9 million in previously accrued litigation expenses and a $1.0 million charitable contribution to the Sandy Spring Bank Foundation, also in 2015. Excluding these transactions, non-interest expenses for the year ended December 31, 2016 increased 1% over the prior year.

Salaries and employee benefits, the largest component of non-interest expenses, increased in 2016 due primarily to higher compensation expenses as a result of merit increases. The average number of full-time equivalent employees was 728 in 2016 compared to 721 for 2015.

Occupancy expenses increased in 2016 compared to 2015 due to higher rental expenses.

Equipment expenses increased in 2016 compared to 2015 due to an increase in software expenses related to new systems.

Outside data services expense increased due to new contract services to prevent bank card fraud.

FDIC insurance expense increased in 2016 compared to 2015 due to loan growth during the year.

Amortization of intangible assets decreased due to the costs of prior year acquisitions being fully amortized during the year.

Litigation expenses decreased due to the settlement in 2015 of all claims that were the subject of an adverse jury verdict originally rendered in 2014.

Other non-interest expenses increased in 2016 compared to 2015 due primarily to prepayment penalties of $3.2 million for the early payoff of $75 million in high-rate FHLB advances in 2016. Excluding the prepayment penalties and the charitable contribution accrued in 2015, other non-interest expenses decreased due largely to lower EFT losses in the current losses.

Expenses for marketing and other real estate owned expenses remained essentially unchanged for 2016 compared to the prior year.

2015 vs. 2014

Non-interest expenses decreased in 2015 compared to 2014 due primarily to the impact of $6.5 million in accrued litigation expenses related to an adverse jury verdict in a particular legal action in 2014 and a $4.5 million recapture of such accrual due to its settlement in 2016. The Company also incurred a $1.0 million contribution to the Sandy Spring Foundation in 2015. Excluding these transactions, non-interest expenses increased 3% over the prior year. Salary and benefits expenses increased due to merit salary increases, higher pension expenses due to a change in the discount rate assumption and a lower return on plan assets and an increase in health insurance expense due to higher claims experience. Occupancy expenses decreased in 2014 compared to the prior year due to the closure of two branches and the relocation of a third branch. Equipment expenses increased due to higher software amortization expense. FDIC insurance expense increased in 2015 compared to 2014 due to an increase in total assets. Amortization of intangible assets decreased due to the costs of prior year acquisitions being fully amortized during the year. Litigation expenses decreased due to the settlement of all claims that were the subject of an adverse jury verdict originally rendered in 2014. Professional fees increased due to higher consulting and other professional fees. Expenses for marketing, outside data services, other real estate owned and other non-interest expenses remained essentially unchanged for 2015 compared to the prior year.

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 remained level for 2016 compared to the prior year. The non-GAAP efficiency ratio improved in 2016 compared to the prior year as a result of growth in net interest income and expense control discipline.

In addition, the Company excludes certain specific expenses from net 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 losses, the provision for income taxes and merger expenses back to net income.

GAAP and Non-GAAP Efficiency Ratios

	Year ended December 31,				
(Dollars in thousands)	**2016**	2015	2014	2013	2012
Pre-tax pre-provision pre-merger expense income:					
Net income	**$ 48,250**	$ 45,355	$ 38,200	$ 44,422	$ 36,554
Plus Non-GAAP adjustment:					
Litigation expenses	**-**	(3,869)	6,519	-	-
Merger expenses	**-**	-	-	-	2,500
Income taxes	**23,740**	22,027	17,582	22,563	18,045
Provision (credit) for loan losses	**5,546**	5,371	(163)	(1,084)	3,649
Pre-tax pre-provision pre-merger expense income	**$ 77,536**	$ 68,884	$ 62,138	$ 65,901	$ 60,748
Efficiency ratio - GAAP basis:					
Non-interest expenses	**$ 123,058**	$ 115,347	$ 120,800	$ 111,524	$ 109,927
Net interest income plus non-interest income	**$ 200,594**	$ 188,100	$ 176,419	$ 177,425	$ 168,175
Efficiency ratio - GAAP basis	**61.35%**	61.32%	68.47%	62.86%	65.36%
Efficiency ratio - Non-GAAP basis:					
Non-interest expenses	**$ 123,058**	$ 115,347	$ 120,800	$ 111,524	$ 109,927
Less Non-GAAP adjustment:					
Amortization of intangible assets	**130**	372	821	1,845	1,881
Loss on FHLB redemption	**3,167**	-	-	-	-
Litigation expenses	**-**	(3,869)	6,519	-	-
Merger expenses	**-**	-	-	-	2,500
Non-interest expenses - as adjusted	**$ 119,761**	$ 118,844	$ 113,460	$ 109,679	$ 105,546
Net interest income plus non-interest income	**$ 200,594**	$ 188,100	$ 176,419	$ 177,425	$ 168,175
Plus Non-GAAP adjustment:					
Tax-equivalent income	**6,711**	6,478	5,192	5,292	5,374
Less Non-GAAP adjustments:					
Securities gains	**1,932**	36	5	115	459
Gain on redemption of subordinated debentures	**1,200**	-	-	-	-
OTTI recognized in earnings	**-**	-	-	-	(109)
Net interest income plus non-interest income - as adjusted	**$ 204,173**	$ 194,542	$ 181,606	$ 182,602	$ 173,199
Efficiency ratio - Non-GAAP basis	**58.66%**	61.09%	62.48%	60.06%	60.94%

Income Taxes

The Company had income tax expense of $23.7 million in 2016, compared to expense of $22.0 million in 2015 and $17.6 million in 2014. The resulting effective rates were 33% for 2016, 33% for 2015 and 32% for 2014. The increase in the effective rate in 2015 compared to 2014 was due to tax exempt income comprising a lower proportion of income before taxes in 2015 compared to 2014.

FINANCIAL CONDITION

The Company's total assets were $5.1 billion at December 31, 2016, increasing $436 million or 9% compared to $4.7 billion at December 31, 2015. Interest-earning assets increased $423 million to $4.8 billion at December 31, 2016 compared to December 31, 2015. The increase in interest-earning assets was primarily due to organic loan growth during 2016.

Loans

A comparison of loan portfolio for the years indicated is presented in the following table:

	December 31,					
	2016		2015		Year-to-Year Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$ Change	% Change
Residential real estate:						
Residential mortgage	**$ 841,692**	**21.4%**	$ 796,358	22.8%	$ 45,334	5.7%
Residential construction	**150,229**	**3.8**	129,281	3.7	20,948	16.2
Commercial real estate:						
Commercial owner occupied real estate	**775,552**	**19.8**	678,027	19.4	97,525	14.4
Commercial investor real estate	**928,113**	**23.6**	719,084	20.6	209,029	29.1
Commercial AD&C	**308,279**	**7.9**	255,980	7.3	52,299	20.4
Commercial Business	**467,286**	**11.9**	465,765	13.3	1,521	0.3
Consumer	**456,657**	**11.6**	450,875	12.9	5,782	1.3
Total loans	**$3,927,808**	**100.0%**	$3,495,370	100.0%	$ 432,438	12.4

Total loans, excluding loans held for sale, increased $432 million or 12% at December 31, 2016 compared to December 31, 2015. The commercial loan portfolio increased by 17% to $2.5 billion at December 31, 2016 compared to the prior year end due to double-digit increases in investor real estate loans, owner occupied real estate loans and ADC loans. These increases reflect an improving economy and the Company's increased emphasis on growth in its commercial portfolio.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, increased 7% at December 31, 2016 compared to December 31, 2015. Permanent residential mortgages, most of which are 1-4 family, increased 6% due to higher loan origination volumes of both fixed and adjustable rate mortgage loans. The Company generally retains adjustable rate mortgages in its portfolio. The Company also retains a substantial portion of its fixed rate mortgage originations to low and moderate income borrowers in its portfolio. During 2016, the Company elected to sell $32 million of these loans. Residential construction loans increased 16% at December 31, 2016 compared to the balance at December 31, 2015 due to higher volume of such loans and the timing of construction draws.

The consumer loan portfolio increased by 1% to $457 million at December 31, 2016 compared to December 31, 2015 due to growth in home equity lines of credit as the Company continued to actively promote this product line during the past year.

Analysis of Loans

The trends in the composition of the loan portfolio over the previous five years are presented in following table:

	December 31,							
(Dollars in thousands)	**2016**	**%**	2015	%	2014	%	2013	%
Residential real estate:								
Residential mortgage	**$ 841,692**	**21.4 %**	$ 796,358	22.8 %	$ 717,886	22.9 %	$ 618,381	22.2 %
Residential construction	**150,229**	**3.8**	129,281	3.7	136,741	4.4	129,177	4.7
Commercial real estate:								
Commercial owner occupied	**775,552**	**19.8**	678,027	19.4	611,061	19.5	592,823	21.3
Commercial investor	**928,113**	**23.6**	719,084	20.6	640,193	20.5	552,178	19.8
Commercial AD&C loans	**308,279**	**7.9**	255,980	7.3	205,124	6.6	160,696	5.8
Commercial business	**467,286**	**11.9**	465,765	13.3	390,781	12.5	356,651	12.8
Leases	**-**	**-**	-	-	54	-	703	-
Consumer	**456,657**	**11.6**	450,875	12.9	425,552	13.6	373,657	13.4
Total loans	**$3,927,808**	**100.0 %**	$3,495,370	100.0 %	$3,127,392	100.0 %	$2,784,266	100.0 %

42

Loan Maturities and Interest Rate Sensitivity

Loan maturities and interest rate characteristics for specific lending portfolios is presented in the following table:

	At December 31, 2016			
	Remaining Maturities of Selected Credits in Years			
(In thousands)	1 or less	Over 1-5	Over 5	Total
Residential construction loans	$ 252,792	$ 28,586	$ 26,901	$ 308,279
Commercial AD&C loans	283,642	145,632	38,012	467,286
Commercial business loans [1]	117,550	28,741	3,938	150,229
Total	$ 653,984	$ 202,959	$ 68,851	$ 925,794
Rate Terms:				
Fixed	$ 108,486	$ 139,289	$ 61,152	$ 308,927
Variable or adjustable	545,498	63,670	7,699	616,867
Total	$ 653,984	$ 202,959	$ 68,851	$ 925,794

(1) Loans not secured by real estate

Investment Securities

The investment portfolio, consisting of available-for-sale, held-to-maturity and other equity securities, decreased 7% to $780 million at December 31, 2016, from $842 million at December 31, 2015.

Composition of Investment Securities

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

	December 31,					
(Dollars in thousands)	**2016**	**%**	2015	%	2014	%
Available-for-Sale: [1]						
U.S. government agencies	**$ 121,790**	**15.6 %**	$ 108,400	12.9 %	$ 141,679	15.2%
State and municipal	**287,684**	**36.9**	164,707	19.6	167,052	17.9
Mortgage-backed [2]	**312,711**	**40.1**	316,696	37.6	361,519	38.7
Corporate debt	**9,134**	**1.2**	-	-	-	-
Trust preferred	**1,012**	**0.1**	1,023	0.1	1,236	0.1
Marketable equity securities	**1,223**	**0.2**	1,223	0.1	723	0.1
Total available-for-sale securities[3]	**733,554**	**94.1**	592,049	70.3	672,209	72.0
Held-to-Maturity and Other Equity						
U.S. government agencies	**-**	**-**	56,460	6.7	64,512	6.9
State and municipal	**-**	**-**	149,537	17.8	155,261	16.6
Mortgage-backed [2]	**-**	**-**	168	-	200	-

Corporate debt	**-**	**-**		2,100	0.3		-	-	
Other equity securities	**46,094**	**5.9**		41,336	4.9		41,437	4.5	
Total held-to-maturity and other equity	**46,094**	**5.9**		249,601	29.7		261,410	28.0	
Total Securities(3)	**$ 779,648**	**100.0**	**%**	$ 841,650	100.0	%	$ 933,619	100.0	%

(1) At estimated fair value.

(2) Issued by a U. S. Government Agency or secured by U.S. Government Agency collateral.

(3) The outstanding balance of no single issuer, except for U.S. Government Agency securities, exceeded ten percent of stockholders' equity at December 31, 2016, 2015 or 2014.

Available-for-sale securities increased 24% due to the Company's designation of the held-to-maturity portfolio as available-for-sale in 2016. This offset calls of agency securities, amortization of mortgage-backed securities and the sale of $40 million in mortgage-backed securities during the current year. The overall investment portfolio decreased as the Company funded loan growth together with deposit growth and increased short-term borrowings at historically low rates to maintain the net interest margin.

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 3.3 years at December 31, 2016 and 3.3 years at December 31, 2015. The Company considers the duration of the portfolio to be adequate for liquidity purposes. This 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.

Maturities and weighted average yields for investment securities available-for-sale at December 31, 2016 are presented in the following table. Amounts appear in the table at amortized cost, without market value adjustments, by stated maturity.

Maturity of Investment Securities

	Years to Maturity at December 31, 2016									
	Within One Year or Less		After One Year Through Five years		After Five Years Through Ten Years		Over Ten Years			
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
Available-for-Sale (1)										
U. S. government agencies and corporations	$ -	-%	$ -	-%	$ 124,314	2.29%	$ -	-%	$ 124,314	2.29%
State and municipal (2)	7,493	4.70	129,987	4.55	130,729	4.11	12,881	3.69	281,090	4.31
Mortgage-backed	-	-	26,966	3.19	18,325	2.85	268,738	2.33	314,029	2.43
Corporate debt	-	-	-	-	9,100	5.94	-	-	9,100	5.94
Trust preferred	-	-	-	-	-	-	1,089	9.25	1,089	9.25
Total	$ 7,493	4.70	$ 156,953	4.32	$ 282,468	3.29	$ 282,708	2.42	$ 729,622	3.19

(1) At cost, adjusted for amortization and accretion of purchase premiums and discounts, respectively.
(2) Yields on state and municipal securities have been calculated on a tax-equivalent basis using the applicable federal income tax rate of 35%.

Other Earning Assets

Residential mortgage loans held for sale decreased $2 million to $13 million at December 31, 2016 compared to $15 million as of December 31, 2015 due to the volume of loan sales at the end of the year. The aggregate of federal funds sold and interest-bearing deposits with banks increased $55 million to $81 million in 2016 in anticipation of projected loan activity and the repurchase of $30 million in subordinated debentures in January, 2017.

Deposits

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

	December 31,				Year-to-Year Change	
	2016		2015			
(Dollars in thousands)	**Amount**	**%**	Amount	%	$ Change	% Change
Noninterest-bearing deposits	**$1,138,139**	**31.8%**	$1,001,841	30.7%	$ 136,298	13.6%
Interest-bearing deposits:						
Demand	**615,058**	**17.2**	570,333	17.5	44,725	7.8
Money market savings	**927,837**	**25.9**	898,655	27.5	29,182	3.2
Regular savings	**310,471**	**8.7**	284,457	8.7	26,014	9.1
Time deposits of less than $100,000	**258,621**	**7.2**	248,172	7.6	10,449	4.2
Time deposits of $100,000 or more	**327,418**	**9.2**	260,272	8.0	67,146	25.8
Total interest-bearing deposits	**2,439,405**	**68.2**	2,261,889	69.3	177,516	7.8
Total deposits	**$3,577,544**	**100.0%**	$3,263,730	100.0%	$ 313,814	9.6

Deposits and Borrowings

Total deposits increased $314 million or 10% at December 31, 2016 compared to December 31, 2015. The primary drivers of this increase were increases of 15% in certificates of deposit and 9% in regular savings accounts compared to the prior year. In addition, combined noninterest-bearing and interest-bearing checking accounts increased 12% and money market deposit accounts increased 3% over 2015. The increases in regular savings and money market deposit products can be attributed primarily to clients' emphasis on safety and liquidity. The increase in certificates of deposit occurred as the Company began to offer higher rates to manage its funding of the growth in the loan portfolio and to maintain multiple product relationships. Total borrowings increased 14% at December 31, 2016 compared to December 31, 2015. This increase was due primarily to the Company's strategy to take advantage of extraordinarily low short-term interest rates to fund loan originations with short-term FHLB advances.

Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on- and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. Total stockholders' equity increased to $534 million at December 31, 2016, from $524 million at December 31, 2015. This increase was due primarily to net income during the year which was offset by dividends and stock repurchases. The ratio of average equity to average assets was 11.12% for 2016, as compared to 11.58% for 2015.

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

Risk-Based Capital Ratios

	Ratios at December 31,		Minimum Regulatory
	2016	2015	Requirements
Total Capital to risk-weighted assets	**12.80%**	14.25%	8.00%
Tier 1 Capital to risk-weighted assets	**11.74%**	13.13%	6.00%
Common Equity Tier 1 Capital to risk-weighted assets	**11.01%**	12.17%	4.50%
Tier 1 Leverage	**10.14%**	10.60%	4.00%

Tier 1 capital of $485.9 million and total qualifying capital of $530.0 million each included $30.0 million in trust preferred securities that are considered regulatory capital for purposes of determining the Company’s Tier 1 capital ratio. As of December 31, 2016, the most recent notification from the Bank’s primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

On January 6, 2017 the Company repurchased its outstanding $30 million in trust preferred securities, which were included in Tier 1 capital. This transaction is expected to reduce the Company’s regulatory capital ratios by approximately 75 basis points and represents a part of the Company’s overall strategy to manage its interest expense.

The minimum capital level requirements applicable to the Company and the Bank are: (1) a common equity Tier 1 capital ratio of 4.5%; (2) a Tier 1 capital ratio of 6%; (3) a total capital ratio of 8%; and (4) a Tier 1 leverage ratio of 4%. The rules also establish a “capital conservation buffer” of 2.5% above the regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer requirement is being 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 would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses to executive officers if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Tangible Common Equity

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

Tangible Common Equity Ratio – Non-GAAP

	December 31,				
(Dollars in thousands, except per share data)	**2016**	2015	2014	2013	2012
Tangible common equity ratio:					
Total stockholders' equity	**$ 533,572**	$ 524,427	$ 521,751	$ 499,363	$ 483,512
Accumulated other comprehensive income (loss)	**6,614**	1,297	823	2,970	(11,312)
Goodwill	**(85,768)**	(84,171)	(84,171)	(84,171)	(84,808)
Other intangible assets, net	**(680)**	(138)	(510)	(1,330)	(3,163)
Tangible common equity	**$ 453,738**	$ 441,415	$ 437,893	$ 416,832	$ 384,229
Total assets	**$ 5,091,383**	$ 4,655,380	$ 4,397,132	$ 4,106,100	$ 3,955,206
Goodwill	**(85,768)**	(84,171)	(84,171)	(84,171)	(84,808)
Other intangible assets, net	**(680)**	(138)	(510)	(1,330)	(3,163)
Tangible assets	**$ 5,004,935**	$ 4,571,071	$ 4,312,451	$ 4,020,599	$ 3,867,235
Tangible common equity ratio	**9.07%**	9.66%	10.15%	10.37%	9.94%
Tangible book value per share	**$18.98**	$18.17	$17.48	$16.68	$15.43

Credit Risk

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

Total non-performing loans decreased 7% to $31.9 million at December 31, 2016 compared to the balance at December 31, 2015. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by any volatility being experienced in various sectors of the economy on both a regional and national level.

