SANDY SPRING BANCORP INC
Form 10-K
March 14, 2014

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2013

Commission File Number 0-19065
SANDY SPRING BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland	**52-1532952**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
17801 Georgia Avenue, Olney, Maryland	**20832**
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
¨ Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
¨ Yes x No*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

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

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

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

The aggregate market value of the voting common stock of the registrant held by non-affiliates on June 30, 2013, the last day of the registrant’s most recently completed second fiscal quarter was approximately $528 million, based on the closing sales price of $21.62 per share of the registrant's Common Stock on that date.

The number of outstanding shares of common stock outstanding as of March 3, 2014.

Common stock, $1.00 par value 25,001,788 shares

Documents Incorporated By Reference

Part III: Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held on May 7, 2014 (the "Proxy Statement").

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

SANDY SPRING BANCORP, INC.
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Forward-Looking Statements

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

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

· general business and economic conditions nationally or in the markets that the Company serves could adversely affect, among other things, real estate prices, unemployment levels, and consumer and business confidence, which could lead to decreases in the demand for loans, deposits and other financial services that we provide and increases in loan delinquencies and defaults;

· changes or volatility in the capital markets and interest rates may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet as well as our liquidity;

· our liquidity requirements could be adversely affected by changes in our assets and liabilities;

· our investment securities portfolio is subject to credit risk, market risk, and liquidity risk as well as changes in the estimates we use to value certain of the securities in our portfolio;

· the effect of legislative or regulatory developments including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;

· competitive factors among financial services companies, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;

· the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the Securities and Exchange Commission, the Public Company Accounting Oversight Board and other regulatory agencies; and

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

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

PART I

Item 1. BUSINESS

General

Sandy Spring Bancorp, Inc. (the “Company") is the one-bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. The Bank was founded in 1868 and is the oldest banking business based in Maryland. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 49 community offices located in Central Maryland and Northern Virginia. The Bank is a state chartered bank subject to supervision and regulation by the Federal Reserve and the State of Maryland. The Bank's deposit accounts are insured by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum permitted by law. The Bank is a member of the Federal Reserve System and is an Equal Housing Lender. The Company, the Bank, and its other subsidiaries are Affirmative Action/Equal Opportunity Employers.

With $4.1 billion in assets, the Company is the largest publicly traded banking company headquartered and operating in Maryland. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank also offers a comprehensive menu of insurance and investment management services.

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

Availability of Information

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

Market and Economic Overview

Sandy Spring Bank is headquartered in Montgomery County, Maryland and conducts business primarily in Central Maryland and Northern Virginia. The Bank’s business footprint serves Greater Washington, which includes the District of Columbia proper, Northern Virginia and suburban Maryland, one of the country’s most economically successful regions. The region’s economic strength is due not only to the region’s significant federal presence, but also to strong growth in the business and professional services sector. The creation of the United States Cyber Command in Ft. Meade, Maryland together with a strategic location between two of the country’s leading ports-the Port of Baltimore and the Port of Virginia, has created new opportunities for growth in a variety of areas, including logistics and transportation.

Over the last several years, the unemployment rate in the region has remained well below the national average and, with the end of the recent recession, this difference has become even more pronounced. Much of this success is due to the region’s highly trained and educated workforce. According to the U.S. Census Bureau, the region is home to six of

the top ten most highly educated counties in the nation and seven of the top ten most affluent counties, as measured by household income. The Company's geographical location provides access to key neighboring markets such as Philadelphia, New York City, Pittsburgh and the Richmond/Norfolk, Virginia corridor.

While the local economy continues to slowly recover from the impact of the recent recession, management believes the regional economy has turned around and will continue to experience further recovery and expansion, which will present growth opportunities for the Company.

Loan and Lease Products

The Company currently offers a complete menu of loan products primarily in our identified market footprint that are discussed in detail below and on the following pages. These following sections should be read in conjunction with the section “Credit Risk” on page 44 of this report.

Residential Real Estate Loans

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

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

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

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

Commercial Loans and Leases

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

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

Included in commercial loans are credits directly originated by the Company and syndicated transactions or loan participations that are originated by other lenders. The Company's commercial lending policy requires each loan, regardless of whether it is directly originated or is purchased, to have viable repayment sources. The risks associated with syndicated loans or purchased participations are similar to those of directly originated commercial loans, although additional risk may arise from the limited ability to control actions of the primary lender. Shared National Credits (SNC), as defined by the banking regulatory agencies, represent syndicated lending arrangements with three or more participating financial institutions and credit exceeding $20.0 million in the aggregate. As of December 31, 2013, the Company had $16.6 million in SNC purchases outstanding and no SNC sold outstanding. During 2013, the Company’s primary regulator completed its annual SNC examination. As a result of this review no action was required on the Company’s SNC participations.

The Company also sells participations in loans it originates to other financial institutions in order to build long-term customer relationships or limit loan concentration. Strict policies are in place governing the degree of risk assumed and volume of loans held. At December 31, 2013, other financial institutions had $32.6 million in outstanding commercial and commercial real estate loan participations sold by the Company, and the Company had $15.2 million in outstanding commercial and commercial real estate loan participations purchased from other lenders, excluding SNC participations.

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

The Company primarily lends for commercial construction in local markets that are familiar and understandable, works selectively with top-quality builders and developers, and requires substantial equity from its borrowers. The underwriting process is designed to confirm that the project will be economically feasible and financially viable; it is

generally evaluated as though the Company will provide permanent financing. The Company's portfolio growth objectives do not include speculative commercial construction projects or projects lacking reasonable proportionate sharing of risk. Development and construction loans are secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely upon the value of the underlying collateral, the Company considers the financial condition and reputation of the borrower and any guarantors, the amount of the borrower's equity in the project, independent appraisals, cost estimates and pre-construction sales information. A risk rating system is used on the commercial loan portfolio to determine any exposures to losses.

