

SANDY SPRING BANCORP INC  
Form 10-Q  
May 04, 2018

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

**FORM 10-Q**

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

**For the Quarterly Period Ended March 31, 2018**

OR

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

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

Commission File Number: 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

**Maryland**

**52-1532952**

(State of incorporation)

(I.R.S. Employer Identification Number)

**17801 Georgia Avenue, Olney, Maryland**

**20832**

(Address of principal executive office)

(Zip Code)

**301-774-6400**

(Registrant's telephone number, including area code)

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

Yes  No

—

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

Yes  No

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

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

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

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

Yes      No  X

The number of outstanding shares of common stock outstanding as of April 30, 2018

**Common stock, \$1.00 par value – 35,504,707 shares**

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**SANDY SPRING BANCORP, INC.**

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## Forward-Looking Statements

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

Forward-looking statements reflect our expectation or prediction of future conditions, events or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risks and uncertainties include, but are not limited to, the risks identified in Item 1A of the Company’s 2017 Annual Report on Form 10-K, Item 1A of Part II of this report and the following:

- general business and economic conditions nationally or in the markets that the Company serves could adversely affect, among other things, real estate prices, unemployment levels, and consumer and business confidence, which could lead to decreases in the demand for loans, deposits and other financial services that we provide and increases in loan delinquencies and defaults;
- changes or volatility in the capital markets and interest rates may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet as well as our liquidity;
- our liquidity requirements could be adversely affected by changes in our assets and liabilities;
- our investment securities portfolio is subject to credit risk, market risk, and liquidity risk as well as changes in the estimates we use to value certain of the securities in our portfolio;
- the effect of legislative or regulatory developments including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;
- acquisition integration risks, including potential deposit attrition, higher than expected costs, customer loss, business disruption and the inability to realize benefits and costs savings from, and limit any unexpected liabilities associated with, any business combinations;
- competitive factors among financial services companies, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;
- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the Securities and Exchange Commission, the Public Company Accounting Oversight Board and

other regulatory agencies; and

- the effect of fiscal and governmental policies of the United States federal government.

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

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

| <i>(Dollars in thousands)</i>                                                                                                                                                 | <b>March 31,<br/>2018</b> | December<br>31,<br>2017 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-------------------------|
| <b>Assets</b>                                                                                                                                                                 |                           |                         |
| Cash and due from banks                                                                                                                                                       | \$ 64,064                 | \$ 55,693               |
| Federal funds sold                                                                                                                                                            | 1,407                     | 2,845                   |
| Interest-bearing deposits with banks                                                                                                                                          | 153,948                   | 53,962                  |
| Cash and cash equivalents                                                                                                                                                     | 219,419                   | 112,500                 |
| Residential mortgage loans held for sale (at fair value)                                                                                                                      | 28,486                    | 9,848                   |
| Investments available-for-sale (at fair value)                                                                                                                                | 977,224                   | 729,507                 |
| Other equity securities                                                                                                                                                       | 63,115                    | 45,518                  |
| Total loans                                                                                                                                                                   | 6,061,551                 | 4,314,248               |
| Less: allowance for loan losses                                                                                                                                               | (46,931)                  | (45,257)                |
| Net loans                                                                                                                                                                     | 6,014,620                 | 4,268,991               |
| Premises and equipment, net                                                                                                                                                   | 60,352                    | 54,761                  |
| Other real estate owned                                                                                                                                                       | 2,761                     | 2,253                   |
| Accrued interest receivable                                                                                                                                                   | 22,383                    | 15,480                  |
| Goodwill                                                                                                                                                                      | 342,907                   | 85,768                  |
| Other intangible assets, net                                                                                                                                                  | 11,408                    | 580                     |
| Other assets                                                                                                                                                                  | 152,243                   | 121,469                 |
| <b>Total assets</b>                                                                                                                                                           | <b>\$ 7,894,918</b>       | <b>\$ 5,446,675</b>     |
| <b>Liabilities</b>                                                                                                                                                            |                           |                         |
| Noninterest-bearing deposits                                                                                                                                                  | \$ 1,767,523              | \$ 1,264,392            |
| Interest-bearing deposits                                                                                                                                                     | 3,859,683                 | 2,699,270               |
| Total deposits                                                                                                                                                                | 5,627,206                 | 3,963,662               |
| Securities sold under retail repurchase agreements and federal funds purchased                                                                                                | 149,323                   | 119,359                 |
| Advances from FHLB                                                                                                                                                            | 1,011,109                 | 765,833                 |
| Subordinated debentures                                                                                                                                                       | 37,530                    | -                       |
| Accrued interest payable and other liabilities                                                                                                                                | 55,142                    | 34,005                  |
| Total liabilities                                                                                                                                                             | 6,880,310                 | 4,882,859               |
| <b>Stockholders' Equity</b>                                                                                                                                                   |                           |                         |
| Common stock -- par value \$1.00; shares authorized 50,000,000; shares issued and outstanding 35,463,269 and 23,996,293 at March 31, 2018 and December 31, 2017, respectively | 35,463                    | 23,996                  |
| Additional paid in capital                                                                                                                                                    | 604,399                   | 168,188                 |
| Retained earnings                                                                                                                                                             | 392,364                   | 378,489                 |
| Accumulated other comprehensive loss                                                                                                                                          | (17,618)                  | (6,857)                 |
| Total stockholders' equity                                                                                                                                                    | 1,014,608                 | 563,816                 |
| <b>Total liabilities and stockholders' equity</b>                                                                                                                             | <b>\$ 7,894,918</b>       | <b>\$ 5,446,675</b>     |



The accompanying notes are an integral part of these statements

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

|                                                                      | Three Months Ended March<br>31, |                  |
|----------------------------------------------------------------------|---------------------------------|------------------|
|                                                                      | 2018                            | 2017             |
| <i>(Dollars in thousands, except per share data)</i>                 |                                 |                  |
| <b>Interest Income:</b>                                              |                                 |                  |
| Interest and fees on loans and leases                                | \$ 67,592                       | \$ 40,223        |
| Interest on loans held for sale                                      | 368                             | 82               |
| Interest on deposits with banks                                      | 357                             | 90               |
| Interest and dividends on investment securities:                     |                                 |                  |
| Taxable                                                              | 5,102                           | 3,608            |
| Exempt from federal income taxes                                     | 2,072                           | 1,951            |
| Interest on federal funds sold                                       | 13                              | 4                |
| Total interest income                                                | 75,504                          | 45,958           |
| <b>Interest Expense:</b>                                             |                                 |                  |
| Interest on deposits                                                 | 6,959                           | 2,488            |
| Interest on retail repurchase agreements and federal funds purchased | 108                             | 76               |
| Interest on advances from FHLB                                       | 5,078                           | 3,129            |
| Interest on subordinated debt                                        | 468                             | 12               |
| Total interest expense                                               | 12,613                          | 5,705            |
| <b>Net interest income</b>                                           | <b>62,891</b>                   | <b>40,253</b>    |
| Provision for loan losses                                            | 1,997                           | 194              |
| Net interest income after provision for loan losses                  | <b>60,894</b>                   | <b>40,059</b>    |
| <b>Non-interest Income:</b>                                          |                                 |                  |
| Investment securities gains                                          | 63                              | 2                |
| Service charges on deposit accounts                                  | 2,259                           | 1,964            |
| Mortgage banking activities                                          | 2,207                           | 608              |
| Wealth management income                                             | 5,061                           | 4,484            |
| Insurance agency commissions                                         | 1,824                           | 1,752            |
| Income from bank owned life insurance                                | 2,331                           | 594              |
| Bank card fees                                                       | 1,370                           | 1,145            |
| Other income                                                         | 2,003                           | 2,083            |
| Total non-interest income                                            | <b>17,118</b>                   | <b>12,632</b>    |
| <b>Non-interest Expenses:</b>                                        |                                 |                  |
| Salaries and employee benefits                                       | 23,912                          | 17,801           |
| Occupancy expense of premises                                        | 4,942                           | 3,402            |
| Equipment expenses                                                   | 2,225                           | 1,724            |
| Marketing                                                            | 1,148                           | 663              |
| Outside data services                                                | 1,397                           | 1,392            |
| FDIC insurance                                                       | 1,193                           | 805              |
| Amortization of intangible assets                                    | 541                             | 26               |
| Merger expenses                                                      | 8,958                           | -                |
| Other expenses                                                       | 5,325                           | 4,168            |
| Total non-interest expenses                                          | <b>49,641</b>                   | <b>29,981</b>    |
| Income before income taxes                                           | <b>28,371</b>                   | <b>22,710</b>    |
| Income tax expense                                                   | 6,706                           | 7,598            |
| <b>Net income</b>                                                    | <b>\$ 21,665</b>                | <b>\$ 15,112</b> |

**Net Income Per Share Amounts:**

|                                     |    |             |    |      |
|-------------------------------------|----|-------------|----|------|
| Basic net income per share          | \$ | <b>0.61</b> | \$ | 0.63 |
| Diluted net income per share        | \$ | <b>0.61</b> | \$ | 0.63 |
| Dividends declared per common share | \$ | <b>0.26</b> | \$ | 0.26 |

The accompanying notes are an integral part of these statements

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

| <i>(In thousands)</i>                                                     | Three Months Ended March<br>31, |           |
|---------------------------------------------------------------------------|---------------------------------|-----------|
|                                                                           | <b>2018</b>                     | 2017      |
| Net income                                                                | <b>\$ 21,665</b>                | \$ 15,112 |
| Other comprehensive income:                                               |                                 |           |
| Investments available-for-sale:                                           |                                 |           |
| Net change in unrealized gains (losses) on investments available-for-sale | <b>(12,689)</b>                 | 1,502     |
| Related income tax expense                                                | <b>3,321</b>                    | (598)     |
| Net investment gains reclassified into earnings                           | <b>(63)</b>                     | (2)       |
| Related income tax expense                                                | <b>16</b>                       | -         |
| Net effect on other comprehensive income for the period                   | <b>(9,415)</b>                  | 902       |
| Defined benefit pension plan:                                             |                                 |           |
| Recognition of unrealized loss                                            | <b>250</b>                      | 295       |
| Related income tax benefit                                                | <b>(119)</b>                    | (117)     |
| Net effect on other comprehensive income for the period                   | <b>131</b>                      | 178       |
| Total other comprehensive income (loss)                                   | <b>(9,284)</b>                  | 1,080     |
| Comprehensive income                                                      | <b>\$ 12,381</b>                | \$ 16,192 |

The accompanying notes are an integral part of these statements

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

| <i>(Dollars in thousands)</i>                                                            | Three Months Ended March 31, |             |
|------------------------------------------------------------------------------------------|------------------------------|-------------|
|                                                                                          | <b>2018</b>                  | 2017        |
| <b>Operating activities:</b>                                                             |                              |             |
| Net income                                                                               | \$ 21,665                    | \$ 15,112   |
| Adjustments to reconcile net income to net cash provided by operating activities:        |                              |             |
| Depreciation and amortization                                                            | 2,990                        | 1,980       |
| Provision for loan losses                                                                | 1,997                        | 194         |
| Stock based compensation expense                                                         | 582                          | 496         |
| Tax benefits associated with share based compensation                                    | 34                           | 239         |
| Deferred income tax expense                                                              | (1,673)                      | (214)       |
| Origination of loans held for sale                                                       | (47,975)                     | (34,895)    |
| Proceeds from sales of loans held for sale                                               | 58,121                       | 41,850      |
| (Gains)/losses on sales of loans held for sale                                           | (2,872)                      | 924         |
| (Gains)/losses on sales of other real estate owned                                       | 90                           | (17)        |
| Investment securities gains                                                              | (63)                         | (2)         |
| Net (increase)/decrease in accrued interest receivable                                   | (397)                        | 57          |
| Net (increase)/decrease in other assets                                                  | 11,407                       | (195)       |
| Net increase/(decrease) in accrued expenses and other liabilities                        | (403)                        | 6,076       |
| Other – net                                                                              | 754                          | 2,654       |
| Net cash provided by operating activities                                                | 44,257                       | 34,259      |
| <b>Investing activities:</b>                                                             |                              |             |
| (Purchases)/Proceeds of other equity securities                                          | (700)                        | 4,483       |
| Purchases of investments available-for-sale                                              | (497)                        | (105,028)   |
| Proceeds from sales of investment available-for-sale                                     | 994                          | -           |
| Proceeds from maturities, calls and principal payments of investments available-for-sale | 23,975                       | 25,296      |
| Net increase in loans                                                                    | (123,945)                    | (77,674)    |
| Proceeds from the sales of other real estate owned                                       | 292                          | 759         |
| Proceeds from sales of loans previously held for investment                              | 59,945                       | -           |
| Acquisition of business activity, net of cash paid                                       | 32,552                       | -           |
| Expenditures for premises and equipment                                                  | (2,842)                      | (1,131)     |
| Net cash used in investing activities                                                    | (10,226)                     | (153,295)   |
| <b>Financing activities:</b>                                                             |                              |             |
| Net increase in deposits                                                                 | 52,702                       | 221,654     |
| Net increase in retail repurchase agreements and federal funds purchased                 | 23,078                       | 16,125      |
| Proceeds from advances from FHLB                                                         | 1,990,000                    | 1,130,000   |
| Repayment of advances from FHLB                                                          | (1,984,081)                  | (1,245,000) |
| Retirement of subordinated debt                                                          | -                            | (30,000)    |
| Proceeds from issuance of common stock                                                   | 456                          | 276         |
| Dividends paid                                                                           | (9,267)                      | (6,275)     |
| Net cash provided by financing activities                                                | 72,888                       | 86,780      |
| Net increase (decrease) in cash and cash equivalents                                     | 106,919                      | (32,256)    |
| Cash and cash equivalents at beginning of period                                         | 112,500                      | 134,125     |
| Cash and cash equivalents at end of period                                               | \$ 219,419                   | \$ 101,869  |

**Supplemental disclosures:**

|                                                                 |    |               |    |        |
|-----------------------------------------------------------------|----|---------------|----|--------|
| Interest payments                                               | \$ | <b>11,680</b> | \$ | 5,936  |
| Income tax payments                                             |    | <b>15</b>     |    | 7      |
| Transfer from loans to residential mortgage loans held for sale |    | <b>60,043</b> |    | 12,374 |
| Transfer from loans to other real estate owned                  |    | <b>289</b>    |    | 113    |

The accompanying notes are an integral part of these statements

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

|                                                                        | Common<br>Stock  | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|------------------------------------------------------------------------|------------------|----------------------------------|----------------------|-----------------------------------------------------------|----------------------------------|
| <i>(Dollars in thousands, except per share data)</i>                   |                  |                                  |                      |                                                           |                                  |
| <b>Balances at January 1, 2018</b>                                     | <b>\$ 23,996</b> | <b>\$ 168,188</b>                | <b>\$ 378,489</b>    | <b>\$ (6,857)</b>                                         | <b>\$ 563,816</b>                |
| Net income                                                             | -                | -                                | 21,665               | -                                                         | 21,665                           |
| Other comprehensive income, net of tax                                 | -                | -                                | -                    | (9,284)                                                   | (9,284)                          |
| Common stock dividends - \$0.26 per share                              | -                | -                                | (9,267)              | -                                                         | (9,267)                          |
| Stock compensation expense                                             | -                | 582                              | -                    | -                                                         | 582                              |
| Common stock issued pursuant to:                                       |                  |                                  |                      |                                                           |                                  |
| Acquisition of WashingtonFirst<br>Bankshares, Inc. - 11,446,197 shares | 11,446           | 435,194                          | -                    | -                                                         | 446,640                          |
| Stock option plan - 12,353 shares                                      | 12               | 220                              | -                    | -                                                         | 232                              |
| Employee stock purchase plan - 6,912 shares                            | 7                | 217                              | -                    | -                                                         | 224                              |
| Restricted stock - 1,514 shares                                        | 2                | (2)                              | -                    | -                                                         | -                                |
| Reclassification of tax effects<br>from other comprehensive income     | -                | -                                | 1,477                | (1,477)                                                   | -                                |
| <b>Balances at March 31, 2018</b>                                      | <b>\$ 35,463</b> | <b>\$ 604,399</b>                | <b>\$ 392,364</b>    | <b>\$ (17,618)</b>                                        | <b>\$ 1,014,608</b>              |
| Balance at January 1, 2017                                             | \$ 23,901        | \$ 165,871                       | \$ 350,414           | \$ (6,614)                                                | \$ 533,572                       |
| Net income                                                             | -                | -                                | 15,112               | -                                                         | 15,112                           |
| Other comprehensive income, net of tax                                 | -                | -                                | -                    | 1,080                                                     | 1,080                            |
| Common stock dividends - \$0.26 per share                              | -                | -                                | (6,275)              | -                                                         | (6,275)                          |
| Stock compensation expense                                             | -                | 496                              | -                    | -                                                         | 496                              |
| Common stock issued pursuant to:                                       |                  |                                  |                      |                                                           |                                  |
| Stock option plan - 17,362 shares                                      | 17               | 283                              | -                    | -                                                         | 300                              |
| Employee stock purchase plan - 4,431 shares                            | 5                | 151                              | -                    | -                                                         | 156                              |
| Restricted stock - 7,288 shares                                        | 7                | (187)                            | -                    | -                                                         | (180)                            |
| <b>Balances at March 31, 2017</b>                                      | <b>\$ 23,930</b> | <b>\$ 166,614</b>                | <b>\$ 359,251</b>    | <b>\$ (5,534)</b>                                         | <b>\$ 544,261</b>                |

The accompanying notes are an integral part of these statements

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

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

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

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

Sandy Spring Bancorp (the “Company”), a Maryland corporation, is the bank holding company for Sandy Spring Bank (the “Bank”). The Bank offers a broad range of commercial banking, retail banking, mortgage and trust services throughout central Maryland, Northern Virginia and the greater Washington D.C. market through its operation of 55 community offices and six financial centers across the region. The Bank also offers a comprehensive menu of insurance and wealth management services through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc.

##### **Basis of Presentation**

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and prevailing practices within the financial services industry for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements and prevailing practices within the banking industry. The following summary of significant accounting policies of the Company is presented to assist the reader in understanding the financial and other data presented in this report. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2018. In the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. Certain reclassifications have been made to prior period amounts, as necessary, to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

These statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s 2017 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on February 23, 2018. There have been no significant changes to the Company’s accounting policies as disclosed in the 2017 Annual Report on Form 10-K.

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

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

## **Use of Estimates**

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

## **Cash Flows**

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

## **Revenue from Contracts with Customers**

The Company's revenue includes net interest income on financial instruments and non-interest income. Specific categories of revenue are presented in the Condensed Consolidated Statements of Income. Most of the Company's revenue is not within the scope of Accounting Standard Update (ASU) No. 2014-09 – *Revenue from Contracts with Customers*. For revenue within the scope of ASU 2014-09, the Company provides services to customers and has related performance obligations. The revenue is recognized upon satisfaction of all contractual performance obligations. The following discusses key revenue streams within the scope of the new revenue recognition guidance.