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

The allowance represents an estimation of the probable losses that are inherent in the loan 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 based on historical loss experience and consideration of current economic trends, which may be susceptible to significant change. Loans deemed uncollectible are charged against the allowance, while recoveries are credited to the allowance. Management adjusts the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense.

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

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

The Company's methodology for evaluating whether a loan is impaired begins with risk-rating credits on an individual basis and includes consideration of the borrower's overall financial condition, payment record and available cash resources that may include the sufficiency of collateral value and, in a select few cases, verifiable support from financial guarantors. In measuring impairment, the Company looks primarily to the discounted cash flows of the project itself or to the value of the collateral as the primary sources of repayment of the loan. The Company may consider the existence of guarantees and the financial strength and wherewithal of the guarantors involved in any loan relationship. Guarantees may be considered as a source of repayment based on the guarantor's financial condition and respective payment capacity. Accordingly, absent a verifiable payment capacity, a guarantee alone would not be sufficient to avoid classifying the loan as impaired.

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

- An internal evaluation is updated annually 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 status is examined and 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, net of estimated cost to sell.

- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal net of closing costs. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

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

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

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

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

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

The Company makes provisions for loan losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology previously discussed. The provision for loan losses was a charge of $5.5 million in 2016 and $5.4 million in 2015 and a credit of $0.2 million in 2014. Historical net charge-offs represent a principal component in the application of the Company's allowance methodology. The provision for 2016 remained virtually level compared to 2015 due to the effect of higher loan growth that was offset by improvement in loan quality and a reduction in non-performing loans. The credit to the provision in 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.

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

Allowance for Loan Losses

The following table presents a five-year history for the allocation of the allowance for losses. The allowance is allocated in the following table to various loan categories based on the methodology used to estimate loan losses; however, the allocation does not restrict the usage of the allowance for any specific loan or lease category.

			December 31,		
(In thousands)	**2016**	2015	2014	2013	2012
Residential real estate:					
Residential mortgage	**$ 7,261**	$ 6,901	$ 6,232	$ 7,819	$ 8,522
Residential construction	**963**	894	923	1,156	2,445
Total residential real estate	**8,224**	7,795	7,155	8,975	10,967
Commercial real estate:					
Commercial investor	**12,939**	10,440	9,784	9,263	9,583
Commercial owner occupied	**7,885**	7,984	7,143	6,308	6,997
Commercial AD&C	**4,652**	4,691	4,267	3,754	4,737
Total commercial real estate	**25,476**	23,115	21,194	19,325	21,317
Commercial Business	**7,539**	6,529	5,852	6,308	6,495
Leases	**-**	-	9	16	332
Consumer	**2,828**	3,456	3,592	4,142	3,846
Total allowance	**$ 44,067**	$ 40,895	$ 37,802	$ 38,766	$ 42,957

During 2016, there were no changes in the Company’s methodology for assessing the appropriateness of the allowance for loan losses from the prior year. Variations can occur over time in the estimation of the adequacy of the allowance as a result of the credit performance of borrowers.

At December 31, 2016, total non-performing loans were $31.9 million, or 0.81% of total loans, compared to $34.5 million, or 0.99% of total loans, at December 31, 2015. The allowance represented 138% of non-performing loans at December 31, 2016 as compared to 119% at December 31, 2015. The increase in this ratio was due primarily to the increase in the allowance over the prior year while total non-performing loans decreased. The allowance for loan losses as a percent of total loans was 1.12% at December 31, 2016 as compared to 1.17% at December 31, 2015.

Continued analysis of the actual loss history on the problem credits in 2015 and 2016 provided an indication that the coverage of the inherent losses on the problem credits was adequate. The Company continues to monitor the impact of the economic conditions on our commercial customers, the reduced inflow of non-accruals, lower inflow in criticized loans and the significant decline in early stage delinquencies. The improvement in these credit metrics supports management’s outlook for continued improved credit quality performance.

The balance of impaired loans was $24.1 million, with specific allowances of $4.8 million against those loans at December 31, 2016, as compared to $28.9 million with specific allowances of $3.4 million, at December 31, 2015.

The Company's borrowers are concentrated in central Maryland, Northern Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 76% of total loans at December 31, 2016 and at December 31, 2015. Certain loan terms may create concentrations of credit risk and increase the Company’s exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

Summary of Loan Loss Experience

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

	Year Ended December 31,				
(Dollars in thousands)	**2016**	2015	2014	2013	2012
Balance, January 1	**$ 40,895**	$ 37,802	$ 38,766	$ 42,957	$ 49,426
Provision (credit) for loan losses	**5,546**	5,371	(163)	(1,084)	3,649
Loan charge-offs:					
Residential real estate:					
Residential mortgage	**(1,404)**	(614)	(323)	(1,194)	(2,107)
Residential construction	**-**	-	(4)	(104)	(224)
Commercial real estate:					
Commercial investor	**(197)**	(91)	(3)	(4,774)	(3,690)
Commercial owner occupied	**-**	(1,043)	(265)	(240)	(1,174)
Commercial AD&C	**(48)**	(739)	(529)	(85)	(3,281)
Commercial business	**(597)**	(306)	(729)	(2,915)	(1,022)
Leases	**-**	(4)	-	-	(8)
Consumer	**(888)**	(998)	(834)	(1,853)	(1,298)
Total charge-offs	**(3,134)**	(3,795)	(2,687)	(11,165)	(12,804)
Loan recoveries:					
Residential real estate:					
Residential mortgage	**358**	145	121	162	213
Residential construction	**32**	51	79	11	12
Commercial real estate:					
Commercial investor	**133**	20	38	3,354	97
Commercial owner occupied	**5**	3	6	425	38
Commercial AD&C	**40**	580	-	3,080	528
Commercial business	**44**	475	1,477	818	1,548
Leases	**-**	-	-	10	23
Consumer	**148**	243	165	198	227
Total recoveries	**760**	1,517	1,886	8,058	2,686
Net charge-offs	**(2,374)**	(2,278)	(801)	(3,107)	(10,118)
Balance, period end	$ **44,067**	$ 40,895	$ 37,802	$ 38,766	$ 42,957
Net charge-offs to average loans	**0.06%**	0.07%	0.03%	0.12%	0.42%
Allowance to total loans	**1.12%**	1.17%	1.21%	1.39%	1.70%

52

Analysis of Credit Risk

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

	At December 31,				
(Dollars in thousands)	**2016**	2015	2014	2013	2012
Non-accrual loans					
Residential real estate					
Residential mortgage	**$ 7,257**	$ 8,822	$ 3,012	$ 5,735	$ 4,681
Residential construction	**195**	418	1,105	2,315	3,125
Commercial real estate:					
Commercial investor	**8,107**	8,368	8,156	6,802	11,843
Commercial owner occupied	**4,823**	6,340	8,941	5,936	13,681
Commercial AD&C	**137**	194	2,464	4,127	6,332
Commercial business	**5,833**	3,696	3,184	3,400	4,611
Leases	**-**	-	-	-	865
Consumer	**2,859**	2,193	1,668	2,259	2,410
Total non-accrual loans(1)	**29,211**	30,031	28,530	30,574	47,548
Loans 90 days past due					
Residential real estate:					
Residential mortgage	**232**	-	-	-	-
Residential construction	**-**	-	-	-	-
Commercial real estate:					
Commercial investor	**-**	-	-	-	-
Commercial owner occupied	**-**	-	-	-	209
Commercial AD&C	**-**	-	-	-	-
Commercial business	**-**	-	-	-	24
Leases	**-**	-	-	-	-
Consumer	**-**	-	-	1	14
Total 90 days past due loans	**232**	-	-	1	247
Restructured loans (accruing)	**2,489**	4,467	5,497	9,459	10,110
Total non-performing loans(2)	**31,932**	34,498	34,027	40,034	57,905
Other real estate owned, net	**1,911**	2,742	3,195	1,338	5,926
Total non-performing assets	$ **33,843**	$ 37,240	$ 37,222	$ 41,372	$ 63,831
Non-performing loans to total loans	**0.81%**	0.99%	1.09%	1.44%	2.29%
Non-performing assets to total assets	**0.66%**	0.80%	0.85%	1.01%	1.61%
Allowance for loan losses to non-performing loans	**138.00%**	118.54%	111.09%	96.83%	74.18%

(1) Gross interest income that would have been recorded in 2016 if non-accrual loans shown above had been current and in accordance with their original terms was $2.1 million. No interest was recorded on these loans during the year. Please see Note 1 of the Notes to Consolidated Financial Statements for a description of the Company’s policy for placing loans on non-accrual status.

(2) Performing loans considered potential problem loans, as defined and identified by management, amounted to $11.9 million at December 31, 2016. Although these are loans where known information about the borrowers' possible credit problems causes management to have concerns as to the borrowers' ability to comply with the loan repayment terms, most are current as to payment terms, well collateralized and are not believed to present significant risk of loss. Loans classified for regulatory purposes not included in either non-performing or potential problem loans consist only of "other loans especially mentioned" and do not, in management's opinion, represent or result from trends or uncertainties reasonably expected to materially impact future operating results, liquidity or capital resources, or represent material credits where known information about the borrowers' possible credit problems causes management to have doubts as to the borrowers' ability to comply with the loan repayment terms.

Market Risk Management

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

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

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

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

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

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

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

Estimated Changes in Net Interest Income

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	23.50%	17.50%	15.00%	10.00%	10.00%	15.00%	17.50%	23.50%
December 31, 2016	**(8.55%)**	**(5.76%)**	**(2.84%)**	**(1.20%)**	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2015	(5.99%)	(3.63%)	(1.52%)	(0.68%)	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk increased from December 31, 2015 at all rising interest rate shock levels. All measures remained well within prescribed policy limits.

The increase in the risk position with respect to net interest income from December 31, 2015 to December 31, 2016 was the result of an increase in short-term FHLB borrowings which will increase the Company’s exposure to increases in interest rates.

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

Estimated Changes in Economic Value of Equity (EVE)

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	35.00%	25.00%	20.00%	10.00%	10.00%	20.00%	25.00%	35.00%
December 31, 2016	**(14.83%)**	**(10.72%)**	**(6.42%)**	**(2.86%)**	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2015	(8.24%)	(5.50%)	(2.72%)	(1.28%)	N/A	N/A	N/A	N/A

Measures of the economic value of equity (“EVE”) at risk increased from December 31, 2015 in all rising shock scenarios. The increased risk is due to a substantial increase in long-term fixed rate assets coupled with shorter durations on deposits and borrowings. Higher fixed rate assets together with shorter durations on liabilities increase the Company’s exposure in rising rate scenarios.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan repayments, maturing investments, deposit growth, borrowed funds, capital and the sale of highly marketable assets such as investment securities and residential mortgage loans. The Company's liquidity position, considering both internal and external sources available, exceeded anticipated short-term and long-term needs at December 31, 2016. Management considers core deposits, defined to include all deposits other than time deposits of $100 thousand or more, to be a relatively stable funding source. Core deposits equaled 68% of total interest-earning assets at December 31, 2016. In addition, loan payments, maturities, calls and pay downs of securities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements. In assessing liquidity, management considers operating requirements, the seasonality of deposit flows, investment, loan and deposit maturities and calls, expected funding of loans and deposit withdrawals, and the market values of available-for-sale investments, so that sufficient funds are available on short notice to meet obligations as they arise and to ensure that the Company is able to pursue new business opportunities.

Liquidity is measured using an approach designed to take into account, in addition to factors already discussed above, the Company's growth and mortgage banking activities. Also considered are changes in the liquidity of the investment portfolio due to fluctuations in interest rates. Under this approach, implemented by the Funds Management Subcommittee of ALCO under formal policy guidelines, the Company's liquidity position is measured weekly, looking forward at thirty day intervals from thirty (30) to three hundred sixty (360) days. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Resulting projections as of December 31, 2016, 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 $1.4 billion, of which $1.4 billion was available for borrowing based on pledged collateral, with $790 million borrowed against it as of December 31, 2016. The line of credit at the Federal Reserve totaled $349 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of December 31, 2016. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled $70 million at December 31, 2016, against which there were no outstanding borrowings. In addition, the Company had a secured line of credit with a correspondent bank of $20 million as of December 31, 2016. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at December 31, 2016.

The parent company ("Bancorp") is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Bancorp is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. Bancorp's primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Bancorp in any calendar year, without the receipt of prior approval from the Federal Reserve, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. Based on this requirement, as of December 31, 2016, the Bank could have declared a dividend of $27 million to Bancorp. At December 31, 2016, Bancorp had liquid assets of $11 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.

The Company has various contractual obligations that affect its cash flows and liquidity. For information regarding material contractual obligations, please see "Market Risk Management" previously discussed, "Contractual Obligations" below, and "Note 6-Premises and Equipment," "Note 9-Borrowings," "Note 13-Pension, Profit Sharing and Other Employee Benefit Plans," "Note 18-Financial Instruments with Off-balance Sheet Risk and Derivatives," and "Note 20-Fair Value" of the Notes to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

With the exception of the Company's obligations in connection with its trust preferred securities, irrevocable letters of credit, and loan commitments, the Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources, that is material to investors. The trust preferred securities were issued by Sandy Spring Capital Trust II (the "Trust"), a subsidiary of the Company created for the purpose of issuing the trust preferred securities and purchasing the Company's junior subordinated debentures, which are its sole assets. These junior subordinated debentures bear a maturity date of October 7, 2034, which may be shortened, subject to conditions, to a date no earlier than October 7, 2009. The Company owns all of the Trust's outstanding common securities. The Company and the Trust believe that, taken together, the Company's obligations under the junior subordinated debentures, the Indenture, the Trust Agreement, and the Guarantee entered into in connection with the issuance of the trust preferred securities and the debentures, in the aggregate constitute a full, irrevocable and unconditional guarantee of the Trust's obligations. For additional information on off-balance sheet arrangements, please see "Note 18-Financial Instruments with Off-balance Sheet Risk and Derivatives" and "Note 9-Borrowings" and "Note 3-Investments" of the Notes to the Consolidated Financial Statements, and "Capital Management".

Contractual Obligations

The Company enters into contractual obligations in the normal course of business. Among these obligations are FHLB advances, operating leases related to branch and administrative facilities and a long-term contract with a data processing provider. Payments required under these obligations, are set forth in the table following as of December 31, 2016.

		Projected Maturity Date or Payment Period[1]			
(In thousands)	Total	Less than 1 year	1-3 Years	3-5 Years	After 5 Years
Retail repurchase agreements	$ 125,119	$ 125,119	$ -	$ -	$ -
Advances from FHLB	790,000	470,000	230,000	90,000	-
Certificates of deposit	586,039	343,819	179,567	62,653	-
Operating lease obligations	39,064	6,133	10,194	8,730	14,007
Purchase obligations [2]	8,682	3,297	2,084	1,870	1,431
Total	$ 1,548,904	$ 948,368	$ 421,845	$ 163,253	$ 15,438

(1) Assumed a seven year term for purposes of this table.

(2) Represents payments required under contract, based on average monthly charges for 2017 with the Company's current data processing service provider that expires in September 2020.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk.

The information required by this item is incorporated by reference to Part II, Item 7 of this report.

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

Internal Control Over Financial Reporting

As part of the Corporation's program to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2016 (the "Assessment"). In making this Assessment, management used the control criteria framework of the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission published in its report entitled Internal Control — Integrated Framework (2013). Management's Assessment included an evaluation of the design of the Corporation's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Based on this assessment, the Company's management concluded that the Company's internal control over financial reporting was effective as of December 31, 2016.

The attestation reports by the Company's independent registered public accounting firm, Ernst & Young LLP, on the Company's internal control over financial reporting begins on the following pages.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Sandy Spring Bancorp, Inc.

We have audited the accompanying consolidated statements of condition of Sandy Spring Bancorp, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, cash flows and changes in stockholders' equity for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sandy Spring Bancorp, Inc. and subsidiaries at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sandy Spring Bancorp, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated March 3, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia

March 3, 2017

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Sandy Spring Bancorp, Inc.