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

The Company makes commercial business loans. Commercial term loans are made to provide funds for equipment and general corporate needs. This loan category is designed to support borrowers who have a proven ability to service debt over a term generally not to exceed 84 months. The Company generally requires a first lien position on all collateral and requires guarantees from owners having at least a 20% interest in the involved business. Interest rates on commercial term loans are generally floating or fixed for a term not to exceed five years. Management monitors industry and collateral concentrations to avoid loan exposures to a large group of similar industries or similar collateral. Commercial business loans are evaluated for historical and projected cash flow attributes, balance sheet strength, and primary and alternate resources of personal guarantors. Commercial term loan documents require borrowers to forward regular financial information on both the business and personal guarantors. Loan covenants require at least annual submission of complete financial information and in certain cases this information is required monthly, quarterly or semi-annually depending on the degree to which the Company desires information resources for monitoring a borrower's financial condition and compliance with loan covenants. Examples of properly margined collateral for loans, as required by bank policy, would be a 75% advance on the lesser of appraisal or recent sales price on commercial property, an 80% or less advances on eligible receivables, a 50% or less advances on eligible inventory and an 80% advance on appraised residential property. Collateral borrowing certificates may be required to monitor certain collateral categories on a monthly or quarterly basis. Loans may require personal guarantees. Key person life insurance may be required as appropriate and as necessary to mitigate the risk of loss of a primary owner or manager. Whenever appropriate and available, the Bank seeks governmental loan guarantees, such as the Small Business Administration loan programs, to reduce risks.

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

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

The home equity category consists mainly of revolving lines of credit to consumers that are secured by residential real estate. Home equity lines of credit and other home equity loans are originated by the Company for typically up to 90% of the appraised value, less the amount of any existing prior liens on the property. While home equity loans have maximum terms of up to twenty years and interest rates are generally fixed, home equity lines of credit have maximum terms of up to ten years for draws and thirty years for repayment, and interest rates are generally adjustable. The Company secures these loans with mortgages on the homes (typically a second mortgage). Purchase money second mortgage loans originated by the Company have maximum terms ranging from ten to thirty years. These loans generally carry a fixed rate of interest for the entire term or a fixed rate of interest for the first five years, re-pricing every five years thereafter at a predetermined spread to the prime rate of interest. Home equity lines are generally governed by the same lending policies and subject to credit risk as described for residential real estate loans.

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

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

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

One of the Company's primary objectives as a community bank is to develop long-term, multi-product customer relationships from its comprehensive menu of financial products. To that end, the lead product to develop such relationships is typically a deposit product. Deposit growth will be relied upon to fund long-term future loan growth as the economy recovers.

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

The primary objective of the investment portfolio is to provide the necessary liquidity consistent with anticipated levels of deposit funding and loan demand with a minimal level of risk. The overall average duration of 3.9 years of the investment portfolio together with the types of investments (99% of the portfolio is rated AA or above) is intended to provide sufficient cash flows to support the Company's lending goals. Liquidity is also provided by lines of credit maintained with the Federal Home Loan Bank of Atlanta ("FHLB"), the Federal Reserve, and to a lesser extent, bank lines of credit.

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

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

Employees
The Company and its subsidiaries employed 725 persons, including executive officers, loan and other banking and trust officers, branch personnel, and others at December 31, 2013. None of the Company's employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers its employee relations to be excellent.

Competition
The Bank's principal competitors for deposits are other financial institutions, including other banks, credit unions, and savings institutions located in the Bank's primary market area of Anne Arundel, Carroll, Frederick, Howard,

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

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

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

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

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

Monetary Policy

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

Regulation, Supervision, and Governmental Policy

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

Bank Holding Company Regulation

The Company is registered as a bank holding company under the Holding Company Act and, as such, is subject to supervision and regulation by the Federal Reserve. As a bank holding company, the Company is required to furnish to

the Federal Reserve annual and quarterly reports of its operations and additional information and reports. The Company is also subject to regular examination by the Federal Reserve.

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

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

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

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

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

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

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

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

Bank Regulation

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

The Federal Reserve regularly examines the operations and condition of the Bank, including, but not limited to, its capital adequacy, reserves, loans, investments, and management practices. These examinations are for the protection of the Bank's depositors and the Deposit Insurance Fund. In addition, the Bank is required to furnish quarterly and annual reports to the Federal Reserve. The Federal Reserve's enforcement authority includes the power to remove

officers and directors and the authority to issue cease-and-desist orders to prevent a bank from engaging in unsafe or unsound practices or violating laws or regulations governing its business.

The Federal Reserve has adopted regulations regarding capital adequacy, which require member banks to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See "Regulatory Capital Requirements." Federal Reserve and State regulations limit the amount of dividends that the Bank may pay to the Company. See “Note 12 Stockholders’ Equity” in the Notes to the Consolidated Financial Statements.

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

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

Sandy Spring Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. Under the Federal Deposit Insurance Corporation’s risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution’s assessment rate depends upon the category to which it is assigned. Assessment rates currently range from 2-1/2 to 45 basis points. No institution may pay a dividend if in default of the federal deposit insurance assessment. Deposit insurance assessments are based on total assets less tangible equity. The Federal Deposit Insurance Corporation imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital, as of June 30, 2009 (capped at ten basis points of an institution’s deposit assessment base), in order to cover losses to the Deposit Insurance Fund. That special assessment was collected on September 30, 2009. The Federal Deposit Insurance Corporation provided for similar assessments during the final two quarters of 2009, if deemed necessary. However, in lieu of further special assessments, the Federal Deposit Insurance Corporation required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which include an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, a charge to earnings was recorded for each regular assessment with an offsetting credit to the prepaid asset. All remaining prepaid assets were repaid to financial institutions in the second quarter of 2013. The Federal Deposit Insurance Corporation has authority to increase insurance assessments. Management cannot predict what insurance assessment rates will be in the future.

Regulatory Capital Requirements

The Federal Reserve has established guidelines for maintenance of appropriate levels of capital by bank holding companies and member banks. The regulations impose two sets of capital adequacy requirements: minimum leverage rules, which require bank holding companies and banks to maintain a specified minimum ratio of capital to total assets, and risk-based capital rules, which require the maintenance of specified minimum ratios of capital to risk-weighted assets. These capital regulations are subject to change.

The regulations of the Federal Reserve require bank holding companies and member banks to maintain a minimum leverage ratio of "Tier 1 capital" (as defined in the risk-based capital guidelines discussed in the following paragraphs) to total assets of 3.0%. The capital regulations state, however, that only the strongest bank holding companies and banks, with composite examination ratings of 1 under the rating system used by the federal bank regulators, would be permitted to operate at or near this minimum level of capital. All other bank holding companies and banks are expected to maintain a leverage ratio of at least 1% to 2% above the minimum ratio, depending on the assessment of an individual organization's capital adequacy by its primary regulator. A bank or bank holding company experiencing or anticipating significant growth is expected to maintain capital well above the minimum levels. In addition, the Federal Reserve has indicated that it also may consider the level of an organization's ratio of tangible Tier 1 capital (after deducting all intangibles) to total assets in making an overall assessment of capital.