## *Wealth Management Income*

West Financial Services, Inc., a subsidiary of the Bank, provides comprehensive investment management and financial planning services. Wealth management income is comprised of income for providing trust, estate and investment management services. Trust services include acting as a trustee for corporate or personal trusts. Investment management services include investment management, record-keeping and reporting of security portfolios. Fees for these services are recognized based on contractually agreed fixed percentage applied to net assets under management at the end of each reporting period. The Company does not charge/recognize any performance based fees.

#### *Insurance Agency Commissions*

Sandy Spring Insurance, the Company's subsidiary, performs the function of an insurance intermediary by introducing the policyholder and insurer and is compensated by a commission fee for placement of an insurance policy. Sandy Spring Insurance does not provide any captive management services or any claim handling services. Commission fees are set as a percentage of the premium for the insurance policy for which the Sandy Spring Insurance is a producer. The Company recognizes revenue when the insurance policy has been contractually agreed to by the insurer and policyholder (at transaction date).

#### *Service Charges on Deposit Accounts*

Service charges on deposit accounts are earned on depository accounts for consumer and commercial account holders and include fees for account and overdraft services. Account services include fees for event-driven services and periodic account maintenance activities. The obligation for event-driven services is satisfied at the time of the event when service is delivered and revenue recognized as earned. Obligation for maintenance activities is satisfied over the course of each month and revenue recognized at month end. Obligation for overdraft services is satisfied at the time of the overdraft and revenue recognized as earned.

#### **Loans Acquired with Deteriorated Credit Quality**

Acquired loans with evidence of credit deterioration since their origination as of the date of the acquisition are recorded at their initial fair value. Credit deterioration is determined based on the probability of collection of all contractually required principal and interest payments. The historical allowance for loan and lease losses related to the acquired loans is not carried over to the Company. The determination of credit quality deterioration as of the purchase date may include parameters such as past due and non-accrual status, commercial risk ratings, cash flow projections, type of loan and collateral, collateral value and recent loan-to-value ratios or appraised values. For loans acquired with evidence of credit deterioration, the Company determines at the acquisition date the excess of the loan's contractually required payments over all cash flows expected to be collected as an amount that should not be accreted into interest income (non-accretable difference). The remaining amount, representing the difference in the expected cash flows of acquired loans and the initial investment in the acquired loans, is accreted into interest income over the remaining life of the loan or pool of loans (accretable yield). Subsequent to the purchase date, increases in expected cash flows over those expected at the purchase date are recognized prospectively as interest income over the remaining life of the loan as an adjustment to the accretable yield. The present value of any decreases in expected cash flows after the purchase date is recognized as an impairment through addition to the valuation allowance.

### Adopted Accounting Pronouncements

The FASB issued Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, in May 2014 that provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to customers. The guidance also provides for a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. The Company's revenue is comprised of net interest income and non-interest income. The guidance does not apply to revenue associated with financial instruments, net interest income, mortgage origination and servicing activities, and gains and losses from securities. Accordingly, the majority of the Company's revenues are not be affected. The following revenue streams were identified to be in scope of ASC 606: 1) wealth management income; 2) insurance agency commissions; and 3) service charges on deposit accounts. The Company adopted the standard on January 1, 2018. The Company's accounting policies and revenue recognition principles did not change materially as the principles of ASC 606 are largely consistent with the current revenue recognition practices.

The FASB issued Update No. 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, in February 2018. The guidance permits entities to reclassify from accumulated other comprehensive income (“OCI”) to retained earnings stranded income tax effects resulting from the Tax Cuts and Jobs Act enacted in December 2017. The Company made the election to adopt this guidance during the first quarter of 2018 and reclassified \$1.5 million of stranded income tax effects from OCI to retained earnings. The Company made the adjustment between OCI and retained earnings in the Condensed Consolidated Statements of Changes in Stockholders’ Equity as of the beginning of the current reporting period.

The FASB issued Update No. 2016-01, *Financial Instruments – (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*”, in January 2016. This guidance amends the presentation and accounting for certain financial instruments, including liabilities measured at fair value under fair value option and equity investments. The guidance also updates fair value presentation and disclosure requirements for financial instruments measured at amortized cost. The Company adopted the guidance in the first quarter 2018 with no impact to retained earnings or other comprehensive income. The Company has no investments in marketable equity securities classified as available-for-sale accounted for at fair value. The Company’s marketable equity securities that do not have determinable fair values are measured at cost less any impairment. The Company’s existing accounting policy is similar to measurement alternative provided by the guidance, except the carrying value is adjusted through earnings for subsequent observable transactions in the same or similar investment. For purposes of disclosing fair values of financial instruments carried at amortized cost, we determined the fair values based on “exit price” as required by the guidance.

## Pending Accounting Pronouncements

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

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

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

the first interim or annual period beginning after December 15, 2019. The standard's provisions will be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Early adoption by public business entities is permitted for the first interim or annual period beginning after December 15, 2018. The Company is assessing this guidance to determine its impact on the Company's financial position, results of operations and cash flows.

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

## **NOTE 2 - ACQUISITION OF WASHINGTONFIRST BANKSHARES, INC.**

On January 1, 2018 ("Acquisition Date"), the Company completed its acquisition of WashingtonFirst Bankshares, Inc. ("WashingtonFirst") in a transaction valued at approximately \$447 million in the aggregate, based on the Company's closing market price of \$39.02 on December 29, 2017. The Company issued an aggregate of 11,446,197 shares of the Company's common stock in the transaction. At the effective date of the acquisition, Sandy Spring shareholders owned approximately 67.7% and WashingtonFirst's shareholders owned approximately 32.3% of the combined company. As of the Acquisition Date, WashingtonFirst was merged into the Company and WashingtonFirst's wholly-owned subsidiary, WashingtonFirst Bank, was merged with and into Sandy Spring Bank.

WashingtonFirst, headquartered in Reston, Virginia, had 19 community banking offices throughout the Washington D.C. metropolitan region and more than \$2.1 billion in assets as of December 31, 2017. In addition, WashingtonFirst provided wealth management services through its subsidiary, 1st Portfolio Wealth Advisors, and mortgage banking services through the bank's subsidiary, WashingtonFirst Mortgage Corporation.

The acquisition of WashingtonFirst is being accounted for as a business combination using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid are recorded at estimated fair values on the Acquisition Date. The provisional amount of goodwill recognized was approximately \$257 million. The estimated fair values of the acquired assets and assumed liabilities will be subject to refinement as additional information relative to closing date fair values becomes available. Any subsequent adjustments to the fair values of acquired assets and liabilities assumed, identifiable intangible assets, or other purchase accounting adjustments will result in adjustments to goodwill within the first 12 months following the closing date of acquisition.

The consideration paid for WashingtonFirst's common equity and the provisional fair values of acquired identifiable assets and liabilities assumed as of the Acquisition Date were as follows:





|                                                                                                       |                 |
|-------------------------------------------------------------------------------------------------------|-----------------|
| <i>(In thousands)</i>                                                                                 | January 1, 2018 |
| Purchase Price:                                                                                       |                 |
| Fair value of common shares issued (11,446,197 shares) based on Sandy Spring's share price of \$39.02 | \$ 446,640      |
| Cash for fractional shares                                                                            | 10              |
| Total purchase price                                                                                  | \$ 446,650      |
| Identifiable assets:                                                                                  |                 |
| Cash and cash equivalents                                                                             | \$ 32,497       |
| Residential mortgage loans held for sale                                                              | 25,789          |
| Investment securities                                                                                 | 302,321         |
| Loans                                                                                                 | 1,683,683       |
| Premises and equipment                                                                                | 4,602           |
| Other Real Estate Owned                                                                               | 497             |
| Accrued Interest Receivable                                                                           | 6,648           |
| Other Intangible assets                                                                               | 11,370          |
| Other Assets                                                                                          | 33,764          |
| Total identifiable assets                                                                             | \$ 2,101,171    |
| Identifiable liabilities:                                                                             |                 |
| Deposits                                                                                              | \$ 1,610,327    |
| Borrowings                                                                                            | 283,808         |
| Other Liabilities                                                                                     | 17,525          |
| Total identifiable liabilities                                                                        | \$ 1,911,660    |
| Provisional fair value of net assets acquired including identifiable intangible assets                | 189,511         |
| Provisional resulting goodwill                                                                        | \$ 257,139      |

### Note 3 – Investments

#### Investments available-for-sale

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

| (In thousands)           | March 31, 2018 |                        |                         |                      | December 31, 2017 |                        |                         |                      |
|--------------------------|----------------|------------------------|-------------------------|----------------------|-------------------|------------------------|-------------------------|----------------------|
|                          | 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 | \$213,734      | \$ 1                   | \$ (5,431)              | \$208,304            | \$109,349         | \$ -                   | \$(2,781)               | \$106,568            |
| State and municipal      | 328,324        | 3,918                  | (1,696)                 | 330,546              | 306,109           | 6,313                  | (169)                   | 312,253              |

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|                                      |                  |                 |                   |                  |           |          |           |           |
|--------------------------------------|------------------|-----------------|-------------------|------------------|-----------|----------|-----------|-----------|
| Mortgage-backed                      | <b>436,797</b>   | <b>920</b>      | <b>(9,573)</b>    | <b>428,144</b>   | 302,664   | 1,585    | (4,209)   | 300,040   |
| Corporate debt                       | <b>9,100</b>     | <b>252</b>      | -                 | <b>9,352</b>     | 9,100     | 332      | -         | 9,432     |
| Trust preferred                      | <b>310</b>       | -               | -                 | <b>310</b>       | 931       | 71       | -         | 1,002     |
| Total debt securities                | <b>988,265</b>   | <b>5,091</b>    | <b>(16,700)</b>   | <b>976,656</b>   | 728,153   | 8,301    | (7,159)   | 729,295   |
| Marketable equity securities         | <b>568</b>       | -               | -                 | <b>568</b>       | 212       | -        | -         | 212       |
| Total investments available-for-sale | <b>\$988,833</b> | <b>\$ 5,091</b> | <b>\$(16,700)</b> | <b>\$977,224</b> | \$728,365 | \$ 8,301 | \$(7,159) | \$729,507 |

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at March 31, 2018 are not the result of credit related events but due to changes in interest rates. These declines in fair market value are considered temporary in nature and are expected to recover over time as these securities approach maturity.

The mortgage-backed securities portfolio at March 31, 2018 is composed entirely of either the most senior tranches of GNMA, FNMA or FHLMC collateralized mortgage obligations (\$155.0 million), or GNMA, FNMA or FHLMC mortgage-backed securities (\$273.1 million). The Company does not intend to sell these securities and has sufficient liquidity to hold these securities for an adequate period of time to allow for any anticipated recovery in fair value.

During the first quarter of 2018, the Company sold the pooled trust preferred security for an insignificant gain. This security had incurred credit related other-than-temporary impairment which was recognized in periods prior to 2017.

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

| <i>(Dollars in thousands)</i> | <b>March 31, 2018</b>               |                   |                                |                                |                                        |
|-------------------------------|-------------------------------------|-------------------|--------------------------------|--------------------------------|----------------------------------------|
|                               | <b>Continuous Unrealized</b>        |                   |                                |                                |                                        |
|                               | <b>Losses Existing for:</b>         |                   |                                |                                |                                        |
|                               | <b>Number<br/>of<br/>Securities</b> | <b>Fair Value</b> | <b>Less than<br/>12 months</b> | <b>More than<br/>12 months</b> | <b>Total<br/>Unrealized<br/>Losses</b> |
| U.S. government agencies      | 57                                  | \$ 206,828        | \$ 2,208                       | \$ 3,223                       | \$ 5,431                               |
| State and municipal           | 116                                 | 109,344           | 1,652                          | 44                             | 1,696                                  |
| Mortgage-backed               | 139                                 | 393,630           | 3,478                          | 6,095                          | 9,573                                  |
| <b>Total</b>                  | <b>312</b>                          | <b>\$ 709,802</b> | <b>\$ 7,338</b>                | <b>\$ 9,362</b>                | <b>\$ 16,700</b>                       |

| <i>(Dollars in thousands)</i> | <b>December 31, 2017</b>            |                   |                                |                                |                                        |
|-------------------------------|-------------------------------------|-------------------|--------------------------------|--------------------------------|----------------------------------------|
|                               | <b>Continuous Unrealized</b>        |                   |                                |                                |                                        |
|                               | <b>Losses Existing for:</b>         |                   |                                |                                |                                        |
|                               | <b>Number<br/>of<br/>Securities</b> | <b>Fair Value</b> | <b>Less than<br/>12 months</b> | <b>More than<br/>12 months</b> | <b>Total<br/>Unrealized<br/>Losses</b> |
| U.S. government agencies      | 13                                  | \$ 106,568        | \$ 545                         | \$ 2,236                       | \$ 2,781                               |
| State and municipal           | 20                                  | 18,228            | 107                            | 62                             | 169                                    |
| Mortgage-backed               | 46                                  | 221,621           | 402                            | 3,807                          | 4,209                                  |
| <b>Total</b>                  | <b>79</b>                           | <b>\$ 346,417</b> | <b>\$ 1,054</b>                | <b>\$ 6,105</b>                | <b>\$ 7,159</b>                        |

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

| <i>(In thousands)</i>                           | <b>March 31, 2018</b>     |                                     | <b>December 31, 2017</b>  |                                     |
|-------------------------------------------------|---------------------------|-------------------------------------|---------------------------|-------------------------------------|
|                                                 | <b>Amortized<br/>Cost</b> | <b>Estimated<br/>Fair<br/>Value</b> | <b>Amortized<br/>Cost</b> | <b>Estimated<br/>Fair<br/>Value</b> |
| Due in one year or less                         | \$ 40,224                 | \$ 40,564                           | \$ 12,789                 | \$ 12,889                           |
| Due after one year through five years           | 265,558                   | 267,383                             | 180,109                   | 184,264                             |
| Due after five years through ten years          | 278,570                   | 273,027                             | 228,484                   | 227,688                             |
| Due after ten years                             | 403,913                   | 395,682                             | 306,771                   | 304,454                             |
| <b>Total debt securities available for sale</b> | <b>\$ 988,265</b>         | <b>\$ 976,656</b>                   | <b>\$ 728,153</b>         | <b>\$ 729,295</b>                   |

At March 31, 2018 and December 31, 2017, investments available-for-sale with a book value of \$649.3 million and \$431.7 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agencies securities, exceeded ten percent of stockholders' equity at March 31, 2018 and December 31, 2017.

Equity securities

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

| <i>(In thousands)</i>                   | <b>March 31, 2018</b> | December 31, 2017 |
|-----------------------------------------|-----------------------|-------------------|
| Federal Reserve Bank stock              | \$ <b>13,349</b>      | \$ 8,398          |
| Federal Home Loan Bank of Atlanta stock | <b>49,766</b>         | 37,120            |
| Total equity securities                 | \$ <b>63,115</b>      | \$ 45,518         |

**Note 4 – LOANS**

Outstanding loan balances at March 31, 2018 and December 31, 2017 are net of unearned income including net deferred loan costs of \$1.2 million and \$1.8 million, respectively. The loan portfolio segment balances at the dates indicated are presented in the following table:

| <i>(In thousands)</i>                 | <b>March 31, 2018</b> | December 31, 2017 |
|---------------------------------------|-----------------------|-------------------|
| Residential real estate:              |                       |                   |
| Residential mortgage                  | \$ 992,287            | \$ 921,435        |
| Residential construction              | 215,445               | 176,687           |
| Commercial real estate:               |                       |                   |
| Commercial owner occupied real estate | 1,174,739             | 857,196           |
| Commercial investor real estate       | 1,928,439             | 1,112,710         |
| Commercial AD&C                       | 564,871               | 292,443           |
| Commercial business                   | 652,797               | 497,948           |
| Consumer                              | 532,973               | 455,829           |
| Total loans                           | \$ 6,061,551          | \$ 4,314,248      |

The fair value of the financial assets acquired in the WashingtonFirst transaction included loans receivable with a gross amortized cost basis of \$1.7 billion. The table below illustrates the fair value adjustments made to the amortized cost basis in order to present a fair value of the loans acquired. Interest and credit fair value adjustments related to loans acquired without evidence of credit quality deterioration are accreted or amortized into interest income over the remaining expected lives of the loans. The specific credit adjustment on acquired credit impaired loans includes accretable and non-accretable components. Of the \$7.3 million specific credit mark on acquired credit impaired loans, approximately \$2.5 million is estimated to be an accretable adjustment recognized over the remaining expected lives of the loans and \$4.7 million non-accretable adjustment.

In conjunction with the WashingtonFirst Bank merger, the acquired loan portfolio was accounted for at fair value as follows:

| <i>(Dollars in thousands)</i>                                   | <b>January 1, 2018</b> |
|-----------------------------------------------------------------|------------------------|
| Gross amortized cost basis at January 1, 2018                   | \$ 1,697,760           |
| Interest rate fair value adjustment                             | 15,591                 |
| Credit fair value adjustment on pools of homogeneous loans      | (22,421)               |
| Credit fair value adjustment on purchased credit impaired loans | (7,247)                |
| Fair value of acquired loan portfolio at January 1, 2018        | \$ 1,683,683           |

The following table presents the acquired credit impaired loans receivable as of the Acquisition Date:

| <i>(Dollars in thousands)</i>                                             |    | <b>January 1, 2018</b> |
|---------------------------------------------------------------------------|----|------------------------|
| Contractual principal and interest at acquisition                         | \$ | 28,502                 |
| Contractual cash flows not expected to be collected (Nonaccretable yield) |    | (9,027)                |
| Expected cash flows at acquisition                                        |    | 19,475                 |
| Interest component of expected cash flows (Accretable yield)              |    | (2,511)                |
| Fair value of purchased credit impaired loans                             | \$ | 16,964                 |

The outstanding balance of purchased credit impaired loans receivable totaled \$24.2 million and \$23.1 million at January 1, 2018 and March 31, 2018, respectively. The fair value of purchased credit impaired loans was \$17.3 million at March 31, 2018.