We have audited Sandy Spring Bancorp, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) (the COSO criteria). Sandy Spring Bancorp, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Sandy Spring Bancorp, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated statements of condition of Sandy Spring Bancorp, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, cash flows and changes in stockholders' equity for each of the three years in the period ended December 31, 2016 and our report dated March 3, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia

March 3, 2017

Sandy Spring Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CONDITION

(Dollars in thousands)	**December 31, 2016**	December 31, 2015
Assets		
Cash and due from banks	**$ 53,190**	$ 46,956
Federal funds sold	**1,953**	472
Interest-bearing deposits with banks	**78,982**	25,454
Cash and cash equivalents	**134,125**	72,882
Residential mortgage loans held for sale (at fair value)	**13,222**	15,457
Investments available-for-sale (at fair value)	**733,554**	592,049
Investments held-to-maturity -- fair value of $211,704 at December 31, 2015, respectively	**-**	208,265
Other equity securities	**46,094**	41,336
Total loans	**3,927,808**	3,495,370
Less: allowance for loan losses	**(44,067)**	(40,895)
Net loans	**3,883,741**	3,454,475
Premises and equipment, net	**53,562**	53,214
Other real estate owned	**1,911**	2,742
Accrued interest receivable	**14,589**	13,443
Goodwill	**85,768**	84,171
Other intangible assets, net	**680**	138
Other assets	**124,137**	117,208
Total assets	**$ 5,091,383**	$ 4,655,380
Liabilities		
Noninterest-bearing deposits	**$ 1,138,139**	$ 1,001,841
Interest-bearing deposits	**2,439,405**	2,261,889
Total deposits	**3,577,544**	3,263,730
Securities sold under retail repurchase agreements and federal funds purchased	**125,119**	109,145
Advances from FHLB	**790,000**	685,000
Subordinated debentures	**30,000**	35,000
Accrued interest payable and other liabilities	**35,148**	38,078
Total liabilities	**4,557,811**	4,130,953
Stockholders' Equity		
Common stock -- par value $1.00; shares authorized 50,000,000; shares issued and outstanding 23,901,084 and 24,295,971 at December 31, 2016 and 2015, respectively	**23,901**	24,296
Additional paid in capital	**165,871**	175,588
Retained earnings	**350,414**	325,840
Accumulated other comprehensive loss	**(6,614)**	(1,297)
Total stockholders' equity	**533,572**	524,427
Total liabilities and stockholders' equity	**$ 5,091,383**	$ 4,655,380

The accompanying notes are an integral part of these financial statements

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

	Year Ended December 31,		
(Dollars in thousands, except per share data)	**2016**	2015	2014
Interest Income:			
Interest and fees on loans	**$ 150,868**	$ 135,170	$ 123,369
Interest on loans held for sale	**387**	544	312
Interest on deposits with banks	**213**	98	85
Interest and dividends on investment securities:			
Taxable	**11,500**	14,440	15,377
Exempt from federal income taxes	**7,583**	8,059	9,222
Interest on federal funds sold	**5**	1	1
Total interest income	**170,556**	158,312	148,366
Interest Expense:			
Interest on deposits	**8,161**	5,878	4,791
Interest on retail repurchase agreements and federal funds purchased	**290**	255	164
Interest on advances from FHLB	**11,610**	13,081	12,982
Interest on subordinated debt	**943**	899	881
Total interest expense	**21,004**	20,113	18,818
Net interest income	**149,552**	138,199	129,548
Provision (credit) for loan losses	**5,546**	5,371	(163)
Net interest income after provision (credit) for loan losses	**144,006**	132,828	129,711
Non-interest Income:			
Investment securities gains	**1,932**	36	5
Service charges on deposit accounts	**7,953**	7,607	8,422
Mortgage banking activities	**4,049**	3,114	1,994
Wealth management income	**17,805**	19,931	19,086
Insurance agency commissions	**5,408**	5,176	4,996
Income from bank owned life insurance	**2,462**	2,571	2,444
Bank card fees	**4,674**	4,652	4,439
Other income	**6,759**	6,814	5,485
Total non-interest income	**51,042**	49,901	46,871
Non-interest Expenses:			
Salaries and employee benefits	**71,354**	71,003	66,387
Occupancy expense of premises	**12,960**	12,809	13,692
Equipment expenses	**6,883**	6,071	5,188
Marketing	**2,851**	2,896	2,926
Outside data services	**5,377**	5,023	4,947
FDIC insurance	**2,741**	2,491	2,302
Amortization of intangible assets	**130**	372	821
Litigation expenses	**-**	(3,869)	6,519
Other expenses	**20,762**	18,551	18,018
Total non-interest expenses	**123,058**	115,347	120,800
Income before income taxes	**71,990**	67,382	55,782
Income tax expense	**23,740**	22,027	17,582
Net income	**$ 48,250**	$ 45,355	$ 38,200

Net Income Per Share Amounts:

Basic net income per share	**$**	**2.00**	$	1.84	$	1.53
Diluted net income per share	**$**	**2.00**	$	1.84	$	1.52
Dividends declared per share	**$**	**0.98**	$	0.90	$	0.76

The accompanying notes are an integral part of these financial statements

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

	Year Ended December 31,		
(In thousands)	**2016**	2015	2014
Net income	**$ 48,250**	$ 45,355	$ 38,200
Other comprehensive income:			
Investments available-for-sale:			
Net change in unrealized gains (losses) on investments available-for-sale	**(6,246)**	(2,520)	12,812
Related income tax (expense) benefit	**2,484**	1,030	(5,089)
Net investment gains reclassified into earnings	**(1,932)**	(36)	(5)
Related income tax expense	**770**	14	2
Net effect on other comprehensive income (loss)	**(4,924)**	(1,512)	7,720
Defined benefit pension plan:			
Recognition of unrealized gain (loss)	**(651)**	1,736	(9,235)
Related income tax (expense) benefit	**258**	(698)	3,662
Net effect on other comprehensive income (loss)	**(393)**	1,038	(5,573)
Total other comprehensive income (loss)	**(5,317)**	(474)	2,147
Comprehensive income	**$ 42,933**	$ 44,881	$ 40,347

The accompanying notes are an integral part of these financial statements

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

	Year Ended December 31,		
(Dollars in thousands)	**2016**	2015	2014
Operating activities:			
Net income	**$ 48,250**	$ 45,355	$ 38,200
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**7,958**	7,305	7,157
Provision (credit) for loan losses	**5,546**	5,371	(163)
Share based compensation expense	**2,139**	1,979	1,452
Deferred income tax expense (benefit)	**349**	(3)	808
Origination of loans held for sale	**(196,726)**	(193,316)	(137,339)
Proceeds from sales of loans held for sale	**239,705**	191,232	137,131
Gains on sales of loans held for sale	**(3,877)**	(2,861)	(1,939)
Loss on sales of other real estate owned	**48**	267	161
Investment securities gains	**(1,932)**	(36)	(5)
Net increase in accrued interest receivable	**(1,146)**	(809)	(102)
Net increase in other assets	**(5,134)**	(2,015)	(6,866)
Net increase (decrease) in accrued expenses and other liabilities	**(2,932)**	(6,267)	20,166
Other – net	**(1,873)**	4,628	(4,997)
Net cash provided by operating activities	**90,375**	50,830	53,664
Investing activities:			
Proceeds (purchases) of other equity securities	**(4,758)**	101	(750)
Purchases of investments held-to-maturity	**-**	(2,100)	-
Purchases of investments available-for-sale	**(287,211)**	(46,190)	-
Proceeds from sales of investment available-for-sale	**40,863**	-	-
Proceeds from maturities, calls and principal payments of investments held-to-maturity	**5,004**	12,943	3,786
Proceeds from maturities, calls and principal payments of investments available-for-sale	**298,803**	121,994	89,076
Net increase in loans	**(469,942)**	(372,203)	(346,373)
Proceeds from the sales of other real estate owned	**1,393**	2,112	488
Acquisition of business activity, net of cash acquired	**(1,347)**	-	-
Expenditures for premises and equipment	**(5,798)**	(8,572)	(8,564)
Net cash used in investing activities	**(422,993)**	(291,915)	(262,337)
Financing activities:			
Net increase in deposits	**313,814**	197,221	189,284
Net increase in retail repurchase agreements and federal funds purchased	**15,974**	34,713	20,590
Proceeds from advances from FHLB	**2,665,000**	2,274,000	1,805,000
Repayment of advances from FHLB	**(2,560,000)**	(2,244,000)	(1,765,000)
Retirement of subordinated debt	**(5,000)**	-	-
Proceeds from issuance of common stock	**897**	487	394
Tax benefits associated with shared based compensation	**125**	350	321
Repurchase of Common Stock	**(13,273)**	(22,624)	(910)
Dividends paid	**(23,676)**	(22,397)	(19,216)
Net cash provided by financing activities	**393,861**	217,750	230,463

Net increase (decrease) in cash and cash equivalents	**61,243**	(23,335)	21,790
Cash and cash equivalents at beginning of period	**72,882**	96,217	74,427
Cash and cash equivalents at end of period	**$ 134,125**	$ 72,882	$ 96,217
Supplemental Disclosures:			
Interest payments	**$ 21,377**	$ 20,040	$ 18,833
Income tax payments	**22,331**	21,060	15,154
Transfers of investments from held-to-maturity to available-for-sale	**203,118**	-	-
Transfers from loans to residential mortgage loans held for sale	**36,867**	-	-
Transfers from loans to other real estate owned	**637**	1,947	2,446

The accompanying notes are an integral part of these financial statements

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

`

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances at January 1, 2014	$ 24,990	$ 193,445	$ 283,898	$ (2,970)	$ 499,363
Net income	-	-	38,200	-	38,200
Other comprehensive loss, net of tax	-	-	-	2,147	2,147
Common stock dividends - $0.76 per share	-	-	(19,216)	-	(19,216)
Stock compensation expense	-	1,773	-	-	1,773
Common stock issued pursuant to:					
Stock option plan - 13,834 shares	14	176	-	-	190
Employee stock purchase plan - 24,519 shares	25	484	-	-	509
Restricted stock - 54,535 shares	54	(359)	-	-	(305)
Purchase of treasury shares - 38,032 shares	(38)	(872)	-	-	(910)
Balances at December 31, 2014	25,045	194,647	302,882	(823)	521,751
Net income	-	-	45,355	-	45,355
Other comprehensive loss, net of tax	-	-	-	(474)	(474)
Common stock dividends - $0.90 per share	-	-	(22,397)	-	(22,397)
Stock compensation expense	-	1,979	-	-	1,979
Common stock issued pursuant to:					
Stock option plan - 39,787 shares	40	562	-	-	602
Directors stock purchase plan - 837 shares	1	21	-	-	22
Employee stock purchase plan - 25,136 shares	25	541	-	-	566
Restricted stock - 55,784 shares	56	(409)	-	-	(353)
Purchase of treasury shares - 870,450 shares	(871)	(21,753)	-	-	(22,624)
Balances at December 31, 2015	**24,296**	**175,588**	**325,840**	**(1,297)**	**524,427**
Net income	**-**	**-**	**48,250**	**-**	**48,250**
Other comprehensive loss, net of tax	**-**	**-**	**-**	**(5,317)**	**(5,317)**
Common stock dividends - $0.98 per share	**-**	**-**	**(23,676)**	**-**	**(23,676)**
Stock compensation expense	**-**	**2,264**	**-**	**-**	**2,264**
Common stock issued pursuant to:					
Stock option plan - 44,067 shares	**44**	**672**	**-**	**-**	**716**
Directors stock purchase plan - 258 shares	**-**	**7**	**-**	**-**	**7**
Employee stock purchase plan - 23,779 shares	**24**	**567**	**-**	**-**	**591**
Restricted stock - 49,468 shares	**49**	**(466)**	**-**	**-**	**(417)**
Purchase of treasury shares - 512,459 shares	**(512)**	**(12,761)**	**-**	**-**	**(13,273)**
Balances at December 31, 2016	**$ 23,901**	**$ 165,871**	**$ 350,414**	**$ (6,614)**	**$ 533,572**

The accompanying notes are an integral part of these financial statements
65

Sandy Spring Bancorp, Inc. and Subsidiaries

Notes to thE Consolidated Financial Statements

Note 1 – Significant Accounting Policies

Nature of Operations

Sandy Spring Bancorp (the "Company"), a Maryland corporation, is the bank holding company for Sandy Spring Bank (the "Bank"), which conducts a full-service commercial banking, mortgage banking and trust business. Services to individuals and businesses include accepting deposits, extending real estate, consumer and commercial loans and lines of credit, equipment leasing, general insurance, personal trust, and investment and wealth management services. The Company operates in central Maryland, Northern Virginia, and the greater Washington D.C. market. 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 financial information. 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. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and affect the reported amounts of revenues earned and expenses incurred during the reporting period. Actual results could differ from those estimates. Estimates that could change significantly relate to the provision for loan 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.

Assets Under Management

Assets held for others under fiduciary and agency relationships are not assets of the Company or its subsidiaries and are not included in the accompanying balance sheets. Trust department income and investment management fees are presented on an accrual basis.

Cash Flows

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

Residential Mortgage Loans Held for Sale

The Company engages in sales of residential mortgage loans originated by the Bank. Loans held for sale are carried at fair value. Fair value is derived from secondary market quotations for similar instruments. The Company measures residential mortgage loans at fair value when the Company first recognizes the loan (i.e., the fair value option), as permitted by current accounting standards. Changes in fair value of these loans are recorded in earnings as a component of mortgage banking activities in non-interest income in the Consolidated Statements of Income. The Company's current practice is to sell the majority of such loans on a servicing released basis. Any retained servicing assets are amortized in proportion to their net servicing fee income over the life of the respective loans. Servicing assets are evaluated for impairment on a periodic basis.

Investments Held-to-Maturity

Investments held-to-maturity represents securities which the Company has the ability and positive intent to hold until maturity. These securities are recorded at cost at the time of acquisition. The carrying values of investments held-to-maturity are adjusted for premium amortization and discount accretion to the maturity date on the effective interest method. Related interest and dividends are included in interest income. Declines in the fair value of individual held-to-maturity investments below their cost that are other-than-temporary result in write-downs of the individual securities to their fair value. Factors that may affect the determination of whether other-than-temporary impairment ("OTTI") has occurred include a downgrading of the security below investment grade by the rating agency or due to potential default, a significant deterioration in the financial condition of the issuer, or that management would not have the ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value. During 2016, all investments held-to-maturity were transferred to investments available-for-sale. Accordingly, acquisitions of investments in the future will not be classified as held-to-maturity.

Investments Available-for-Sale

Marketable equity securities and debt securities not classified as held-to-maturity or trading are classified as securities available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk or other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses based on the difference between amortized cost and fair value, reported net of deferred tax, as accumulated other comprehensive income (loss), a separate component of stockholders' equity. The carrying values of securities available-for-sale are adjusted for premium amortization and discount accretion to the maturity date on the effective interest method. Realized gains and losses on security sales or maturities, using the specific identification method, are included as a separate component of non-interest income. Related interest and dividends are included in interest income. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary ("OTTI") result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security below investment grade by a rating agency or due to potential default, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Other Equity Securities

Other equity securities include Federal Reserve stock, Federal Home Loan Bank of Atlanta stock and other equities that are considered restricted as to marketability and recorded at cost. These securities are evaluated for impairment each reporting period.

Loan Financing Receivables

The Company's financing receivables consist primarily of loans that are stated at their principal balance outstanding net of any unearned income and deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans are considered past due or delinquent when the principal or interest due in accordance with the contractual terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment. Immaterial shortfalls in payment amounts do not necessarily result in a loan being considered delinquent or past due. If any payments are past due and subsequent payments are resumed without payment of the delinquent amount, the loan shall continue to be considered past due. Whenever any loan is reported delinquent on a principal or interest payment or portion thereof, the amount reported as delinquent is the outstanding principal balance of the loan.

Loans, except for consumer loans, are placed into non-accrual status when any portion of the loan principal or interest becomes 90 days past due. Management may determine that certain circumstances warrant earlier discontinuance of interest accruals on specific loans if an evaluation of other relevant factors (such as bankruptcy, interruption of cash flows, etc.) indicates collection of amounts contractually due is unlikely. These loans are considered, collectively, to be non-performing loans. Consumer installment loans that are not secured by real estate are not placed on non-accrual, but are charged down to their net realizable value when they are four months past due. Loans designated as non-accrual have all previously accrued but unpaid interest reversed. Payments received on non-accrual loans when doubt about the ultimate collectability of the principal no longer exists may have their interest payments recorded as interest income on a cash basis or using the cost-recovery method with all payments applied to reduce the outstanding principal until the loan returns to accrual status. Loans may be returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Large groups of smaller balance homogeneous loans are not individually evaluated for impairment and include lease financing receivables, residential permanent and construction mortgages and consumer installment loans. All other loans are considered non-homogeneous and are evaluated for impairment if they are placed in non-accrual status. Loans are determined to be impaired when, based on available information, it is probable that the Company may not collect all principal and interest payments according to contractual terms. Factors considered in determining whether a loan is impaired include:

- the financial condition of the borrower;
- reliability and sources of the cash flows;
- absorption or vacancy rates; and
- deterioration of related collateral.

The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's original effective interest rate, or as permitted, the impairment may be measured based on a loan’s observable market price or the fair value of the collateral less cost to sell. The majority of the Company’s impaired loans are considered to be collateral dependent and impairment is measured by determining the fair value of the collateral using third party appraisals conducted at least annually with underlying assumptions that are reviewed by management. Third party appraisals may be obtained on a more frequent basis if deemed necessary. Internal evaluations of collateral value are conducted quarterly to ensure any further deterioration of the collateral value is recognized on a timely basis. The Company may receive updated appraisals which contradict the preliminary determination of fair value used to establish a specific allowance on a loan. In these instances the specific allowance is adjusted to reflect the Company’s evaluation of the appraised fair value. In the event a loss was previously confirmed and the loan was charged down to the estimated fair value based on a previous appraisal, the balance of partially charged-off loans are not subsequently increased but could be further decreased depending on the direction of the change in fair value. Payments on fully or partially charged-off loans are accounted for under the cost-recovery method. Under this method, all payments are applied on a cash basis to reduce the entire outstanding principal, then to recognize a recovery of all previously charged-off amounts before interest income may be recognized. Based on the impairment evaluation, if the Company determines an estimable loss exists, a specific allowance will be established for that loan. Once a loss has been confirmed, the loan is charged-down to its estimated net realizable value. Interest income on impaired loans is recognized using the same method as non-accrual loans, with the exception of loans that are considered troubled debt restructurings.

Loans considered to be troubled debt restructurings (“TDRs”) are loans that have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief to a borrower experiencing financial difficulty. All restructured loans are considered impaired loans and may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided doubt has been removed concerning the collectability of principal and interest as evidenced by a sufficient period of payment performance in accordance with the restructured terms. Loans may be removed from the restructured category if their revised loan terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk and they meet certain performance criteria.

Management uses relevant information available to make the determination on whether loans are impaired in accordance with GAAP. However, the determination of whether loans are impaired and the measurement of the impairment requires significant judgment, and estimates of losses inherent in the loan portfolio can vary significantly from the amounts actually observed.

Allowance for Loan Losses

The allowance for loan losses (“allowance” or “ALL”) represents an amount which, in management's judgment, is adequate to absorb the probable estimate of losses that may be sustained on outstanding loans at the balance sheet date based on the evaluation of the size and current risk characteristics of the loan portfolio. The allowance is reduced by charge-offs, net of recoveries of previous losses, and is increased or decreased by a provision or credit for loan losses, which is recorded as a current period operating expense. The allowance is based on the basic principle that a loss be accrued when it is probable that the loss has occurred and the amount of the loss can be reasonably estimated.

Determination of the adequacy of the allowance is inherently complex and requires the use of significant and highly subjective estimates. The reasonableness of the allowance is reviewed periodically by the Risk Committee of the board of directors and formally approved quarterly by that same committee of the board.

The Company’s methodology for estimating the allowance includes a general component reflecting historical losses, as adjusted, by loan portfolio segment, and a specific component for impaired loans. There were no changes in the Company’s allowance policies or methodology from the prior year.

The general component is based upon historical loss experience by each portfolio segment measured, over the prior eight quarters weighted equally. The historical loss experience is supplemented to address various risk characteristics of the Company’s loan portfolio including:

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

The general component is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Reserves on loans considered to be “classified” under regulatory guidance are calculated separately from loans considered to be “pass” rated under the same guidance. This segregation allows the Company to monitor the allowance component applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and reasonably determine the sufficiency of reserves.

Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific allowance on an impaired credit is warranted. For the particular loan that may have potential impairment, 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. The Company typically relies on current (12 months old or less) third party appraisals of the collateral to assist in measuring impairment. In the cases in which the Company does not rely on a third party appraisal, an internal evaluation is prepared by an approved credit officer. 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. When losses are confirmed, a charge-off is taken that is at least in the amount of the collateral deficiency as determined by the independent third party appraisal. Any further collateral deterioration results in either further specific reserves being established or additional charge-offs. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to ensure that there are no significant time lapses during this process.

The portion of the allowance representing specific allowances is established on individually impaired loans. As a practical expedient, for collateral dependent loans, the Company measures impairment based on the net realizable value of the underlying collateral. For loans on which the Company has not elected to use a practical expedient to measure impairment, the Company will measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. In determining the cash flows to be included in the discount calculation the Company considers the following factors that combine to estimate the probability and severity of potential losses:

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

Management believes it uses relevant information available to make determinations about the allowance and that it has established the existing allowance in accordance with GAAP. However, the determination of the allowance requires significant judgment, and estimates of probable losses in the loan portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize inherent losses, future additions to the allowance may be necessary based on changes in the loans comprising the portfolio and changes in the financial condition of borrowers, such as may result from changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Company, periodically review the loan portfolio and the allowance. Such review may result in additional provisions based on management's judgments of information available at the time of each examination.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization, computed using the straight-line method. Premises and equipment are depreciated over the useful lives of the assets, which generally range from 3 to 10 years for furniture, fixtures and equipment, 3 to 5 years for computer software and hardware, and 10 to 40 years for buildings and building improvements. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful lives of the improvements. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are included in non-interest expense.