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The risk-based capital rules of the Federal Reserve require bank holding companies and member banks to maintain minimum regulatory capital levels based upon a weighting of their assets and off-balance sheet obligations according to risk. The risk-based capital rules have two basic components: a core capital (Tier 1) requirement and a supplementary capital (Tier 2) requirement. Core capital consists primarily of common stockholders' equity, certain perpetual preferred stock (noncumulative perpetual preferred stock with respect to banks), and minority interests in the equity accounts of consolidated subsidiaries; less all intangible assets, except for certain mortgage servicing rights and purchased credit card relationships. Supplementary capital elements include, subject to certain limitations, the allowance for losses on loans and leases; perpetual preferred stock that does not qualify as Tier 1 capital; long-term preferred stock with an original maturity of at least 20 years from issuance; hybrid capital instruments, including perpetual debt and mandatory convertible securities; subordinated debt, intermediate-term preferred stock, and up to 45% of pre-tax net unrealized gains on available-for-sale equity securities.

The risk-based capital regulations assign balance sheet assets and credit equivalent amounts of off-balance sheet obligations to one of four broad risk categories based principally on the degree of credit risk associated with the obligor. The assets and off-balance sheet items in the four risk categories are weighted at 0%, 20%, 50% and 100%. These computations result in the total risk-weighted assets.

The risk-based capital regulations require all commercial banks and bank holding companies to maintain a minimum ratio of total capital to total risk-weighted assets of 8%, with at least 4% as core capital. For the purpose of calculating these ratios: (i) supplementary capital is limited to no more than 100% of core capital; and (ii) the aggregate amount of certain types of supplementary capital is limited. In addition, the risk-based capital regulations limit the allowance for credit losses that may be included in capital to 1.25% of total risk-weighted assets.

The federal bank regulatory agencies have established a joint policy regarding the evaluation of commercial banks' capital adequacy for interest rate risk. Under the policy, the Federal Reserve's assessment of a bank's capital adequacy includes an assessment of the bank's exposure to adverse changes in interest rates. The Federal Reserve has determined to rely on its examination process for such evaluations rather than on standardized measurement systems or formulas. The Federal Reserve may require banks that are found to have a high level of interest rate risk exposure or weak interest rate risk management systems to take corrective actions. Management believes its interest rate risk management systems and its capital relative to its interest rate risk are adequate.

Federal banking regulations also require banks with significant trading assets or liabilities to maintain supplemental risk-based capital based upon their levels of market risk. The Bank did not have significant levels of trading assets or liabilities during 2013 and was not required to maintain such supplemental capital.

Well-capitalized institutions are not subject to limitations on brokered deposits, while an adequately capitalized institution is able to accept, renew, or rollover brokered deposits only with a waiver from the FDIC and subject to certain restrictions on the yield paid on such deposits. Undercapitalized institutions are not permitted to accept brokered deposits.

The Federal Reserve has established regulations that classify banks by capital levels and provide for the Federal Reserve to take various "prompt corrective actions" to resolve the problems of any bank that fails to satisfy the capital standards. Under these regulations, a well-capitalized bank is one that is not subject to any regulatory order or directive to meet any specific capital level and that has a total risk-based capital ratio of 10% or more, a Tier 1 risk-based capital ratio of 6% or more, and a leverage ratio of 5% or more. An adequately capitalized bank is one that does not qualify as well-capitalized but meets or exceeds the following capital requirements: a total risk-based capital ratio of 8%, a Tier 1 risk-based capital ratio of 4%, and a leverage ratio of either (i) 4% or (ii) 3% if the bank has the highest composite examination rating. A bank that does not meet these standards is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized, depending on its capital levels. A bank that falls within any of the three undercapitalized categories established by the prompt corrective action regulation is subject to severe

regulatory sanctions. As of December 31, 2013, the Bank was well-capitalized as defined in the Federal Reserve's regulations.

For information regarding the Company's and the Bank's compliance with their respective regulatory capital requirements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations Capital Management" of this report, and "Note 11-Subordinated Debentures," and "Note 23 Regulatory Matters" of the Notes to the Consolidated Financial Statements of this report.

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Basel Capital Standards

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

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

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

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets.

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

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

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

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Supervision and Regulation of Mortgage Banking Operations

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

Community Reinvestment

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

Bank Secrecy Act

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

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Sarbanes-Oxley Act of 2002

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

Regulatory Restructuring Legislation

The Dodd-Frank Act, enacted in 2010, implements significant changes to the regulation of depository institutions. The Dodd-Frank Act provides for the creation of a new agency, the Consumer Financial Protection Bureau, as an independent bureau of the Federal Reserve Board, to take over the implementation of federal consumer financial protection and fair lending laws from the depository institution regulators. However, institutions of $10 billion or fewer in assets will continue to be examined for compliance with such laws and regulations by, and to be subject to the primary enforcement authority of, their primary federal regulator. In addition, the Dodd-Frank Act, among other things, requires changes in the way that institutions are assessed for deposit insurance, requires that originators of securitized loans retain a percentage of the risk for the transferred loans, directs the Federal Reserve Board to regulate pricing of certain debit card interchange fees, and contains a number of reforms related to mortgage originations. Many of the provisions of the Dodd-Frank Act contain delayed effective dates and/or require the issuance of regulations. As a result, it will be some time before their impact on operations can be assessed by management. Based on recent guidance issued by the applicable federal agencies, the Bank has determined that the trust preferred securities currently held in the investment portfolio are not required to be divested under the provisions of section 619 of the Dodd-Frank Act (the "Volcker Rule"). However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in an increased regulatory burden and higher compliance, operating, and possibly, interest costs for the Company and the Bank.

Other Laws and Regulations

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

Enforcement Actions

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

Executive Officers

The following listing sets forth the name, age (as of February 28, 2014), principal position and recent business experience of each executive officer:

R. Louis Caceres, 51, Executive Vice President of the Bank. Mr. Caceres was made Executive Vice President of the Bank in 2002. Prior to that, Mr. Caceres was a Senior Vice President of the Bank.

Ronald E. Kuykendall, 61, became Executive Vice President, General Counsel and Secretary of the Company and the Bank in 2002. Prior to that, Mr. Kuykendall was General Counsel and Secretary of the Company and Senior Vice President of the Bank.

Philip J. Mantua, CPA, 55, became Executive Vice President and Chief Financial Officer of the Company and the Bank in 2004. Prior to that, Mr. Mantua was Senior Vice President of Managerial Accounting.

Ronda McDowell, 49, became an Executive Vice President and Chief Credit Officer of the Bank in 2013. Prior to that, Ms. McDowell served as a Senior Vice President, Loan Administration and Retail Senior Credit Officer of the Bank.