Activity for the accretable yield since the Acquisition Date was as follows:



| <i>(Dollars in thousands)</i>                    | <b>Three Months Ended<br/>March 31, 2018</b> |       |
|--------------------------------------------------|----------------------------------------------|-------|
| Accretable yield at the beginning of the period  | \$                                           | -     |
| Addition of accretable yield due to acquisitions |                                              | 2,511 |
| Accretion into interest income                   |                                              | (341) |
| Accretable yield at the end of the period.       | \$                                           | 2,170 |

**Note 5– CREDIT QUALITY ASSESSMENT****Allowance for Loan Losses**

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

| <i>(In thousands)</i>        | Three Months Ended March 31, |           |
|------------------------------|------------------------------|-----------|
|                              | <b>2018</b>                  | 2017      |
| Balance at beginning of year | \$ 45,257                    | \$ 44,067 |
| Provision for loan losses    | 1,997                        | 194       |
| Loan charge-offs             | (477)                        | (482)     |
| Loan recoveries              | 154                          | 82        |
| Net charge-offs              | (323)                        | (400)     |
| Balance at period end        | \$ 46,931                    | \$ 43,861 |

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

**For the Three Months Ended March 31, 2018**

|                                                           | Commercial Real Estate |            |              |              | Residential Real Estate |            |              | Total        |              |
|-----------------------------------------------------------|------------------------|------------|--------------|--------------|-------------------------|------------|--------------|--------------|--------------|
|                                                           | Commercial             |            |              |              | Residential             |            |              |              |              |
|                                                           | Commercial             | Commercial | Commercial   | Owner        |                         | Consumer   | Mortgage     |              | Construction |
|                                                           |                        |            |              | Investor     | Occupied                |            |              |              |              |
| <i>(Dollars in thousands)</i>                             | Business               | AD&C       | R/E          | R/E          | Consumer                | Mortgage   | Construction |              |              |
| Balance at beginning of year                              | \$ 8,711               | \$ 3,501   | \$ 14,970    | \$ 7,178     | \$ 2,383                | \$ 7,268   | \$ 1,246     | \$ 45,257    |              |
| Provision (credit)                                        | 415                    | 254        | 1,102        | (172)        | 226                     | (190)      | 362          | 1,997        |              |
| Charge-offs                                               | (331)                  | -          | -            | -            | (146)                   | -          | -            | (477)        |              |
| Recoveries                                                | 9                      | 62         | 8            | -            | 47                      | 22         | 6            | 154          |              |
| Net recoveries (charge-offs)                              | (322)                  | 62         | 8            | -            | (99)                    | 22         | 6            | (323)        |              |
| Balance at end of period                                  | \$ 8,804               | \$ 3,817   | \$ 16,080    | \$ 7,006     | \$ 2,510                | \$ 7,100   | \$ 1,614     | \$ 46,931    |              |
| <br>                                                      |                        |            |              |              |                         |            |              |              |              |
| Total loans and leases                                    | \$ 652,797             | \$ 564,871 | \$ 1,928,439 | \$ 1,174,739 | \$ 532,973              | \$ 992,287 | \$ 215,445   | \$ 6,061,551 |              |
| Allowance for loans losses to total loans ratio           | 1.35%                  | 0.68%      | 0.83%        | 0.60%        | 0.47%                   | 0.72%      | 0.75%        | 0.77%        |              |
| <br>                                                      |                        |            |              |              |                         |            |              |              |              |
| Balance of loans specifically evaluated for impairment    | \$ 7,944               | \$ 136     | \$ 5,813     | \$ 4,009     | N/A                     | \$ 2,891   | \$ -         | \$ 20,793    |              |
| Allowance for loans specifically evaluated for impairment | \$ 3,096               | \$ -       | \$ 1,255     | \$ 128       | N/A                     | \$ -       | \$ -         | \$ 4,479     |              |
| Specific allowance to specific loans ratio                | 38.97%                 | -          | 21.59%       | 3.19%        | N/A                     | -          | -            | 21.54%       |              |
| <br>                                                      |                        |            |              |              |                         |            |              |              |              |
| Balance of loans collectively evaluated                   | \$ 644,853             | \$ 564,735 | \$ 1,922,626 | \$ 1,170,730 | \$ 532,973              | \$ 989,396 | \$ 215,445   | \$ 6,040,758 |              |
| Allowance for loans collectively evaluated                | \$ 5,708               | \$ 3,817   | \$ 14,825    | \$ 6,878     | \$ 2,510                | \$ 7,100   | \$ 1,614     | \$ 42,452    |              |
| Collective allowance to collective loans ratio            | 0.89%                  | 0.68%      | 0.77%        | 0.59%        | 0.47%                   | 0.72%      | 0.75%        | 0.70%        |              |

**For the Year Ended December 31, 2017**

|                               | Commercial Real Estate |            |            |          | Residential Real Estate |          |              | Total     |              |
|-------------------------------|------------------------|------------|------------|----------|-------------------------|----------|--------------|-----------|--------------|
|                               | Commercial             |            |            |          | Residential             |          |              |           |              |
|                               | Commercial             | Commercial | Commercial | Owner    |                         | Consumer | Mortgage     |           | Construction |
|                               |                        |            |            | Investor | Occupied                |          |              |           |              |
| <i>(Dollars in thousands)</i> | Business               | AD&C       | R/E        | R/E      | Consumer                | Mortgage | Construction |           |              |
| Balance at beginning of year  | \$ 7,539               | \$ 4,652   | \$ 12,939  | \$ 7,885 | \$ 2,828                | \$ 7,261 | \$ 963       | \$ 44,067 |              |
| Provision (credit)            | 2,616                  | (1,254)    | 1,930      | (459)    | (57)                    | (56)     | 257          | 2,977     |              |
| Charge-offs                   | (1,538)                | -          | -          | (248)    | (693)                   | (87)     | -            | (2,566)   |              |

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|                                                           |           |           |             |           |           |           |           |             |
|-----------------------------------------------------------|-----------|-----------|-------------|-----------|-----------|-----------|-----------|-------------|
| Recoveries                                                | 94        | 103       | 101         | -         | 305       | 150       | 26        | 779         |
| Net recoveries (charge-offs)                              | (1,444)   | 103       | 101         | (248)     | (388)     | 63        | 26        | (1,787)     |
| Balance at end of period                                  | \$ 8,711  | \$ 3,501  | \$ 14,970   | \$ 7,178  | \$ 2,383  | \$ 7,268  | \$ 1,246  | \$ 45,257   |
| Total loans and leases                                    | \$497,948 | \$292,443 | \$1,112,710 | \$857,196 | \$455,829 | \$921,435 | \$176,687 | \$4,314,248 |
| Allowance for loan losses to total loans ratio            | 1.75%     | 1.20%     | 1.35%       | 0.84%     | 0.52%     | 0.79%     | 0.71%     | 1.05%       |
| Balance of loans specifically evaluated for impairment    | \$ 8,105  | \$ 136    | \$ 5,575    | \$ 4,078  | N/A       | \$ 2,915  | -         | \$ 20,809   |
| Allowance for loans specifically evaluated for impairment | \$ 3,220  | \$ -      | \$ 663      | \$ 131    | N/A       | \$ -      | \$ -      | \$ 4,014    |
| Specific allowance to specific loans ratio                | 39.73%    | -         | 11.89%      | 3.21%     | N/A       | -         | -         | 19.29%      |
| Balance of loans collectively evaluated                   | \$489,843 | \$292,307 | \$1,107,135 | \$853,118 | \$455,829 | \$918,520 | \$176,687 | \$4,293,439 |
| Allowance for loans collectively evaluated                | \$ 5,491  | \$ 3,501  | \$ 14,307   | \$ 7,047  | \$ 2,383  | \$ 7,268  | \$ 1,246  | \$ 41,243   |
| Collective allowance to collective loans ratio            | 1.12%     | 1.20%     | 1.29%       | 0.83%     | 0.52%     | 0.79%     | 0.71%     | 0.96%       |

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

| <i>(In thousands)</i>                                               | March 31, 2018 | December 31, 2017 |
|---------------------------------------------------------------------|----------------|-------------------|
| Impaired loans with a specific allowance                            | \$ 11,446      | \$ 11,693         |
| Impaired loans without a specific allowance                         | 9,347          | 9,116             |
| Total impaired loans                                                | \$ 20,793      | \$ 20,809         |
| Allowance for loan losses related to impaired loans                 | \$ 4,479       | \$ 4,014          |
| Allowance for loan losses related to loans collectively evaluated   | 42,452         | 41,243            |
| Total allowance for loan losses                                     | \$ 46,931      | \$ 45,257         |
| Average impaired loans for the period                               | \$ 20,802      | \$ 23,179         |
| Contractual interest income due on impaired loans during the period | \$ 649         | \$ 2,314          |
| Interest income on impaired loans recognized on a cash basis        | \$ 111         | \$ 754            |
| Interest income on impaired loans recognized on an accrual basis    | \$ 46          | \$ 169            |

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

| <i>(In thousands)</i>                              | March 31, 2018         |               |                               |                                        |                       | Total<br>Recorded<br>Investment<br>in<br>Impaired<br>Loans |
|----------------------------------------------------|------------------------|---------------|-------------------------------|----------------------------------------|-----------------------|------------------------------------------------------------|
|                                                    | Commercial Real Estate |               |                               |                                        |                       |                                                            |
|                                                    | Commercial             | AD&C          | Commercial<br>Investor<br>R/E | Commercial<br>Owner<br>Occupied<br>R/E | All<br>Other<br>Loans |                                                            |
|                                                    |                        |               |                               |                                        |                       |                                                            |
| <b>Impaired loans with a specific allowance</b>    |                        |               |                               |                                        |                       |                                                            |
| Non-accruing                                       | \$ 4,534               | \$ -          | \$ 5,158                      | \$ -                                   | \$ -                  | \$ 9,692                                                   |
| Restructured accruing                              | 863                    | -             | -                             | -                                      | -                     | 863                                                        |
| Restructured non-accruing                          | 111                    | -             | -                             | 780                                    | -                     | 891                                                        |
| <b>Balance</b>                                     | <b>\$ 5,508</b>        | <b>\$ -</b>   | <b>\$ 5,158</b>               | <b>\$ 780</b>                          | <b>\$ -</b>           | <b>\$ 11,446</b>                                           |
| <b>Allowance</b>                                   | <b>\$ 3,096</b>        | <b>\$ -</b>   | <b>\$ 1,255</b>               | <b>\$ 128</b>                          | <b>\$ -</b>           | <b>\$ 4,479</b>                                            |
| <b>Impaired loans without a specific allowance</b> |                        |               |                               |                                        |                       |                                                            |
| Non-accruing                                       | \$ 317                 | \$ -          | \$ 655                        | \$ 1,292                               | \$ -                  | \$ 2,264                                                   |
| Restructured accruing                              | 447                    | -             | -                             | 485                                    | 883                   | 1,815                                                      |
| Restructured non-accruing                          | 1,672                  | 136           | -                             | 1,452                                  | 2,008                 | 5,268                                                      |
| <b>Balance</b>                                     | <b>\$ 2,436</b>        | <b>\$ 136</b> | <b>\$ 655</b>                 | <b>\$ 3,229</b>                        | <b>\$ 2,891</b>       | <b>\$ 9,347</b>                                            |
| <b>Total impaired loans</b>                        |                        |               |                               |                                        |                       |                                                            |
| Non-accruing                                       | \$ 4,851               | \$ -          | \$ 5,813                      | \$ 1,292                               | \$ -                  | \$ 11,956                                                  |

|                                                             |                  |                 |                  |                 |                 |                  |
|-------------------------------------------------------------|------------------|-----------------|------------------|-----------------|-----------------|------------------|
| <b>Restructured accruing</b>                                | <b>1,310</b>     | <b>-</b>        | <b>-</b>         | <b>485</b>      | <b>883</b>      | <b>2,678</b>     |
| <b>Restructured non-accruing</b>                            | <b>1,783</b>     | <b>136</b>      | <b>-</b>         | <b>2,232</b>    | <b>2,008</b>    | <b>6,159</b>     |
| <b>Balance</b>                                              | <b>\$ 7,944</b>  | <b>\$ 136</b>   | <b>\$ 5,813</b>  | <b>\$ 4,009</b> | <b>\$ 2,891</b> | <b>\$ 20,793</b> |
| <b>Unpaid principal balance in total<br/>impaired loans</b> | <b>\$ 11,003</b> | <b>\$ 1,248</b> | <b>\$ 10,401</b> | <b>\$ 6,299</b> | <b>\$ 3,667</b> | <b>\$ 32,618</b> |

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|                                                                     | March 31, 2018         |        |          |                  |          |                              |
|---------------------------------------------------------------------|------------------------|--------|----------|------------------|----------|------------------------------|
|                                                                     | Commercial Real Estate |        |          | Commercial Owner |          | Total Recorded Investment in |
|                                                                     | Commercial             | AD&C   | R/E      | R/E              | Loans    | Loans                        |
| <i>(In thousands)</i>                                               |                        |        |          |                  |          |                              |
| Average impaired loans for the period                               | \$ 8,025               | \$ 136 | \$ 5,694 | \$ 4,044         | \$ 2,903 | \$ 20,802                    |
| Contractual interest income due on impaired loans during the period | \$ 256                 | \$ 89  | \$ 156   | \$ 105           | \$ 43    |                              |
| Interest income on impaired loans recognized on a cash basis        | \$ 51                  | \$ -   | \$ 4     | \$ 44            | \$ 12    |                              |
| Interest income on impaired loans recognized on an accrual basis    | \$ 27                  | \$ -   | \$ -     | \$ 6             | \$ 13    |                              |

|                                                  | December 31, 2017      |                     |                |                               |                 |                              |
|--------------------------------------------------|------------------------|---------------------|----------------|-------------------------------|-----------------|------------------------------|
|                                                  | Commercial Real Estate |                     |                |                               |                 | Total Recorded Investment in |
|                                                  | Commercial             | Commercial Investor | Commercial R/E | Commercial Owner Occupied R/E | All Other Loans | Impaired Loans               |
| <i>(In thousands)</i>                            |                        |                     |                |                               |                 |                              |
| Impaired loans with a specific allowance         |                        |                     |                |                               |                 |                              |
| Non-accruing                                     | \$ 4,516               | \$ -                | \$ 5,157       | \$ -                          | \$ -            | \$ 9,673                     |
| Restructured accruing                            | 1,129                  | -                   | -              | -                             | -               | 1,129                        |
| Restructured non-accruing                        | 108                    | -                   | -              | 783                           | -               | 891                          |
| Balance                                          | \$ 5,753               | \$ -                | \$ 5,157       | \$ 783                        | \$ -            | \$ 11,693                    |
| Allowance                                        | \$ 3,220               | \$ -                | \$ 663         | \$ 131                        | \$ -            | \$ 4,014                     |
| Impaired loans without a specific allowance      |                        |                     |                |                               |                 |                              |
| Non-accruing                                     | \$ 391                 | \$ -                | \$ 418         | \$ 1,318                      | \$ -            | \$ 2,127                     |
| Restructured accruing                            | 273                    | -                   | -              | 496                           | 890             | 1,659                        |
| Restructured non-accruing                        | 1,688                  | 136                 | -              | 1,481                         | 2,025           | 5,330                        |
| Balance                                          | \$ 2,352               | \$ 136              | \$ 418         | \$ 3,295                      | \$ 2,915        | \$ 9,116                     |
| Total impaired loans                             |                        |                     |                |                               |                 |                              |
| Non-accruing                                     | \$ 4,907               | \$ -                | \$ 5,575       | \$ 1,318                      | \$ -            | \$ 11,800                    |
| Restructured accruing                            | 1,402                  | -                   | -              | 496                           | 890             | 2,788                        |
| Restructured non-accruing                        | 1,796                  | 136                 | -              | 2,264                         | 2,025           | 6,221                        |
| Balance                                          | \$ 8,105               | \$ 136              | \$ 5,575       | \$ 4,078                      | \$ 2,915        | \$ 20,809                    |
| Unpaid principal balance in total impaired loans | \$ 11,263              | \$ 1,248            | \$ 10,166      | \$ 6,331                      | \$ 3,681        | \$ 32,689                    |

December 31, 2017

|                                                                     | Commercial | Commercial Real Estate | Commercial | Commercial Owner | Commercial All Other | Total Recorded Investment in Impaired |
|---------------------------------------------------------------------|------------|------------------------|------------|------------------|----------------------|---------------------------------------|
|                                                                     | Commercial | Commercial             | Investor   | Occupied         | Loans                | Loans                                 |
| <i>(In thousands)</i>                                               |            |                        |            |                  |                      |                                       |
| Average impaired loans for the period                               | \$ 7,903   | \$ 137                 | \$ 6,835   | \$ 5,336         | \$ 2,968             | \$ 23,179                             |
| Contractual interest income due on impaired loans during the period | \$ 828     | \$ 333                 | \$ 669     | \$ 400           | \$ 84                |                                       |
| Interest income on impaired loans recognized on a cash basis        | \$ 204     | \$ -                   | \$ 24      | \$ 394           | \$ 132               |                                       |
| Interest income on impaired loans recognized on an accrual basis    | \$ 111     | \$ -                   | \$ -       | \$ 26            | \$ 32                |                                       |

**Credit Quality**

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

| <i>(In thousands)</i>                   | March 31, 2018         |               |                  |                 |                         |                 |               |                  |
|-----------------------------------------|------------------------|---------------|------------------|-----------------|-------------------------|-----------------|---------------|------------------|
|                                         | Commercial Real Estate |               |                  |                 | Residential Real Estate |                 |               |                  |
|                                         | Commercial             |               | Commercial Owner |                 | Residential             |                 | Residential   |                  |
|                                         | Commercial AD&C        | Investor R/E  | Occupied R/E     | Consumer        | Mortgage                | Construction    | Total         |                  |
| <b>Non-performing loans and assets:</b> |                        |               |                  |                 |                         |                 |               |                  |
| Non-accrual loans                       | \$ 6,634               | \$ 136        | \$ 5,813         | \$ 3,524        | \$ 3,244                | \$ 7,063        | \$ 174        | \$ 26,588        |
| Loans 90 days past due                  | -                      | -             | -                | -               | 126                     | -               | -             | 126              |
| Restructured loans                      | 1,310                  | -             | -                | 485             | -                       | 883             | -             | 2,678            |
| <b>Total non-performing loans</b>       | <b>7,944</b>           | <b>136</b>    | <b>5,813</b>     | <b>4,009</b>    | <b>3,370</b>            | <b>7,946</b>    | <b>174</b>    | <b>29,392</b>    |
| Other real estate owned                 | -                      | 365           | 497              | 400             | -                       | 1,499           | -             | 2,761            |
| <b>Total non-performing assets</b>      | <b>\$ 7,944</b>        | <b>\$ 501</b> | <b>\$ 6,310</b>  | <b>\$ 4,409</b> | <b>\$ 3,370</b>         | <b>\$ 9,445</b> | <b>\$ 174</b> | <b>\$ 32,153</b> |

| <i>(In thousands)</i>                   | December 31, 2017      |               |                  |                 |                         |                 |               |                  |
|-----------------------------------------|------------------------|---------------|------------------|-----------------|-------------------------|-----------------|---------------|------------------|
|                                         | Commercial Real Estate |               |                  |                 | Residential Real Estate |                 |               |                  |
|                                         | Commercial             |               | Commercial Owner |                 | Residential             |                 | Residential   |                  |
|                                         | Commercial AD&C        | Investor R/E  | Occupied R/E     | Consumer        | Mortgage                | Construction    | Total         |                  |
| <b>Non-performing loans and assets:</b> |                        |               |                  |                 |                         |                 |               |                  |
| Non-accrual loans                       | \$ 6,703               | \$ 136        | \$ 5,575         | \$ 3,582        | \$ 2,967                | \$ 7,196        | \$ 177        | \$ 26,336        |
| Loans 90 days past due                  | -                      | -             | -                | -               | -                       | 225             | -             | 225              |
| Restructured loans                      | 1,402                  | -             | -                | 496             | -                       | 890             | -             | 2,788            |
| <b>Total non-performing loans</b>       | <b>8,105</b>           | <b>136</b>    | <b>5,575</b>     | <b>4,078</b>    | <b>2,967</b>            | <b>8,311</b>    | <b>177</b>    | <b>29,349</b>    |
| Other real estate owned                 | 39                     | 365           | -                | 400             | -                       | 1,449           | -             | 2,253            |
| <b>Total non-performing assets</b>      | <b>\$ 8,144</b>        | <b>\$ 501</b> | <b>\$ 5,575</b>  | <b>\$ 4,478</b> | <b>\$ 2,967</b>         | <b>\$ 9,760</b> | <b>\$ 177</b> | <b>\$ 31,602</b> |

| <i>(In thousands)</i> | March 31, 2018         |              |                  |          |                         |              |             |           |
|-----------------------|------------------------|--------------|------------------|----------|-------------------------|--------------|-------------|-----------|
|                       | Commercial Real Estate |              |                  |          | Residential Real Estate |              |             |           |
|                       | Commercial             |              | Commercial Owner |          | Residential             |              | Residential |           |
|                       | Commercial AD&C        | Investor R/E | Occupied R/E     | Consumer | Mortgage                | Construction | Total       |           |
| <b>Past due loans</b> |                        |              |                  |          |                         |              |             |           |
| 31-60 days            | \$ 3,834               | \$ -         | \$ 727           | \$ 605   | \$ 2,061                | \$ 5,648     | \$ 587      | \$ 13,462 |