Goodwill and Other Intangible Assets

Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Company’s reporting units be compared to the carrying amount of the reporting unit’s net assets, including goodwill. The Company’s reporting units were identified based upon an analysis of each of its individual operating segments. If the fair values of the reporting units exceed their book values, no write-down of recorded goodwill is required. If the fair value of a reporting unit is less than book value, an expense may be required to write-down the related goodwill to the proper carrying value. Any impairment would be realized through a reduction of goodwill or the intangible and an offsetting charge to non-interest expense. The Company tests for impairment of goodwill as of October 1 of each year, and again at any quarter-end if any triggering events occur during a quarter that may affect goodwill. Examples of such events include, but are not limited to, adverse action by a regulator or a loss of key personnel. Determining the fair value of a reporting unit requires the Company to use a degree of subjectivity.

Current accounting guidance provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it is determined that the carrying value exceeds the fair value the first step, described above, of the two-step process must be performed. At December 31, 2016 and 2015 there was no evidence of impairment of goodwill or intangibles in any of the Company’s reporting units.

Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Other intangible assets have finite lives and are reviewed for impairment annually. These assets are amortized over their estimated useful lives either on a straight-line or sum-of-the-years basis over varying periods that initially did not exceed 15 years.

Other Real Estate Owned (“OREO”)

OREO is comprised of properties acquired in partial or total satisfaction of problem loans. The properties are recorded at fair value less estimated costs of disposal, on the date acquired or on the date that the Company acquires effective control over the property. Gains or losses arising at the time of acquisition of such properties are charged against the allowance for loan losses. During the holding period OREO continues to be measured at lower of cost or fair value less estimated costs of disposal, and any subsequent declines in value are expensed as incurred. Gains and losses realized from the sale of OREO, as well as valuation adjustments and expenses of operation are included in non-interest expense.

Derivative Financial Instruments

Derivative Loan Commitments

Mortgage loan commitments are derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. Derivative loan commitments are recognized at fair value on the consolidated statements of condition in other assets or other liabilities with changes in their fair values recorded as a component of mortgage banking activities in the consolidated statements of income.

Mortgage loan commitments are issued to borrowers. Subsequent to commitment date, changes in the fair value of the loan commitment are recognized based on changes in the fair value of the underlying mortgage loan due to interest rate changes, changes in the probability the derivative loan commitment will be exercised, and the passage of time. In estimating fair value, a probability is assigned to a loan commitment based on an expectation that it will be exercised and the loan will be funded.

Forward Loan Sale Commitments

Loan sales agreements are evaluated to determine whether they meet the definition of a derivative as facts and circumstances may differ significantly. If agreements qualify, to protect against the price risk inherent in derivative loan commitments, the Company utilizes both “mandatory delivery” and “best efforts” forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Mandatory delivery contracts are accounted for as derivative instruments. Generally, best efforts contracts also meet the definition of derivative instruments after the loan to the borrower has closed. Accordingly, forward loan sale commitments that economically hedge the closed loan inventory are recognized at fair value on the consolidated statements of condition in other assets or other liabilities with changes in their fair values recorded as a component of mortgage banking activities in the consolidated statements of income. The Company estimates the fair value of its forward loan sales commitments using a methodology similar to that used for derivative loan commitments.

Interest Rate Swap Agreements

The Company enters into interest rate swaps (“swaps”) with loan customers to provide a facility to mitigate the fluctuations in the variable rate on the respective loans. These swaps are matched in exact offsetting terms to swaps that the Company enters into with an outside third party. The swaps are reported at fair value in other assets or other liabilities. The Company's swaps qualify as derivatives, but are not designated as hedging instruments, thus any net gain or loss resulting from changes in the fair value is recognized in other non-interest income. Further discussion of the Company's financial derivatives is set forth in Note 18 to the Consolidated Financial Statements.

Off-Balance Sheet Credit Risk

The Company issues financial or standby letters of credit that represent conditional commitments to fund transactions by the Company, typically to guarantee performance of a customer to a third party related to borrowing arrangements. The credit risk associated with issuing letters of credit is essentially the same as occurs when extending loan facilities to borrowers. The Company monitors the exposure to the letters of credit as part of its credit review process. Extensions of letters of credit, if any, would become part of the loan balance outstanding and would be evaluated in accordance with the Company’s credit policies. Potential exposure to loss for unfunded letters of credit if deemed necessary would be recorded in other liabilities.

In the ordinary course of business the Company originates and sells whole loans to a variety of investors. Mortgage loans sold are

subject to representations and warranties made to the third party purchasers regarding certain attributes. Subsequent to the sale, if a material underwriting deficiency or documentation defect is determined, the Company may be obligated to repurchase the mortgage loan or reimburse the investor for losses incurred if the deficiency or defect cannot be rectified within a specific period subsequent to discovery. The Company monitors the activity regarding the requirement to repurchase loans and the associated losses incurred. This information is applied to determine an estimated recourse reserve that is recorded in other liabilities.

Valuation of Long-Lived Assets

The Company reviews long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by a comparing the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reported at the lower of the cost or the fair value, less costs to sell.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right or from providing more than a trivial benefit to the transferor) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through any agreement to repurchase or redeem them before their maturity or likely cause a holder to return those assets whether through unilateral ability or a price so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them. A participating interest must be in an entire financial asset and cannot represent an interest in a group of financial assets. Except for compensation paid for services performed, all cash flows from the asset are allocated to the participating interest holders in proportion to their share of ownership. Financial assets obtained or liabilities incurred in a sale are recognized and initially measured at fair value.

Insurance Commissions and Fees

Commission revenue is recognized over the term of the coverage period. The Company also receives contingent commissions from insurance companies as additional incentive for achieving specified premium volume goals and/or the loss experience of the insurance placed by the Company. Contingent commissions from insurance companies are recognized when determinable, which is generally when such commissions are received.

Advertising Costs

Advertising costs are expensed as incurred and included in non-interest expenses.

Net Income per Common Share

Basic net income per common share is derived by dividing net income available to common stockholders by the weighted-average number of common shares outstanding, and does not include the impact of any potentially dilutive common stock equivalents. The diluted net income per common share is derived by dividing net income by the weighted-average number of common shares outstanding, adjusted, if applicable, for the dilutive effect of outstanding stock options as well as any adjustment to income that would result from the assumed issuance. Dilutive shares are determined using the treasury stock method. Dilutive common stock equivalents are excluded from the computation of dilutive net income per common share if the result would be anti-dilutive. Diluted net income per common share may be determined and presented in the financial statements and accompanying notes through the application of the dual class method of computation if the results differ significantly from the aforementioned treasury stock method. Under the dual class method, recognition is provided to participating securities in the form of outstanding shares which may have a further dilutive effect on net income per common share.

Income Taxes

Income tax expense is based on the results of operations, adjusted for permanent differences between items of income or expense reported in the financial statements and those reported for tax purposes. Deferred income tax assets and liabilities are determined using the liability method. Under the liability method, deferred income taxes are determined based on the differences between the financial statement carrying amounts and the income tax bases of assets and liabilities and are measured at the enacted tax rates that will be in effect when these differences reverse.

The Company’s policy is to recognize interest and penalties on income taxes in other non-interest expenses. The Company remains subject to examination for income tax returns by the Internal Revenue Service, as well as all of the states where it conducts business, for the years ending after December 31, 2010. There are currently no examinations in process as of December 31, 2016.

Pending Accounting Pronouncements

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

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

The FASB issued Update No. 2016-09 in March 2016. This guidance requires recognition of all income tax effects of stock awards in the income statement when such awards vest or are settled. In addition, it revises the existing guidance to allow employers to withhold more of an employee's shares to satisfy the employer's statutory withholding requirements and still qualify for equity accounting treatment. Finally, an entity will now be allowed to make an entity-wide accounting policy election to either estimate the number or awards that are expected to vest, as required in the current guidance, or account for forfeitures as they occur. For public entities, this guidance is effective for the first interim or annual period beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

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

The FASB issued Update No. 2016-02 in February 2016. Under this guidance lessees are required to record most leases on their balance sheets but recognize expenses in the income statement. The guidance also eliminates the current real estate-specific provision and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs. With respect to lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. In applying this guidance entities will also need to determine whether an arrangement contains a lease or service agreement. Disclosures are required by lessees and lessors to meet the objective of enabling users of financials statements to assess the amount, timing, and uncertainty of cash flows arising from leases. For public entities, this guidance is effective for the first interim or annual period beginning after December 15, 2018. Early adoption is permitted. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is assessing this guidance to determine its impact on the Company's financial position, results of operations and cash flows.

The FASB issued Update No. 2016-01 in January 2016. This guidance requires entities to measure equity investments at fair value and recognize changes on fair value in net income. The guidance also provides a new measurement alternative for equity investments that do not have readily determinable fair values and don't qualify for the net asset value practical expedient. Entities will have to record changes in instrument –specific credit risk for financial liabilities measured under the fair value option in other comprehensive income, except for certain financial liabilities of consolidated collateralized financing entities. Entities will also have to reassess the realizability of a deferred tax asset related to an available-for-sale debt security in combination with their other deferred tax assets. For public entities, the guidance in this update is effective for the first interim or annual period beginning after December 15, 2017. Early adoption by public entities is permitted as of the beginning of the year of adoption for selected amendments by a cumulative effect adjustment to the balance sheet. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

The FASB issued Update No. 2014-09 in May 2014 that provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to customers. The guidance also provides for a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. This standard may affect an entity's financial statements, business processes and internal control over financial reporting. The guidance is effective for the first interim or annual period beginning after December 15, 2017. The guidance must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. An assessment of the impact of this guidance has been performed and the Company does not expect it to have a material impact on the Company’s financial position, results of operations and cash flows.

The FASB issued Update No. 2014-15 in September 2014 that requires an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year of the issuance of the financial statements. This evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued. Substantial doubt exists when such conditions and events indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date of issuance of the financial statements. When management identifies such conditions or events that raise substantial doubt, management must consider whether its plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt. If such doubt is not alleviated, an entity should include a statement in the footnotes indicating that there is substantial doubt about the entity's ability to continue as a going concern. Regardless of whether such doubt is alleviated or not, the entity should disclose information that enables users of the financial statements to understand the principal conditions or events involved, management's evaluation of the significance of those conditions or events and management's plans that will either alleviate or mitigate such substantial doubt about the entity's ability to continue as a going concern. The guidance is effective for the first interim or annual period ending after December 15, 2016, with early adoption permitted. Management has evaluated the Company's existing aggregate conditions and known events and have determined that there are no substantial doubts regarding the Company to continue to function as a going concern and meet its obligations for the next twelve months.

Note 2 – Cash and Due from Banks

The Federal Reserve Act requires that banks maintain cash reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. At its option, the Company maintains additional balances to compensate for clearing and safekeeping services. The average balance maintained in 2016 was $40.5 million and in 2015 was $37.2 million.

Note 3 – Investments

Investments available-for-sale

The amortized cost and estimated fair values of investments available-for-sale at December 31 are presented in the following table:

	2016				2015			
(In thousands)	**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	**$124,314**	**$ 32**	**$(2,556)**	**$121,790**	$109,602	$ 132	$(1,334)	$108,400
State and municipal	**281,090**	**7,180**	**(586)**	**287,684**	156,402	8,305	-	164,707
Mortgage-backed	**314,029**	**2,851**	**(4,169)**	**312,711**	312,846	6,396	(2,546)	316,696
Corporate debt	**9,100**	**34**	**-**	**9,134**	-	-	-	-
Trust preferred	**1,089**	**-**	**(77)**	**1,012**	1,089	-	(66)	1,023
Total debt securities	**729,622**	**10,097**	**(7,388)**	**732,331**	579,939	14,833	(3,946)	590,826
Marketable equity securities	**1,223**	**-**	**-**	**1,223**	1,223	-	-	1,223
Total investments available-for-sale	**$730,845**	**$10,097**	**$(7,388)**	**$733,554**	$581,162	$14,833	$(3,946)	$592,049

Any unrealized losses in the U.S. government agencies, state and municipal or mortgage-backed securities at December 31, 2016 are the result of changes in interest rates. These declines are considered temporary in nature and will decline over time and recover as these securities approach maturity.

The mortgage-backed portfolio at December 31, 2016 is composed entirely of either the most senior tranches of GNMA, FNMA or FHLMC collateralized mortgage obligations ($106.2 million), or GNMA, FNMA or FHLMC mortgage-backed securities ($206.5 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.

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

At December 31, 2016 the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security, which is backed by debt issued by banks and thrifts, totals $1.1 million with a fair value of $1.0 million. The fair value of this security was determined by management through the use of a third party valuation specialist due to the limited trading activity for this security.

As a result of this evaluation, it was determined that the pooled trust preferred security had not incurred any credit-related other-than-temporary impairment ("OTTI") for the year ended December 31, 2016. The unrealized loss on this security that is recognized in other comprehensive income ("OCI") and is not expected to be sold and which the Company has the ability to hold until maturity, was $0.1 million at December 31, 2016.

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

(In thousands)	OTTI Losses	
Cumulative credit losses on investment securities, through December 31, 2014	$	531
Additions for credit losses not previously recognized		-
Cumulative credit losses on investment securities, through December 31, 2015		531
Additions for credit losses not previously recognized		-
Cumulative credit losses on investment securities, through December 31, 2016	$	531

75

Gross unrealized losses and fair values by length of time that the individual available-for-sale securities have been in an unrealized loss position at December 31 are presented in the following table:

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

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

The amortized cost and estimated fair values of debt securities available-for-sale by contractual maturity at December 31 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.

	2016		2015	
(In thousands)	**Amortized Cost**	**Estimated Fair Value**	Amortized Cost	Estimated Fair Value
Due in one year or less	**$ 7,493**	**$ 7,541**	$ 301	$ 306
Due after one year through five years	**156,953**	**162,233**	157,710	160,257
Due after five years through ten years	**282,468**	**282,713**	168,136	174,677
Due after ten years	**282,708**	**279,844**	253,792	255,586
Total debt securities available-for-sale	**$ 729,622**	**$ 732,331**	$ 579,939	$ 590,826

At December 31, 2016 and 2015, investments available-for-sale with a book value of $453.0 million and $233.2 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. government agency securities, exceeded ten percent of stockholders' equity at December 31, 2016 and 2015.

Investments held-to-maturity

The amortized cost and estimated fair values of investments held-to-maturity at December 31 are presented in the following table:

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

Gross unrealized losses and fair values by length of time that the individual held-to-maturity securities have been in a continuous unrealized loss position at December 31 are presented in the following tables:

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

The Company does not intend to sell these securities and has sufficient liquidity to hold these securities to maturity, to allow for any anticipated recovery in fair value, and substantiates that the unrealized losses in the held-to-maturity portfolio are considered temporary in nature.

The amortized cost and estimated fair values of debt securities held-to-maturity by contractual maturity at December 31 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.

	2015	
(In thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 845	$ 853

Due after one year through five years		19,217		20,041
Due after five years through ten years		163,125		165,620
Due after ten years		25,078		25,190
Total debt securities held-to-maturity	$	208,265	$	211,704

At December 31, 2015, investments held-to-maturity with a book value of $194.3 million were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. government agency securities, exceeded ten percent of stockholders' equity at December 31, 2015.

Equity securities

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

(In thousands)	**2016**	2015
Federal Reserve Bank stock	**$ 8,334**	$ 8,269
Federal Home Loan Bank of Atlanta stock	**37,760**	33,067
Total equity securities	**$ 46,094**	$ 41,336

Securities gains

Gross realized gains and losses on all investments for the years ended December 31 are presented in the following table:

(In thousands)	**2016**	2015	2014
Gross realized gains from sales of investments available-for-sale	**$ 1,491**	$ -	$ -
Net gains from calls of investments available-for-sale	**440**	18	2
Net gains from calls of investments held-to-maturity	**1**	18	3
Net securities gains	**$ 1,932**	$ 36	$ 5

Note 4 – Loans

The lending business of the Company is based on understanding, measuring and controlling the credit risk inherent in the loan portfolio. The Company's loan portfolio is subject to varying degrees of credit risk. Credit risk entails both general risks, which are inherent in the process of lending, and risk specific to individual borrowers. The Company's credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry or collateral type.

Outstanding loan balances at December 31, 2016 and 2015 are net of unearned income including net deferred loan costs of $1.4 million and $1.1 million, respectively.

The loan portfolio segment balances at December 31 are presented in the following table:

(In thousands)	**2016**	2015
Residential real estate:		
Residential mortgage	**$ 841,692**	$ 796,358
Residential construction	**150,229**	129,281
Commercial real estate:		
Commercial owner occupied real estate	**775,552**	678,027

Commercial investor real estate	**928,113**	719,084
Commercial AD&C	**308,279**	255,980
Commercial Business	**467,286**	465,765
Consumer	**456,657**	450,875
Total loans	**$ 3,927,808**	$ 3,495,370

78

Portfolio Segments

The Company currently manages its credit products and the respective exposure to credit losses (credit risk) by the following specific portfolio segments (classes) which are levels at which the Company develops and documents its systematic methodology to determine the allowance for loan losses attributable to each respective portfolio segment. These segments are:

- ***Commercial business loans*** – Commercial loans are made to provide funds for equipment and general corporate needs. Repayment of a loan primarily uses the funds obtained from the operation of the borrower's business. Commercial loans also include lines of credit that are utilized to finance a borrower's short-term credit needs and/or to finance a percentage of eligible receivables and inventory.

- ***Commercial acquisition, development and construction loans*** –Commercial acquisition, development and construction loans are intended to finance the construction of commercial properties and include loans for the acquisition and development of land. Construction loans represent a higher degree of risk than permanent real estate loans and may be affected by a variety of factors such as the borrower's ability to control costs and adhere to time schedules and the risk that constructed units may not be absorbed by the market within the anticipated time frame or at the anticipated price. The loan commitment on these loans often includes an interest reserve that allows the lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan.

- ***Commercial owner occupied real estate loans* -** Commercial owned-occupied real estate loans consist of commercial mortgage loans secured by owner occupied properties where an established banking relationship exists and involves a variety of property types to conduct the borrower's operations. The primary source of repayment for this type of loan is the cash flow from the business and is based upon the borrower's financial health and the ability of the borrower and the business to repay.

- ***Commercial investor real estate loans* -** Commercial investor real estate loans consist of loans secured by non-owner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. This commercial real estate category contains mortgage loans to the developers and owners of commercial real estate where the borrower intends to operate or sell the property at a profit and use the income stream or proceeds from the sale(s) to repay the loan.

