

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

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

**FORM 10-Q**

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

**For the Quarterly Period Ended September 30, 2016**

OR

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

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

Commission File Number: 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

**Maryland**

**52-1532952**

(State of incorporation)

(I.R.S. Employer Identification Number)

**17801 Georgia Avenue, Olney, Maryland**

**20832**

(Address of principal executive office)

(Zip Code)

**301-774-6400**

(Registrant's telephone number, including area code)

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

Yes  No

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

Yes  No

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

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

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

Yes    No

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

**Common stock, \$1.00 par value – 23,889,625 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 2015 Annual Report on Form 10-K, Item 1A of Part II of this report and the following:

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

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

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

<i>(Dollars in thousands)</i>	<b>September 30, 2016</b>	December 31, 2015
<b>Assets</b>		
Cash and due from banks	\$ 48,666	\$ 46,956
Federal funds sold	1,106	472
Interest-bearing deposits with banks	48,425	25,454
Cash and cash equivalents	98,197	72,882
Residential mortgage loans held for sale (at fair value)	15,822	15,457
Investments available-for-sale (at fair value)	655,642	592,049
Investments held-to-maturity -- fair value of \$211,704 at December 31, 2015	-	208,265
Other equity securities	35,829	41,336
Total loans	3,780,507	3,495,370
Less: allowance for loan losses	(43,942)	(40,895)
Net loans	3,736,565	3,454,475
Premises and equipment, net	53,356	53,214
Other real estate owned	1,274	2,742
Accrued interest receivable	13,123	13,443
Goodwill	85,768	84,171
Other intangible assets, net	716	138
Other assets	114,319	117,208
<b>Total assets</b>	<b>\$ 4,810,611</b>	<b>\$ 4,655,380</b>
<b>Liabilities</b>		
Noninterest-bearing deposits	\$ 1,154,227	\$ 1,001,841
Interest-bearing deposits	2,382,930	2,261,889
Total deposits	3,537,157	3,263,730
Securities sold under retail repurchase agreements and federal funds purchased	124,205	109,145
Advances from FHLB	550,000	685,000
Subordinated debentures	30,000	35,000
Accrued interest payable and other liabilities	32,594	38,078
Total liabilities	4,273,956	4,130,953
<b>Stockholders' Equity</b>		
Common stock -- par value \$1.00; shares authorized 50,000,000; shares issued and outstanding 23,886,651 and 24,295,971 at September 30, 2016 and December 31, 2015, respectively	23,887	24,296
Additional paid in capital	164,937	175,588
Retained earnings	343,366	325,840
Accumulated other comprehensive income (loss)	4,465	(1,297)
Total stockholders' equity	536,655	524,427
<b>Total liabilities and stockholders' equity</b>	<b>\$ 4,810,611</b>	<b>\$ 4,655,380</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 September 30,		Nine Months Ended September 30,	
<i>(Dollars in thousands, except per share data)</i>	<b>2016</b>	2015	<b>2016</b>	2015
<b>Interest income:</b>				
Interest and fees on loans and leases	\$ 38,224	\$ 34,484	\$ 111,358	\$ 99,654
Interest on loans held for sale	96	214	294	422
Interest on deposits with banks	49	25	156	69
Interest and dividends on investment securities:				
Taxable	2,623	3,597	8,749	11,024
Exempt from federal income taxes	1,864	1,996	5,753	6,068
Interest on federal funds sold	1	1	3	1
Total interest income	<b>42,857</b>	40,317	<b>126,313</b>	117,238
<b>Interest expense:</b>				
Interest on deposits	2,128	1,632	6,006	4,193
Interest on retail repurchase agreements and federal funds purchased	74	69	212	179
Interest on advances from FHLB	2,699	3,272	8,812	9,774
Interest on subordinated debt	225	228	698	670
Total interest expense	<b>5,126</b>	5,201	<b>15,728</b>	14,816
<b>Net interest income</b>	<b>37,731</b>	35,116	<b>110,585</b>	102,422
Provision for loan losses	781	1,706	4,974	3,521
Net interest income after provision for loan losses	<b>36,950</b>	33,410	<b>105,611</b>	98,901
<b>Non-interest income:</b>				
Investment securities gains	-	1	1,919	20
Service charges on deposit accounts	2,035	1,936	5,894	5,657
Mortgage banking activities	1,129	566	2,770	2,566
Wealth management income	4,347	4,963	13,200	15,040
Insurance agency commissions	1,786	1,648	4,180	4,147
Income from bank owned life insurance	616	618	1,846	1,937
Visa check fees	1,189	1,198	3,498	3,475
Other income	1,482	1,460	5,391	4,816
Total non-interest income	<b>12,584</b>	12,390	<b>38,698</b>	37,658
<b>Non-interest expense:</b>				
Salaries and employee benefits	17,848	17,733	53,299	52,566
Occupancy expense of premises	3,130	3,086	9,765	9,748
Equipment expense	1,745	1,600	5,102	4,463
Marketing	628	688	1,971	2,161
Outside data services	1,349	1,329	4,067	3,692
FDIC insurance	726	565	2,012	1,850
Amortization of intangible assets	34	107	94	320
Litigation expense	-	155	-	517
Other expense	3,866	4,367	16,204	13,034
Total non-interest expense	<b>29,326</b>	29,630	<b>92,514</b>	88,351
Income before income taxes	<b>20,208</b>	16,170	<b>51,795</b>	48,208
Income tax expense	6,734	5,175	16,861	15,655
<b>Net income</b>	<b>\$ 13,474</b>	\$ 10,995	<b>\$ 34,934</b>	\$ 32,553