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|                                                        |                  |                  |                    |                    |                  |                  |                  |                    |
|--------------------------------------------------------|------------------|------------------|--------------------|--------------------|------------------|------------------|------------------|--------------------|
| <b>61-90 days</b>                                      | <b>537</b>       | <b>-</b>         | <b>249</b>         | <b>773</b>         | <b>965</b>       | <b>3,849</b>     | <b>-</b>         | <b>6,373</b>       |
| <b>&gt; 90 days</b>                                    | <b>-</b>         | <b>-</b>         | <b>-</b>           | <b>-</b>           | <b>126</b>       | <b>-</b>         | <b>-</b>         | <b>126</b>         |
| <b>Total past due</b>                                  | <b>4,371</b>     | <b>-</b>         | <b>976</b>         | <b>1,378</b>       | <b>3,152</b>     | <b>9,497</b>     | <b>587</b>       | <b>19,961</b>      |
| <b>Non-accrual loans</b>                               | <b>6,634</b>     | <b>136</b>       | <b>5,813</b>       | <b>3,524</b>       | <b>3,244</b>     | <b>7,063</b>     | <b>174</b>       | <b>26,588</b>      |
| <b>Loans acquired with deteriorated credit quality</b> | <b>2,268</b>     | <b>-</b>         | <b>17,573</b>      | <b>2,337</b>       | <b>1,383</b>     | <b>12</b>        | <b>-</b>         | <b>23,573</b>      |
| <b>Current loans</b>                                   | <b>639,524</b>   | <b>564,735</b>   | <b>1,904,077</b>   | <b>1,167,500</b>   | <b>525,194</b>   | <b>975,715</b>   | <b>214,684</b>   | <b>5,991,429</b>   |
| <b>Total loans</b>                                     | <b>\$652,797</b> | <b>\$564,871</b> | <b>\$1,928,439</b> | <b>\$1,174,739</b> | <b>\$532,973</b> | <b>\$992,287</b> | <b>\$215,445</b> | <b>\$6,061,551</b> |

December 31, 2017

| <i>(In thousands)</i> | Commercial Real Estate |           |              |                    | Residential Real Estate |           |              |             | Total |
|-----------------------|------------------------|-----------|--------------|--------------------|-------------------------|-----------|--------------|-------------|-------|
|                       | Commercial             |           | Commercial   |                    | Residential             |           | Residential  |             |       |
|                       | Commercial             | AD&C      | Investor R/E | Owner Occupied R/E | Consumer                | Mortgage  | Construction |             |       |
|                       |                        |           |              |                    |                         |           |              |             |       |
| <b>Past due loans</b> |                        |           |              |                    |                         |           |              |             |       |
| 31-60 days            | \$ 587                 | \$ -      | \$ 775       | \$ 414             | \$ 2,107                | \$ 6,100  | \$ -         | \$ 9,983    |       |
| 61-90 days            | -                      | -         | -            | -                  | 106                     | 3,103     | -            | 3,209       |       |
| > 90 days             | -                      | -         | -            | -                  | -                       | 225       | -            | 225         |       |
| Total past due        | 587                    | -         | 775          | 414                | 2,213                   | 9,428     | -            | 13,417      |       |
| Non-accrual loans     | 6,703                  | 136       | 5,575        | 3,582              | 2,967                   | 7,196     | 177          | 26,336      |       |
| Current loans         | 490,658                | 292,307   | 1,106,360    | 853,200            | 450,649                 | 904,811   | 176,510      | 4,274,495   |       |
| Total loans           | \$497,948              | \$292,443 | \$1,112,710  | \$857,196          | \$455,829               | \$921,435 | \$176,687    | \$4,314,248 |       |

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

| <b>March 31, 2018</b>         |                   |                                |                                    |                                              |                     |
|-------------------------------|-------------------|--------------------------------|------------------------------------|----------------------------------------------|---------------------|
| <b>Commercial Real Estate</b> |                   |                                |                                    |                                              |                     |
| <i>(In thousands)</i>         | <b>Commercial</b> | <b>Commercial<br/>AD&amp;C</b> | <b>Commercial<br/>Investor R/E</b> | <b>Commercial<br/>Owner<br/>Occupied R/E</b> | <b>Total</b>        |
| Pass                          | \$ 635,564        | \$ 564,433                     | \$ 1,901,769                       | \$ 1,159,886                                 | \$ 4,261,652        |
| Special Mention               | 2,492             | 302                            | 3,576                              | 5,262                                        | 11,632              |
| Substandard                   | 14,741            | 136                            | 23,094                             | 9,591                                        | 47,562              |
| Doubtful                      | -                 | -                              | -                                  | -                                            | -                   |
| <b>Total</b>                  | <b>\$ 652,797</b> | <b>\$ 564,871</b>              | <b>\$ 1,928,439</b>                | <b>\$ 1,174,739</b>                          | <b>\$ 4,320,846</b> |

| <b>December 31, 2017</b>      |                   |                                |                                    |                                              |                     |
|-------------------------------|-------------------|--------------------------------|------------------------------------|----------------------------------------------|---------------------|
| <b>Commercial Real Estate</b> |                   |                                |                                    |                                              |                     |
| <i>(In thousands)</i>         | <b>Commercial</b> | <b>Commercial<br/>AD&amp;C</b> | <b>Commercial<br/>Investor R/E</b> | <b>Commercial<br/>Owner<br/>Occupied R/E</b> | <b>Total</b>        |
| Pass                          | \$ 482,924        | \$ 292,307                     | \$ 1,103,480                       | \$ 845,102                                   | \$ 2,723,813        |
| Special Mention               | 2,443             | -                              | 3,517                              | 5,505                                        | 11,465              |
| Substandard                   | 12,581            | 136                            | 5,713                              | 6,589                                        | 25,019              |
| Doubtful                      | -                 | -                              | -                                  | -                                            | -                   |
| <b>Total</b>                  | <b>\$ 497,948</b> | <b>\$ 292,443</b>              | <b>\$ 1,112,710</b>                | <b>\$ 857,196</b>                            | <b>\$ 2,760,297</b> |

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

| <b>March 31, 2018</b>          |                   |                                 |                                     |                     |
|--------------------------------|-------------------|---------------------------------|-------------------------------------|---------------------|
| <b>Residential Real Estate</b> |                   |                                 |                                     |                     |
| <i>(In thousands)</i>          | <b>Consumer</b>   | <b>Residential<br/>Mortgage</b> | <b>Residential<br/>Construction</b> | <b>Total</b>        |
| Performing                     | \$ 529,603        | \$ 984,341                      | \$ 215,271                          | \$ 1,729,215        |
| Non-performing:                |                   |                                 |                                     |                     |
| 90 days past due               | 126               | -                               | -                                   | 126                 |
| Non-accruing                   | 3,244             | 7,063                           | 174                                 | 10,481              |
| Restructured loans             | -                 | 883                             | -                                   | 883                 |
| <b>Total</b>                   | <b>\$ 532,973</b> | <b>\$ 992,287</b>               | <b>\$ 215,445</b>                   | <b>\$ 1,740,705</b> |

December 31, 2017  
Residential Real Estate

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| <i>(In thousands)</i> | Consumer   | Residential<br>Mortgage | Residential<br>Construction | Total        |
|-----------------------|------------|-------------------------|-----------------------------|--------------|
| Performing            | \$ 452,862 | \$ 913,124              | \$ 176,510                  | \$ 1,542,496 |
| Non-performing:       |            |                         |                             |              |
| 90 days past due      | -          | 225                     | -                           | 225          |
| Non-accruing          | 2,967      | 7,196                   | 177                         | 10,340       |
| Restructured loans    | -          | 890                     | -                           | 890          |
| Total                 | \$ 455,829 | \$ 921,435              | \$ 176,687                  | \$ 1,553,951 |

During the three months ended March 31, 2018, the Company restructured an insignificant amount of loans that were designated as troubled debt restructurings. 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 2018 did not have significant specific reserves. For the year ended December 31, 2017, the Company restructured \$2.1 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 2017 had specific reserves of \$0.2 million at December 31, 2017. The commitments to lend additional funds on loans that have been restructured at March 31, 2018 and December 31, 2017 were not significant.

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

| <b>For the Three Months Ended March 31, 2018</b> |            |      |                        |      |                                 |              |       |
|--------------------------------------------------|------------|------|------------------------|------|---------------------------------|--------------|-------|
| <b>Commercial Real Estate</b>                    |            |      |                        |      |                                 |              |       |
| <i>(In thousands)</i>                            | Commercial |      | Commercial<br>Investor |      | Commercial<br>Owner<br>Occupied | All<br>Other | Total |
|                                                  | Commercial | AD&C | R/E                    | R/E  | Loans                           |              |       |
| <b>Troubled debt restructurings</b>              |            |      |                        |      |                                 |              |       |
| <b>Restructured accruing</b>                     | \$ -       | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ -  |
| <b>Restructured non-accruing</b>                 | 14         | -    | -                      | -    | -                               | -            | 14    |
| <b>Balance</b>                                   | \$ 14      | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ 14 |
| <b>Specific allowance</b>                        | \$ 14      | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ 14 |
| <b>Restructured and subsequently defaulted</b>   | \$ -       | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ -  |

| <b>For the Year Ended December 31, 2017</b>    |            |      |                        |      |                                 |              |          |
|------------------------------------------------|------------|------|------------------------|------|---------------------------------|--------------|----------|
| <b>Commercial Real Estate</b>                  |            |      |                        |      |                                 |              |          |
| <i>(In thousands)</i>                          | Commercial |      | Commercial<br>Investor |      | Commercial<br>Owner<br>Occupied | All<br>Other | Total    |
|                                                | Commercial | AD&C | R/E                    | R/E  | Loans                           |              |          |
| <b>Troubled debt restructurings</b>            |            |      |                        |      |                                 |              |          |
| <b>Restructured accruing</b>                   | \$ 492     | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ 492   |
| <b>Restructured non-accruing</b>               | 1,019      | -    | -                      | -    | 540                             | -            | 1,559    |
| <b>Balance</b>                                 | \$ 1,511   | \$ - | \$ -                   | \$ - | \$ 540                          | \$ -         | \$ 2,051 |
| <b>Specific allowance</b>                      | \$ 247     | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ 247   |
| <b>Restructured and subsequently defaulted</b> | \$ -       | \$ - | \$ -                   | \$ - | \$ -                            | \$ -         | \$ -     |

**Other Real Estate Owned**

Other real estate owned totaled \$2.8 million and \$2.3 million at March 31, 2018 and December 31, 2017, respectively. There were no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process as of March 31, 2018.

**Note 6 – Goodwill and Other Intangible Assets**

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

|                                    | March 31, 2018              |                             | Weighted<br>Average<br>Remaining<br>Life | December 31, 2017         |                             | Weighted<br>Average<br>Remaining<br>Life |                             |                           |
|------------------------------------|-----------------------------|-----------------------------|------------------------------------------|---------------------------|-----------------------------|------------------------------------------|-----------------------------|---------------------------|
|                                    | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization |                                          | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount |                                          | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| <i>(Dollars in thousands)</i>      |                             |                             |                                          |                           |                             |                                          |                             |                           |
| Amortizing intangible assets:      |                             |                             |                                          |                           |                             |                                          |                             |                           |
| Core deposit intangibles           | \$ 10,678                   | \$ (485)                    | \$ 10,193                                | 9.8 years                 | \$ -                        | \$ -                                     | -                           |                           |
| Other identifiable intangibles     | 1,271                       | (56)                        | 1,215                                    | 11.2 years                | 786                         | (206)                                    | 580                         | 13.1 years                |
| Total amortizing intangible assets | \$ 11,949                   | \$ (541)                    | \$ 11,408                                |                           | \$ 786                      | \$ (206)                                 | \$ 580                      |                           |
| Goodwill                           | \$ 342,907                  |                             | \$ 342,907                               |                           | \$ 85,768                   |                                          | \$ 85,768                   |                           |

During 2018, the acquisition of WashingtonFirst Bankshares and subsidiaries resulted in the addition of \$0.7 million in other intangible assets.

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

| <i>(In thousands)</i>              | Amount    |
|------------------------------------|-----------|
| 2018                               | \$ 1,621  |
| 2019                               | 1,944     |
| 2020                               | 1,720     |
| 2021                               | 1,507     |
| Thereafter                         | 4,616     |
| Total amortizing intangible assets | \$ 11,408 |

The amount of goodwill by reportable segment recognized in the WashingtonFirst acquisition is presented in the following table:

| <i>(Dollars in thousands)</i> | Community<br>Banking | Insurance | Investment<br>Management | Total      |
|-------------------------------|----------------------|-----------|--------------------------|------------|
| Balance December 31, 2017     | \$ 69,991            | \$ 6,788  | \$ 8,989                 | \$ 85,768  |
| WashingtonFirst Acquisition   | 256,940              | -         | 199                      | 257,139    |
| Balance March 31, 2018        | \$ 326,931           | \$ 6,788  | \$ 9,188                 | \$ 342,907 |

## Note 7 – Deposits

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

*(In thousands)*

**March 31, 2018**

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|                                      |                     | December 31,<br>2017 |
|--------------------------------------|---------------------|----------------------|
| Noninterest-bearing deposits         | <b>\$ 1,767,523</b> | \$ 1,264,392         |
| Interest-bearing deposits:           |                     |                      |
| Demand                               | <b>750,899</b>      | 658,716              |
| Money market savings                 | <b>1,544,580</b>    | 1,030,432            |
| Regular savings                      | <b>357,601</b>      | 321,171              |
| Time deposits of less than \$100,000 | <b>378,428</b>      | 293,201              |
| Time deposits of \$100,000 or more   | <b>828,175</b>      | 395,750              |
| Total interest-bearing deposits      | <b>3,859,683</b>    | 2,699,270            |
| Total deposits                       | <b>\$ 5,627,206</b> | \$ 3,963,662         |

**Note 8 -SUBORDINATED DEBENTURES**

In conjunction with the acquisition, the Company assumed \$25.0 million in non-callable subordinated debt and \$10.3 million in callable junior subordinated debt securities. The associated purchase premiums at acquisition were \$2.2 million and \$0.1 million, respectively. The premiums are amortized over the contractual life of each obligation.

The subordinated debt has a maturity of ten years, is due in full on October 15, 2025, is non-callable and currently bears a fixed interest rate of 6.00% per annum, payable quarterly, subject to a reset after 5 years (on October 5, 2020) at 3 month LIBOR plus 467 basis points. The entire amount of subordinated debt is considered Tier 2 capital under current regulatory guidelines.

In 2003, Alliance Bankshares Corporation, which was acquired by WashingtonFirst in 2012, issued \$10.3 million of junior subordinated debt securities to Alliance Virginia Capital Trust I, of which Alliance Bankshares Corporation owned all of the common securities. The trust used the proceeds from the issuance of its underlying common securities and preferred securities, which were sold to third parties, to purchase the debt securities. These debt securities are the trust's only assets and the interest payments from the debentures finance the distributions paid on the preferred securities. The obligations under the debt securities were assumed by the Company at the date of acquisition. The debt securities are due on June 30, 2033 and are callable at any time, without penalty. The interest rate associated with the debt securities is three month LIBOR plus 3.15% subject to quarterly interest rate adjustments. The interest rate as of March 31, 2018 was 5.46%. Under the indenture governing the debt securities, the Company has the right to defer payments of interest for up to twenty consecutive quarterly periods. During any such extension period, distributions on the trust's preferred securities will also be deferred, and the Company's ability to pay dividends on its common stock will be restricted. The trust's preferred securities are mandatorily redeemable upon maturity of the debt securities, or upon earlier redemption as provided in the indenture. If the debt securities are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest. The Company unconditionally guarantees payment of accrued and unpaid distributions required to be paid on the trust securities subject to certain exceptions, the redemption price with respect to any trust securities called for redemption and amounts due if the trust is liquidated or terminated. As of March 31, 2018, the Company was current on all interest payments. Under current regulatory guidelines the trust preferred securities are considered to be Tier 1 capital.

The following table provides information on subordinated debentures for the period indicated:

| <i>(In thousands)</i>            | As of,          |                |
|----------------------------------|-----------------|----------------|
|                                  | January 1, 2018 | March 31, 2018 |
| Subordinated debentures          | \$ 25,000       | \$ 25,000      |
| Add: Purchase accounting premium | 2,158           | 2,125          |
| Trust preferred securities       | 10,310          | 10,310         |
| Add: Purchase accounting premium | 96              | 95             |
| Total subordinated debentures    | \$ 37,564       | \$ 37,530      |



**Note 9 – Share Based Compensation**

At March 31, 2018, the Company had two share based compensation plans in existence, the 2005 Omnibus Stock Plan (“Omnibus Stock Plan”) and the 2015 Omnibus Incentive Plan (“Omnibus Incentive Plan”). The Omnibus Stock Plan expired during the second quarter of 2015 but has outstanding options that may still be exercised. The Omnibus Incentive Plan is described in the following paragraph.

The Company’s Omnibus Incentive Plan was approved on May 6, 2015 and provides for the granting of incentive stock options, non-qualifying stock options, stock appreciation rights, restricted stock grants, restricted stock units and performance awards to selected employees on a periodic basis at the discretion of the board. The Omnibus Incentive Plan authorizes the issuance of up to 1,500,000 shares of common stock, of which 1,288,144 are available for issuance at March 31, 2018, has a term of ten years, and is administered by a committee of at least three directors appointed by the board of directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within seven to ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The board committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

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

|                                            | Three Months Ended March 31, |         |
|--------------------------------------------|------------------------------|---------|
|                                            | 2018                         | 2017    |
| Dividend yield                             | 2.64%                        | 2.45%   |
| Weighted average expected volatility       | 39.13%                       | 40.27%  |
| Weighted average risk-free interest rate   | 2.61%                        | 2.14%   |
| Weighted average expected lives (in years) | 5.61                         | 5.67    |
| Weighted average grant-date fair value     | \$11.73                      | \$13.42 |

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

Compensation expense is recognized on a straight-line basis over the vesting period of the respective stock option or restricted stock grant. The Company recognized compensation expense of \$0.5 million and \$0.5 million for the three months ended March 31, 2018 and 2017, respectively, related to the awards of stock options and restricted stock grants. The intrinsic value of stock options exercised in the three months ended March 31, 2018 and 2017 was \$0.2 million and \$0.4 million, respectively. The total of unrecognized compensation cost related to stock options was approximately \$0.3 million as of March 31, 2018. That cost is expected to be recognized over a weighted average period of approximately 2.4 years. The total of unrecognized compensation cost related to restricted stock was approximately \$5.1 million as of March 31, 2018. That cost is expected to be recognized over a weighted average period of approximately 3.3 years. The fair value of the options vested during the three months ended March 31, 2018 and 2017, was not significant.