- ***Consumer loans* -** This category of loans includes primarily home equity loans and lines, installment loans, personal lines of credit and marine loans. The home equity category consists mainly of revolving lines of credit to consumers which are secured by residential real estate. These loans are typically secured with second mortgages on the homes. Other consumer loans include installment loans used by customers to purchase automobiles, boats and recreational vehicles.

- ***Residential mortgage loans*** – The residential real estate category contains permanent mortgage loans principally to consumers secured by residential real estate. Residential real estate loans are evaluated for the adequacy of repayment sources at the time of approval, based upon measures including credit scores, debt-to-income ratios, and collateral values. Loans may be either conforming or non-conforming.

- ***Residential construction loans* -** The Company makes residential real estate construction loans generally to provide interim financing on residential property during the construction period. Borrowers are typically individuals who will ultimately occupy the single-family dwelling. Loan funds are disbursed periodically as pre-specified stages of completion are attained based upon site inspections.

Loans to Related Parties

Certain directors and executive officers have loan transactions with the Company. The following schedule summarizes changes in amounts of loans outstanding, both direct and indirect, to these persons during the periods indicated:

(In thousands)	**2016**	2015	2014
Balance at January 1	**$ 21,050**	$ 21,756	$ 18,921
Additions	**21,355**	8,684	7,060
Repayments	**(417)**	(9,390)	(4,225)
Balance at December 31	**$ 41,988**	$ 21,050	$ 21,756

Note 5 – CREDIT QUALITY ASSESSMENT

Allowance for Loan Losses

Credit risk can vary significantly as losses, as a percentage of outstanding loans, can vary widely during economic cycles and are sensitive to changing economic conditions. The amount of loss in any particular type of loan can vary depending on the purpose of the loan and the underlying collateral securing the loan. Collateral securing commercial loans can range from accounts receivable to equipment to improved or unimproved real estate depending on the purpose of the loan. Home mortgage and home equity loans and lines are typically secured by first or second liens on residential real estate. Consumer loans may be secured by personal property, such as auto loans or they may be unsecured loan products.

Management has an internal credit process in place to maintain credit standards. This process along with an in-house loan administration, accompanied by oversight and review procedures, combines to control and manage credit risk. The primary purpose of loan underwriting is the evaluation of specific lending risks that 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 the portfolio credit quality, early identification of potential problem credits and the management of the problem credits. As part of the oversight and review process, the Company maintains an allowance for loan losses (the “allowance”) to absorb estimated and probable losses in the loan portfolio. The allowance is based on consistent, periodic review and evaluation of the loan portfolio, along with ongoing, monthly assessments of the probable losses and problem credits in each portfolio. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio.

Summary information on the allowance for loan loss activity for the years ended December 31 is provided in the following table:

(In thousands)	**2016**	2015	2014
Balance at beginning of year	**$ 40,895**	$ 37,802	$ 38,766
Provision for loan losses	**5,546**	5,371	(163)
Loan charge-offs	**(3,134)**	(3,795)	(2,687)

Loan recoveries	**760**	1,517	1,886
Net charge-offs	**(2,374)**	(2,278)	(801)
Balance at period end	**$ 44,067**	$ 40,895	$ 37,802

The following tables provide information on the activity in the allowance for loan losses by the respective loan portfolio segment for the years ended December 31:

2016

		Commercial Real Estate				Residential Real Estate		
(Dollars in thousands)	**Commercial Business**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**Consumer**	**Residential Mortgage**	**Residential Construction**	**Total**
Balance at beginning of year	**$ 6,529**	**$ 4,691**	**$ 10,440**	**$ 7,984**	**$ 3,456**	**$ 6,901**	**$ 894**	**$ 40,895**
Provision (credit)	**1,563**	**(31)**	**2,563**	**(104)**	**112**	**1,406**	**37**	**5,546**
Charge-offs	**(597)**	**(48)**	**(197)**	**-**	**(888)**	**(1,404)**	**-**	**(3,134)**
Recoveries	**44**	**40**	**133**	**5**	**148**	**358**	**32**	**760**
Net charge-offs	**(553)**	**(8)**	**(64)**	**5**	**(740)**	**(1,046)**	**32**	**(2,374)**
Balance at end of period	**$ 7,539**	**$ 4,652**	**$ 12,939**	**$ 7,885**	**$ 2,828**	**$ 7,261**	**$ 963**	**$ 44,067**
Total loans	**$467,286**	**$308,279**	**$928,113**	**$775,552**	**$456,657**	**$841,692**	**$150,229**	**$3,927,808**
Allowance for loans to total loans ratio	**1.61%**	**1.51%**	**1.39%**	**1.02%**	**0.62%**	**0.86%**	**0.64%**	**1.12%**
Balance of loans specifically evaluated for impairment	**$ 7,018**	**$ 137**	**$ 8,107**	**$ 5,567**	**na.**	**$ 3,263**	**$ -**	**$ 24,092**
Allowance for loans specifically evaluated for impairment	**$ 2,604**	**$ -**	**$ 1,736**	**$ 485**	**na.**	**$ -**	**$ -**	**$ 4,825**
Specific allowance to specific loans ratio	**37.10%**	**0.00%**	**21.41%**	**8.71%**	**na.**	**na.**	**na.**	**20.03%**
Balance of loans collectively evaluated	**$460,268**	**$308,142**	**$920,006**	**$769,985**	**$456,657**	**$838,429**	**$150,229**	**$3,903,716**
Allowance for loans collectively evaluated	**$ 4,935**	**$ 4,652**	**$ 11,203**	**$ 7,400**	**$ 2,828**	**$ 7,261**	**$ 963**	**$ 39,242**
Collective allowance to collective loans ratio	**1.07%**	**1.51%**	**1.22%**	**0.96%**	**0.62%**	**0.87%**	**0.64%**	**1.01%**

2015

		Commercial Real Estate					Residential Real Estate		
(Dollars in thousands)	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Balance at beginning of year	$ 5,852	$ 4,267	$ 9,784	$ 7,143	$ 9	$ 3,592	$ 6,232	$ 923	$ 37,802

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

The 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 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. 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 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.

81

Management has established a credit process that dictates that procedures be performed to monitor impaired 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.
- 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 determined for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

The Company generally follows a policy of not extending maturities on non-performing loans under existing terms. Certain performing loans that have displayed some inherent weakness in the underlying collateral values, an inability to comply with certain loan covenants which do not affect the performance of the credit or other identified weakness may have their terms extended on an exception basis. Maturity date extensions only occur under revised terms that place the Company in a better position to fully collect 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. Documented or demonstrated 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.

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 trouble debt restructured loans. All restructurings that constitute concessions to a troubled borrower are considered impaired loans that may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from the restructured category in the year subsequent to the restructuring if their revised loans terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk. At December 31, 2016, restructured loans totaled $9.2 million, of which $2.5 million were accruing and $6.7 million were non-accruing. The Company has commitments to lend $0.1 million in additional funds on loans that have been restructured at December 31, 2016. Restructured loans at December 31, 2015 totaled $11.4 million, of which $4.5 million were accruing and $6.9 million were non-accruing. Commitments to lend additional funds on loans that have been restructured at December 31, 2015 amounted to $0.1 million.

The following table provides summary information regarding impaired loans at December 31 and for the years then ended:

(In thousands)	**2016**	2015	2014
Impaired loans with a specific allowance	**$ 13,563**	$ 14,208	$ 11,411
Impaired loans without a specific allowance	**10,529**	14,719	18,008
Total impaired loans	**$ 24,092**	$ 28,927	$ 29,419
Allowance for loan losses related to impaired loans	**$ 4,825**	$ 3,375	$ 2,894
Allowance for loan related to loans collectively evaluated	**39,242**	37,520	34,908
Total allowance for loan losses	**$ 44,067**	$ 40,895	$ 37,802
Average impaired loans for the period	**$ 26,382**	$ 29,828	$ 34,331
Contractual interest income due on impaired loans during the period	**$ 2,082**	$ 2,527	$ 2,339
Interest income on impaired loans recognized on a cash basis	**$ 511**	$ 961	$ 773
Interest income on impaired loans recognized on an accrual basis	**$ 186**	$ 274	$ 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 December 31 for the years indicated:

	2016					
		Commercial Real Estate				**Total Recorded Investment in Impaired**
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**All Other Loans**	**Loans**
Impaired loans with a specific allowance						
Non-accruing	**$ 2,807**	**$ -**	**$ 7,029**	**$ 1,884**	**$ -**	**$ 11,720**
Restructured accruing	**1,140**	**-**	**-**	**-**	**-**	**1,140**
Restructured non-accruing	**64**	**-**	**-**	**639**	**-**	**703**
Balance	**$ 4,011**	**$ -**	**$ 7,029**	**$ 2,523**	**$ -**	**$ 13,563**
Allowance	**$ 2,604**	**$ -**	**$ 1,736**	**$ 485**	**$ -**	**$ 4,825**
Impaired loans without a specific allowance						
Non-accruing	**$ 1,562**	**$ -**	**$ 562**	**$ 1,083**	**$ -**	**$ 3,207**
Restructured accruing	**45**	**-**	**-**	**744**	**560**	**1,349**
Restructured non-accruing	**1,400**	**137**	**516**	**1,217**	**2,703**	**5,973**
Balance	**$ 3,007**	**$ 137**	**$ 1,078**	**$ 3,044**	**$ 3,263**	**$ 10,529**
Total impaired loans						
Non-accruing	**$ 4,369**	**$ -**	**$ 7,591**	**$ 2,967**	**$ -**	**$ 14,927**
Restructured accruing	**1,185**	**-**	**-**	**744**	**560**	**2,489**

Restructured non-accruing	**1,464**	**137**	**516**	**1,856**	**2,703**	**6,676**
Balance	**$ 7,018**	**$ 137**	**$ 8,107**	**$ 5,567**	**$ 3,263**	**$ 24,092**
Unpaid principal balance in total impaired loans	**$10,082**	**$ 4,398**	**$ 12,805**	**$ 7,760**	**$ 3,971**	**$ 39,016**

83

	2016					
		Commercial Real Estate				Total Recorded Investment in
(In thousands)	**Commercial**	**Commercial AD&C**	**Commercial Investor R/E**	**Commercial Owner Occupied R/E**	**All Other Loans**	**Impaired Loans**
Average impaired loans for the period	**$ 5,646**	**$ 150**	**$ 9,480**	**$ 6,561**	**$ 4,545**	**$ 26,382**
Contractual interest income due on impaired loans during the period	**$ 570**	**$ 294**	**$ 718**	**$ 310**	**$ 190**	
Interest income on impaired loans recognized on a cash basis	**$ 153**	**$ -**	**$ 43**	**$ 266**	**$ 49**	
Interest income on impaired loans recognized on an accrual basis	**$ 107**	**$ -**	**$ -**	**$ 37**	**$ 42**	

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

2015

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

Credit Quality

The following tables provide information on the credit quality of the loan portfolio by segment at December 31 for the years indicated:

	2016							
		Commercial Real Estate				Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:								
Non-accrual loans	**$ 5,833**	**$ 137**	**$ 8,107**	**$ 4,823**	**$ 2,859**	**$ 7,257**	**$ 195**	**$ 29,211**
Loans 90 days past due	**-**	**-**	**-**	**-**	**-**	**232**	**-**	**232**
Restructured loans	**1,185**	**-**	**-**	**744**	**-**	**560**	**-**	**2,489**
Total non-performing loans	**7,018**	**137**	**8,107**	**5,567**	**2,859**	**8,049**	**195**	**31,932**
Other real estate owned	**39**	**365**	**395**	**637**	**-**	**475**	**-**	**1,911**
Total non-performing assets	**$ 7,057**	**$ 502**	**$ 8,502**	**$ 6,204**	**$ 2,859**	**$ 8,524**	**$ 195**	**$ 33,843**

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

	2016							
		Commercial Real Estate				Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans								
31-60 days	**$ 663**	**$ 896**	**$ 850**	**$ 1,479**	**$ 808**	**$ 3,969**	**$ -**	**$ 8,665**
61-90 days	**672**	**-**	**1,206**	**744**	**1,104**	**2,139**	**-**	**5,865**

> 90 days	**-**	**-**	**-**	**-**	**-**	**232**	**-**	**232**
Total past due	**1,335**	**896**	**2,056**	**2,223**	**1,912**	**6,340**	**-**	**14,762**
Non-accrual loan	**5,833**	**137**	**8,107**	**4,823**	**2,859**	**7,257**	**195**	**29,211**
Current loans	**460,118**	**307,246**	**917,950**	**768,506**	**451,886**	**828,095**	**150,034**	**3,883,835**
Total loans	**$467,286**	**$308,279**	**$928,113**	**$775,552**	**$456,657**	**$841,692**	**$150,229**	**$3,927,808**

2015

		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans									
31-60 days	$ 119	$ -	$ 616	$ 1,819	$ -	$ 1,642	$ 2,602	$ -	$ 6,798
61-90 days	404	-	2,200	849	-	550	986	-	4,989
> 90 days	-	-	-	-	-	-	-	-	-
Total past due	523	-	2,816	2,668	-	2,192	3,588	-	11,787
Non-accrual loans	3,696	194	8,368	6,340	-	2,193	8,822	418	30,031
Current loans	461,546	255,786	707,900	669,019	-	446,490	783,948	128,863	3,453,552
Total loans	$465,765	$255,980	$719,084	$678,027	$ -	$450,875	$796,358	$129,281	$3,495,370

Loans are monitored for credit quality on a recurring basis. The credit quality indicators used are dependent on the portfolio segment to which the loan relates. Commercial loans and non-commercial loans have different credit quality indicators as a result of the methods used to monitor each of these loan segments.

The credit quality indicators for commercial loans are developed through review of individual borrowers on an ongoing basis. Each borrower is evaluated at least annually with more frequent evaluation of more severely criticized loans. The indicators represent the rating for loans as of the date presented based on the most recent credit review performed. These credit quality indicators are defined as follows:

Pass - A pass rated credit is not adversely classified because it does not display any of the characteristics for adverse classification.

Special mention – A special mention credit has potential weaknesses that deserve management's close attention. If uncorrected, such weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention assets are not adversely classified and do not warrant adverse classification.

Substandard – A substandard loan is inadequately protected by the current net worth and payment capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful – A loan that is classified as doubtful has all the weaknesses inherent in a loan classified as substandard with added characteristics that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values.

Loss – Loans classified as a loss are considered uncollectible and of such little value that their continuing to be carried as a loan is not warranted. This classification is not necessarily equivalent to no potential for recovery or salvage value, but rather that it is not appropriate to defer a full write-off even though partial recovery may be effected in the future.

The following tables provide information by credit risk rating indicators for each segment of the commercial loan portfolio at December 31 for the years indicated:

2016
Commercial Real Estate

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

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

Homogeneous loan pools do not have individual loans subjected to internal risk ratings therefore, the credit indicator applied to these pools is based on their delinquency status. The following tables provide information by credit risk rating indicators for those remaining segments of the loan portfolio at December 31 for the years indicated:

		2016		
		Residential Real Estate		
		Residential	Residential	
(In thousands)	**Consumer**	**Mortgage**	**Construction**	**Total**
Performing	**$ 453,798**	**$ 833,643**	**$ 150,034**	**$ 1,437,475**
Non-performing:				
90 days past due	**-**	**232**	**-**	**232**
Non-accruing	**2,859**	**7,257**	**195**	**10,311**
Restructured loans	**-**	**560**	**-**	**560**
Total	**$ 456,657**	**$ 841,692**	**$ 150,229**	**$ 1,448,578**

		2015		
		Residential Real Estate		
		Residential	Residential	
(In thousands)	Consumer	Mortgage	Construction	Total
Performing	$ 448,682	$ 786,959	$ 128,863	$ 1,364,504
Non-performing:				
90 days past due	-	-	-	-
Non-accruing	2,193	8,822	418	11,433
Restructured loans	-	577	-	577
Total	$ 450,875	$ 796,358	$ 129,281	$ 1,376,514

During the year ended December 31, 2016, the Company restructured $0.6 million in loans that were designated as troubled debt restructurings. Modifications consisted principally of interest rate concessions. No modifications resulted in the reduction of the principal in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2016 do not have significant specific reserves at December 31, 2016. For the year ended December 31, 2015, the Company restructured $1.9 million in loans. Modifications consisted principally of interest rate concessions and no modifications resulted in the reduction of the recorded investment in the associated loan balances. Loans restructured during 2015 had specific reserves of $0.5 million thousand at December 31, 2015.

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

		For the Year Ended December 31, 2016				
		Commercial Real Estate				
				Commercial	All	
		Commercial	Commercial	Owner	Other	
			Investor	Occupied		
(In thousands)	**Commercial**	**AD&C**	**R/E**	**R/E**	**Loans**	**Total**

Troubled debt restructurings												
Restructured accruing	**$**	**42**	**$**	**-**	**$**	**-**	**$**	**508**	**$**	**-**	**$**	**550**
Restructured non-accruing		**-**		**-**		**-**		**-**		**-**		**-**
Balance	**$**	**42**	**$**	**-**	**$**	**-**	**$**	**508**	**$**	**-**	**$**	**550**
Specific allowance	**$**	**39**	**$**	**-**	**$**	**-**	**$**	**-**	**$**	**-**	**$**	**39**
Restructured and subsequently defaulted	**$**	**-**	**$**	**-**	**$**	**479**	**$**	**-**	**$**	**-**	**$**	**479**

87

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

Other Real Estate Owned

Other real estate owned totaled $1.9 million and $2.7 million at December 31, 2016 and 2015, respectively. At December 31, 2016, $0.5 million of the other real estate owned was comprised of consumer mortgage loans.

Note 6 – Premises and Equipment

Presented in the following table are the components of premises and equipment at December 31:

(In thousands)		**2016**		2015
Land	**$**	**10,160**	$	9,954
Buildings and leasehold improvements		**62,215**		61,357
Equipment		**35,152**		31,419
Total premises and equipment		**107,527**		102,730
Less: accumulated depreciation and amortization		**(53,965)**		(49,516)
Net premises and equipment	**$**	**53,562**	$	53,214

Depreciation and amortization expense for premises and equipment amounted to $5.3 million, $4.6 million and $4.6 million for each of the years ended December 31, 2016, 2015 and 2014, respectively.

Total rental expense of premises and equipment, net of rental income, for the years ended December 31, 2016, 2015 and 2014 was $7.6 million, $7.3 million and $7.6 million, respectively. Lease commitments entered into by the Company bear initial terms varying from 3 to 15 years, or they are 20-year ground leases, and are associated with premises.