**Per share information:**

Basic net income per share	\$	<b>0.56</b>	\$	0.45	\$	<b>1.45</b>	\$	1.32
Diluted net income per share	\$	<b>0.56</b>	\$	0.45	\$	<b>1.45</b>	\$	1.31
Dividends declared per common share	\$	<b>0.24</b>	\$	0.22	\$	<b>0.72</b>	\$	0.66

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

The accompanying notes are an integral part of these statements

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

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

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

The accompanying notes are an integral part of these statements

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

	Common	Additional Paid-In	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
<i>(Dollars in thousands, except per share data)</i>					
<b>Balances at January 1, 2016</b>	<b>\$ 24,296</b>	<b>\$ 175,588</b>	<b>\$ 325,840</b>	<b>\$ (1,297)</b>	<b>\$ 524,427</b>
Net income	-	-	34,934	-	34,934
Other comprehensive income, net of tax	-	-	-	5,762	5,762
Common stock dividends - \$0.72 per share	-	-	(17,408)	-	(17,408)
Stock compensation expense	-	1,628	-	-	1,628
Common stock issued pursuant to:					
Stock option plan - 34,646 shares	35	500	-	-	535
Employee stock purchase plan - 18,767 shares	19	433	-	-	452
Director stock purchase plan - 258 shares	-	15	-	-	15
Restricted stock - 49,648 shares	49	(466)	-	-	(417)
Purchase of treasury shares - 512,459 shares	(512)	(12,761)	-	-	(13,273)
<b>Balances at September 30, 2016</b>	<b>\$ 23,887</b>	<b>\$ 164,937</b>	<b>\$ 343,366</b>	<b>\$ 4,465</b>	<b>\$ 536,655</b>
Balance at January 1, 2015	\$ 25,045	\$ 194,647	\$ 302,882	\$ (823)	\$ 521,751
Net income	-	-	32,553	-	32,553
Other comprehensive income, net of tax	-	-	-	2,624	2,624
Common stock dividends - \$0.66 per share	-	-	(16,496)	-	(16,496)
Stock compensation expense	-	1,450	-	-	1,450
Common stock issued pursuant to:					
Stock option plan - 35,039 shares	35	474	-	-	509
Director stock purchase plan - 837 shares	1	21	-	-	22
Employee stock purchase plan - 19,377 shares	19	412	-	-	431
Restricted stock - 53,746 shares	54	(435)	-	-	(381)
Purchase of treasury shares - 728,932 shares	(729)	(18,140)	-	-	(18,869)
<b>Balances at September 30, 2015</b>	<b>\$ 24,425</b>	<b>\$ 178,429</b>	<b>\$ 318,939</b>	<b>\$ 1,801</b>	<b>\$ 523,594</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 44 community offices and six financial centers across the region. The Bank also offers a comprehensive menu of insurance and wealth management services through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc.