In the first quarter of 2018, 16,212 stock options were granted, subject to a three year vesting schedule with one third of the options vesting on April 1<sup>st</sup> of each year. The Company granted 36,003 shares of restricted stock in the first quarter of 2018, of which 9,170 shares are subject to a three year vesting schedule with one third of the shares vesting each year and 26,833 shares subject to a five year vesting schedule with one fifth of the shares vesting each year. All of these restricted shares will vest on April 1<sup>st</sup> of each year.

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

|  | Number<br>of | Weighted<br>Average | Weighted<br>Average<br>Contractual | Aggregate<br>Intrinsic |
|--|--------------|---------------------|------------------------------------|------------------------|
|--|--------------|---------------------|------------------------------------|------------------------|

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|                                                                   | Common<br>Shares | Exercise<br>Share Price | Remaining<br>Life (Years) | Value<br>(in thousands) |
|-------------------------------------------------------------------|------------------|-------------------------|---------------------------|-------------------------|
| Balance at January 1, 2018                                        | 87,300           | \$ 26.22                |                           | \$ 1,160                |
| Granted                                                           | 16,212           | \$ 38.15                |                           |                         |
| Exercised                                                         | (12,353)         | \$ 18.78                |                           | \$ 249                  |
| Balance at March 31, 2018                                         | 91,159           | \$ 29.35                | 4.4                       | \$ 904                  |
| Exercisable at March 31, 2018                                     | 44,462           | \$ 23.44                | 2.9                       | \$ 904                  |
| Weighted average fair value of options<br>granted during the year |                  | \$ 11.73                |                           |                         |

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

| <i>(In dollars, except share data):</i> | Number<br>of<br>Common<br>Shares | Weighted<br>Average<br>Grant-Date<br>Fair Value |
|-----------------------------------------|----------------------------------|-------------------------------------------------|
| Restricted stock at January 1, 2018     | 189,035                          | \$ 30.67                                        |
| Granted                                 | 36,003                           | \$ 38.15                                        |
| Vested                                  | (1,514)                          | \$ 33.04                                        |
| Restricted stock at March 31, 2018      | 223,524                          | \$ 31.86                                        |

## Note 10 – Pension, Profit Sharing, and Other Employee Benefit Plans

### Defined Benefit Pension Plan

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

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

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

| <i>(In thousands)</i>                         | Three Months Ended March 31, |        |
|-----------------------------------------------|------------------------------|--------|
|                                               | 2018                         | 2017   |
| Interest cost on projected benefit obligation | \$ 385                       | \$ 410 |
| Expected return on plan assets                | (465)                        | (496)  |
| Recognized net actuarial loss                 | 250                          | 295    |
| Net periodic benefit cost                     | \$ 170                       | \$ 209 |

### 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 did not make a contribution to the plan during the first quarter of 2018. Management continues to

monitor the funding level of the pension plan and may make contributions as necessary during 2018.

**Note 11 – Net Income per Common Share**

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

| <i>(Dollars and amounts in thousands, except per share data)</i> | Three Months Ended March 31, |           |
|------------------------------------------------------------------|------------------------------|-----------|
|                                                                  | 2018                         | 2017      |
| Net income                                                       | \$ 21,665                    | \$ 15,112 |
| <b>Basic:</b>                                                    |                              |           |
| Basic weighted average EPS shares                                | 35,659                       | 24,119    |
| Basic net income per share                                       | \$ 0.61                      | \$ 0.63   |
| <b>Diluted:</b>                                                  |                              |           |
| Basic weighted average EPS shares                                | 35,659                       | 24,119    |
| Dilutive common stock equivalents                                | 25                           | 40        |
| Dilutive EPS shares                                              | 35,684                       | 24,159    |
| Diluted net income per share                                     | \$ 0.61                      | \$ 0.63   |
| Anti-dilutive shares                                             | 4                            | -         |

**NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

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

| <i>(In thousands)</i>                                                          | Unrealized<br>Gains<br>(Losses) on<br>Investments<br>Available-for-Sale | Defined Benefit<br>Pension Plan | Total      |
|--------------------------------------------------------------------------------|-------------------------------------------------------------------------|---------------------------------|------------|
| Balance at January 1, 2018                                                     | \$ 687                                                                  | \$ (7,544)                      | \$ (6,857) |
| Other comprehensive income before reclassification,<br>net of tax              | (9,368)                                                                 | -                               | (9,368)    |
| Reclassifications from accumulated other<br>comprehensive income, net of tax   | (47)                                                                    | 131                             | 84         |
| Current period change in other comprehensive income,<br>net of tax             | (9,415)                                                                 | 131                             | (9,284)    |
| Reclassification of tax effects from accumulated other<br>comprehensive income | 148                                                                     | (1,625)                         | (1,477)    |

|                                  |                   |                   |                    |
|----------------------------------|-------------------|-------------------|--------------------|
| <b>Balance at March 31, 2018</b> | <b>\$ (8,580)</b> | <b>\$ (9,038)</b> | <b>\$ (17,618)</b> |
|----------------------------------|-------------------|-------------------|--------------------|

| <i>(In thousands)</i>                                                     | Unrealized<br>Gains<br>(Losses) on<br>Investments<br>Available-for-Sale | Defined Benefit<br>Pension Plan | Total      |
|---------------------------------------------------------------------------|-------------------------------------------------------------------------|---------------------------------|------------|
| Balance at January 1, 2017                                                | \$ 1,642                                                                | \$ (8,256)                      | \$ (6,614) |
| Other comprehensive income before reclassification, net of tax            | 904                                                                     | -                               | 904        |
| Reclassifications from accumulated other comprehensive income, net of tax | (2)                                                                     | 178                             | 176        |
| Current period change in other comprehensive income, net of tax           | 902                                                                     | 178                             | 1,080      |
| Balance at March 31, 2017                                                 | \$ 2,544                                                                | \$ (8,078)                      | \$ (5,534) |

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

| <i>(In thousands)</i>                                       | Three Months Ended March 31, |          |
|-------------------------------------------------------------|------------------------------|----------|
|                                                             | <b>2018</b>                  | 2017     |
| Unrealized gains/(losses) on investments available-for-sale |                              |          |
| Affected line item in the Statements of Income:             |                              |          |
| Investment securities gains                                 | \$ 63                        | \$ 2     |
| Income before taxes                                         | 63                           | 2        |
| Tax expense                                                 | 16                           | -        |
| Net income                                                  | \$ 47                        | \$ 2     |
| Amortization of defined benefit pension plan items          |                              |          |
| Affected line item in the Statements of Income:             |                              |          |
| Recognized actuarial loss <sup>(1)</sup>                    | \$ (250)                     | \$ (295) |
| Income before taxes                                         | (250)                        | (295)    |
| Tax benefit                                                 | (119)                        | (117)    |
| Net loss                                                    | \$ (131)                     | \$ (178) |

(1) This amount is included in the computation of net periodic benefit cost, see Note 10

In the first quarter of 2018, the Company elected to make a one-time reclassification from accumulated other comprehensive income to retained earnings for the effects of re-measuring the deferred tax assets and liabilities originally recorded in other comprehensive income as a result of the change in the federal tax rate by the Tax Cuts and Jobs Act.

### **Note 13 – Financial Instruments with Off-balance Sheet Risk and Derivatives**

The Company has entered into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk. The notional value of commercial loan swaps outstanding was \$17.7 million with a fair value of \$0.6 million as of March 31, 2018 compared to \$17.8 million with a fair value of \$0.7 million as of December 31, 2017. The swap positions are offset to minimize the potential impact on the Company’s financial statements. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The associated net gains and losses on the swaps are recorded in other non-interest income.

### **Note 14 – Litigation**

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



**Note 15 – Fair Value**

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

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

**Basis of Fair Value Measurement:**

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

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

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

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

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

**Assets and Liabilities**

*Mortgage loans held for sale*

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

*Investments available-for-sale*

U.S. government agencies and mortgage-backed securities

Valuations are based on active market data and use of evaluated broker pricing models that vary based by asset class and includes available trade, bid, and other market information. Generally, the methodology includes broker quotes, proprietary models, descriptive terms and conditions databases coupled with extensive quality control programs. Multiple quality control evaluation processes review available market, credit and deal level information to support the evaluation of the security. If there is a lack of objectively verifiable information available to support the valuation, the evaluation of the security is discontinued. Additionally, proprietary models and pricing systems, mathematical tools,

actual transacted prices, integration of market developments and experienced evaluators are used to determine the value of a security based on a hierarchy of market information regarding a security or securities with similar characteristics. The Company does not adjust the quoted price for such securities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

State and municipal securities

Proprietary valuation matrices are used for valuing all tax-exempt municipals that can incorporate changes in the municipal market as they occur. Market evaluation models include the ability to value bank qualified municipals and general market municipals that can be broken down further according to insurer, credit support, state of issuance and rating to incorporate additional spreads and municipal curves. Taxable municipals are valued using a third party model that incorporates a methodology that captures the trading nuances associated with these bonds. Such instruments are generally classified within Level 2 of the fair value hierarchy.

*Interest rate swap agreements*

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

**Assets Measured at Fair Value on a Recurring Basis**

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

|                                          | March 31, 2018                                                                   |                                                           |                                                    |  | Total     |
|------------------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|--|-----------|
|                                          | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |  |           |
| <i>(In thousands)</i>                    |                                                                                  |                                                           |                                                    |  |           |
| <b>Assets</b>                            |                                                                                  |                                                           |                                                    |  |           |
| Residential mortgage loans held for sale | \$ -                                                                             | \$ 28,486                                                 | \$ -                                               |  | \$ 28,486 |
| Investments available-for-sale:          |                                                                                  |                                                           |                                                    |  |           |
| U.S. government agencies                 | -                                                                                | 208,304                                                   | -                                                  |  | 208,304   |
| State and municipal                      | -                                                                                | 330,546                                                   | -                                                  |  | 330,546   |
| Mortgage-backed                          | -                                                                                | 428,144                                                   | -                                                  |  | 428,144   |
| Corporate debt                           | -                                                                                | -                                                         | 9,352                                              |  | 9,352     |
| Trust preferred                          | -                                                                                | -                                                         | 310                                                |  | 310       |
| Marketable equity securities             | -                                                                                | 568                                                       | -                                                  |  | 568       |
| Interest rate swap agreements            | -                                                                                | 574                                                       | -                                                  |  | 574       |
| <b>Liabilities</b>                       |                                                                                  |                                                           |                                                    |  |           |
| Interest rate swap agreements            | \$ -                                                                             | \$ (574)                                                  | \$ -                                               |  | \$ (574)  |

|                                          | December 31, 2017                                                                |                                                           |                                                    |  | Total    |
|------------------------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|--|----------|
|                                          | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |  |          |
| <i>(In thousands)</i>                    |                                                                                  |                                                           |                                                    |  |          |
| <b>Assets</b>                            |                                                                                  |                                                           |                                                    |  |          |
| Residential mortgage loans held for sale | \$ -                                                                             | \$ 9,848                                                  | \$ -                                               |  | \$ 9,848 |
| Investments available-for-sale:          |                                                                                  |                                                           |                                                    |  |          |
| U.S. government agencies                 | -                                                                                | 106,568                                                   | -                                                  |  | 106,568  |
| State and municipal                      | -                                                                                | 312,253                                                   | -                                                  |  | 312,253  |
| Mortgage-backed                          | -                                                                                | 300,040                                                   | -                                                  |  | 300,040  |
| Corporate debt                           | -                                                                                | -                                                         | 9,432                                              |  | 9,432    |
| Trust preferred                          | -                                                                                | -                                                         | 1,002                                              |  | 1,002    |
| Marketable equity securities             | -                                                                                | 212                                                       | -                                                  |  | 212      |

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|                               |   |     |   |     |
|-------------------------------|---|-----|---|-----|
| Interest rate swap agreements | - | 707 | - | 707 |
|-------------------------------|---|-----|---|-----|

Liabilities

|                               |      |          |      |          |
|-------------------------------|------|----------|------|----------|
| Interest rate swap agreements | \$ - | \$ (707) | \$ - | \$ (707) |
|-------------------------------|------|----------|------|----------|

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

| <i>(In thousands)</i>                                        | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--------------------------------------------------------------|----------------------------------------------------|
| Investments available-for-sale:                              |                                                    |
| Balance at January 1, 2018                                   | \$ 10,434                                          |
| Additions of Level 3 assets                                  | 310                                                |
| Principal sales                                              | (1,002)                                            |
| Total unrealized losses included in other comprehensive loss | (80)                                               |
| Balance at March 31, 2018                                    | \$ 9,662                                           |

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

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

| <i>(In thousands)</i>      | March 31, 2018                                                                   |                                                           |                                                    |           | Total         | Total Losses       |
|----------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-----------|---------------|--------------------|
|                            | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level<br>3) |           |               |                    |
| Impaired loans             | \$ -                                                                             | \$ -                                                      | \$ 8,234                                           | \$        | 8,234         | \$ (10,749)        |
| Other real estate<br>owned | -                                                                                | -                                                         | 2,761                                              |           | 2,761         | (54)               |
| <b>Total</b>               | <b>\$ -</b>                                                                      | <b>\$ -</b>                                               | <b>\$ 10,995</b>                                   | <b>\$</b> | <b>10,995</b> | <b>\$ (10,803)</b> |

| <i>(In thousands)</i>      | December 31, 2017                                                                |                                                           |                                                 |    | Total | Total Losses |
|----------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|-------------------------------------------------|----|-------|--------------|
|                            | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs (Level 3) |    |       |              |
| Impaired loans             | \$ -                                                                             | \$ -                                                      | \$ 8,474                                        | \$ | 8,474 | \$ (11,806)  |
| Other real estate<br>owned | -                                                                                | -                                                         | 2,253                                           |    | 2,253 | (158)        |

|       |    |   |    |   |    |        |    |        |    |          |
|-------|----|---|----|---|----|--------|----|--------|----|----------|
| Total | \$ | - | \$ | - | \$ | 10,727 | \$ | 10,727 | \$ | (11,964) |
|-------|----|---|----|---|----|--------|----|--------|----|----------|

At March 31, 2018, impaired loans totaling \$20.8 million were written down to fair value of \$16.3 million as a result of specific loan loss allowances of \$4.5 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling \$20.8 million were written down to fair value of \$16.8 million at December 31, 2017 as a result of specific loan loss allowances of \$4.0 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 of financial instruments that are not measured at fair value in the financial statements based on the exit price notion. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price, if one exists.

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

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



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

|                                                                                | Fair Value Measurements |                                                                                 |                                                                |                                                    |           |
|--------------------------------------------------------------------------------|-------------------------|---------------------------------------------------------------------------------|----------------------------------------------------------------|----------------------------------------------------|-----------|
|                                                                                | March 31, 2018          | Quoted<br>Prices<br>in<br>Active<br>Markets<br>Identical<br>Assets<br>(Level 1) | Estimated<br>for<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           |
| Carrying<br>Amount                                                             |                         |                                                                                 |                                                                |                                                    |           |
| <i>(In thousands)</i>                                                          |                         |                                                                                 |                                                                |                                                    |           |
| <b>Financial Assets</b>                                                        |                         |                                                                                 |                                                                |                                                    |           |
| Other equity securities                                                        | \$ 63,115               | \$ 63,115                                                                       | \$ -                                                           | \$ 63,115                                          | \$ -      |
| Loans, net of allowance                                                        | 6,014,620               | 6,043,115                                                                       | -                                                              | -                                                  | 6,043,115 |
| Other assets                                                                   | 108,839                 | 108,839                                                                         | -                                                              | 108,839                                            | -         |
| <b>Financial Liabilities</b>                                                   |                         |                                                                                 |                                                                |                                                    |           |
| Time deposits                                                                  | \$1,206,603             | \$1,222,469                                                                     | \$ -                                                           | \$1,222,469                                        | \$ -      |
| Securities sold under retail repurchase agreements and federal funds purchased | 149,323                 | 149,323                                                                         | -                                                              | 149,323                                            | -         |
| Advances from FHLB                                                             | 1,011,109               | 1,012,398                                                                       | -                                                              | 1,012,398                                          | -         |
| Subordinated debentures                                                        | 37,530                  | 37,530                                                                          | -                                                              | -                                                  | 37,530    |

|                                                                                | Fair Value Measurements |                                                                                 |                                                                |                                                    |           |
|--------------------------------------------------------------------------------|-------------------------|---------------------------------------------------------------------------------|----------------------------------------------------------------|----------------------------------------------------|-----------|
|                                                                                | December 31, 2017       | Quoted<br>Prices<br>in<br>Active<br>Markets<br>Identical<br>Assets<br>(Level 1) | Estimated<br>for<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           |
| Carrying<br>Amount                                                             |                         |                                                                                 |                                                                |                                                    |           |
| <i>(In thousands)</i>                                                          |                         |                                                                                 |                                                                |                                                    |           |
| <b>Financial Assets</b>                                                        |                         |                                                                                 |                                                                |                                                    |           |
| Other equity securities                                                        | \$ 45,518               | \$ 45,518                                                                       | \$ -                                                           | \$ 45,518                                          | \$ -      |
| Loans, net of allowance                                                        | 4,268,991               | 4,320,719                                                                       | -                                                              | -                                                  | 4,320,719 |
| Other assets                                                                   | 95,730                  | 95,730                                                                          | -                                                              | 95,730                                             | -         |
| <b>Financial Liabilities</b>                                                   |                         |                                                                                 |                                                                |                                                    |           |
| Time deposits                                                                  | \$ 688,951              | \$ 684,139                                                                      | \$ -                                                           | \$ 684,139                                         | \$ -      |
| Securities sold under retail repurchase agreements and federal funds purchased | 119,359                 | 119,359                                                                         | -                                                              | 119,359                                            | -         |

|                         |         |         |   |         |   |
|-------------------------|---------|---------|---|---------|---|
| Advances from FHLB      | 765,833 | 769,860 | - | 769,860 | - |
| Subordinated debentures | -       | -       | - | -       | - |

### Note 16 - Segment Reporting

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

The Community Banking segment is conducted through Sandy Spring Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. Parent company income is included in the Community Banking segment, as the majority of effort of these functions is related to this segment. Major revenue sources include net interest income, gains on sales of mortgage loans, trust income fees and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Non-cash charges associated with amortization of intangibles was \$0.5 million for the three months ended March 31, 2018. This amount was not significant for the three months ended March 31, 2017.

The Insurance segment is conducted through Sandy Spring Insurance Corporation, a subsidiary of the Bank, and offers annuities as an alternative to traditional deposit accounts. Sandy Spring Insurance Corporation operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff and Associates, located in Ocean City, Maryland. Major sources of revenue are insurance commissions from commercial lines, personal lines, and medical liability lines. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles was not significant for the three months ended March 31, 2018 and 2017, 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 \$1.5 billion in assets under management. Major revenue sources include non-interest income earned on the above services. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles was not significant for the three months ended March 31, 2018 and 2017, respectively.