Future minimum lease payments, including any additional rents due to escalation clauses, for all non-cancelable operating leases within the years ending December 31 are presented in the table below:

(In thousands)		Operating Leases
2017	$	6,133
2018		5,042
2019		5,152
2020		4,577
2021		4,153
Thereafter		14,007
Total minimum lease payments	$	39,064

Note 7 – Goodwill and Other Intangible Assets

The gross carrying amounts and accumulated amortization of intangible assets and goodwill are presented at December 31 in the following table:

	2016		**Weighted**	2015		Weighted
	Gross	**Net**	**Average**	Gross	Net	Average

(Dollars in thousands)	**Carrying Amount**	**Accumulated Amortization**	**Carrying Amount**	**Remaining Life**	Carrying Amount	Accumulated Amortization	Carrying Amount	Remaining Life
Amortizing intangible assets:								
Other identifiable intangibles	**$ 786**	**$ (106)**	**$ 680**	**13.8 years**	$ 1,294	$ (1,156)	$ 138	2.0 years
Total amortizing intangible assets	**$ 786**	**$ (106)**	**$ 680**		$ 1,294	$ (1,156)	$ 138	
Goodwill	**$ 85,768**		**$ 85,768**		$ 84,171		$ 84,171	

The following table presents the net carrying amount of goodwill by segment for the periods indicated:

(In thousands)	Community Banking	Insurance	Investment Management	Total
Balance December 31, 2014	$ 69,991	$ 5,191	$ 8,989	$ 84,171
No Activity	-	-	-	-
Balance December 31, 2015	69,991	5,191	8,989	84,171
Purchase of insurance agency	-	1,597	-	1,597
Balance December 31, 2016	$ 69,991	$ 6,788	$ 8,989	$ 85,768

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

(In thousands)	Amount
2017	$ 100
2018	95
2019	83
2020	66
Thereafter	336
Total amortizing intangible assets	$ 680

Note 8 – Deposits

The following table presents the composition of deposits at December 31 for the years indicated:

(In thousands)	**2016**	2015
Noninterest-bearing deposits	**$ 1,138,139**	$ 1,001,841
Interest-bearing deposits:		
Demand	**615,058**	570,333
Money market savings	**927,837**	898,655
Regular savings	**310,471**	284,457
Time deposits of less than $100,000	**258,621**	248,172
Time deposits of $100,000 or more	**327,418**	260,272
Total interest-bearing deposits	**2,439,405**	2,261,889
Total deposits	**$ 3,577,544**	$ 3,263,730

Demand deposit overdrafts reclassified as loan balances were $1.3 million and $1.4 million at December 31, 2016 and 2015, respectively. Overdraft charge-offs and recoveries are reflected in the allowance for loan losses.

The following table presents the maturity schedule for time deposits maturing within years ending December 31:

(In thousands)		Amount
2017	$	343,819
2018		131,375
2019		48,192
2020		33,013
Thereafter		29,640
Total time deposits	$	586,039

The Company's time deposits of $100,000 or more represented 9.0% of total deposits at December 31, 2016 and are presented by maturity in the following table:

	Months to Maturity				
(In thousands)	3 or Less	Over 3 to 6	Over 6 to 12	Over 12	Total
Time deposits--$100 thousand or more	$ 28,606	$ 54,666	$ 105,296	$ 138,850	$ 327,418

Interest expense on time deposits of $100,000 or more amounted to $3.2 million, $2.2 million and $1.5 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Deposits received in the ordinary course of business from the directors and officers of the Company amounted to $26.7 million and $31.0 million for the years ended December 31, 2016 and 2015, respectively

Note 9 – Borrowings

Information relating to retail repurchase agreements and other short-term borrowings is presented in the following table at and for the years ending December 31:

	2016		2015		2014	
(Dollars in thousands)	**Amount**	**Rate**	Amount	Rate	Amount	Rate
Retail repurchase agreements	**$ 125,119**	**0.24%**	$ 109,145	0.23%	$ 74,432	0.24%
Average for the Year:						
Retail repurchase agreements	**$ 120,711**	**0.24%**	$ 110,776	0.23%	$ 70,097	0.23%
Maximum Month-end Balance:						
Retail repurchase agreements	**$ 139,325**		$ 128,511		$ 82,702	

The Company pledges U.S. Agencies and Corporate securities, based upon their market values, as collateral for 102.5% of the principal and accrued interest of its retail repurchase agreements.

At December 31, 2016, the Company has an available line of credit for $1.4 billion with the Federal Home Loan Bank of Atlanta (the "FHLB") under which its borrowings are limited to $1.4 billion based on pledged collateral at prevailing market interest rates with $790.0 million borrowed against it at December 31, 2016. At December 31, 2015, lines of credit totaled $1.4 billion under which $1.4 billion was available based on pledged collateral with $685.0 million borrowed against it as of December 31, 2015. Under a blanket lien, the Company has pledged qualifying residential mortgage loans amounting to $725.1 million, commercial loans amounting to $1.03 billion, home equity lines of credit (“HELOC”) amounting to $307.2 million and multifamily loans amounting to $60.4 million at December 31, 2016 as collateral under the borrowing agreement with the FHLB. At December 31, 2015 the Company had pledged collateral of qualifying mortgage loans of $677.3 million, commercial loans of $932.8 million, HELOC loans of $323.0 million and multifamily loans of $23.5 million under the FHLB borrowing agreement. The Company also had lines of credit available from the Federal Reserve and correspondent banks of $369.4 million and $375.1 million at December 31, 2016 and 2015, respectively, collateralized by loans and state and municipal securities. In addition, the Company had unsecured lines of credit with correspondent banks of $70.0 million at December 31, 2016 and 2015. At December 31, 2016 there were no outstanding borrowings against these lines of credit.

Advances from FHLB and the respective maturity schedule at December 31 for the years indicated consisted of the following:

	2016		2015	
		Weighted Average		Weighted Average
(Dollars in thousands)	**Amounts**	**Rate**	Amounts	Rate
Maturity:				
One year	**$ 470,000**	**0.65%**	$ 280,000	0.38%
Two years	**150,000**	**2.40**	75,000	3.48
Three years	**80,000**	**3.50**	160,000	2.45
Four years	**80,000**	**3.54**	80,000	3.50
Five years	**10,000**	**3.49**	80,000	3.54
After five years	**-**	**-**	10,000	3.49
Total advances from FHLB	**$ 790,000**	**1.60**	$ 685,000	1.98

Note 10 – SUBORDINATED DEBENTURES

The Company formed Sandy Spring Capital Trust II ("Capital Trust") to facilitate the pooled placement issuance of $35.0 million of trust preferred securities on August 10, 2004. In conjunction with this issuance, the Company issued subordinated debt to the Capital Trust. The subordinated debt converted from a fixed rate interest of 6.35% at July 7, 2009 to a variable rate, adjusted quarterly, equal to 225 basis points over the three month Libor. At December 31, 2016, the rate on the subordinated debt was 3.13%. The obligations of the Company under the debt are subordinated to all other debt except other trust preferred securities, which may have equal subordination. The debt has a maturity date of October 7, 2034, but may be called by the Company at any time subsequent to October 7, 2009 on each respective quarterly distribution date.

In the second quarter of 2016, the Company repurchased $5 million liquidation value of the trust preferred securities issued by the Capital Trust, which allowed the Company to retire $5 million of the subordinated debt. The Company recognized a gain of $1.2 million on this transaction.

On January 6, 2017, the Company repurchased the remaining $30 million in subordinated debentures at par value. In conjunction with this transaction, the Capital Trust redeemed its balance of $30 million of trust preferred securities that were outstanding at December 31, 2016.

Note 11 – Stockholders' Equity

The Company's Articles of Incorporation authorize 50,000,000 shares of capital stock (par value $1.00 per share). Issued shares have been classified as common stock. The Articles of Incorporation provide that remaining unissued shares may later be designated as either common or preferred stock.

The Company has a director stock purchase plan (the “Director Plan”) which commenced on May 1, 2004. Under the Director Plan, members of the board of directors may elect to use a portion (minimum 50%) of their annual retainer fee to purchase shares of Company stock. The Company has reserved 45,000 authorized but unissued shares of common stock for purchase under the plan. Purchases are made at the fair market value of the stock on the purchase date. At December 31, 2016, there were 25,291 shares available for issuance under the plan.

The Company has an employee stock purchase plan (the “Purchase Plan”) which was authorized on July 1, 2011. The Company has reserved 300,000 authorized but unissued shares of common stock for purchase under the current version of the plan. Shares are purchased at 85% of the fair market value on the exercise date through monthly payroll deductions of not less than 1% or more than 10% of cash compensation paid in the month. The Purchase Plan is administered by a committee of at least three directors appointed by the board of directors. At December 31, 2016, there were 156,475 shares available for issuance under this plan.

The Company re-approved the stock repurchase program in August 2015. The current program permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1,200,000 shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. During 2016, 512,459 shares were repurchased for a total cost of $13.3 million. During 2015, 870,450 shares were repurchased for a total cost of $22.6 million. During 2014, 38,032 shares were repurchased for a total cost of $0.9 million.

The Company has a dividend reinvestment plan that is sponsored and administered by Computershare Shareholder Services as independent agent, which enables current shareholders as well as first-time buyers to purchase and sell common stock of Sandy Spring Bancorp, Inc. directly through Computershare at low commissions. Participants may reinvest cash dividends and make periodic supplemental cash payments to purchase additional shares.

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company. At December 31, 2016, the Bank could have paid additional dividends of $27.0 million to its parent company without regulatory approval. In conjunction with the Company's long-term borrowing from Capital Trust, the Bank issued a note to Bancorp for $35.0 million, of which $30 million was outstanding at December 31, 2016. There were no other loans outstanding between the Bank and the Company at December 31, 2016 and 2015, respectively.

Note 12 – Share Based Compensation

At December 31, 2016, the Company had two share-based compensation plans in existence, the 2005 Omnibus Stock Plan ("Omnibus Stock Plan") and the 2015 Omnibus Incentive Plan ("Omnibus Incentive Plan"). The Omnibus Stock Plan expired during the second quarter of 2015 but has outstanding options that may still be exercised. The Omnibus Incentive Plan is described in the following paragraph.

The Company's Omnibus Incentive Plan was approved on May 6, 2015 and provides for the granting of non-qualifying stock options to the Company's directors, and incentive and non-qualifying stock options, stock appreciation rights, restricted stock grants, restricted stock units 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, of which 1,403,186 shares are available for issuance at December 31, 2016, has a term of ten years, and is administered by a committee of at least three directors appointed by the board of directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within seven to ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The board committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

The fair values of all of the options granted for the periods indicated have been estimated using a binomial option-pricing model with the weighted-average assumptions for the years ended December 31 are presented in the following table:

	2016	2015	2014
Dividend yield	**3.48%**	3.40%	3.04%
Weighted average expected volatility	**41.54%**	42.98%	46.78%
Weighted average risk-free interest rate	**1.42%**	1.42%	1.56%
Weighted average expected lives (in years)	**5.71**	5.42	5.08
Weighted average grant-date fair value	**$7.75**	$7.63	$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. Compensation expense of $1.9 million, $1.9 million and $1.7 million was recognized for the years ended December 31, 2016, 2015 and 2014, respectively, related to the awards of stock options and restricted stock grants. The intrinsic value for the stock options exercised was $0.6 million, $0.5 million and $0.1 million in the years ended December 31, 2016, 2015 and 2014, respectively. The total of unrecognized compensation cost related to stock options was approximately $0.2 million as of December 31, 2016. That cost is expected to be recognized over a weighted average period of approximately 1.8 years. The total of unrecognized compensation cost related to restricted stock was approximately $4.0 million as of December 31, 2016. That cost is expected to be recognized over a weighted average period of approximately 3.1 years. The fair value of the options vested during the years ended December 31, 2016, 2015 and 2014, was $0.2 million, $0.2 million and $0.2 million, respectively.

In the first quarter of 2016, 21,238 stock options were granted, subject to a three year vesting schedule with one third of the options vesting on April 1st of each year. The Company granted 78,081 shares of restricted stock in the first quarter of 2016, of which 10,010 shares are subject to a three year vesting schedule with one third of the shares vesting on April 1 of each year and 59,298 shares are subject to a five year vesting schedule with one fifth of the shares vesting on April 1 of each year. An additional 8,773 shares of performance based restricted stock grants were also approved as part of the restricted shares granted in the first quarter. The performance shares are subject to cliff vesting after three years based on the relative performance of the Company's stock in comparison to a selected peer group. Vesting can vary from 0-150% of the target grant based on the results of the Company's stock performance. There were no additional stock options or shares of restricted stock granted during the remainder of 2016.

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

	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life(Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2016	133,779	$ 19.68		$ 974
Granted	21,238	$ 27.46		
Exercised	(44,067)	$ 16.25		$ 583
Forfeited or expired	(2,447)	$ 25.96		
Balance at December 31, 2016	108,503	$ 22.46	3.6	$ 1,902
Exercisable at December 31, 2016	68,672	$ 20.04	2.4	$ 1,370
Weighted average fair value of options granted during the year		$ 7.75		

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

(In dollars, except share data):	Number of Common Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2016	218,571	$ 23.30

Granted	78,081	$ 27.42
Vested	(73,975)	$ 22.04
Forfeited	(10,031)	$ 24.53
Restricted stock at December 31, 2016	212,646	$ 25.19

Note 13 – 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. All benefit accruals for employees were frozen as of December 31, 2007 based on past service and thus future salary increases and additional years of service will no longer affect the defined benefit provided by the plan although additional vesting may continue to occur.

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

The Plan's funded status at December 31 is as follows:

(In thousands)	**2016**	2015
Reconciliation of Projected Benefit Obligation:		
Projected obligation at January 1	**$ 39,416**	$ 42,629
Interest cost	**1,657**	1,629
Actuarial gain (loss)	**251**	(212)
Benefit payments	**(1,248)**	(1,971)
Increase (decrease) related to change in assumptions	**707**	(2,659)
Projected obligation at December 31	**40,783**	39,416
Reconciliation of Fair Value of Plan Assets:		
Fair value of plan assets at January 1	**30,683**	33,200
Actual return on plan assets	**755**	(546)
Contribution	**5,830**	-
Benefit payments	**(1,248)**	(1,971)
Fair value of plan assets at December 31	**36,020**	30,683
Funded status at December 31	**$ (4,763)**	$ (8,733)
Accumulated benefit obligation at December 31	**$ 40,783**	$ 39,416
Unrecognized net actuarial loss	**$ 13,689**	$ 13,038
Net periodic pension cost not yet recognized	**$ 13,689**	$ 13,038

Weighted-average assumptions used to determine benefit obligations at December 31 are presented in the following table:

	2016	2015	2014
Discount rate	**4.15%**	4.26%	3.91%
Rate of compensation increase	**N/A**	N/A	N/A

The components of net periodic benefit cost for the years ended December 31 are presented in the following table:

(In thousands)	**2016**	2015	2014
Interest cost on projected benefit obligation	**$ 1,657**	$ 1,629	$ 1,600
Expected return on plan assets	**(1,614)**	(1,622)	(1,971)
Recognized net actuarial loss	**1,164**	1,032	251
Net periodic benefit cost	**$ 1,207**	$ 1,039	$ (120)

Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31 are presented in the following table:

	2016	2015	2014
Discount rate	**4.26%**	3.91%	4.77%
Expected return on plan assets	**5.00%**	5.00%	6.00%
Rate of compensation increase	**N/A**	N/A	N/A

The expected rate of return on assets of 5.00% reflects the Plan's predominant investment of assets in equity securities and an analysis of the average rate of return of the S&P 500 index and 10 year U. S. Treasury bonds over the past 10 years.

The following table reflects the components of the net unrecognized benefits costs that is reflected in accumulated other comprehensive income (loss) for the periods indicated. Additions represent the growth in the unrecognized actuarial loss during the period. Reductions represent the portion of the unrecognized benefits that are recognized each period as a component of the net periodic benefit cost.

(In thousands)	Unrecognized Net Gain/(Loss)
Included in accumulated other comprehensive income (loss) at January 1, 2014	$ 5,539
Additions during the year	977
Reclassifications due to recognition as net periodic pension cost	(251)
Increase related to change in assumptions	8,509
Included in accumulated other comprehensive income (loss) as of December 31, 2014	14,774
Additions during the year	1,955
Reclassifications due to recognition as net periodic pension cost	(1,032)
Decrease related to change in assumptions	(2,659)
Included in accumulated other comprehensive income (loss) as of December 31, 2015	13,038
Additions during the year	1,108
Reclassifications due to recognition as net periodic pension cost	(1,164)
Increase related to change in assumptions	707
Included in accumulated other comprehensive income (loss) as of December 31, 2016	13,689
Applicable tax effect	(5,433)
Included in accumulated other comprehensive income (loss) net of tax effect at December 31, 2016	$ 8,256
Amount expected to be recognized as part of net periodic pension cost in the next fiscal year	$ 836

There are no plan assets expected to be returned to the employer in the next twelve months.

The following items have not yet been recognized as a component of net periodic benefit cost at December 31:

(In thousands)	**2016**	2015	2014

Net actuarial loss	**$ (13,689)**	$ (13,038)	$ (14,774)
Net periodic benefit cost not yet recognized	**$ (13,689)**	$ (13,038)	$ (14,774)

Pension Plan Assets

The Company's pension plan weighted average allocations at December 31 are presented in the following table:

	2016	2015
Asset Category:		
Cash and certificates of deposit	**2.6%**	9.7%
Equity Securities:	**71.2**	71.6
Debt Securities	**26.2**	18.7
Total pension plan assets	**100.0%**	100.0%

The Company has a written investment policy approved by the board of directors that governs the investment of the defined benefit pension fund trust portfolio. The investment policy is designed to provide limits on risk that is undertaken by the investment managers both in terms of market volatility of the portfolio and the quality of the individual assets that are held in the portfolio. The investment policy statement focuses on the following areas of concern: preservation of capital, diversification, risk tolerance, investment duration, rate of return, liquidity and investment management costs.

The Company has constituted the Retirement Plans Investment Committee ("RPIC") in part to monitor the investments of the Plan as well as to recommend to executive management changes in the Investment Policy Statement which governs the Plan's investment operations. These recommendations include asset allocation changes based on a number of factors including the investment horizon for the Plan. The Company uses outside third parties to advise RPIC on the Plan's investment matters.

Investment strategies and asset allocations are based on careful consideration of plan liabilities, the plan's funded status and the Company's financial condition. Investment performance and asset allocation are measured and monitored on an ongoing basis. The current target allocations for plan assets are 50-70% for equity securities, 30-40% for fixed income securities and 0-10% for cash equivalents. This asset allocation has been set after taking into consideration the Plan's current frozen status and the possibility of partial plan terminations over the intermediate term.