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

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and prevailing practices within the financial services industry for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements and prevailing practices within the banking industry. The following summary of significant accounting policies of the Company is presented to assist the reader in understanding the financial and other data presented in this report. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2016. In the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. Certain reclassifications have been made to prior period amounts, as necessary, to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

These statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s 2015 Annual Report on Form 10-K as filed with the Securities and Exchange Commission (“SEC”) on March 4, 2016. There have been no significant changes to the Company’s accounting policies as disclosed in the 2015 Annual Report on Form 10-K.

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

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

### **Use of Estimates**

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

### **Cash Flows**

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

## **Pending Accounting Pronouncements**

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

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

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

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

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

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

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

## **Note 2 – Investments**

### Investments available-for-sale

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

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(In thousands)	September 30, 2016				December 31, 2015			
	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	\$ 54,742	\$ 22	\$ -	\$ 54,764	\$109,602	\$ 132	\$(1,334)	\$108,400
State and municipal	284,830	12,987	(26)	297,791	156,402	8,305	-	164,707
Mortgage-backed	285,078	6,484	(67)	291,495	312,846	6,396	(2,546)	316,696
Corporate debt	9,100	246	-	9,346	-	-	-	-
Trust preferred	1,089	-	(66)	1,023	1,089	-	(66)	1,023
Total debt securities	634,839	19,739	(159)	654,419	579,939	14,833	(3,946)	590,826
Marketable equity securities	1,223	-	-	1,223	1,223	-	-	1,223
Total investments available-for-sale	\$636,062	\$ 19,739	\$ (159)	\$655,642	\$581,162	\$14,833	\$(3,946)	\$592,049

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

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

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

At September 30, 2016 the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security, which is backed by debt issued by banks and thrifts, totals \$1.1 million with a fair value of \$1.0 million. The fair value of this security was determined by management through the use of a third party valuation specialist due to the limited trading activity for this security.

As a result of this evaluation, it was determined that the pooled trust preferred security had not incurred any credit-related other-than-temporary impairment (“OTTI”) for the quarter ended September 30, 2016. The unrealized loss on this security that is recognized in other comprehensive income (“OCI”) and is not expected to be sold and which the Company has the ability to hold until maturity, was \$0.1 million at September 30, 2016.

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

<i>(In thousands)</i>	OTTI Losses
Cumulative credit losses on investment securities, through December 31, 2015	\$ 531
Additions for credit losses not previously recognized	-
Cumulative credit losses on investment securities through September 30, 2016	\$ 531

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

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

<i>(Dollars in thousands)</i>	<b>December 31, 2015</b>				
	<b>Number of Securities</b>	<b>Fair Value</b>	<b>Continuous Unrealized Losses Existing for:</b>		<b>Total Unrealized Losses</b>
			<b>Less than 12 months</b>	<b>More than 12 months</b>	
<b>U.S. government agencies</b>	<b>7</b>	<b>\$ 78,555</b>	<b>\$ 1,020</b>	<b>\$ 314</b>	<b>\$ 1,334</b>
<b>Mortgage-backed</b>	<b>26</b>	<b>140,556</b>	<b>716</b>	<b>1,830</b>	<b>2,546</b>
<b>Trust preferred</b>	<b>1</b>	<b>1,023</b>	<b>-</b>	<b>66</b>	<b>66</b>
<b>Total</b>	<b>34</b>	<b>\$ 220,134</b>	<b>\$ 1,736</b>	<b>\$ 2,210</b>	<b>\$ 3,946</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>September 30, 2016</b>		<b>December 31, 2015</b>	
	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
<b>Due in one year or less</b>	<b>\$ 6,554</b>	<b>\$ 6,631</b>	<b>\$ 301</b>	<b>\$ 306</b>
<b>Due after one year through five years</b>	<b>169,896</b>	<b>177,379</b>	<b>157,710</b>	<b>160,257</b>
<b>Due after five years through ten years</b>	<b>204,061</b>	<b>211,554</b>	<b>168,136</b>	<b>174,677</b>
<b>Due after ten years</b>	<b>254,328</b>	<b>258,855</b>	<b>253,792</b>	<b>255,586</b>
<b>Total debt securities available for sale</b>	<b>\$ 634,839</b>	<b>\$ 654,419</b>	<b>\$ 579,939</b>	<b>\$ 590,826</b>



At September 30, 2016 and December 31, 2015, investments available-for-sale with a book value of \$464.2 million and \$233.2 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agencies securities, exceeded ten percent of stockholders' equity at September 30, 2016 and December 31, 2015.