Joseph J. O'Brien, Jr., 50, became Executive Vice President for Commercial and Retail Banking on January 1, 2011. Mr. O’Brien joined the Bank in July 2007 as Executive Vice President for Commercial Banking. Additionally, on January 1, 2008, he became president of the Northern Virginia Market. Prior to joining the Bank, Mr. O'Brien was an Executive Vice President and senior lender for a local banking institution.

John D. Sadowski, 50, became Executive Vice President and Chief Information Officer of the Bank on February 1, 2011. Prior to that, Mr. Sadowski served as a Senior Vice President of the Bank.

Daniel J. Schrider, 49, became President of the Company and the Bank effective March 26, 2008 and Chief Executive Officer effective January 1, 2009. Prior to that, Mr. Schrider served as an Executive Vice President and Chief Revenue Officer of the Bank.

Item 1A. RISK FACTORS

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

Changes in U.S. or regional economic conditions could have an adverse effect on the Company's business, financial condition or results of operations.
The Company's business activities and earnings are affected by general business conditions in the United States and in the local market area. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and in the Company's market area in particular. The national economy recently experienced a recession, with rising unemployment levels, declines in real estate values and erosion in consumer confidence. Dramatic declines in the U.S. housing market during the recession, with falling home prices and higher levels of foreclosures, negatively affected the performance of mortgage loans and resulted in significant write-downs of asset values by many financial institutions. Although the housing sector has improved and real estate prices have rebounded, the economy remains weak and consumer confidence is shaky. Continued elevated levels of unemployment, further declines in the values of real estate, or other events that affect household and/or corporate incomes could impair the ability of the Company's borrowers to repay their loans in accordance with their terms and reduce demand for banking products and services.

The geographic concentration of our operations makes the Company susceptible to downturns in local economic conditions.
The Company's commercial and commercial real estate lending operations are concentrated in Anne Arundel, Carroll, Frederick, Howard, Montgomery, and Prince George's counties in Maryland, and Arlington, Fairfax and Loudoun counties in Virginia. The Company's success depends in part upon economic conditions in these markets. Adverse changes in economic conditions in these markets could limit growth in loans and deposits, impair the Company's ability to collect amounts due on loans, increase problem loans and charge-offs and otherwise negatively affect performance and financial condition. Declines in real estate values could cause some of the residential and commercial real estate loans to be inadequately collateralized, which would expose the Company to a greater risk of loss in the event that the recovery on amounts due on defaulted loans is resolved by selling the real estate collateral.

The Company's allowance for loan and lease losses may not be adequate to cover our actual loan and lease losses, which could adversely affect the Company's financial condition and results of operations.
An allowance for loan and lease losses is maintained in an amount that is believed to be adequate to provide for probable losses inherent in the portfolio. The Company has an aggressive program to monitor credit quality and to identify loans and leases that may become non-performing, however, at any time there are loans and leases included in the portfolio that will result in losses, but that have not been identified as non-performing or potential problem credits. There can be no assurance that the ability exists to identify all deteriorating credits prior to them becoming non-performing assets, or that the Company will have the ability to limit losses on those loans and leases that are

identified. As a result, future additions to the allowance may be necessary. Additionally, future additions may be required based on changes in the loans and leases comprising the portfolio and changes in the financial condition of borrowers, or as a result of assumptions by management in determining the allowance. Additionally, banking regulators, as an integral part of their supervisory function, periodically review the Company's allowance for loan and lease losses. These regulatory agencies may require an increase in the provision for loan and lease losses or to recognize further loan or lease charge-offs based upon their judgments, which may be different from the Company's. Any increase in the allowance for loan and lease losses could have a negative effect on the financial condition and results of operations of the Company.

If non-performing assets increase, earnings will be adversely impacted.
At December 31, 2013, non-performing assets, which are comprised of non-accrual loans, 90 days past due loans and other real estate owned, totaled $41.4 million, or 1.01%, of total assets, compared to non-performing assets of $63.8 million, or 1.61% of total assets at December 31, 2012. Non-performing assets adversely affect net income in various ways. Interest income is not recorded on non-accrual loans or other real estate owned. The Company must record a reserve for probable losses on loans and leases, which is established through a current period charge to the provision for loan and lease losses, and from time to time must write-down the value of properties in the Company's other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to other real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activity. Finally, if the estimate for the recorded allowance for loan and lease losses proves to be incorrect and the allowance is inadequate, the allowance will have to be increased and, as a result, Company earnings would be adversely affected. A further downturn in the Company's market areas could increase credit risk associated with the loan portfolio, as it could have a material adverse effect on both the ability of borrowers to repay loans as well as the value of the real property or other property held as collateral for such loans. There can be no assurance that non-performing loans will not experience an increase in the future, or that the Company's non-performing assets will not result in further losses in the future.

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

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

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

Changes in market interest rates are affected by many factors beyond the Company's control, including inflation, unemployment, money supply, international events, and events in world financial markets. The Company attempts to manage its risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest-earning assets and interest-bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on the net interest margin and results of operations. Changes in the market interest rates for types of products and services in various markets also may vary significantly from location to location and over time based upon competition and local or regional economic factors. At December 31, 2013, the Company's interest rate sensitivity simulation model projected that net interest income would decrease by 1.63% if interest rates immediately rose by 200 basis points. The results of an interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that the Company will be able to successfully manage interest rate risk.

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

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

The Company is subject to liquidity risks.

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

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

At December 31, 2013, goodwill totaled $84.2 million. Goodwill is initially recorded at fair value and is not amortized, but is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. There could be a requirement to evaluate the recoverability of goodwill prior to the normal annual assessment if there is a disruption in the Company's business, unexpected significant declines in operating results, or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill impairment charges in the future, which would adversely affect the results of operations. A goodwill impairment charge does not adversely affect regulatory capital ratios or tangible capital. Based on an analysis, it was determined that the fair value of the Company's reporting units exceeded the carrying value of their assets and liabilities and, therefore, goodwill was not considered impaired at December 31, 2013.

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

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

condition or operating results.

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

The market price for the Company's common stock has fluctuated, ranging between $18.66 and $29.45 per share during the 12 months ended December 31, 2013. The overall market and the price of the Company's common stock may experience volatility. There may be a significant impact on the market price for the common stock due to, among other things:

- past and future dividend practice;
- financial condition, performance, creditworthiness and prospects;

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

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

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

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

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

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

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

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

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

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. Sandy Spring Bank is subject to regulation and supervision by the

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

The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may have a material effect on our operations.