Market volatility risk is controlled by limiting the asset allocation of the most volatile asset class, equities, to no more than 70% of the portfolio and by ensuring that there is sufficient liquidity to meet distribution requirements from the portfolio without disrupting long-term assets. Diversification of the equity portion of the portfolio is controlled by limiting the value of any initial acquisition so that it does not exceed 5% of the market value of the portfolio when purchased. The policy requires the sale of any portion of an equity position when its value exceeds 10% of the portfolio. Fixed income market volatility risk is managed by limiting the term of fixed income investments to five years. Fixed income investments must carry an "A" or better rating by a recognized credit rating agency. Corporate debt of a single issuer may not exceed 10% of the market value of the portfolio. The investment in derivative instruments such as "naked" call options, futures, commodities, and short selling is prohibited. Investment in equity index funds and the writing of "covered" call options (a conservative strategy to increase portfolio income) are permitted. Foreign currency-denominated debt instruments are not permitted. At December 31, 2016, management is of the opinion that there are no significant concentrations of risk in the assets of the plan with respect to any single entity, industry, country, commodity or investment fund that are not otherwise mitigated by FDIC insurance available to the participants of the plan and collateral pledged for any such amount that may not be covered by FDIC insurance. Investment performance is measured against industry accepted benchmarks. The risk tolerance and asset allocation limitations imposed by the policy are consistent with attaining the rate of return assumptions used in the actuarial funding calculations. The RPIC committee meets quarterly to review the activities of the investment managers to ensure adherence with the Investment Policy Statement.

Fair Values

The fair values of the Company's pension plan assets by asset category at December 31 are presented in the following tables:

	2016			
(In thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Asset Category:				
Money market funds	**$ -**	**$ 925**	**$ -**	**$ 925**
Mutual funds:				
Large cap U.S. equity funds	**7,189**	**10,168**	**-**	**17,357**
Small/Mid cap U.S. equity funds	**2,288**	**2,140**	**-**	**4,428**
International equity funds	**2,053**	**1,806**	**-**	**3,859**
Short-term fixed income funds	**-**	**9,451**	**-**	**9,451**
Total mutual funds	**11,530**	**23,565**	**-**	**35,095**
Total pension plan assets	**$ 11,530**	**$ 24,490**	**$ -**	**$ 36,020**

	2015			
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Asset Category:				
Cash and certificates of deposit	$ 2,853	$ -	$ -	$ 2,853
Equity Securities:				
Industrials	2,020	-	-	2,020
Financials	2,025	-	-	2,025
Telecommunication services	1,060	-	-	1,060
Consumer	3,061	-	-	3,061
Health care	2,355	-	-	2,355
Information technology	3,156	-	-	3,156
Energy	758	-	-	758
Materials	367	-	-	367
Equity-based mutual funds	5,205	-	-	5,205
Other	1,949	-	-	1,949
Total equity securities	21,956	-	-	21,956
Fixed income securities:				
Corporate bonds	-	5,750	-	5,750

Other		124		-		-	124
Total pension plan assets	$	24,933	$	5,750	$	-	$ 30,683

Contributions

The decision as to whether or not to make a plan contribution and the amount of any such contribution is dependent on a number of factors. Such factors include the investment performance of the plan assets in the current economy and, since the plan is currently frozen, the remaining investment horizon of the plan. After consideration of these factors, the Company made a contribution of $5.8 million in 2016. Management continues to monitor the funding level of the pension plan and may make contributions as necessary during 2017.

Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, as appropriate, that are expected to be paid for the years ending December 31 are presented in the following table:

(In thousands)	Pension Benefits
2017	$ 2,520
2018	1,920
2019	1,950
2020	1,680
2021	2,580
2022 - 2026	12,900

Cash and Deferred Profit Sharing Plan

The Sandy Spring Bank 401(k) Plan includes a 401(k) provision with a Company match. The 401(k) provision is voluntary and covers all eligible employees after ninety days of service. Employees contributing to the 401(k) provision receive a matching contribution of 100% of the first 3% of compensation and 50% of the next 2% of compensation subject to employee contribution limitations. The Company matching contribution vests immediately. The Plan permits employees to purchase shares of Sandy Spring Bancorp, Inc. common stock with their 401(k) contributions, Company match, and other contributions under the Plan. The Company’s matching contribution to the 401(k) Plan that are included in non-interest expenses totaled $2.0 million, $2.0 million and $ 1.8 million in 2016, 2015 and 2014, respectively.

Executive Incentive Retirement Plan

The Executive Incentive Retirement Plan is a non-qualified deferred compensation defined contribution plan that provides for contributions to be made to the participants’ plan accounts based on the attainment of a level of financial performance compared to a selected group of peer banks. This level of performance is determined annually by the board of directors. Benefit costs related to the Plan included in non-interest expense for 2016, 2015 and 2014 were $0.3 million, $0.2 million, and $0.4 million, respectively.

Note 14 – OTHER NON-INTEREST INCOME AND OTHER NON-INTEREST EXPENSE

Selected components of other non-interest income and other non-interest expense for the years ended December 31 are presented in the following table:

(In thousands)	**2016**	2015	2014
Letter of credit fees	**$ 888**	$ 790	$ 706
Extension fees	**559**	503	560
Other income	**5,312**	5,521	4,219
Total other non-interest income	**$ 6,759**	$ 6,814	$ 5,485

(In thousands)	**2016**	2015	2014
Professional fees	**$ 4,840**	$ 4,819	$ 4,544
Other real estate owned	**19**	76	100
Postage and delivery	**1,155**	1,173	1,286
Communications	**1,583**	1,587	1,507
Loss on FHLB redemption	**3,167**	-	-
Other expenses	**9,998**	10,896	10,581
Total other non-interest expense	**$ 20,762**	$ 18,551	$ 18,018

Note 15 – Income Taxes

The following table provides the components of income tax expense for the years ended December 31:

(In thousands)	**2016**	2015	2014
Current income taxes:			
Federal	**$ 18,699**	$ 17,890	$ 13,671
State	**4,692**	4,140	3,103
Total current	**23,391**	22,030	16,774
Deferred income taxes:			
Federal	**516**	10	554
State	**(167)**	(13)	254
Total deferred	**349**	(3)	808
Total income tax expense	**$ 23,740**	$ 22,027	$ 17,582

The Company does not have uncertain tax positions that are deemed material, and did not recognize any adjustments for unrecognized tax benefits.

Temporary differences between the amounts reported in the financial statements and the tax bases of assets and liabilities result in deferred taxes. Deferred tax assets and liabilities, shown as the sum of the appropriate tax effect for each significant type of temporary difference, are presented in the following table at December 31 for the years indicated:

(In thousands)	**2016**	2015
Deferred Tax Assets:		
Allowance for loan losses	**$ 17,517**	$ 16,231
Employee benefits	**2,034**	1,852
Pension plan OCI	**5,433**	5,175
Deferred loan fees and costs	**457**	315
Non-qualified stock option expense	**555**	522
Losses on other real estate owned	**43**	32
Other than temporary impairment	**322**	322
Loan and deposit premium/discount	**187**	293
Reserve for recourse loans	**199**	199
Other	**9**	9
Gross deferred tax assets	**26,756**	24,950
Deferred Tax Liabilities:		
Unrealized gains on investments available-for-sale	**(1,065)**	(4,319)
Pension plan costs	**(3,550)**	(1,709)
Depreciation	**(1,179)**	(1,338)
Intangible assets	**(1,721)**	(1,542)
Bond accretion	**(133)**	(228)
Other	**(155)**	(18)
Gross deferred tax liabilities	**(7,803)**	(9,154)
Net deferred tax asset	**$ 18,953**	$ 15,796

The reconcilements between the statutory federal income tax rate and the effective rate for the years ended December 31 are presented in the following table:

(Dollars in thousands)	**2016**		2015		2014	
	Amount	**Percentage of Pre-Tax Income**	Amount	Percentage of Pre-Tax Income	Amount	Percentage of Pre-Tax Income
Income tax expense at federal statutory rate	**$ 25,194**	**35.0%**	$ 23,584	35.0%	$ 19,523	35.0%
Increase (decrease) resulting from:						
Tax exempt income, net	**(3,606)**	**(5.0)**	(3,457)	(5.1)	(3,468)	(6.2)
Bank-owned life insurance	**(862)**	**(1.1)**	(900)	(1.3)	(855)	(1.5)
State income taxes, net of federal income tax benefits	**2,965**	**4.1**	2,687	4.0	2,182	3.9
Other, net	**49**	**-**	113	0.1	200	0.4
Total income tax expense and rate	**$ 23,740**	**33.0%**	$ 22,027	32.7%	$ 17,582	31.6%

The variability in the effective tax rate over the three year period was due primarily to the proportion of tax exempt income compared to income before taxes for each year.

Note 16 – Net Income per Common Share

The calculation of net income per common share for the years ended December 31 is presented in the following table:

(Dollars and amounts in thousands, except per share data)	**2016**	2015	2014
Net income	**$ 48,250**	$ 45,355	$ 38,200
Basic:			
Basic weighted average EPS shares	**24,120**	24,609	25,047
Basic net income per share	**$ 2.00**	$ 1.84	$ 1.53
Diluted:			
Basic weighted average EPS shares	**24,120**	24,609	25,047
Dilutive common stock equivalents	**29**	89	92
Dilutive EPS shares	**24,149**	24,698	25,139
Diluted net income per share	**$ 2.00**	$ 1.84	$ 1.52
Anti-dilutive shares	**3**	7	56

NOTE 17 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is defined as net income plus transactions and other occurrences that are the result of non-owner changes in equity. For financial statements presented for the Company, non-equity changes are comprised of unrealized gains or losses on available-for-sale debt securities and any minimum pension liability adjustments. These do not have an impact on the Company's net income. The following table presents the activity in net accumulated other comprehensive income (loss) for the periods indicated:

(In thousands)	Unrealized Gains (Losses) on Investments Available-for-Sale	Defined Benefit Pension Plan	Total
Balance at January 1, 2014	$ 358	$ (3,328)	$ (2,970)
Period change, net of tax	7,720	(5,573)	2,147
Balance at December 31, 2014	8,078	(8,901)	(823)
Period change, net of tax	(1,512)	1,038	(474)
Balance at December 31, 2015	6,566	(7,863)	(1,297)
Period change, net of tax	(4,924)	(393)	(5,317)
Balance at December 31, 2016	$ 1,642	$ (8,256)	$ (6,614)

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

	Year Ended December 31,		
(In thousands)	**2016**	2015	2014
Unrealized gains/(losses) on investments available-for-sale			
Affected line item in the Statements of Income:			
Investment securities gains	**$ 1,932**	$ 36	$ 5
Income before taxes	**1,932**	36	5
Tax expense	**770**	14	2
Net income	**$ 1,162**	$ 22	$ 3
Amortization of defined benefit pension plan items			
Affected line item in the Statements of Income:			
Recognized actuarial gain (loss) (1)	**$ (651)**	$ 1,736	$ (9,235)
Income before taxes (benefit)	**(651)**	1,736	(9,235)
Tax expense (benefit)	**(258)**	698	(3,662)
Net income	**$ (393)**	$ 1,038	$ (5,573)

(1)This amount is included in the computation of net periodic benefit cost, see Note 13

NOTE 18 – Financial Instruments with Off-balance Sheet Risk and Derivatives

In the normal course of business, the Company has various outstanding credit commitments that are not reflected in the financial statements. These commitments are made to satisfy the financing needs of the Company's clients. The associated credit risk is controlled by subjecting such activity to the same credit and quality controls as exist for the Company's lending and investing activities. The commitments involve diverse business and consumer customers and are generally well collateralized. Collateral held varies, but may include residential real estate, commercial real estate, property and equipment, inventory and accounts receivable. Commitments do not necessarily represent future cash requirements as a portion of the commitments have some reduced likelihood being exercised. Additionally, many of the commitments are subject to annual reviews, material change clauses or requirements for inspections prior to draw funding that could result in a curtailment of the funding commitments.

A summary of the financial instruments with off-balance sheet credit risk is as follows at December 31 for the years indicated:

(In thousands)	**2016**	2015
Commercial real estate development and construction	**$ 334,552**	$ 234,552
Residential real estate-development and construction	**97,524**	80,935
Real estate-residential mortgage	**22,970**	23,375
Lines of credit, principally home equity and business lines	**949,939**	879,326
Standby letters of credit	**68,748**	66,012
Total Commitments to extend credit and available credit lines	**$ 1,473,733**	$ 1,284,200

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 swap positions are offset to minimize the potential impact on the Company’s financial statements. Credit risk exists if the borrower’s collateral or financial condition indicates that the underlying collateral or financial condition of the borrower makes it probable that amounts due will be uncollectible. Any amounts due to the Company will be expected to be collected from the borrower. Management reviews this credit exposure on a monthly basis. At December 31, 2016 and 2015, all loans associated with the swap agreements were determined to be “pass” rated credits as provided by regulatory guidance and therefore no component of credit loss was factored into the valuation of the swaps. A summary of the Company’s interest rate swaps at December 31 for the years indicated is included in the following table:

(Dollars in thousands)	**Notional Amount**	**Estimated Fair Value**	**2016 Years to Maturity**	**Receive Rate**	**Pay Rate**
Interest Rate Swap Agreements:					
Pay Fixed/Receive Variable Swaps	**$ 9,433**	**$ (1,010)**	**6.3**	**1.86%**	**5.38%**
Pay Variable/Receive Fixed Swaps	**9,433**	**1,010**	**6.3**	**5.38%**	**1.86%**
Total Swaps	**$ 18,866**	**$ -**	**6.3**	**3.62%**	**3.62%**

(Dollars in thousands)	Notional Amount	Estimated Fair Value	2015 Years to Maturity	Receive Rate	Pay Rate
Interest Rate Swap Agreements:					
Pay Fixed/Receive Variable Swaps	$ 9,942	$ (1,312)	7.4	1.56%	5.34%
Pay Variable/Receive Fixed Swaps	9,942	1,312	7.4	5.34%	1.56%
Total Swaps	$ 19,884	$ -	7.4	3.45%	3.45%

The estimated fair value of the swaps at December 31 for the periods indicated in the table above were recorded in other assets and other liabilities. The associated net gains and losses on the swaps are recorded in other non-interest income.

Note 19 - litigation

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

In 2014, as a result of an adverse jury verdict the Company accrued $6.5 million for litigation expenses associated with the actions of an employee of from an institution that was acquired in 2012. During 2015, as a result of a settlement of all claims, including claims for a contribution from its insurer relating to this litigation, the Company reversed $4.5 million in previously accrued litigation expenses.

Note 20 – Fair Value

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

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

Basis of Fair Value Measurement:

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

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

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

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

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

Assets and Liabilities

Mortgage loans held for sale

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

Investments available-for-sale

U.S. government agencies, 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 3 – Investments. Positions that are not traded in active markets or are subject to transfer restrictions are classified within Level 3 of the fair value hierarchy.

Interest rate swap agreements

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

Assets Measured at Fair Value on a Recurring Basis

The following tables set forth the Company's financial assets and liabilities at the December 31 for the years 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:

	2016			
(In thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets				
Residential mortgage loans held for sale	**$ -**	**$ 13,222**	**$ -**	**$ 13,222**
Investments available-for-sale:				
U.S. government agencies	**-**	**121,790**	**-**	**121,790**
State and municipal	**-**	**287,684**	**-**	**287,684**
Mortgage-backed	**-**	**312,711**	**-**	**312,711**
Corporate debt	**-**	**-**	**9,134**	**9,134**
Trust preferred	**-**	**-**	**1,012**	**1,012**
Marketable equity securities	**-**	**1,223**	**-**	**1,223**
Interest rate swap agreements	**-**	**1,010**	**-**	**1,010**
Liabilities				
Interest rate swap agreements	**$ -**	**$ (1,010)**	**$ -**	**$ (1,010)**

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

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

107

The fair value of investments transferred or that are purchased and placed in Level 3 is estimated by discounting the expected future cash flows using the current rates for investments with similar credit ratings and similar remaining maturities. Expected cash flows were projected based on contractual cash flows.

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

(In thousands)	Significant Unobservable Inputs (Level 3)
Investments available-for-sale:	
Balance at January 1, 2016	$ 1,023
Transfer into Level 3 assets	2,116
Purchases of Level 3 assets	7,000
Total unrealized gains included in other comprehensive income (loss)	7
Balance at December 31, 2016	$ 10,146

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 December 31 for the year 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:

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

(1) Amounts represent the fair value of collateral for impaired loans allocated to the allowance for loan losses. Fair values are determined using actual market prices
(Level 2), independent third party valuations and borrower records, discounted as appropriate (Level 3).

2015

Significant

(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Total Losses
Impaired loans (1)	$ -	$ -	$ 9,349	$ 9,349	$ (10,348)
Other real estate owned	-	-	2,742	2,742	(80)
Total	$ -	$ -	$ 12,091	$ 12,091	$ (10,428)

(1) Amounts represent the fair value of collateral for impaired loans allocated to the allowance for loan losses. Fair values are determined using actual market prices
(Level 2), independent third party valuations and borrower records, discounted as appropriate (Level 3).

At December 31, 2016, impaired loans totaling $24.1 million were written down to fair value of $19.3 million as a result of specific loan loss allowances of $4.8 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling $28.9 million were written down to fair value of $25.5 million at December 31, 2015 as a result of specific loan loss allowances of $3.4 million associated with the impaired loans.