Investments held-to-maturity

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

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

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

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

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

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

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

Equity securities

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

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

**Note 3 – LOANS**

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

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

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

##### **Allowance for Loan Losses**

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

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

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

	For the Nine Months Ended September 30, 2016							
	Commercial Real Estate				Residential Real Estate			
	Commercial		Commercial		Residential		Residential	
	Commercial	Commercial	Commercial	Owner	Consumer	Mortgage	Construction	Total
	Business	AD&C	R/E	R/E				
<i>(Dollars in thousands)</i>								
<b>Balance at beginning of year</b>	\$ 6,529	\$ 4,691	\$ 10,440	\$ 7,984	\$ 3,456	\$ 6,901	\$ 894	\$ 40,895
<b>Provision (credit)</b>	635	456	1,435	253	81	2,132	(18)	4,974
<b>Charge-offs</b>	(289)	(48)	(197)	-	(674)	(1,378)	-	(2,586)
<b>Recoveries</b>	21	22	124	5	111	350	26	659
<b>Net charge-offs</b>	(268)	(26)	(73)	5	(563)	(1,028)	26	(1,927)
<b>Balance at end of period</b>	\$ 6,896	\$ 5,121	\$ 11,802	\$ 8,242	\$ 2,974	\$ 8,005	\$ 902	\$ 43,942
<b>Total loans and leases</b>	\$444,129	\$302,522	\$847,946	\$736,744	\$450,113	\$854,055	\$144,998	\$3,780,507
<b>Allowance for loans losses to total loans ratio</b>	1.55%	1.69%	1.39%	1.12%	0.66%	0.94%	0.62%	1.16%
<b>Balance of loans specifically evaluated for impairment</b>	\$ 5,343	\$ 137	\$ 9,189	\$ 6,336	\$ na.	\$ 3,292	\$ -	\$ 24,297
<b>Allowance for loans specifically evaluated for impairment</b>	\$ 1,884	\$ -	\$ 1,256	\$ 512	\$ na.	\$ -	\$ -	\$ 3,652
<b>Specific allowance to specific loans ratio</b>	35.26%	0.00%	13.67%	8.08%	na.	na.	na.	15.03%
<b>Balance of loans collectively evaluated</b>	\$438,786	\$302,385	\$838,757	\$730,408	\$450,113	\$850,763	\$144,998	\$3,756,210
<b>Allowance for loans collectively evaluated</b>	\$ 5,012	\$ 5,121	\$ 10,546	\$ 7,730	\$ 2,974	\$ 8,005	\$ 902	\$ 40,290
<b>Collective allowance to collective loans ratio</b>	1.14%	1.69%	1.26%	1.06%	0.66%	0.94%	0.62%	1.07%

For the Year Ended December 31, 2015

	Commercial Real Estate				Residential Real Estate			
	Commercial		Commercial		Residential		Residential	
	Commercial	Commercial	Commercial	Owner	Residential	Residential		

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

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

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

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

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

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

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

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

December 31,

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

**Credit Quality**

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

September 30, 2016

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

December 31, 2015

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

September 30, 2016

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

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

December 31, 2015

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

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

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

<b>December 31, 2015</b>					
<b>Commercial Real Estate</b>					
		<b>Commercial</b>	<b>Commercial</b>	<b>Commercial Owner Occupied</b>	
<i>(In thousands)</i>	<b>Commercial</b>	<b>AD&amp;C</b>	<b>Investor R/E</b>	<b>R/E</b>	<b>Total</b>
Pass	\$ 447,439	\$ 255,786	\$ 706,623	\$ 659,281	\$ 2,069,129
Special Mention	797	-	1,509	3,356	5,662
Substandard	17,529	194	10,952	15,390	44,065
Doubtful	-	-	-	-	-
<b>Total</b>	<b>\$ 465,765</b>	<b>\$ 255,980</b>	<b>\$ 719,084</b>	<b>\$ 678,027</b>	<b>\$ 2,118,856</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>September 30, 2016</b>				
<b>Residential Real Estate</b>				
	<b>Consumer</b>	<b>Residential Mortgage</b>	<b>Residential Construction</b>	
<i>(In thousands)</i>				<b>Total</b>
Performing	\$ 447,387	\$ 846,170	\$ 144,799	\$ 1,438,356
Non-performing:				
90 days past due	-	-	-	-
Non-accruing	2,726	7,321	199	10,246
Restructured loans	-	564	-	564
<b>Total</b>	<b>\$ 450,113</b>	<b>\$ 854,055</b>	<b>\$ 144,998</b>	<b>\$ 1,449,166</b>