The Dodd-Frank Act imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on the Company's business are: changes to regulatory capital requirements; exclusion of hybrid securities, including trust preferred securities, issued on or after May 19, 2010 from Tier 1 capital; creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the Consumer Financial Protection Bureau, which develops and enforces rules for bank and non-bank providers of consumer financial products); potential limitations on federal preemption; changes to deposit insurance assessments; regulation of debit interchange fees; changes in retail banking regulations, including potential limitations on certain fees the Company may charge; and changes in regulation of consumer mortgage loan origination and risk retention. Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, require regulations to be promulgated by various federal agencies in order to be implemented, some of which have been proposed by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until implementation. The changes resulting from the Dodd-Frank Act may impact the profitability of the Company's business activities, require changes to certain of the Company's business practices, impose upon the Company more stringent capital, liquidity and leverage requirements or otherwise adversely affect the Company's business. These changes may also require the Company to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact the Company's results of operations and financial condition.

The Company's ability to pay dividends is limited by law and contract.

The ability to pay dividends to shareholders largely depends on Sandy Spring Bancorp's receipt of dividends from Sandy Spring Bank. The amount of dividends that Sandy Spring Bank may pay to Sandy Spring Bancorp is limited by federal laws and regulations. The ability of Sandy Spring Bank to pay dividends is also subject to its profitability, financial condition and cash flow requirements. There is no assurance that Sandy Spring Bank will be able to pay dividends to Sandy Spring Bancorp in the future. The decision may be made to limit the payment of dividends even when the legal ability to pay them exists, in order to retain earnings for other uses. A prohibition from paying dividends on common stock also exists if the required payments on the Company's subordinated debentures have not been made.

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

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

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

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

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

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

Changes in accounting standards or interpretation of new or existing standards may affect how the Company reports its financial condition and results of operations.
From time to time the Financial Accounting Standards Board ("FASB") and the SEC change accounting regulations and reporting standards that govern the preparation of the Company's financial statements. In addition, the FASB, SEC, bank regulators and the outside independent auditors may revise their previous interpretations regarding existing accounting regulations and the application of these accounting standards. These changes can be hard to predict and can materially impact how to record and report the Company's financial condition and results of operations. In some cases, there could be a requirement to apply a new or revised accounting standard retroactively, resulting in the restatement of prior period financial statements.

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

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

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on our financial condition and results of operations.
Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. We outsource many of our major systems, such as data processing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our

information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

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

Item 1B. Unresolved Staff Comments

None.

Item 2. PROPERTIES

The Company’s headquarters is located in Olney, Maryland. As of December 31, 2013, Sandy Spring Bank owned 13 of its 49 full-service community banking centers and leased the remaining banking centers. See Note 7 Premises and Equipment to the Notes to the Consolidated Financial Statements for additional information.

Item 3. LEGAL PROCEEDINGS

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Stock Listing
Common shares of Sandy Spring Bancorp, Inc. are listed on the NASDAQ Global Select Market under the symbol “SASR”. At March 1, 2014 there were 2,373 holders of record of the Company’s common stock.

Transfer Agent and Registrar
Registrar and Transfer Company, 10 Commerce Drive, Cranford, New Jersey 07016-3572.

Dividends
The dividend amount is established by the board of directors each quarter. In making its decision on dividends, the board considers operating results, financial condition, capital adequacy, regulatory requirements, shareholder returns,

and other factors. Shareholders received quarterly cash common dividends totaling $16.1 million in 2013, $11.9 million in 2012 and $8.3 million in 2011. Dividends have increased from 2011 through 2013 due to the Company's improved operating results.

Share Transactions with Employees

Shares issued under the employee stock purchase plan, which was authorized on July 1, 2011, totaled 24,849 in 2013 and 30,795 in 2012, while issuances pursuant to exercises of stock options and grants of restricted stock were 59,780 and 50,418 in the respective years. No shares were issued under the director stock purchase plan in 2013 as compared to 1,083 shares issued in 2012.

Quarterly Stock Information

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

	2013			2012		
	Stock Price Range		Per Share	Stock Price Range		Per Share
Quarter	Low	High	Dividend	Low	High	Dividend
1st	$ 18.66	$ 20.63	$ 0.14	$ 17.01	$ 19.87	$ 0.10
2nd	$ 18.72	$ 22.50	0.16	$ 16.66	$ 18.74	0.12
3rd	$ 21.57	$ 26.82	0.16	$ 17.58	$ 19.85	0.12
4th	$ 22.91	$ 29.45	0.18	$ 16.75	$ 19.81	0.14
Total			$ 0.64			$ 0.48

Issuer Purchases of Equity Securities

The Company re-approved the stock repurchase program in August 2013 that permits the repurchase of up to 5% of the Company's outstanding shares of common stock or approximately 1,260,000 shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. No shares were repurchased during 2013 or 2012 under the re-approved or previously existing programs.

Total Return Comparison

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the Standard and Poor's 500 Index or "S&P 500"), and a narrower index of Mid-Atlantic bank holding company peers with assets of $2 billion to $7 billion. The cumulative total return on the stock or the index equals the total increase in value since December 31, 2007, assuming reinvestment of all dividends paid into the stock or the index. The graph and table were prepared assuming that $100 was invested on December 31, 2008, in the common stock and the securities included in the indexes.

Index	Period Ending 12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Sandy Spring Bancorp, Inc.	100.00	41.88	87.04	84.53	95.99	143.36
S&P 500	100.00	126.46	145.51	148.59	172.37	228.19
SASR Peer Group Index*	100.00	67.70	89.46	74.49	88.03	120.31

*The Peer Group Index includes twenty publicly traded bank holding companies, other than the Company, headquartered in the Mid-Atlantic region and with assets of $2 billion to $7 billion. The companies included in this index are: Bancorp, Inc. (DE); BNC Bancorp (NC); Bryn Mawr Bank Corporation (PA); Cardinal Financial Corporation (VA); City Holding Company (WV); CommunityOne Bancorp (NC); Customers Bancorp, Inc. (PA); Eagle Bancorp, Inc. (MD); First Bancorp (NC); First Commonwealth Financial Corp. (PA), First Community Bancshares, Inc. (VA); First Financial Bancorp (OH); Lakeland Bancorp, Inc. (NJ); Metro Bancorp, Inc. (PA); S&T Bancorp, Inc. (PA); Sun Bancorp, Inc. (NJ); Towne Bank (VA); TriState Capital Holdings, Inc. (PA); Union First Market Bankshares Corporation (VA); Univest Company of Pennsylvania (PA); VantageSouth Bancshares, Inc. (NC); Virginia Commerce Bancorp, Inc. (VA) and WesBanco, Inc. (WV). Returns are weighted according to the issuer's stock market capitalization at the beginning of each year shown.