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

| <i>(In thousands)</i>             | <b>Three Months Ended March 31, 2018</b> |                  |                             |                                      |              |
|-----------------------------------|------------------------------------------|------------------|-----------------------------|--------------------------------------|--------------|
|                                   | <b>Community<br/>Banking</b>             | <b>Insurance</b> | <b>Investment<br/>Mgmt.</b> | <b>Inter-Segment<br/>Elimination</b> | <b>Total</b> |
| <b>Interest income</b>            | \$ 75,504                                | \$ -             | \$ 1                        | \$ (1)                               | \$ 75,504    |
| <b>Interest expense</b>           | 12,614                                   | -                | -                           | (1)                                  | 12,613       |
| <b>Provision for loan losses</b>  | 1,997                                    | -                | -                           | -                                    | 1,997        |
| <b>Noninterest income</b>         | 13,171                                   | 1,822            | 2,279                       | (154)                                | 17,118       |
| <b>Noninterest expense</b>        | 47,031                                   | 1,379            | 1,385                       | (154)                                | 49,641       |
| <b>Income before income taxes</b> | 27,033                                   | 443              | 895                         | -                                    | 28,371       |
| <b>Income tax expense</b>         | 6,353                                    | 123              | 230                         | -                                    | 6,706        |
| <b>Net income</b>                 | \$ 20,680                                | \$ 320           | \$ 665                      | \$ -                                 | \$ 21,665    |
| <br>                              |                                          |                  |                             |                                      |              |
| <b>Assets</b>                     | \$ 7,894,964                             | \$ 8,984         | \$ 16,216                   | \$ (25,246)                          | \$ 7,894,918 |

| <i>(In thousands)</i>             | <b>Three Months Ended March 31, 2017</b> |                  |                             |                                      |              |
|-----------------------------------|------------------------------------------|------------------|-----------------------------|--------------------------------------|--------------|
|                                   | <b>Community<br/>Banking</b>             | <b>Insurance</b> | <b>Investment<br/>Mgmt.</b> | <b>Inter-Segment<br/>Elimination</b> | <b>Total</b> |
| <b>Interest income</b>            | \$ 45,957                                | \$ 1             | \$ 2                        | \$ (2)                               | \$ 45,958    |
| <b>Interest expense</b>           | 5,707                                    | -                | -                           | (2)                                  | 5,705        |
| <b>Provision for loan losses</b>  | 194                                      | -                | -                           | -                                    | 194          |
| <b>Non-interest income</b>        | 9,086                                    | 1,752            | 2,003                       | (209)                                | 12,632       |
| <b>Non-interest expense</b>       | 27,799                                   | 1,355            | 1,036                       | (209)                                | 29,981       |
| <b>Income before income taxes</b> | 21,343                                   | 398              | 969                         | -                                    | 22,710       |
| <b>Income tax expense</b>         | 7,060                                    | 161              | 377                         | -                                    | 7,598        |
| <b>Net income</b>                 | \$ 14,283                                | \$ 237           | \$ 592                      | \$ -                                 | \$ 15,112    |
| <br>                              |                                          |                  |                             |                                      |              |
| <b>Assets</b>                     | \$ 5,202,560                             | \$ 8,066         | \$ 14,577                   | \$ (24,039)                          | \$ 5,201,164 |



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

### The Company

Sandy Spring Bancorp, Inc. (the "Company") is the bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. The Bank traces its origin to 1868, making it among the oldest institutions in the region. This year marks its 150<sup>th</sup> year anniversary. The Bank is an independent, community oriented commercial banking business that conducts full-service banking through 55 community offices located in Central Maryland, Northern Virginia and Washington D.C. The Bank is a state chartered bank subject to supervision and regulation by the Federal Reserve and the State of Maryland. The Bank's deposit accounts are insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum permitted by law. The Bank is a member of the Federal Reserve System and is an Equal Housing Lender. The Company, the Bank, and its other subsidiaries are Affirmative Action/Equal Opportunity Employers.

The Company is a \$7.9 billion community banking organization that focuses its lending and other services on businesses and consumers in the local market area. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank offers a comprehensive menu of insurance and investment management services.

On January 1, 2018, the Company completed the planned acquisition of WashingtonFirst Bankshares, Inc., the parent company for WashingtonFirst Bank, (collectively referred to as "WashingtonFirst") headquartered in Reston, Virginia. At the date of acquisition, WashingtonFirst, had 19 community banking offices and more than \$2.1 billion in assets. The all-stock transaction resulted in the issuance of 11.4 million common shares and was valued at approximately \$447 million.

The results of operations for the first quarter of 2018 include the impact of the acquisition on the various income and expense classifications as presented in the subsequent sections of management's discussion and analysis. Significant period-to-period asset and liability variances are also directly attributable to the WashingtonFirst transaction. Cost savings from the synergies resulting from the combination of the institutions will continue to be realized throughout 2018.

### Overview

Net income for the Company for the first quarter of 2018 totaled \$21.7 million (\$0.61 per diluted share) as compared to net income of \$15.1 million (\$0.63 per diluted share) for the first quarter of 2017 and net income of \$8.3 million (\$0.34 per diluted share) for the fourth quarter of 2017. The current quarter's results included the impact of \$9.0

million in merger expenses. Exclusive of the after-tax impact of these expenses, earnings per diluted share would have been approximately \$0.80 per share. The prior quarter's results included \$5.6 million in additional income tax expense from the revaluation of deferred tax assets as a result of the reduction in the corporate income tax rate under the recently enacted Tax Cuts and Jobs Act, as well as \$1.8 million in post-tax merger expenses. Fourth quarter 2017 earnings per share would have been approximately \$0.64 per share excluding the combined impact of these items. (Please refer to the Non-GAAP Reconciliation table for details on the earnings impact of merger related expenses and additional income tax expense related to the Tax Cuts and Jobs Act).

These results reflect the following events:

- Total assets, loans and deposits grew by 52%, 52% and 48%, respectively compared to the prior year primarily as a result of the acquisition.
- First quarter results reflected an annualized return on average assets of 1.12% and annualized return on average equity of 8.70% as compared to 1.20% and 11.45% respectively for the first quarter of 2017. Exclusive of merger costs on an after tax basis, the return on average assets and return on average equity would have been 1.47% and 11.40%, respectively.
- The net interest margin was 3.58% for the first quarter of 2018, compared to 3.51% for the first quarter of 2017 and 3.57% for the fourth quarter of 2017. The fourth quarter's interest margin would have been 3.53% after excluding the recovery of interest income from a previously charged-off loan.

- Pre-tax merger expenses recognized in the first quarter of 2018 totaled \$9.0 million compared to \$2.9 million recognized in the fourth quarter of 2017.
- The effective tax rate for the current quarter was 23.6% compared to 33.5% for the same quarter of the prior year.
- Tangible book value declined 5% at the end of the first quarter to \$19.12 per share as compared to \$20.18 at the end of 2017 as a result of the acquisition.
- The Non-GAAP efficiency ratio which excludes merger costs was 49.54% for the current quarter as compared to 54.78% for the first quarter of 2017 and 55.69% for the fourth quarter of 2017.

The local economy continues to exhibit positive trends such as low unemployment and increased housing starts; however, these trends have been tempered by other concerns such as the lack of wage growth, deficit growth and geo-political turmoil. These factors, in concert, have acted to continue to restrict the pace of economic expansion and create volatility in global economic markets. Additionally, rising interest rates continue to restrain confidence among individual consumers and small and mid-sized businesses. Despite this mixed economic environment, management remains optimistic that the regional economy will present further growth opportunities for the Company.

Total assets at March 31, 2018 increased 52% compared to December 31, 2017 driven by earning asset balances that increased 48% during this period due to the acquisition. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 47% compared to balances at December 31, 2017 due to the WashingtonFirst transaction. The increase in customer funding sources was driven primarily by increases of 36% in noninterest-bearing and interest-bearing transaction accounts. Liquidity continues to remain 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. As a result of the acquisition and a lesser extent from retained earnings, stockholders' equity increased \$470 million over the preceding twelve months.

Non-performing loans (which excludes purchased credit impaired loans) represented 0.48% of total loans at March 31, 2018 compared to 0.77% at March 31, 2017 as a result of the growth in the loan portfolio. The Company's non-performing loans were \$29.4 million at March 31, 2018 compared to \$30.9 million at March 31, 2017. The ratio of annualized net charge-offs to average loans was 0.02% for the first quarter of 2018 compared to 0.04% for the prior year quarter.

Net interest income for the first quarter of 2018 increased 56% compared to the first quarter of 2017 as a result of the WashingtonFirst acquisition and, to a lesser extent, the Company's organic loan growth during the period. The net interest margin improved to 3.58% for the first quarter of 2018 compared to 3.51% for the first quarter of 2017.

The provision for loan losses was \$2.0 million for the first quarter of 2018 compared to \$0.2 million for the first quarter of 2017. The current quarter's increase to the provision reflects the impact of organic loan growth during the current quarter.

Non-interest income increased 36% for the first quarter of 2018 as compared to the first quarter of 2017. This increase was driven by proceeds from BOLI life insurance policies and mortgage banking activities. The increase in mortgage banking activities is attributable to increases origination volume associated with mortgage lending operations acquired as part of the acquisition.

Non-interest expenses increased 66% to \$49.6 million for the first quarter of 2018 compared to \$30.0 million in the first quarter of 2017. The increase in non-interest expense excluding merger expenses was 36%, primarily in compensation and facility costs. The non-GAAP efficiency ratio was 49.54% for the first quarter of 2018 compared to 54.78% for the first quarter of 2017 as a result of the growth in net interest income.

The recently enacted tax legislation resulted in a significant tax rate reduction. This reduction has provided a net income benefit in the current quarter and this benefit will continue to affect future periods. The resultant effective tax rate at March 31, 2018 was 23.6% as compared to 33.5% at March 31, 2017.



**Results of Operations****For the Three Months Ended March 31, 2018 Compared to the Three Months Ended March 31, 2017**

Net income for the Company for the first quarter of 2018 totaled \$21.7 million (\$0.61 per diluted share) compared to net income of \$15.1 million (\$0.63 per diluted share) for the first quarter of 2017.

**Net Interest Income**

Net interest income for the first quarter of 2018 was \$62.9 million compared to \$40.3 million for the first quarter of 2017. On a tax-equivalent basis, net interest income for the first quarter of 2018 was \$64.0 million compared to \$42.0 million for the first quarter of 2017, an increase of 52%. The increase in the net interest income is the result of the acquisition and, to a lesser degree, the Company's organic earning asset growth during the period. The following table provides an analysis of net interest income performance that reflects a net interest margin that has increased to 3.58% for the first quarter of 2018 compared to 3.51% for the first quarter of 2017. The net interest margin for the current quarter was reduced by approximately 5 basis points as a result of the reduction in the tax rate from the recently enacted tax legislation.

The amortization of the fair value adjustments to both interest-earning assets and interest-bearing liabilities directly attributable to the acquisition had a positive effect on net interest margin for the current period. The amortization of the fair value adjustments is estimated to be 9 basis points on an annual basis. This estimate could be affected by prepayments in the acquired loan portfolio. The impact of the amortization on the net interest income for the current quarter is presented in the following table:

| <i>(In thousands)</i>                                                             | <b>Three Months Ended<br/>March 31, 2018</b> |         |
|-----------------------------------------------------------------------------------|----------------------------------------------|---------|
| <b>Net Interest Income Excluding Purchase Accounting Adjustments:</b>             |                                              |         |
| Net Interest Income                                                               | \$                                           | 62,891  |
| Amortization of loan interest rate fair value adjustment                          |                                              | 1,182   |
| Accretion of loan credit fair value adjustment on pools of homogeneous loans      |                                              | (2,269) |
| Accretion of loan credit fair value adjustment on purchased credit impaired loans |                                              | (341)   |
| Accretion of fair value adjustment on certificates of deposits                    |                                              | (767)   |
| Accretion of fair value adjustment on subordinated debentures                     |                                              | (34)    |
| Net Interest Income Excluding Purchase Accounting Adjustments                     | \$                                           | 60,662  |

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

|                                                   | 2018                |                 | Three Months Ended March 31,        |                     | 2017     |
|---------------------------------------------------|---------------------|-----------------|-------------------------------------|---------------------|----------|
|                                                   | Average<br>Balances | (1)<br>Interest | Annualized<br>Average<br>Yield/Rate | Average<br>Balances |          |
| <i>(Dollars in thousands and tax-equivalent)</i>  |                     |                 |                                     |                     |          |
| <b>Assets</b>                                     |                     |                 |                                     |                     |          |
| Residential mortgage loans                        | \$1,117,478         | \$10,381        | 3.72%                               | \$ 847,896          | \$ 7,348 |
| Residential construction loans                    | 193,327             | 1,844           | 3.87                                | 157,152             | 1,436    |
| Total mortgage loans                              | 1,310,805           | 12,225          | 3.74                                | 1,005,048           | 8,784    |
| Commercial AD&C loans                             | 582,876             | 8,136           | 5.66                                | 310,325             | 3,654    |
| Commercial investor real estate loans             | 1,988,340           | 23,428          | 4.78                                | 945,080             | 10,419   |
| Commercial owner occupied real estate loans       | 940,065             | 10,578          | 4.56                                | 774,964             | 9,028    |
| Commercial business loans                         | 657,372             | 8,049           | 4.97                                | 462,444             | 5,007    |
| Total commercial loans                            | 4,168,653           | 50,191          | 4.88                                | 2,492,813           | 28,108   |
| Consumer loans                                    | 538,198             | 5,546           | 4.24                                | 458,162             | 3,930    |
| Total loans (2)                                   | 6,017,656           | 67,962          | 4.57                                | 3,956,023           | 40,822   |
| Loans held for sale                               | 35,768              | 368             | 4.12                                | 7,402               | 82       |
| Taxable securities                                | 761,392             | 5,267           | 2.77                                | 533,577             | 3,735    |
| Tax-exempt securities (3)                         | 300,933             | 2,622           | 3.49                                | 284,710             | 3,021    |
| Total investment securities                       | 1,062,325           | 7,889           | 2.97                                | 818,287             | 6,756    |
| Interest-bearing deposits with banks              | 93,241              | 357             | 1.55                                | 45,397              | 90       |
| Federal funds sold                                | 3,888               | 13              | 1.32                                | 2,099               | 4        |
| Total interest-earning assets                     | 7,212,878           | 76,589          | 4.29                                | 4,829,208           | 47,754   |
| Less: allowance for loan losses                   | (45,673)            |                 |                                     | (43,728)            |          |
| Cash and due from banks                           | 76,965              |                 |                                     | 48,820              |          |
| Premises and equipment, net                       | 60,143              |                 |                                     | 53,649              |          |
| Other assets                                      | 537,298             |                 |                                     | 223,749             |          |
| <b>Total assets</b>                               | <b>\$7,841,611</b>  |                 |                                     | <b>\$5,111,698</b>  |          |
| <b>Liabilities and Stockholders' Equity</b>       |                     |                 |                                     |                     |          |
| Interest-bearing demand deposits                  | \$ 758,305          | 204             | 0.11%                               | \$ 610,047          | 114      |
| Regular savings deposits                          | 468,651             | 301             | 0.26                                | 315,465             | 49       |
| Money market savings deposits                     | 1,380,380           | 3,127           | 0.92                                | 990,103             | 778      |
| Time deposits                                     | 1,231,121           | 3,327           | 1.10                                | 598,401             | 1,547    |
| Total interest-bearing deposits                   | 3,838,457           | 6,959           | 0.74                                | 2,514,016           | 2,488    |
| Other borrowings                                  | 139,610             | 108             | 0.31                                | 128,486             | 76       |
| Advances from FHLB                                | 1,101,282           | 5,078           | 1.87                                | 730,833             | 3,129    |
| Subordinated debentures                           | 37,555              | 468             | 4.99                                | 1,667               | 12       |
| Total interest-bearing liabilities                | 5,116,904           | 12,613          | 1.00                                | 3,375,002           | 5,705    |
| Noninterest-bearing demand deposits               | 1,651,258           |                 |                                     | 1,159,715           |          |
| Other liabilities                                 | 63,343              |                 |                                     | 41,673              |          |
| Stockholders' equity                              | 1,010,106           |                 |                                     | 535,308             |          |
| <b>Total liabilities and stockholders' equity</b> | <b>\$7,841,611</b>  |                 |                                     | <b>\$5,111,698</b>  |          |

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|                                 |                 |              |          |
|---------------------------------|-----------------|--------------|----------|
| Net interest income and spread  | <b>63,976</b>   | <b>3.29%</b> | 42,049   |
| Less: tax-equivalent adjustment | <b>1,085</b>    |              | 1,796    |
| Net interest income             | <b>\$62,891</b> |              | \$40,253 |
| Interest income/earning assets  |                 | <b>4.29%</b> |          |
| Interest expense/earning assets |                 | <b>0.71</b>  |          |
| Net interest margin             |                 | <b>3.58%</b> |          |

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 26.13% and 39.88% for 2018 and 2017, respectively. The annualized taxable-equivalent

adjustments utilized in the above table to compute yields aggregated to \$1.1 million and \$1.8 million in 2018 and 2017, respectively.

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

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

## **Interest Income**

The Company's total tax-equivalent interest income increased 60% for the first quarter of 2018 compared to the prior year quarter. The previous table reflects the growth in the various categories of interest-earning assets due primarily to the acquisition and, to a lesser degree, organic loan and investment portfolio growth during the previous twelve months.

The average balance of the loan portfolio increased 52% for the first quarter of 2018 compared to the prior year period. The significant amount of growth was concentrated in the commercial real estate loan portfolios. The loan portfolio from the acquisition was similar in composition to the Company's loan portfolio. The yield on average loans increased by 40 basis points compared to the prior year quarter. The increase in the yield on loans was the primary driver of the 30 basis point rise in the yield on interest-earning assets from period to period.

The average yield on total investment securities decreased 33 basis points while the average balance of the investment portfolio increased 30% for the first quarter of 2018 compared to the first quarter of 2017. The decrease in the yield on investments was driven by the impact on the tax-exempt securities as a direct result of the recently enacted tax legislation. This resulted in the 75 basis point decline in the yield on these investments while the average size of the portfolio only increased 6% from period to period.

Average deposits increased 49% in the first quarter of 2018 compared to the first quarter of 2017. While the majority of the increase from period to period was due to the acquisition, during 2017, the Company had increased rates on various categories of deposits to maintain deposit relationship and fund loan growth during the period. Most of the increase occurred in time and noninterest-bearing deposits which increased 106% and 42%, respectively. Deposits and borrowings both experienced rate increases as funding costs rose during the previous twelve months. The average rate on deposits rose 34 basis points and the average rate on borrowings rose 27 basis points from the prior year quarter to the current year. These increases caused the average rate on interest-bearing liabilities to rise 31 basis points from period to period.