December 31, 2015

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

During the nine months ended September 30, 2016, the Company restructured \$0.6 million in loans. No modifications resulted in the reduction of the principal in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2016 have specific reserves that were insignificant at September 30, 2016. For the year ended December 31, 2015, the Company restructured \$1.9 million in loans. Modifications consisted principally of interest rate concessions and no modifications resulted in the reduction of the recorded investment in the associated loan balances. Loans restructured during 2015 had specific reserves of \$0.5 million at December 31, 2015. Commitments to lend additional funds on loans that have been restructured at September 30, 2016 and December 31, 2015 amounted to \$0.1 million and \$0.1 million, respectively.

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

<b>For the Nine Months Ended September 30, 2016</b>							
<b>Commercial Real Estate</b>							
<i>(In thousands)</i>	<b>Commercial</b>		<b>Commercial</b>		<b>Commercial</b>	<b>All</b>	
	<b>Commercial</b>	<b>AD&amp;C</b>	<b>Investor</b>	<b>R/E</b>	<b>Owner</b>	<b>Other</b>	
	<b>Commercial</b>	<b>AD&amp;C</b>	<b>R/E</b>	<b>R/E</b>	<b>Occupied</b>	<b>Loans</b>	<b>Total</b>
<b>Troubled debt restructurings</b>							
<b>Restructured accruing</b>	\$ 42	\$ -	\$ -	\$ -	\$ 508	\$ -	\$ 550
<b>Restructured non-accruing</b>	20	-	-	-	-	-	20
<b>Balance</b>	\$ 62	\$ -	\$ -	\$ -	\$ 508	\$ -	\$ 570
<b>Specific allowance</b>	\$ 59	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 59
<b>Restructured and subsequently defaulted</b>	\$ -	\$ -	\$ 479	\$ -	\$ -	\$ -	\$ 479

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

**Other Real Estate Owned**

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

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

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

	September 30, 2016		Weighted Average Remaining Life	December 31, 2015		Weighted Average Remaining Life	
	Gross Carrying Amount	Accumulated Amortization Amount		Net Carrying Amount	Gross Carrying Amount		Accumulated Amortization Amount
<i>(Dollars in thousands)</i>							
Amortizing intangible assets:							
Other identifiable intangibles	\$ 9,296	\$ (8,580)	\$ 716	13.8 years	\$ 8,623	\$ (8,485) \$ 138	2.0 years
Total amortizing intangible assets	\$ 9,296	\$ (8,580)	\$ 716		\$ 8,623	\$ (8,485) \$ 138	
Goodwill	\$ 85,768		\$ 85,768		\$ 84,171		\$ 84,171



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

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

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

#### **Note 6 – Deposits**

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

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

#### **Note 7 – Stockholders' Equity**

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

#### **Note 8 – Share Based Compensation**

At September 30, 2016, the Company had two share based compensation plans in existence, the 2005 Omnibus Stock Plan (“Omnibus Stock Plan”) and the 2015 Omnibus Incentive Plan (“Omnibus Incentive Plan”). The Omnibus Stock Plan expired during the second quarter of 2015 but has outstanding options that may still be exercised. The Omnibus Incentive Plan is described in the following paragraph.

The Company’s Omnibus Incentive Plan was approved on May 6, 2015 and provides for the granting of incentive stock options, non-qualifying stock options, stock appreciation rights, restricted stock grants, restricted stock units and performance awards to selected employees on a periodic basis at the discretion of the board. The Omnibus Incentive Plan authorizes the issuance of up to 1,500,000 shares of common stock, of which 1,403,186 are available for issuance at September 30, 2016, has a term of ten years, and is administered by a committee of at least three directors appointed by the board of directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within seven to ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The board committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

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

	Nine Months Ended September 30,	
	2016	2015
Dividend yield	3.48%	3.40%
Weighted average expected volatility	41.54%	42.98%
Weighted average risk-free interest rate	1.42%	1.42%
Weighted average expected lives (in years)	5.71	5.42
Weighted average grant-date fair value	\$7.75	\$7.63