Equity Compensation Plans

The following table presents disclosures regarding equity compensation plans in existence at December 31, 2013, consisting only of the 1999 Stock Option Plan (expired but with outstanding options that may still be exercised) and the 2005 Omnibus Stock Plan, each of which was approved by the shareholders.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	310,950	$ 25.28	1,055,661
Equity compensation plans not approved by security holders	-	-	-
Total	310,950	$ 25.28	1,055,661

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Item 6. Selected Financial Data
Consolidated Summary of Financial Results

(Dollars in thousands, except per share data)	2013		2012		2011		2010		2009
Results of Operations:									
Tax-equivalent interest income	$ 154,639		$ 149,244		$ 145,072		$ 153,185		$ 160,069
Interest expense	19,433		22,651		26,524		32,742		51,522
Tax-equivalent net interest income	135,206		126,593		118,548		120,443		108,547
Tax-equivalent adjustment	5,292		5,374		5,602		4,836		4,839
Provision (credit) for loan and lease losses	(1,084)		3,649		1,428		25,908		76,762
Net interest income after provision (credit) for loan and lease losses	130,998		117,570		111,518		89,699		26,946
Non-interest income	47,511		46,956		43,500		43,782		43,356
Non-interest expenses	111,524		109,927		105,071		100,912		101,154
Income (loss) before taxes	66,985		54,599		49,947		32,569		(30,852)
Income tax expense (benefit)	22,563		18,045		15,845		9,049		(15,997)
Net income (loss)	44,422		36,554		34,102		23,520		(14,855)
Net income (loss) available to common stockholders	44,422		36,554		34,102		17,371		(19,665)
Per Share Data:									
Net income (loss) - basic per share	$ 1.78		$ 1.49		$ 1.42		$ 1.05		$ (0.90)
Net income (loss) - basic per common share	1.78		1.49		1.42		0.78		(1.20)
Net income (loss) -diluted per share	1.77		1.48		1.41		1.05		(0.90)
Net income (loss) - diluted per common share	1.77		1.48		1.41		0.78		(1.20)
Dividends declared per common share	0.64		0.48		0.34		0.04		0.37
Book value per common share	19.98		19.41		18.52		16.95		17.80
Dividends declared to diluted net income per common share	36.16	%	32.43	%	24.11	%	5.13	%	n/m
Period End Balances:									
Assets	$ 4,106,100		$ 3,955,206		$ 3,711,370		$ 3,519,388		$ 3,630,47
Investment securities	1,016,609		1,075,032		1,164,699		1,042,943		1,023,79
Loans and leases	2,784,266		2,531,128		2,239,692		2,156,232		2,298,01
Deposits	2,877,225		2,913,034		2,656,520		2,549,872		2,696,84
Borrowings	703,842		526,987		584,021		537,001		535,646
Stockholders' equity	499,363		483,512		446,109		407,569		373,586
Average Balances:									
Assets	$ 4,007,411		$ 3,780,084		$ 3,581,566		$ 3,612,988		$ 3,557,23
Investment securities	1,063,247		1,062,377		1,129,981		1,039,126		824,802
Loans and leases	2,642,872		2,415,459		2,161,759		2,236,885		2,416,47
Deposits	2,889,875		2,777,098		2,614,220		2,611,009		2,599,28
Borrowings	595,842		510,704		518,784		534,629		535,272
Stockholders' equity	487,836		465,719		422,681		441,195		389,221
Performance Ratios:									
Return on average assets	1.11	%	0.97	%	0.95	%	0.48	%	(0.55)
Return on average common equity	9.11		7.85		8.07		4.56		(6.35)

Yield on average interest-earning assets	4.15		4.24		4.37		4.58		4.85
Rate on average interest-bearing liabilities	0.74		0.89		1.06		1.27		1.97
Net interest spread	3.41		3.35		3.31		3.31		2.88
Net interest margin	3.63		3.60		3.57		3.60		3.29
Efficiency ratio GAAP (1)	62.86		65.36		67.16		63.31		68.78
Efficiency ratio Non-GAAP (1)	60.06		60.94		63.75		60.36		64.37
Capital Ratios:									
Tier 1 leverage	11.32	%	10.98	%	10.84	%	10.30	%	9.09
Tier 1 capital to risk-weighted assets	14.42		14.15		14.57		14.11		12.01
Total regulatory capital to risk-weighted assets	15.65		15.40		15.83		15.37		13.27
Tangible common equity to tangible assets - Non-GAAP (2)	10.37		9.94		9.68		9.51		5.95
Average equity to average assets	12.17		12.32		11.80		12.21		10.94
Credit Quality Ratios:									
Allowance for loan losses to loans and leases	1.39	%	1.70	%	2.21	%	2.88	%	2.81
Non-performing loans to total loans	1.44		2.29		3.53		4.08		5.82
Non-performing assets to total assets	1.01		1.61		2.25		2.78		3.89
Net charge-offs to average loans and leases	0.12		0.42		0.66		1.27		2.61

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

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

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

Overview

Net income for Sandy Spring Bancorp, Inc. and subsidiaries (the "Company") for the year ended December 31, 2013 totaled $44.4 million ($1.77 per diluted share), compared to net income of $36.6 million ($1.48 per diluted share) for the prior year. These results reflect the following events:

- Net interest income increased 7% in 2013 compared to 2012. This increase was due primarily to growth in average interest-earning assets, largely resulting from higher-earning commercial loans added due to organic loan growth. Combined with an improved deposit mix, these factors more than offset lower overall earning asset yields.
- Total loans at December 31, 2013 increased 10% compared to the balance at December 31, 2012. This improvement was driven primarily by the growth in commercial loans.
- The provision for loan and lease losses was a credit of $1.1 million for 2013 compared to a charge of $3.6 million for 2012. The resolution of non-performing loans and reduced migration of existing loans into non-performing status resulted in a decrease in the provision for 2013.Non-interest income increased $0.5 million or 1% for 2013 compared to 2012 due largely to growth in wealth management income, insurance agency commissions and other non-interest income which were substantially offset by a decrease in mortgage banking activities due to a lower volume of refinancing activity.