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

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

| <i>(Dollars in thousands and tax equivalent)</i>      | 2018 vs. 2017    |                  |               | 2017 vs. 2016   |                  |               |
|-------------------------------------------------------|------------------|------------------|---------------|-----------------|------------------|---------------|
|                                                       | Increase         | Due to Change In |               | Increase        | Due to Change In |               |
|                                                       | Or               | Average:*        |               | Or              | Average:*        |               |
|                                                       | (Decrease)       | Volume           | Rate          | (Decrease)      | Volume           | Rate          |
| <b>Interest income from earning assets:</b>           |                  |                  |               |                 |                  |               |
| Residential mortgage loans                            | \$ 3,033         | \$ 2,473         | \$ 560        | \$ 480          | \$ 340           | \$ 140        |
| Residential construction loans                        | 408              | 344              | 64            | 241             | 195              | 46            |
| Commercial AD&C loans                                 | 4,482            | 3,697            | 785           | 656             | 553              | 103           |
| Commercial investor real estate loans                 | 13,009           | 12,240           | 769           | 1,807           | 2,081            | (274)         |
| Commercial owner occupied real estate loans           | 1,550            | 1,865            | (315)         | 943             | 1,084            | (141)         |
| Commercial business loans                             | 3,042            | 2,316            | 726           | (6)             | (3)              | (3)           |
| Consumer loans                                        | 1,616            | 751              | 865           | 41              | 35               | 6             |
| Loans held for sale                                   | 286              | 292              | (6)           | (52)            | (70)             | 18            |
| Taxable securities                                    | 1,532            | 1,572            | (40)          | 322             | 65               | 257           |
| Tax exempt securities                                 | (399)            | 159              | (558)         | (35)            | (21)             | (14)          |
| Interest-bearing deposits with banks                  | 267              | 141              | 126           | 37              | 4                | 33            |
| Federal funds sold                                    | 9                | 5                | 4             | 3               | 2                | 1             |
| <b>Total interest income</b>                          | <b>28,835</b>    | <b>25,855</b>    | <b>2,980</b>  | <b>4,437</b>    | <b>4,265</b>     | <b>172</b>    |
| <b>Interest expense on funding of earning assets:</b> |                  |                  |               |                 |                  |               |
| Interest-bearing demand deposits                      | 90               | 35               | 55            | 6               | 6                | -             |
| Regular savings deposits                              | 252              | 32               | 220           | 7               | 7                | -             |
| Money market savings deposits                         | 2,349            | 408              | 1,941         | 341             | 50               | 291           |
| Time deposits                                         | 1,780            | 1,703            | 77            | 297             | 181              | 116           |
| Other borrowings                                      | 32               | 7                | 25            | 10              | 10               | -             |
| Advances from FHLB                                    | 1,949            | 1,699            | 250           | (245)           | 231              | (476)         |
| Subordinated debentures                               | 456              | 441              | 15            | (242)           | (240)            | (2)           |
| <b>Total interest expense</b>                         | <b>6,908</b>     | <b>4,325</b>     | <b>2,583</b>  | <b>174</b>      | <b>245</b>       | <b>(71)</b>   |
| <b>Net interest income</b>                            | <b>\$ 21,927</b> | <b>\$ 21,530</b> | <b>\$ 397</b> | <b>\$ 4,263</b> | <b>\$ 4,020</b>  | <b>\$ 243</b> |

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

### Non-interest Income

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

| <i>(Dollars in thousands)</i>         | Three Months Ended March 31, 2018/2017 |           |           | 2018/2017 |
|---------------------------------------|----------------------------------------|-----------|-----------|-----------|
|                                       | 2018                                   | 2017      | \$ Change | % Change  |
| Securities gains                      | \$ 63                                  | \$ 2      | \$ 61     | n.m. %    |
| Service charges on deposit accounts   | 2,259                                  | 1,964     | 295       | 15.0      |
| Mortgage banking activities           | 2,207                                  | 608       | 1,599     | n.m.      |
| Wealth management income              | 5,061                                  | 4,484     | 577       | 12.9      |
| Insurance agency commissions          | 1,824                                  | 1,752     | 72        | 4.1       |
| Income from bank owned life insurance | 2,331                                  | 594       | 1,737     | n.m.      |
| Bank card fees                        | 1,370                                  | 1,145     | 225       | 19.7      |
| Other income                          | 2,003                                  | 2,083     | (80)      | (3.8)     |
| Total non-interest income             | \$ 17,118                              | \$ 12,632 | \$ 4,486  | 35.5      |

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Total non-interest income was \$17.1 million for the first quarter of 2018 compared to \$12.6 million for the first quarter of 2017, an increase of 36%. The current quarter included \$1.6 million in BOLI life insurance proceeds. Exclusive of these proceeds, the growth in non-interest income for the quarter would have been 23% or \$2.8 million compared to the prior year quarter. The majority of this increase was derived from mortgage banking activities and, to a lesser extent, wealth management income and bank card fees. Further detail by type of non-interest income follows:

- Income from mortgage banking activities increased by \$1.6 million in the first three months of 2018 as compared to the first three months of 2017. The increase in mortgage banking activities is attributable to the increased origination volume associated with the mortgage lending operations acquired as part of the acquisition.
- 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 12% for the first three months of 2018 compared to the prior year period due to growth in assets under management. Investment management fees in West Financial Services increased 14% for the first three months of 2018 compared to the same period of 2017, also due to an increase in assets under management. Overall total assets under management increased to \$2.9 billion at March 31, 2018 compared to \$2.5 billion at March 31, 2017 due to positive market movements and additions from new and existing clients.
- BOLI life insurance income rose during the current quarter compared to the prior year quarter primarily due to the receipt of \$1.6 million in mortality proceeds.
- Insurance agency commissions increased 4% for the current quarter compared to the prior year quarter.
- Bank card income grew 20% in the first quarter of 2018 compared to the first quarter of 2017 as transaction volume increased from the prior year.

## Non-interest Expense

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

| <i>(Dollars in thousands)</i>     | Three Months Ended March 31, |           | 2018/2017 | 2018/2017 |
|-----------------------------------|------------------------------|-----------|-----------|-----------|
|                                   | <b>2018</b>                  | 2017      | \$ Change | % Change  |
| Salaries and employee benefits    | \$ <b>23,912</b>             | \$ 17,801 | \$ 6,111  | 34.3 %    |
| Occupancy expense of premises     | <b>4,942</b>                 | 3,402     | 1,540     | 45.3      |
| Equipment expenses                | <b>2,225</b>                 | 1,724     | 501       | 29.1      |
| Marketing                         | <b>1,148</b>                 | 663       | 485       | 73.2      |
| Outside data services             | <b>1,397</b>                 | 1,392     | 5         | 0.4       |
| FDIC insurance                    | <b>1,193</b>                 | 805       | 388       | 48.2      |
| Amortization of intangible assets | <b>541</b>                   | 26        | 515       | n.m.      |
| Merger expenses                   | <b>8,958</b>                 | -         | 8,958     | n.m.      |
| Professional fees                 | <b>1,040</b>                 | 955       | 85        | 8.9       |

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|                            |    |               |    |        |    |        |  |      |
|----------------------------|----|---------------|----|--------|----|--------|--|------|
| Other real estate owned    |    | <b>38</b>     |    | 5      |    | 33     |  | n.m. |
| Other expense              |    | <b>4,247</b>  |    | 3,208  |    | 1,039  |  | 32.4 |
| Total non-interest expense | \$ | <b>49,641</b> | \$ | 29,981 | \$ | 19,660 |  | 65.6 |
|                            |    | 43            |    |        |    |        |  |      |

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Non-interest expenses increased 66% to \$49.6 million for the first quarter of 2018 compared to \$30.0 million in the first quarter of 2017. The current quarter included \$9.0 million in merger expense related to the acquisition. The increase in non-interest expense excluding merger expenses was 36%, primarily driven by higher compensation and occupancy costs. These costs reflect the increase in staffing for the additional branch and business unit locations resulting from the acquisition. Further detail by category of non-interest expense follows:

- Salaries and employee benefits, the largest component of non-interest expenses, increased 34% in the first quarter of 2018 due to the increase in the average number of full-time equivalent employees which increased to 921 in the first quarter of 2018 compared to 727 in the first quarter of 2017.
- Occupancy and equipment expense increased as a result of the impact from additional acquired branches and business offices.
- Focused customer driven initiatives and media campaigns were the primary drivers of the 73% increase in marketing expense for the current quarter.
- FDIC insurance expense increased due to growth in the commercial loan portfolio.
- Core deposit intangible amortization associated with the acquisition resulted in a \$0.5 million increase from the prior year quarter.
- Merger expenses encompass various categories of expenses related to personnel decisions, systems conversions, professional fees and directly related expenses that are considered to be outside the normal day-to-day operating expenses on a prospective basis.

## Income Taxes

The Company had income tax expense of \$6.7 million in the first quarter of 2018, compared to income tax expense of \$7.6 million in the first quarter of 2017. The resultant effective tax rate was 23.6% for the first quarter of 2018 compared to 33.5% for the first quarter of 2017. The recently enacted tax legislation resulted in the significant tax rate reduction. The rate reduction provides a net income benefit in the current quarter and will continue to benefit future periods.

## 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 the amortization of intangibles, merger expenses and, if applicable, other non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Condensed Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. The GAAP efficiency ratio in the first quarter of 2018 compared to the first quarter of 2017 was adversely affected by the inclusion of merger expenses included in non-interest expenses despite the significant growth in net interest income. Conversely, the exclusion of the merger expenses, in addition to the traditional exclusions, reflected a significant improvement in the non-GAAP efficiency ratio in the current period compared to the prior year period.

In addition, the Company uses pre-tax, pre-provision income, excluding merger expenses, as a measure of the level of recurring income before taxes. Management believes this provides financial statement users with a useful metric of the run-rate of revenues and expenses which is readily comparable to other financial institutions. This measure is calculated by adding the provision for loan losses, merger expenses and the provision for income taxes back to net income. This metric increased in the first quarter of 2018 compared to the first quarter of 2017 primarily due to an increase in net interest income.

| <i>(Dollars in thousands)</i>                                           | <b>March 31,<br/>2018</b> | Three Months Ended<br>December 31,<br>2017 | March 31,<br>2017 |
|-------------------------------------------------------------------------|---------------------------|--------------------------------------------|-------------------|
| <b>Pre-tax pre-provision income:</b>                                    |                           |                                            |                   |
| Net income                                                              | \$ 21,665                 | \$ 8,267                                   | \$ 15,112         |
| Plus non-GAAP adjustment:                                               |                           |                                            |                   |
| Merger expenses                                                         | 8,958                     | 2,920                                      | -                 |
| Income taxes                                                            | 6,706                     | 11,933                                     | 7,598             |
| Provision for loan and lease losses                                     | 1,997                     | 527                                        | 194               |
| Pre-tax pre-provision income                                            | \$ 39,326                 | \$ 23,647                                  | \$ 22,904         |
| <b>Efficiency ratio - GAAP basis:</b>                                   |                           |                                            |                   |
| Non-interest expenses                                                   | \$ 49,641                 | \$ 35,059                                  | \$ 29,981         |
| Net interest income plus non-interest income                            | \$ 80,009                 | \$ 55,786                                  | \$ 52,885         |
| <b>Efficiency ratio - GAAP basis</b>                                    | <b>62.04%</b>             | 62.85%                                     | 56.69%            |
| <b>Efficiency ratio - Non-GAAP basis:</b>                               |                           |                                            |                   |
| Non-interest expenses                                                   | \$ 49,641                 | \$ 35,059                                  | \$ 29,981         |
| Less non-GAAP adjustment:                                               |                           |                                            |                   |
| Amortization of intangible assets                                       | 541                       | 25                                         | 26                |
| Merger expenses                                                         | 8,958                     | 2,920                                      | -                 |
| Non-interest expenses - as adjusted                                     | \$ 40,142                 | \$ 32,114                                  | \$ 29,955         |
| Net interest income plus non-interest income                            | \$ 80,009                 | \$ 55,786                                  | \$ 52,885         |
| Plus non-GAAP adjustment:                                               |                           |                                            |                   |
| Tax-equivalent income                                                   | 1,085                     | 1,874                                      | 1,796             |
| Less non-GAAP adjustments:                                              |                           |                                            |                   |
| Securities gains                                                        | 63                        | (2)                                        | 2                 |
| Net interest income plus non-interest income - as adjusted              | \$ 81,031                 | \$ 57,662                                  | \$ 54,679         |
| <b>Efficiency ratio - Non-GAAP basis</b>                                | <b>49.54%</b>             | 55.69%                                     | 54.78%            |
| <b>Supplemental Non-GAAP Performance Measurements:</b>                  |                           |                                            |                   |
| Net income - GAAP                                                       | \$ 21,665                 | \$ 8,267                                   | \$ 15,112         |
| Merger expenses - net of tax                                            | 6,719                     | 1,756                                      | -                 |
| Income taxes - Incremental impact of revaluation of deferred tax assets | -                         | 5,544                                      | -                 |
| Net income - Non-GAAP                                                   | \$ 28,384                 | \$ 15,567                                  | \$ 15,112         |
| Diluted net income per share - Non-GAAP                                 | \$ 0.80                   | 0.64                                       | 0.63              |
| Return on average assets - Non-GAAP                                     | 1.47%                     | 1.16%                                      | 1.20%             |
| Return on average common equity - Non-GAAP                              | 11.40%                    | 10.96%                                     | 11.45%            |

## Analysis of Loans

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

| <i>(Dollars in thousands)</i>         | <b>March 31, 2018</b> |               | December 31, 2017 |        | Period-to-Period<br>Change |      |
|---------------------------------------|-----------------------|---------------|-------------------|--------|----------------------------|------|
|                                       | <b>Amount</b>         | <b>%</b>      | Amount            | %      | Amount                     | %    |
| <b>Residential real estate:</b>       |                       |               |                   |        |                            |      |
| Residential mortgage                  | <b>\$ 992,287</b>     | <b>16.4%</b>  | \$ 921,435        | 21.4%  | \$ 70,852                  | 7.7% |
| Residential construction              | <b>215,445</b>        | <b>3.5</b>    | 176,687           | 4.1    | 38,758                     | 21.9 |
| <b>Commercial real estate:</b>        |                       |               |                   |        |                            |      |
| Commercial owner occupied real estate | <b>1,174,739</b>      | <b>19.4</b>   | 857,196           | 19.9   | 317,543                    | 37.0 |
| Commercial investor real estate       | <b>1,928,439</b>      | <b>31.8</b>   | 1,112,710         | 25.8   | 815,729                    | 73.3 |
| Commercial AD&C                       | <b>564,871</b>        | <b>9.3</b>    | 292,443           | 6.8    | 272,428                    | 93.2 |
| Commercial business                   | <b>652,797</b>        | <b>10.8</b>   | 497,948           | 11.5   | 154,849                    | 31.1 |
| Consumer                              | <b>532,973</b>        | <b>8.8</b>    | 455,829           | 10.5   | 77,144                     | 16.9 |
| <b>Total loans</b>                    | <b>\$6,061,551</b>    | <b>100.0%</b> | \$4,314,248       | 100.0% | \$1,747,303                | 40.5 |

Total loans, excluding loans held for sale, increased 41% at March 31, 2018 compared to December 31, 2017. The commercial loan portfolio increased 57% during the quarter driven by an increase in each category of commercial loans. The mortgage and consumer loan portfolios also reflect significant growth. The vast majority of the increase in these individual portfolios was due to the acquisition. Organic loan growth was 3% from December 31, 2017 through March 31, 2018. The composition of the acquired loan portfolio was comparable to the Company's and did not cause a significant redistribution of the Company's pre-acquisition portfolio.

## Analysis of Investment Securities

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

| <i>(Dollars in thousands)</i>              | <b>March 31, 2018</b> |              | December 31, 2017 |       | Period-to-Period<br>Change |        |
|--------------------------------------------|-----------------------|--------------|-------------------|-------|----------------------------|--------|
|                                            | <b>Amount</b>         | <b>%</b>     | Amount            | %     | Amount                     | %      |
| <b>Investments available-for-sale:</b>     |                       |              |                   |       |                            |        |
| U.S. government agencies and corporations  | <b>\$ 208,304</b>     | <b>20.0%</b> | \$ 106,568        | 13.8% | \$ 101,736                 | 95.5%  |
| State and municipal                        | <b>330,546</b>        | <b>31.8</b>  | 312,253           | 40.3  | 18,293                     | 5.9    |
| Mortgage-backed                            | <b>428,144</b>        | <b>41.1</b>  | 300,040           | 38.7  | 128,104                    | 42.7   |
| Corporate debt                             | <b>9,352</b>          | <b>0.9</b>   | 9,432             | 1.2   | (80)                       | (0.8)  |
| Trust preferred                            | <b>310</b>            | <b>-</b>     | 1,002             | 0.1   | (692)                      | (69.1) |
| Marketable equity securities               | <b>568</b>            | <b>0.1</b>   | 212               | -     | 356                        | 167.9  |
| <b>Total available-for-sale securities</b> | <b>977,224</b>        | <b>93.9</b>  | 729,507           | 94.1  | 247,717                    | 34.0   |

**Investments held-to-maturity and other equity:**

|                                         |                    |               |            |        |            |      |
|-----------------------------------------|--------------------|---------------|------------|--------|------------|------|
| Other equity securities                 | <b>63,115</b>      | <b>6.1</b>    | 45,518     | 5.9    | 17,597     | 38.7 |
| Total held-to-maturity and other equity | <b>63,115</b>      | <b>6.1</b>    | 45,518     | 5.9    | 17,597     | 38.7 |
| <b>Total securities</b>                 | <b>\$1,040,339</b> | <b>100.0%</b> | \$ 775,025 | 100.0% | \$ 265,314 | 34.2 |

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. As a result of the acquisition, the portfolio increased 34% at March 31, 2018 compared to December 31, 2017. An effect of this growth was a shift in the allocation of the portfolio to a greater proportion being placed in U.S. government agencies and corporation securities. Recent tax legislation has had an impact on the tax advantages associated earnings streams from state and municipal securities. The Company intends to continue to retain a significant portion of the portfolio in these securities.

The Company considers the duration of the portfolio to be adequate for liquidity purposes. This investment strategy has resulted in a portfolio with low credit risk that would provide the liquidity necessary to meet loan demand. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis. The duration of the portfolio was 3.8 years at March 31, 2018 and 3.7 years at December 31, 2017. This increase in the duration is directly attributable to flattening of the yield curve.

## Other Earning Assets

Residential mortgage loans held for sale were \$28 million at March 31, 2018 compared to \$10 million at December 31, 2017 due to the effect of the timing of loan sales on the amounts held for sale at quarter end. The aggregate of federal funds sold and interest-bearing deposits with banks increased by \$99 million to \$155 million at March 31, 2018 compared to December 31, 2017 due to the timing of cash flows.