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

Compensation expense is recognized on a straight-line basis over the vesting period of the respective stock option or restricted stock grant. The Company recognized compensation expense of \$0.5 million and \$0.5 million for the three months ended September 30, 2016 and 2015, respectively, related to the awards of stock options and restricted stock grants. Compensation expense of \$1.4 million and \$1.4 million was recognized for the nine months ended September 30, 2016 and 2015, respectively. The intrinsic value of stock options exercised in the nine months ended September 30, 2016 and 2015 was \$0.4 million and \$0.4 million, respectively. The total of unrecognized compensation cost related to stock options was approximately \$0.2 million as of September 30, 2016. That cost is expected to be recognized over a weighted average period of approximately 2.0 years. The total of unrecognized compensation cost related to restricted stock was approximately \$4.4 million as of September 30, 2016. That cost is expected to be recognized over a weighted average period of approximately 3.2 years. The fair value of the options vested during the nine months ended September 30, 2016 and 2015, was not significant.

In the first quarter of 2016, 21,238 stock options were granted, subject to a three year vesting schedule with one third of the options vesting on April 1<sup>st</sup> of each year. The Company granted 78,081 shares of restricted stock in the first quarter of 2016, 10,010 shares are subject to a three year vesting schedule with one third of the shares vesting each year and 59,298 shares are subject to a five year vesting schedule with one fifth of the shares vesting each year. All of these restricted shares will vest on April 1<sup>st</sup> of each year. An additional 8,773 shares of performance based restricted stock grants were also approved as part of the restricted shares granted in the first quarter. The performance shares are subject to cliff vesting after three years based on the relative performance of the Company's stock price in comparison to a selected peer group. Vesting can vary from 0-150% of the initial grant based on the results of the Company's stock performance.

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

	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life (Years)	Aggregate Intrinsic Value (in thousands)
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Balance at January 1, 2016	134,131	\$ 19.70		\$ 974
Granted	21,238	\$ 27.46		
Exercised	(34,646)	\$ 15.44		\$ 430
Forfeited or expired	(3,274)	\$ 25.82		
Balance at September 30, 2016	117,449	\$ 22.19	3.7	\$ 974
Exercisable at September 30, 2016	78,093	\$ 19.95	2.6	\$ 831
Weighted average fair value of options granted during the year		\$ 7.75		

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

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

## Note 9 – Pension, Profit Sharing, and Other Employee Benefit Plans

### Defined Benefit Pension Plan

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

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

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

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

### Contributions

The decision as to whether or not to make a plan contribution and the amount of any such contribution is dependent on a number of factors. Such factors include the investment performance of the plan assets in the current economy and, since the plan is currently frozen, the remaining investment horizon of the plan. After consideration of these factors, the Company made a contribution of \$5.8 million in the third quarter of 2016.

**Note 10 – Net Income per Common Share**

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

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

**NOTE 11 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

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

<i>(In thousands)</i>	Unrealized Gains (Losses) on Defined Investments Benefit Pension Available-for-SalPlan		Total
Balance at January 1, 2016	\$ 6,566	\$ (7,863)	\$ (1,297)
Other comprehensive income before reclassification, net of tax	6,385	-	6,385
Reclassifications from accumulated other comprehensive income, net of tax	(1,154)	531	(623)
Current period change in other comprehensive income, net of tax	5,231	531	5,762
Balance at September 30, 2016	\$ 11,797	\$ (7,332)	\$ 4,465

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

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



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

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

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

The Company has entered into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk. The notional value of commercial loan swaps outstanding was \$19.2 million with a fair value of \$1.3 million as of September 30, 2016 compared to \$19.9 million with a fair value of \$1.3 million as of December 31, 2015. The offsetting nature of the swaps results in a neutral effect on the Company’s operations. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The associated net gains and losses on the swaps are recorded in other non-interest income.

## Note 13 – Litigation

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

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

**Note 14 – Fair Value**

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

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

**Basis of Fair Value Measurement:**

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

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

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

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

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

**Assets and Liabilities**

*Mortgage loans held for sale*

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

*Investments available-for-sale*

U.S. government agencies and mortgage-backed securities

Valuations are based on active market data and use of evaluated broker pricing models that vary based by asset class and includes available trade, bid, and other market information. Generally, the methodology includes broker quotes, proprietary models, descriptive terms and conditions databases coupled with extensive quality control programs. Multiple quality control evaluation processes review available market, credit and deal level information to support the evaluation of the security. If there is a lack of objectively verifiable information available to support the valuation, the evaluation of the security is discontinued. Additionally, proprietary models and pricing systems, mathematical tools, actual transacted prices, integration of market developments and experienced evaluators are used to determine the value of a security based on a hierarchy of market information regarding a security or securities with similar characteristics. The Company does not adjust the quoted price for such securities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