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

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

Fair Value of Financial Instruments

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

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

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

The carrying amounts and fair values of the Company's financial instruments at December 31 for the year indicated are presented in the following table:

	2016		Fair Value Measurements		
(In thousands)	**Carrying Amount**	**Estimated Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Financial Assets					
Other equity securities	**$ 46,094**	**$ 46,094**	**$ -**	**$ 46,094**	**$ -**
Loans, net of allowance	**3,883,741**	**3,933,700**	**-**	**-**	**3,933,700**
Other assets	**93,328**	**93,328**	**-**	**93,328**	**-**
Financial Liabilities					
Time deposits	**$ 586,039**	**$ 584,868**	**$ -**	**$ 584,868**	**$ -**
Securities sold under retail repurchase agreements and federal funds purchased	**125,119**	**125,119**	**-**	**125,119**	**-**
Advances from FHLB	**790,000**	**800,756**	**-**	**800,756**	**-**
Subordinated debentures	**30,000**	**29,985**	**-**	**-**	**29,985**

	2015		Fair Value Measurements		
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets					
Investments held-to-maturity and other equity securities	$ 249,601	$ 253,040	$ -	$ 253,040	$ -
Loans, net of allowance	3,454,475	3,526,807	-	-	3,526,807
Other assets	90,866	90,866	-	90,866	-
Financial Liabilities					
Time deposits	$ 508,444	$ 508,000	$ -	$ 508,000	$ -
Securities sold under retail repurchase agreements and federal funds purchased	109,145	109,145	-	109,145	-
Advances from FHLB	685,000	704,410	-	704,410	-
Subordinated debentures	35,000	14,694	-	-	14,694

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

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

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

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

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

Other assets: The investment in bank-owned life insurance represents the cash surrender value of the policies at December 31, 2016 and 2015, respectively, 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 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 these 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 21 – Parent Company Financial Information

Financial statements for Sandy Spring Bancorp, Inc. (Parent Only) for the periods indicated are presented in the following tables:

<u>Statement of Condition</u>

	December 31,	
(In thousands)	**2016**	2015
Assets		
Cash and cash equivalents	**$ 10,869**	$ 9,154
Investments available-for-sale (at fair value)	**10,357**	1,223
Investments held-to-maturity	**-**	2,100
Investment in subsidiary	**513,083**	511,841
Loan to subsidiary	**30,000**	35,000
Other assets	**515**	352
Total assets	**$ 564,824**	$ 559,670
Liabilities		

Subordinated debentures	**$**	**30,000**	$	35,000
Accrued expenses and other liabilities		**1,252**		243
Total liabilities		**31,252**		35,243
Stockholders' Equity				
Common stock		**23,901**		24,296
Additional paid in capital		**165,871**		175,588
Retained earnings		**350,414**		325,840
Accumulated other comprehensive loss		**(6,614)**		(1,297)
Total stockholders' equity		**533,572**		524,427
Total liabilities and stockholders' equity	**$**	**564,824**	$	559,670

Statements of Income

(In thousands)	Year Ended December 31, 2016	2015	2014
Income:			
Cash dividends from subsidiary	**$ 43,975**	$ 42,580	$ 19,530
Other income	**2,476**	995	902
Total income	**46,451**	43,575	20,432
Expenses:			
Interest	**944**	899	881
Other expenses	**1,139**	1,123	1,060
Total expenses	**2,083**	2,022	1,941
Income before income taxes and equity in undistributed income of subsidiary	**44,368**	41,553	18,491
Income tax expense (benefit)	**78**	(308)	(266)
Income before equity in undistributed income of subsidiary	**44,290**	41,861	18,757
Equity in undistributed income of subsidiary	**3,960**	3,494	19,443
Net income	**$ 48,250**	$ 45,355	$ 38,200

Statements of Cash Flows

(In thousands)	Year Ended December 31, 2016	2015	2014
Cash Flows from Operating Activities:			
Net income	**$ 48,250**	$ 45,355	$ 38,200
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed income-subsidiary	**(3,960)**	(3,494)	(19,443)
Dividends receivable from subsidiary bank			
Share based compensation expense	**2,139**	1,979	1,452
Other-net	**3,213**	10	(261)
Net cash provided by operating activities	**49,642**	43,850	19,948
Cash Flows from Investing Activities:			
Purchase of investment available-for-sale	**(7,000)**	(2,600)	-
Net cash used by investing activities	**(7,000)**	(2,600)	-
Cash Flows from Financing Activities:			
Retirement of subordinated debt	**(5,000)**	-	-
Proceeds from issuance of common stock	**897**	487	394
Tax benefit from stock options exercised	**125**	350	321
Repurchase of common stock	**(13,273)**	(22,624)	(910)
Dividends paid	**(23,676)**	(22,397)	(19,216)
Net cash provided (used) by financing activities	**(40,927)**	(44,184)	(19,411)
Net increase (decrease) in cash and cash equivalents	**1,715**	(2,934)	537
Cash and cash equivalents at beginning of year	**9,154**	12,088	11,551
Cash and cash equivalents at end of year	**$ 10,869**	$ 9,154	$ 12,088

Note 22 – Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established and defined by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total, Tier 1 and Common Equity Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of December 31, 2016 and 2015, the capital levels of the Company and the Bank substantially exceeded all applicable capital adequacy requirements.

As of December 31, 2016, the most recent notification from the Bank’s primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Company's and the Bank's actual capital amounts and ratios at December 31 for the years indicated are presented in the following table:

(Dollars in thousands)	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
As of December 31, 2016:						
Total Capital to risk-weighted assets						
Company	**$ 529,990**	**12.80%**	**$ 331,177**	**8.00%**	**N/A**	**N/A**
Sandy Spring Bank	**$ 508,593**	**12.33%**	**$ 330,023**	**8.00%**	**$ 412,529**	**10.00%**
Tier 1 Capital to risk-weighted assets						
Company	**$ 485,923**	**11.74%**	**$ 248,383**	**6.00%**	**N/A**	**N/A**
Sandy Spring Bank	**$ 434,526**	**10.53%**	**$ 247,517**	**6.00%**	**$ 330,023**	**8.00%**
Common Equity Tier 1 Capital to risk-weighted assets						
Company	**$ 455,923**	**11.01%**	**$ 186,287**	**4.50%**	**N/A**	**N/A**
Sandy Spring	**$ 434,526**	**10.53%**	**$ 185,638**	**4.50%**	**$ 268,144**	**6.50%**
Tier 1 Leverage						
Company	**$ 485,923**	**10.14%**	**$ 191,776**	**4.00%**	**N/A**	**N/A**
Sandy Spring Bank	**$ 434,526**	**9.09%**	**$ 191,304**	**4.00%**	**$ 239,130**	**5.00%**
As of December 31, 2015:						
Total Capital to risk-weighted assets						
Company	$ 519,179	14.25%	$ 291,444	8.00%	N/A	N/A
Sandy Spring Bank	$ 505,510	13.90%	$ 290,920	8.00%	$ 363,650	10.00%
Tier 1 Capital to risk-weighted assets						
Company	$ 478,284	13.13%	$ 218,583	6.00%	N/A	N/A
Sandy Spring Bank	$ 429,615	11.81%	$ 218,190	6.00%	$ 290,920	8.00%
Common Equity Tier 1 Capital to risk-weighted assets						
Company	$ 443,284	12.17%	$ 163,937	4.50%	N/A	N/A
Sandy Spring	$ 429,615	11.81%	$ 163,642	4.50%	$ 236,372	6.50%
Tier 1 Leverage						
Company	$ 478,284	10.60%	$ 180,463	4.00%	N/A	N/A
Sandy Spring Bank	$ 429,615	9.53%	$ 180,279	4.00%	$ 225,349	5.00%

Note 23 - 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 years ended December 31, 2016, 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 years ended December 31, 2016, 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 $1.2 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 years ended December 31, 2016, 2015 and 2014, respectively.

Information for the operating segments and reconciliation of the information to the consolidated financial statements for the years ended December 31 is presented in the following tables:

			2016		
(In thousands)	**Community Banking**	**Insurance**	**Investment Mgmt.**	**Inter-Segment Elimination**	**Total**
Interest income	**$ 170,556**	**$ 3**	**$ 5**	**$ (8)**	**$ 170,556**
Interest expense	**21,012**	**-**	**-**	**(8)**	**21,004**
Provision for loan losses	**5,546**	**-**	**-**	**-**	**5,546**
Non-interest income	**38,769**	**5,418**	**7,568**	**(713)**	**51,042**
Non-interest expenses	**114,368**	**5,097**	**4,306**	**(713)**	**123,058**
Income before income taxes	**68,399**	**324**	**3,267**	**-**	**71,990**
Income tax expense	**22,337**	**130**	**1,273**	**-**	**23,740**
Net income	**$ 46,062**	**$ 194**	**$ 1,994**	**$ -**	**$ 48,250**
Assets	**$ 5,092,283**	**$ 7,732**	**$ 13,650**	**$ (22,282)**	**$ 5,091,383**

			2015		
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$ 158,313	$ 1	$ 4	$ (6)	$ 158,312
Interest expense	20,119	-	-	(6)	20,113
Provision for loan losses	5,371	-	-	-	5,371
Non-interest income	53,398	5,516	7,104	(16,117)	49,901
Non-interest expenses	122,183	5,189	4,092	(16,117)	115,347
Income before income taxes	64,038	328	3,016	-	67,382
Income tax expense	20,710	141	1,176	-	22,027
Net income	$ 43,328	$ 187	$ 1,840	$ -	$ 45,355
Assets	$ 4,656,573	$ 5,542	$ 12,658	$ (19,393)	$ 4,655,380

			2014		
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$ 148,366	$ 6	$ 11	$ (17)	$ 148,366
Interest expense	18,835	-	-	(17)	18,818
Provision (credit) for loan losses	(163)	-	-	-	(163)
Non-interest income	38,388	5,386	6,798	(3,701)	46,871
Non-interest expenses	115,577	5,290	3,634	(3,701)	120,800
Income before income taxes	52,505	102	3,175	-	55,782
Income tax expense	16,300	43	1,239	-	17,582
Net income	$ 36,205	$ 59	$ 1,936	$ -	$ 38,200

Assets	$ 4,399,133	$ 5,842	$ 11,913	$ (19,756)	$ 4,397,132

Note 24 – Quarterly Financial Results (unaudited)

A summary of selected consolidated quarterly financial data for the years ended December 31 is provided in the following tables:

	2016			
(In thousands, except per share data)	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Interest income	**$ 41,653**	**$ 41,803**	**$ 42,857**	**$ 44,243**
Interest expense	**5,531**	**5,071**	**5,126**	**5,276**
Net interest income	**36,122**	**36,732**	**37,731**	**38,967**
Provision for loan losses	**1,236**	**2,957**	**781**	**572**
Non-interest income	**13,363**	**12,751**	**12,584**	**12,344**
Non-interest expense	**32,317**	**30,871**	**29,326**	**30,544**
Income before income taxes	**15,932**	**15,655**	**20,208**	**20,195**
Income tax expense	**5,119**	**5,008**	**6,734**	**6,879**
Net income	**$ 10,813**	**$ 10,647**	**$ 13,474**	**$ 13,316**
Basic net income per share	**$ 0.45**	**$ 0.45**	**$ 0.56**	**$ 0.55**
Diluted net income per share	**$ 0.45**	**$ 0.44**	**$ 0.56**	**$ 0.55**

	2015			
(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$ 38,072	$ 38,849	$ 40,317	$ 41,074
Interest expense	4,699	4,916	5,201	5,297
Net interest income	33,373	33,933	35,116	35,777
Provision for loan losses	597	1,218	1,706	1,850
Non-interest income	13,159	12,109	12,390	12,243
Non-interest expense	29,244	29,477	29,630	26,996
Income before income taxes	16,691	15,347	16,170	19,174
Income tax expense	5,466	5,014	5,175	6,372
Net income	$ 11,225	$ 10,333	$ 10,995	$ 12,802
Basic net income per share	$ 0.45	$ 0.42	$ 0.45	$ 0.53
Diluted net income per share	$ 0.45	$ 0.42	$ 0.45	$ 0.52

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Fourth Quarter 2016 Changes In Internal Controls Over Financial Reporting

No change occurred during the fourth quarter of 2016 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Disclosure Controls and Procedures

As required by SEC rules, the Company's management evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) as of December 31, 2016. The Company's chief executive officer and chief financial officer participated in the evaluation. Based on this evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2016.

Management’s annual report on internal control over financial reporting is located on page 58 of this report.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The material labeled “Information About Nominees and Incumbent Directors,” “Corporate Governance and Other Matters,” “Section 16(a) Beneficial Ownership Reporting Compliance,” “Shareholder Proposals and Communications,” and “Report of the Audit Committee” in the Proxy Statement is incorporated in this Report by reference. Information regarding executive officers is included under the caption “Executive Officers” on page 15 of this Report.

Item 11. Executive Compensation

The material labeled "Corporate Governance and Other Matters," "Compensation Discussion and Analysis," and "Compensation Committee Report" in the Proxy Statement is incorporated in this Report by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The material labeled “Owners of More than 5% of Bancorp’s Common Stock” and, "Stock Ownership of Directors and Executive Officers" in the Proxy Statement is incorporated in this Report by reference. Information regarding securities authorized for issuance under equity compensation plans is incorporated by reference from “Equity Compensation Plans” on page 26.

Item 13. Certain Relationships and Related Transactions and Director Independence

The material labeled “Director Independence” and "Transactions and Relationships with Management" in the Proxy Statement is incorporated in this Report by reference.

Item 14. Principal Accounting Fees and Services

The material labeled “Audit and Non-Audit” Fees in the Proxy Statement is incorporated in this Report by reference.

PART IV.

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following financial statements are filed as a part of this report:

Consolidated Statements of Condition at December 31, 2016 and 2015

Consolidated Statements of Income for the years ended December 31, 2016, 2015 and 2014

Consolidates Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014

Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2016, 2015 and 2014

Notes to the Consolidated Financial Statements

Reports of Registered Public Accounting Firm

All financial statement schedules have been omitted, as the required information is either not applicable or included in the Consolidated Financial Statements or related Notes.

Exhibit No.	Description	Incorporated by Reference to:
3(a)	Articles of Incorporation of Sandy Spring Bancorp, Inc., as amended	Exhibit 3.1 to Form 10-Q for the quarter ended June 30, 1996, SEC File No. 0-19065
3(b)	Articles of Amendment to the Articles of Incorporation of Sandy Spring Bancorp, Inc.	Exhibit 3(b) to Form 10-K for the year ended December 31, 2011, SEC File No. 0-19065
3(c)	Bylaws of Sandy Spring Bancorp, Inc.	
4(a)	No long-term debt instrument issued by the Company exceeds 10% of consolidated assets or is registered. In accordance with paragraph 4(iii) of Item 601(b) of Regulation S-K, the Company will furnish the SEC copies of all long-term debt instruments and related agreements upon request.	
10(a)*	Sandy Spring Bancorp, Inc. 2005 Omnibus Stock Plan	Exhibit 10.1 to Form 8-K dated June 27, 2005, SEC File No. 0-19065
10(b)*	Form of Director Fee Deferral Agreement, August 26, 1997, as amended	Exhibit 10(h) to Form 10-K for the year ended December 31, 2003, SEC File No. 0-19065
10(c)*	Form of Amendment to Directors' Fee Deferral Agreement	Exhibit 10(o) to Form 10-K for the year ended December 31, 2008, SEC File No. 0-19065
10(d)*	Sandy Spring Bank Directors' Deferred Fee Plan	
10(e)*	Employment Agreement by and among Sandy Spring Bancorp, Inc., Sandy Spring Bank, and Philip J. Mantua	Exhibit 10.1 to Form 8-K filed on January 17, 2012, SEC File No. 0-19065
10(f)*	Employment Agreement by and among Sandy Spring Bancorp, Inc., Sandy Spring Bank, and Daniel J. Schrider	Exhibit 10(h) to Form 10-K for the year ended December 31, 2008, SEC File No. 0-19065
10(g)*	Form of Sandy Spring National Bank of Maryland Officer Group Term Replacement Plan	Exhibit 10(r) to Form 10-K for the year ended December 31, 2001, SEC File No. 0-19065
10(h)*	Sandy Spring Bancorp, Inc. Directors' Stock Purchase Plan	Exhibit 4 to Registration Statement on Form S-8, File No. 333-166808
10(i)*	Sandy Spring Bank Executive Incentive Retirement Plan	Exhibit 10(v) to Form 10-K for the year ended December 31, 2007, SEC File No. 0-19065
10(j)*	Sandy Spring Bancorp, Inc. 2011 Employee Stock Purchase Plan	Appendix A of the Definitive Proxy Statement filed on March 28, 2011, SEC File No. 0-19065
10(k)*	Change in Control Agreement by and among Sandy Spring Bancorp, Inc., Sandy Spring Bank, and R. Louis Caceres	Exhibit 10(m) to Form 10-K for the year ended December 31, 2011, SEC File No. 0-19065
10(l)*	Employment Agreement by and among Sandy Spring Bancorp, Inc., Sandy Spring Bank, and Joseph J. O'Brien, Jr.	Exhibit 10.2 to Form 8-K filed on January 17, 2012, SEC File No. 0-19065
10(m)*	Second Amendment to Employment Agreement Between Sandy Spring Bancorp, Inc., Sandy Spring Bank and Daniel J. Schrider dated January 1, 2009	Exhibit 10.1 to Form 8-K dated March 7, 2013, SEC File No. 0-19065
10(n)*	Amendment to Employment Agreement Between Sandy Spring Bancorp, Inc., Sandy Spring Bank and Philip J. Mantua dated January 13, 2012	Exhibit 10.2 to Form 8-K dated March 7, 2013, SEC File No. 0-19065
10(o)*	Amendment to Employment Agreement Between Sandy Spring Bancorp, Inc., Sandy Spring Bank	Exhibit 10.3 to Form 8-K dated March 7, 2013, SEC File No. 0-19065

	and Joseph J. O'Brien, Jr. dated January 13, 2012	
10(p)*	Amendment to Change in Control Agreement Between Sandy Spring Bancorp, Inc., Sandy Spring Bank and R. Louis Caceres dated March 9, 2012	Exhibit 10.4 to Form 8-K dated March 7, 2013, SEC File No. 0-19065
10(q)*	Change in Control Agreement Between Sandy Spring Bancorp, Inc., Sandy Spring Bank and Ronald E. Kuykendall dated March 7, 2013	Exhibit 10(t) to Form 10-K for the year ended December 31, 2013, SEC File No. 0-19065
10(r)*	Sandy Spring Bancorp, Inc. 2015 Omnibus Incentive Plan	Appendix A of the Definitive Proxy Statement filed on March 31, 2015, SEC File No. 0-19065
21	Subsidiaries	
23(a)	Consent of Ernst and Young LLP	
31(a)	Rule 13a-14(a)/15d-14(a) Certification	
31(b)	Rule 13a-14(a)/15d-14(a) Certification	
32(a)	18 U.S.C. Section 1350 Certification	
32(b)	18 U.S.C. Section 1350 Certification	
101	The following materials from the Sandy Spring Bancorp, Inc. Annual Report on Form 10-K for the year ended December 31, 2016 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Statements of Condition; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; (v) the Consolidated Statements of Changes in Stockholders' Equity; and (vi) related notes.	

* Management Contract or Compensatory Plan or Arrangement filed pursuant to Item 15(b) of this Report.

Shareholders may obtain, upon payment of a reasonable fee, a copy of the exhibits to this Report on Form 10-K by writing Ronald E. Kuykendall, General Counsel and Secretary, at Sandy Spring Bancorp, Inc., 17801 Georgia Avenue, Olney, Maryland 20832. Shareholders also may access a copy of the Form 10-K including exhibits on the SEC Web site at www.sec.gov or through the Company's Investor Relations Web site maintained at *www.sandyspringbank.com*.

SIGNATURES

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

SANDY SPRING BANCORP, INC.
(Registrant)

By:/ s/ Daniel J. Schrider
Daniel J. Schrider
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons
on behalf of the registrant and in the capacities indicated as of March 1, 2016.

Principal Executive Officer and Director:	Principal Financial and Accounting Officer:
/s/ Daniel J. Schrider	/s/ Philip J. Mantua
Daniel J. Schrider President and Chief Executive Officer	Philip J. Mantua Executive Vice President and Chief Financial Officer

Signature	Title
/s/ Mona Abutaleb Mona Abutaleb	Director
/s/ Ralph F. Boyd, Jr. Ralph F. Boyd, Jr.	Director
/s/ Mark E. Friis Mark E. Friis	Director
/s/ Susan D. Goff Susan D. Goff	Director
/s/ Robert E. Henel, Jr. Robert E. Henel, Jr.	Director
/s/ Pamela A. Little Pamela A. Little	Director
/s/ James J. Maiwurm James J. Maiwurm	Director
/s/ Gary G. Nakamoto Gary G. Nakamoto	Director

/s/ Robert L. Orndorff Robert L. Orndorff	Director
/s/ Craig A. Ruppert Craig A. Ruppert	Director
/s/ Dennis A. Starliper Dennis A. Starliper	Director