In 2013, the Mid-Atlantic region in which the Company operates continued to show slow but steady economic improvement. Concerns over a struggling national economy and a continued high unemployment rate at year-end continued to impede both the regional and national economic outlook. While the housing markets have improved, this sector is still significantly below levels experienced in prior economic recoveries due in part to higher long-term interest rates. The positive trends in housing and consumer spending have been offset by concerns over the possible effect of the Affordable Care Act and stubbornly high unemployment, which have caused uncertainty on the part of both large and small businesses and has thus limited economic expansion. The financial stability of the European Union continues to be an underlying volatility factor. Together with state and municipal budget challenges across the country, these factors have caused enough economic uncertainty, particularly among individual consumers and small and medium-sized businesses, to suppress confidence and thus constrain the pace of economic expansion and lending. Despite this challenging business environment, the Company has emphasized the fundamentals of community banking as it has maintained strong levels of liquidity and capital while overall credit quality has continued to improve.

The net interest margin increased to 3.63% in 2013 compared to 3.60% for 2012. During 2013, loan growth together with interest recoveries from the resolution of previously non-performing commercial real estate loans served to offset the effect of lower rates on average interest-earning assets. Excluding the interest recoveries mentioned above, the net interest margin was 3.53% for 2013. Average loans increased 9%, compared to the prior year, while average total deposits increased 4% compared to 2012.

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

The Company's credit quality continued to improve as non-performing assets decreased to $41.4 million at December 31, 2013 from $63.8 million at December 31, 2012. This decrease was due primarily to a combination of the Company's continuing efforts at resolution of non-performing loans and reduced migration of existing loans into non-performing status, particularly in the commercial real estate portfolio. Non-performing assets represented 1.01% of total assets at December 31, 2013 compared to 1.61% at December 31, 2012. The ratio of net charge-offs to average loans and leases was 0.12% for 2013, compared to 0.42% for the prior year.

At December 31, 2013, the Bank remained above all "well-capitalized" regulatory requirement levels. In addition, tangible book value per common share increased 8% to $16.68 from $15.43 at December 31, 2012.

Total assets at December 31, 2013 increased 4% compared to December 31, 2012. Loan balances increased 10% compared to the prior year end due primarily to increases of 16% in residential mortgage and construction loans, 9% in commercial loans and 5% in consumer loans. The growth in commercial loans was primarily due to growth of 21% in commercial investor real estate loans. Customer funding sources, which include deposits plus other short-term borrowings from core customers, decreased 1% compared to balances at December 31, 2012. The decrease in customer funding sources was driven primarily by decreases of 11% in certificates of deposit and 2% in money market accounts. These decreases were somewhat offset by a combined increase of 2% in interest-bearing and noninterest-bearing checking accounts and an increase of 7% in regular savings accounts. The Company continued to manage its net interest margin, primarily by reducing rates on certificates of deposit and by utilizing short-term FHLB borrowings during this extended period of historically low interest rates. During the same period, stockholders' equity increased to $499 million due to net income in 2013.

Net interest income increased by $8.7 million, or 7% compared to the prior year. The effects of a 15 basis point decrease in the cost of interest-bearing liabilities, growth of 15% in average noninterest-bearing deposits, 6% growth in average interest-earning assets and a 35% decrease in non-performing assets more than offset a decline of 9 basis points in the yield on average interest-earning assets.

Non-interest income increased 1% in 2013 compared to 2012. Wealth management income increased 10% over the prior year due to growth in assets under management and market conditions. Insurance agency commissions increased 7% due to growth in commissions on physicians' liability and commercial lines. In addition, other non-interest income increased 42% over the prior year due to sales and dispositions of loans and fixed assets and a non-recurring legal settlement. These increases were largely offset by a 49% decrease in income from mortgage banking activities due to lower volumes from refinancing activity in the current year. Service charges on deposits decreased 4% due to lower overdraft fees.

Non-interest expenses increased 1% in 2013 compared to the prior year due primarily to higher salaries and benefits expenses due to additional staff and higher sales incentive compensation. Occupancy expenses also increased due to the recognition of expenses for the planned 2014 closing of three branches. These increases were somewhat offset by an 11% decrease in FDIC insurance expense due primarily to improved financial ratios compared to 2012.

Critical Accounting Policies

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

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

Allowance for Loan and Lease Losses

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

Management believes that the allowance is adequate. However, its determination requires significant judgment, and estimates of probable losses in the lending portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions or reductions to the allowance may be necessary based on changes in the loans and leases comprising the portfolio and changes in the financial condition of borrowers, resulting from changes in economic conditions. In addition, various regulatory agencies, as an

integral part of their examination process, and independent consultants engaged by the Company periodically review the loan and lease portfolio and the allowance. Such reviews may result in additional provisions based on their judgments of information available at the time of each examination.

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

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

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

The general allowance comprised 92% of the total allowance at December 31, 2013 and 88% at December 31, 2012. The general allowance is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Allowances on loans considered to be "criticized" and "classified" under regulatory guidance are calculated separately from loans considered to be "pass" rated under the same guidance. This segregation allows the Company to monitor the allowance applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and ensure the sufficiency of the allowance for loan and lease losses.

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

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

At December 31, 2013, the specific allowance accounted for 8% of the total allowance as compared to 12% at December 31, 2012. The estimated losses on impaired loans can differ substantially from actual losses.

Goodwill and Other Intangible Asset Impairment

Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of the Company's reporting units be compared to the carrying amount of the reporting unit's net assets, including goodwill. The Company's reporting units were identified based upon an analysis of each of its individual operating segments. If the fair values of the reporting units exceed their book values, no write-down of recorded goodwill is required. If the fair value of a reporting unit is less than book value, an expense may be required to write-down the

related goodwill to the proper carrying value. The Company tests for impairment of goodwill as of October 1 of each year using September 30 data and again at any quarter-end if any triggering events occur during a quarter that may affect goodwill. Examples of such events include, but are not limited to, a significant deterioration in future operating results, adverse action by a regulator or a loss of key personnel. Determining the fair value of a reporting unit requires the Company to use a degree of subjectivity.

Under current accounting guidance, the Company has the option to assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it is determined that the carrying value exceeds the fair value the first step, described on the previous page, of the two-step process must be performed. The Company has elected this accounting guidance with respect to its Community Banking and Investment Management segments. At September 30, 2013 there was no evidence of impairment of goodwill or intangibles in any of the Company's reporting units.

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

Accounting for Income Taxes

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

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

Fair Value Measurements

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

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

the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

The above accounting policies with respect to fair value are discussed in further detail in “Note 21-Fair Value” to the Consolidated Financial Statements.