State and municipal securities

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

Trust preferred securities and corporate debt

In active markets, these types of instruments are valued based on quoted market prices that are readily accessible at the measurement date and are classified within Level 1 of the fair value hierarchy. Positions that are not traded in active markets or are subject to transfer restrictions are valued or adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management uses a process that employs certain assumptions to determine the present value. Positions that are not traded in active markets or are subject to transfer restrictions are classified within Level 3 of the fair value hierarchy.

*Interest rate swap agreements*

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

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

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

	September 30, 2016				Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<i>(In thousands)</i>					
<b>Assets</b>					
Residential mortgage loans held for sale	\$ -	\$ 15,822	\$ -		\$ 15,822
Investments available-for-sale:					
U.S. government agencies	-	54,764	-		54,764
State and municipal	-	297,791	-		297,791
Mortgage-backed	-	291,495	-		291,495
Corporate debt	-	-	9,346		9,346
Trust preferred	-	-	1,023		1,023
Marketable equity securities	-	1,223	-		1,223
Interest rate swap agreements	-	1,296	-		1,296
<b>Liabilities</b>					
Interest rate swap agreements	\$ -	\$ (1,296)	\$ -		\$ (1,296)

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

Liabilities

Interest rate swap agreements	\$	-	\$	(1,312)	\$	-	\$	(1,312)
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The following table provides unrealized losses included in assets measured in the Condensed Consolidated Statements of Condition at fair value on a recurring basis for the period indicated:

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

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

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

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

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

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

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



December 31, 2015 as a result of specific loan loss allowances of \$3.4 million associated with the impaired loans.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Other assets:** The investment in bank-owned life insurance represents the cash surrender value of the policies at September 30, 2016 and December 31, 2015 as determined by each insurance carrier.

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

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

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

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

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

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

The Community Banking segment is conducted through Sandy Spring Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. Parent company income is included in the Community Banking segment, as the majority of effort of these functions is related to this segment. Major revenue sources include net interest income, gains on sales of mortgage loans, trust income fees and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three and nine months ended September 30, 2016 and 2015, respectively.

The Insurance segment is conducted through Sandy Spring Insurance Corporation, a subsidiary of the Bank, and offers annuities as an alternative to traditional deposit accounts. Sandy Spring Insurance Corporation operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff and Associates, located in Ocean City, Maryland. Major sources of revenue are insurance commissions from commercial lines, personal lines, and medical liability lines. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities were not significant for the three and nine months ended September 30, 2016 and 2015, respectively.

The Investment Management segment is conducted through West Financial Services, Inc., a subsidiary of the Bank. This asset management and financial planning firm, located in McLean, Virginia, provides comprehensive investment management and financial planning to individuals, families, small businesses and associations including cash flow analysis, investment review, tax planning, retirement planning, insurance analysis and estate planning. West Financial currently has approximately \$1.1 billion in assets under management. Major revenue sources include non-interest income earned on the above services. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities were not significant for the three and nine months ended September 30, 2016 and 2015, respectively.

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

<i>(In thousands)</i>	Three Months Ended September 30, 2016				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 42,856	\$ 1	\$ 2	\$ (2)	\$ 42,857
Interest expense	5,128	-	-	(2)	5,126
Provision for loan losses	781	-	-	-	781
Noninterest income	9,071	1,783	1,909	(179)	12,584
Noninterest expense	26,822	1,510	1,173	(179)	29,326
Income before income taxes	19,196	274	738	-	20,208
Income tax expense	6,339	108	287	-	6,734
Net income	\$ 12,857	\$ 166	\$ 451	\$ -	\$ 13,474
Assets	\$ 4,811,948	\$ 7,986	\$ 12,064	\$ (21,387)	\$ 4,810,611

<i>(In thousands)</i>	Three Months Ended September 30, 2015				
	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	\$ 40,318	\$ -	\$ 1	\$ (2)	\$ 40,317
Interest expense	5,203	-	-	(2)	5,201
Provision for loan losses	1,706	-	-	-	1,706
Non-interest income	9,106	1,716	1,749	(181)	