## Deposits

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

| <i>(Dollars in thousands)</i>        | March 31, 2018      |               | December 31, 2017   |               | Period-to-Period Change |             |
|--------------------------------------|---------------------|---------------|---------------------|---------------|-------------------------|-------------|
|                                      | Amount              | %             | Amount              | %             | Amount                  | %           |
| Noninterest-bearing deposits         | \$ 1,767,523        | 31.4%         | \$ 1,264,392        | 31.9%         | \$ 503,131              | 39.8%       |
| Interest-bearing deposits:           |                     |               |                     |               |                         |             |
| Demand                               | 750,899             | 13.3          | 658,716             | 16.6          | 92,183                  | 14.0        |
| Money market savings                 | 1,544,580           | 27.5          | 1,030,432           | 26.0          | 514,148                 | 49.9        |
| Regular savings                      | 357,601             | 6.4           | 321,171             | 8.1           | 36,430                  | 11.3        |
| Time deposits of less than \$100,000 | 378,428             | 6.7           | 293,201             | 7.4           | 85,227                  | 29.1        |
| Time deposits of \$100,000 or more   | 828,175             | 14.7          | 395,750             | 10.0          | 432,425                 | 109.3       |
| Total interest-bearing deposits      | 3,859,683           | 68.6          | 2,699,270           | 68.1          | 1,160,413               | 43.0        |
| <b>Total deposits</b>                | <b>\$ 5,627,206</b> | <b>100.0%</b> | <b>\$ 3,963,662</b> | <b>100.0%</b> | <b>\$ 1,663,544</b>     | <b>42.0</b> |

## Deposits and Borrowings

Total deposits increased \$1.7 billion or 42% at March 31, 2018 compared to December 31, 2017. This increase was due primarily from deposits acquired with the WashingtonFirst transaction. Organic deposit growth during this time period was 1%. The acquisition did not significantly alter the relative composition between the product lines. Interest-bearing deposits represented 69% with the remaining 31% in noninterest-bearing balances at March 31, 2018. This compares to 68% and 32% for interest-bearing and noninterest-bearing balances December 31, 2017. Total borrowings increased 35% at March 31, 2018 compared to December 31, 2017 primarily in advances from the FHLB and the subordinated debentures of \$38 million as a result of the acquisition.

## Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. Total stockholders' equity was \$1.0 billion at March 31, 2018 compared to \$564 million at December 31, 2017. The growth in stockholders' equity was the result of the \$447 million in equity issued in connection with the acquisition in addition to net income during the period exceeding the payment of dividends. The ratio of average equity to average assets was 12.88% for the three months ended March 31, 2018, as compared to 10.47% for the first three months of

2017.

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

### Risk-Based Capital Ratios

|                                        | <b>March 31, 2018</b> | Ratios at<br>December 31, 2017 | Minimum<br>Regulatory<br>Requirements |
|----------------------------------------|-----------------------|--------------------------------|---------------------------------------|
| Total capital to risk-weighted assets  | <b>12.27%</b>         | 11.85%                         | 8.00%                                 |
| Tier 1 capital to risk-weighted assets | <b>11.08%</b>         | 10.84%                         | 6.00%                                 |
| Common equity tier 1 capital           | <b>10.92%</b>         | 10.84%                         | 4.50%                                 |
| Tier 1 leverage                        | <b>9.21%</b>          | 9.24%                          | 4.00%                                 |

As of March 31, 2018, 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.

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**

| <i>(Dollars in thousands, except per share data)</i> | <b>March 31, 2018</b> | December 31,<br>2017 |
|------------------------------------------------------|-----------------------|----------------------|
| <b>Tangible common equity ratio:</b>                 |                       |                      |
| Total stockholders' equity                           | \$ 1,014,608          | \$ 563,816           |
| Accumulated other comprehensive loss                 | 17,618                | 6,857                |
| Goodwill                                             | (342,907)             | (85,768)             |
| Other intangible assets, net                         | (11,408)              | (580)                |
| Tangible common equity                               | \$ 677,911            | \$ 484,325           |
| <br>                                                 |                       |                      |
| Total assets                                         | \$ 7,894,918          | \$ 5,446,675         |
| Goodwill                                             | (342,907)             | (85,768)             |
| Other intangible assets, net                         | (11,408)              | (580)                |
| Tangible assets                                      | \$ 7,540,603          | \$ 5,360,327         |
| <br>                                                 |                       |                      |
| Tangible common equity ratio                         | 8.99%                 | 9.04%                |
| <br>                                                 |                       |                      |
| Tangible book value per share                        | \$ 19.12              | \$ 20.18             |

**Credit Risk**

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

Loans acquired with evidence of credit deterioration since their origination as of the date of the acquisition are recorded at their initial fair value. Credit deterioration is determined based on the probability of collection of all contractually required principal and interest payments. These loans are not considered non-performing for reporting

purposes but are managed and monitored in the same manner and using the same techniques and strategies as organically generated loans. In accordance with GAAP, the historical allowance for loan losses related to the acquired loans is not carried over to the Company. The following credit related sections should be read in conjunction with the section “Loans Acquired with Deteriorated Credit Quality” in “Note 1 – Significant Accounting Policies” of the Notes to the Condensed Consolidated Financial Statements.



Total non-performing loans increased to \$29.4 million at March 31, 2018 compared to the balance at December 31, 2017. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by the conditions being experienced in various business sectors of the economy on both a regional and national level.

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

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

The methodology for assessing the appropriateness of the allowance includes: (1) a general allowance that reflects historical losses supplemented by qualitative factors, as adjusted, by credit category, and (2) a specific allowance for impaired credits on an individual or portfolio basis. 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 first applied to the remaining principal balance of the loans. Any additional recoveries are credited to the allowance. Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific allowance on an impaired loan is warranted and, when losses are confirmed, a charge-off is taken to reduce the loan to its net realizable value. Any further collateral deterioration results in either further specific allowances being established or additional charge-offs. When additional deterioration becomes apparent, an action plan is developed for the particular loan and an appraisal will be obtained depending on the time elapsed since the prior appraisal, the loan balance and/or the result of the internal evaluation. A current appraisal on large loans is usually obtained if the appraisal on file is more than 12 months old and there has been a material change in market conditions, zoning, physical use or the adequacy of the collateral based on an internal evaluation. The Company's policy is to strictly adhere to regulatory appraisal standards. If an appraisal is ordered, no more than a 30 day turnaround is requested from the appraiser, who is selected by Credit Administration from an approved appraiser list. After receipt of the updated appraisal, the assigned credit officer will recommend to the Chief Credit Officer whether a specific allowance or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to ensure that there are no significant time lapses

during this process.

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

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

- An internal evaluation is updated quarterly to include borrower financial statements and/or cash flow projections.

- The borrower may be contacted for a meeting to discuss an updated or revised action plan which may include a request for additional collateral.
- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.
- At the monthly credit committee meeting the loan may be downgraded and a specific allowance may be decided upon in advance of the receipt of the appraisal.
- Upon receipt of the updated appraisal (or based on an updated internal financial evaluation) the loan balance is compared to the appraisal and a specific allowance is decided upon for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal net of closing costs.

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

Loans 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 the borrower is no longer experiencing financial difficulty, a re-underwriting event took place and the revised loan terms of the subsequent restructuring agreement are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk.

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

are not affecting the performance of the credit or other identified weakness may be extended.

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

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

The Company makes provisions for loan losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology previously discussed. The provision for loan losses was \$2.0 million in the first three months of 2018 compared to \$0.2 million in the first three months of 2017. The increase in the provision in the first three months of 2018 reflects the impact of organic loan growth during the first quarter of 2018.



The Company typically sells a substantial portion of its fixed-rate residential mortgage originations in the secondary mortgage market. Concurrent with such sales, the Company is required to make customary representations and warranties to the purchasers about the mortgage loans and the manner in which they were originated. The related sale agreements grant the purchasers recourse back to the Company, which could require the Company to repurchase loans or to share in any losses incurred by the purchasers. This recourse exposure typically extends for a period of six to twelve months after the sale of the loan although the time frame for repurchase requests can extend for an indefinite period. Such transactions could be due to a number of causes including borrower fraud or early payment default. The Company has seen a very limited number of repurchase and indemnity demands from purchasers for such events and routinely monitors its exposure in this regard. The Company maintains a liability of \$0.8 million for probable losses due to repurchases.

The Company periodically engages in whole loan sale transactions of its residential mortgage loans as a part its interest rate risk management strategy. The Company sold \$60.0 million of loans on a servicing-retained basis during the three months ended March 31, 2018. The gain on the sale was not significant. The servicing asset associated with these sales during the three months ended March 31, 2018 was \$0.5 million. Income earned by the Company on its loan servicing rights is derived primarily from contractually specified servicing fees and other ancillary fees. Such income earned for the current quarter was not significant.

Mortgage loan servicing rights are accounted for at amortized cost and are monitored for impairment on an ongoing basis. At March 31, 2018 and December 31, 2017, the amortized cost of the Company's mortgage loan servicing rights was \$1.1 million and \$0.7 million, respectively. The Company did not incur any impairment losses during the current period.

### **Allowance for Loan Losses**

During the first quarter of 2018, there were no changes in the Company's methodology for assessing the appropriateness of the allowance for loan losses from the prior year. Variations can occur over time in the estimation of the allowance as a result of the credit performance of borrowers.

At March 31, 2018, total non-performing loans, excluding credit deteriorated loans from acquisitions, were \$29.4 million, or 0.48% of total loans, compared to \$29.3 million, or 0.68% of total loans, at December 31, 2017. This decline in the ratio was due to the increase in the size of the loan portfolio. The allowance represented 160% of non-performing loans at March 31, 2018 as compared to 154% at December 31, 2017. The allowance for loan losses as a percent of total loans was 0.77% at March 31, 2018 as compared to 1.05% at December 31, 2017.

Continued analysis of the actual loss history on the problem credits in 2017 and 2018 provided an indication that the coverage of the inherent losses on the problem credits was adequate. The Company continues to monitor the impact of

the economic conditions on our commercial customers together with the reduced inflow of non-accruals and criticized loans. The improvement in these credit metrics supports management's outlook for continued improved credit quality performance.

The balance of impaired loans was \$20.8 million, with specific allowances of \$4.5 million against those loans at March 31, 2018, as compared to \$20.8 million with specific allowances of \$4.0 million, at December 31, 2017.

The Company's borrowers are concentrated in nine counties in Maryland, three counties in Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 89% of total loans at March 31, 2018 and 77% of total loans at December 31, 2017. Certain loan terms may create concentrations of credit risk and increase the Company's exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

**Summary of Loan Loss Experience**

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

| <i>(Dollars in thousands)</i>      | <b>Three Months Ended<br/>March 31, 2018</b> | <b>Year Ended<br/>December 31, 2017</b> |
|------------------------------------|----------------------------------------------|-----------------------------------------|
| Balance, January 1                 | \$ 45,257                                    | \$ 44,067                               |
| Provision for loan losses          | 1,997                                        | 2,977                                   |
| Loan charge-offs:                  |                                              |                                         |
| Residential real estate:           |                                              |                                         |
| Residential mortgage               | -                                            | (87)                                    |
| Residential construction           | -                                            | -                                       |
| Commercial real estate:            |                                              |                                         |
| Commercial owner occupied          | -                                            | (248)                                   |
| Commercial business                | (331)                                        | (1,538)                                 |
| Consumer                           | (146)                                        | (693)                                   |
| Total charge-offs                  | (477)                                        | (2,566)                                 |
| Loan recoveries:                   |                                              |                                         |
| Residential real estate:           |                                              |                                         |
| Residential mortgage               | 22                                           | 150                                     |
| Residential construction           | 6                                            | 26                                      |
| Commercial real estate:            |                                              |                                         |
| Commercial investor                | 8                                            | 101                                     |
| Commercial owner occupied          | -                                            | -                                       |
| Commercial AD&C                    | 62                                           | 103                                     |
| Commercial business                | 9                                            | 94                                      |
| Consumer                           | 47                                           | 305                                     |
| Total recoveries                   | 154                                          | 779                                     |
| Net charge-offs                    | (323)                                        | (1,787)                                 |
| Balance, period end                | \$ 46,931                                    | \$ 45,257                               |
| Net charge-offs to average loans   | <b>0.02%</b>                                 | 0.04%                                   |
| Allowance for loan losses to loans | <b>0.77%</b>                                 | 1.05%                                   |

## Analysis of Credit Risk

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

| <i>(Dollars in thousands)</i>              | <b>March 31, 2018</b> | December 31, 2017 |
|--------------------------------------------|-----------------------|-------------------|
| Non-accrual loans:                         |                       |                   |
| Residential real estate:                   |                       |                   |
| Residential mortgage                       | \$ 7,063              | \$ 7,196          |
| Residential construction                   | 174                   | 177               |
| Commercial real estate:                    |                       |                   |
| Commercial investor                        | 5,813                 | 5,575             |
| Commercial owner occupied                  | 3,524                 | 3,582             |
| Commercial AD&C                            | 136                   | 136               |
| Commercial business                        | 6,634                 | 6,703             |
| Consumer                                   | 3,244                 | 2,967             |
| Total non-accrual loans                    | <b>26,588</b>         | 26,336            |
| Loans 90 days past due                     |                       |                   |
| Residential real estate:                   |                       |                   |
| Residential mortgage                       | -                     | 225               |
| Residential construction                   | -                     | -                 |
| Commercial real estate:                    |                       |                   |
| Commercial investor                        | -                     | -                 |
| Commercial owner occupied                  | -                     | -                 |
| Commercial AD&C                            | -                     | -                 |
| Commercial business                        | -                     | -                 |
| Consumer                                   | 126                   | -                 |
| Total 90 days past due loans               | <b>126</b>            | 225               |
| Restructured loans (accruing)              | 2,678                 | 2,788             |
| Total non-performing loans                 | <b>29,392</b>         | 29,349            |
| Other real estate owned, net               | 2,761                 | 2,253             |
| Total non-performing assets                | \$ <b>32,153</b>      | \$ 31,602         |
| Non-performing loans to total loans        | <b>0.48%</b>          | 0.68%             |
| Non-performing assets to total assets      | <b>0.41%</b>          | 0.58%             |
| Allowance for loan to non-performing loans | <b>159.67%</b>        | 154.20%           |

## Market Risk Management

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

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

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

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

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

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

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

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

**Estimated Changes in Net Interest Income**

| Change in Interest Rates: | + 400 bp       | + 300 bp       | + 200 bp       | + 100 bp     | - 100 bp       | - 200 bp   | -300 bp    | 400 bp     |
|---------------------------|----------------|----------------|----------------|--------------|----------------|------------|------------|------------|
| Policy Limit              | 23.50%         | 17.50%         | 15.00%         | 10.00%       | 10.00%         | 15.00%     | 17.50%     | 23.50%     |
| <b>March 31, 2018</b>     | <b>(2.86%)</b> | <b>(1.39%)</b> | <b>(0.68%)</b> | <b>0.09%</b> | <b>(0.99%)</b> | <b>N/A</b> | <b>N/A</b> | <b>N/A</b> |
| December 31, 2017         | (7.36%)        | (4.93%)        | (2.82%)        | (1.13%)      | (2.24%)        | N/A        | N/A        | N/A        |

As shown above, measures of net interest income at risk improved from December 31, 2017 at all shock levels. All measures remained well within prescribed policy limits. The significant improvement in the risk position from December 31, 2017 to March 31, 2018 was the result of the combined impact of the acquisition and the anticipated effects of interest rate movements on specific deposit products. The acquired loan portfolio was comprised of a large percentage of variable rate products which would benefit interest income in a rising rate environment. These positive benefits would be partially offset by an increase in the rates paid on money market deposits, certificates of deposits and short-term borrowings resulting in an increase to interest expense.

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

**Estimated Changes in Economic Value of Equity (EVE)**

| Change in Interest Rates: | + 400 bp        | + 300 bp        | + 200 bp       | + 100 bp       | - 100 bp     | - 200 bp   | -300 bp    | -400 bp    |
|---------------------------|-----------------|-----------------|----------------|----------------|--------------|------------|------------|------------|
| Policy Limit              | 35.00%          | 25.00%          | 20.00%         | 10.00%         | 10.00%       | 20.00%     | 25.00%     | 35.00%     |
| <b>March 31, 2018</b>     | <b>(13.37%)</b> | <b>(10.67%)</b> | <b>(5.98%)</b> | <b>(6.49%)</b> | <b>0.20%</b> | <b>N/A</b> | <b>N/A</b> | <b>N/A</b> |
| December 31, 2017         | (21.09%)        | (14.75%)        | (8.58%)        | (3.39%)        | (0.98%)      | N/A        | N/A        | N/A        |

Measures of the economic value of equity (“EVE”) at risk decreased from December 31, 2017 to March 31, 2018 in all of the shock scenarios. The improvement in the EVE risk position was a result of the benefits from the impact of the shorter duration from loans from the acquisition and the lengthening of the duration on borrowings. These benefits were partially mitigated by the shortened deposit durations.

**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 March 31, 2018. 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 66% of total interest-earning assets at March 31, 2018. 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 March 31, 2018, show short-term investments exceeding short-term borrowings by \$77 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 \$2.2 billion, of which \$2.2 billion was available for borrowing based on pledged collateral, with \$1.0 billion borrowed against it as of March 31, 2018. The line of credit at the Federal Reserve totaled \$351 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of March 31, 2018. 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 March 31,



2018, 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 March 31, 2018. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at March 31, 2018.

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 March 31, 2018, the Bank could have declared a dividend of \$44 million to Bancorp. At March 31, 2018, Bancorp had liquid assets of \$26 million.

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

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

| <i>(In thousands)</i>                                         | <b>March 31,<br/>2018</b> | December 31,<br>2017 |
|---------------------------------------------------------------|---------------------------|----------------------|
| Commercial                                                    | <b>\$ 539,634</b>         | \$ 390,646           |
| Real estate-development and construction                      | <b>138,808</b>            | 130,751              |
| Real estate-residential mortgage                              | <b>61,572</b>             | 18,238               |
| Lines of credit, principally home equity and business lines   | <b>1,236,721</b>          | 1,044,949            |
| Standby letters of credit                                     | <b>69,550</b>             | 62,937               |
| Total commitments to extend credit and available credit lines | <b>\$ 2,046,285</b>       | \$ 1,647,521         |

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

### **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

### **Item 4. CONTROLS AND PROCEDURES**

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

concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the three months ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

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

### **Item 1A. Risk Factors**

There have been no material changes in the risk factors as discussed in the 2017 Annual Report on Form 10-K.

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

The Company's 2015 stock repurchase program expired on August 31, 2017 and has not been renewed.

### **Item 3. Defaults Upon Senior Securities – None**

**Item 4. Mine Safety Disclosures – Not applicable**

**Item 5. Other Information - None**

**Item 6. Exhibits**

Exhibit 31(a) Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a)

Exhibit 31(b) Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a)

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

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

Exhibit 101 The following materials from the Sandy Spring Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter end March 31, 2018 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Condition; (ii) The Condensed Consolidated Statements of Income; (iii) The Condensed Consolidated Statements of Comprehensive Income; (iv) The Condensed Consolidated Statements of Cash Flows; (v) The Condensed Consolidated Statements of Changes in Stockholders' Equity; (vi) related notes.

**Signatures**

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

SANDY SPRING BANCORP, INC.

(Registrant)

By: /s/ Daniel J. Schrider

Daniel J. Schrider

President and Chief Executive Officer

Date: May 4, 2018

By: /s/ Philip J. Mantua

Philip J. Mantua

Executive Vice President and Chief Financial Officer

Date: May 4, 2018