Defined Benefit Pension Plan

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

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

Consolidated Average Balances, Yields and Rates

	Year Ended December 31,							
	2013				2012			
(Dollars in thousands and tax-equivalent)	Average Balances	(1) Interest	Annualized Average Yield/Rate		Average Balances	(1) Interest	Annualized Average Yield/Rate	
Assets								
Residential mortgage loans (2)	$ 591,068	$ 21,385	3.62	%	$ 503,963	$ 21,281	4.22	%
Residential construction loans	121,488	4,331	3.57		125,295	4,581	3.66	
Commercial ADC loans	156,115	9,596	6.15		147,881	7,721	5.22	
Commercial investor real estate loans	495,562	27,901	5.63		421,505	23,167	5.50	
Commercial owner occupied real estate loans	569,065	29,696	5.36		554,397	30,236	5.45	
Commercial business loans	343,554	17,807	5.07		299,462	16,511	5.51	
Leasing	1,525	102	6.70		5,117	326	6.36	
Consumer loans	364,495	12,491	3.45		357,839	12,592	3.52	
Total loans and leases (3)	2,642,872	123,309	4.69		2,415,459	116,415	4.82	
Taxable securities	761,713	18,133	2.38		774,030	19,254	2.49	
Tax-exempt securities (4)	301,534	13,112	4.35		288,347	13,463	4.67	
Interest-bearing deposits with banks	33,261	84	0.25		42,668	111	0.26	
Federal funds sold	475	1	0.22		724	1	0.18	
Total interest-earning assets	3,739,855	154,639	4.15		3,521,228	149,244	4.24	
Less: allowance for loan and lease losses	(41,606)				(46,260)			
Cash and due from banks	45,836				46,588			
Premises and equipment, net	47,244				48,875			
Other assets	216,082				209,653			
Total assets	$ 4,007,411				$ 3,780,084			
Liabilities and Stockholders' Equity								
Interest-bearing demand deposits	$ 438,183	373	0.09	%	$ 385,004	344	0.09	%
Regular savings deposits	238,818	204	0.09		212,659	199	0.09	
Money market savings deposits	879,588	1,414	0.16		877,546	1,943	0.22	
Time deposits	490,278	3,448	0.70		566,658	4,871	0.86	
Total interest-bearing deposits	2,046,867	5,439	0.27		2,041,867	7,357	0.36	
Other borrowings	60,249	163	0.27		70,477	204	0.29	
Advances from FHLB	500,593	12,936	2.58		405,227	14,131	3.49	
Subordinated debentures	35,000	895	2.56		35,000	959	2.74	
Total interest-bearing liabilities	2,642,709	19,433	0.74		2,552,571	22,651	0.89	
Noninterest-bearing demand deposits	843,008				735,231			
Other liabilities	33,858				26,563			
Stockholders' equity	487,836				465,719			
Total liabilities and stockholders' equity	$ 4,007,411				$ 3,780,084			
Net interest income and spread		$ 135,206	3.41	%		$ 126,593	3.35	%
Less: tax-equivalent adjustment		5,292				5,374		
Net interest income		$ 129,914				$ 121,219		

Interest income/earning assets	4.15	%	4.24	%
Interest expense/earning assets	0.52		0.64	
Net interest margin	3.63	%	3.60	%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2013, 2012 and 2011. The annualized taxable-equivalent adjustments utilized in the above table to compute yields aggregated to $5.3 million, $5.4 million and $5.6 million in 2013, 2012 and 2011, respectively.
(2) Includes residential mortgage loans held for sale. Home equity loans and lines are classified as consumer loans.
(3) Non-accrual loans are included in the average balances.
(4) Includes only investments that are exempt from federal taxes.

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Net Interest Income

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

2013 vs. 2012

Net interest income for 2013 was $129.9 million compared to $121.2 million for 2012. On a tax-equivalent basis, net interest income for 2013 was $135.2 million compared to $126.6 million for 2012, an increase of 7%. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.63% for 2013 compared to 3.60% for 2012. Average interest-earning assets increased by 6% while average interest-bearing liabilities increased 4% in 2013. Average noninterest-bearing deposits increased 15% in 2013 while the percentage of average noninterest-bearing deposits to total deposits also increased to 29% for 2013 compared to 26% for 2012.

2012 vs. 2011

Net interest income for 2012 was $121.2 million compared to $112.9 million for 2011. On a tax-equivalent basis, net interest income for 2012 was $126.6 million compared to $118.5 million for 2011, an increase of 7%. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.60% for 2012 compared to 3.57% for 2011. Average interest-earning assets increased by 6% while average interest-bearing liabilities increased 2% in 2012. Average noninterest-bearing deposits increased 19% in 2012 while the percentage of average noninterest-bearing deposits to total deposits also increased to 26% for 2012 compared to 24% for 2011.

Effect of Volume and Rate Changes on Net Interest Income

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

	2013 vs. 2012			2012 vs. 2011		
	Increase Or	Due to Change In Average:*		Increase Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate
Interest income from earning assets:						
Loans and leases	$ 6,894	$ 10,191	$ (3,297)	$ 8,483	$ 12,454	$ (3,971)
Securities	(1,472)	27	(1,499)	(4,344)	(2,156)	(2,188)
Other earning assets	(27)	(24)	(3)	33	29	4
Total interest income	5,395	10,194	(4,799)	4,172	10,327	(6,155)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	29	48	(19)	(20)	50	(70)
Regular savings deposits	5	17	(12)	16	28	(12)
Money market savings deposits	(529)	4	(533)	(1,604)	71	(1,675)
Time deposits	(1,423)	(605)	(818)	(2,037)	(475)	(1,562)
Total borrowings	(1,300)	2,316	(3,616)	(228)	(242)	14
Total interest expense	(3,218)	1,780	(4,998)	(3,873)	(568)	(3,305)
Net interest income	$ 8,613	$ 8,414	$ 199	$ 8,045	$ 10,895	$ (2,850)

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

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Interest Income

2013 vs. 2012
The Company's total tax-equivalent interest income increased 4% for 2013 compared to the prior year. The previous table shows that, in 2013, the increase in average loans and leases more than offset a continued decline in earning asset yields with respect to the loan portfolio which resulted in an increase in total tax-equivalent interest income. During 2013, the Company experienced interest recoveries of $3.7 million from the resolution of two previously non-performing commercial real estate loans. Excluding such interest recoveries, total tax-equivalent interest income increased 1% for 2013 compared to the prior year.

In 2013, the average balance of the loan portfolio, including residential mortgage loans held for sale, increased 9% compared to the prior year. This growth was primarily in the commercial investor real estate, commercial business and residential mortgage portfolios. These increases were driven by organic loan growth as the regional economy slowly improved. The yield on average loans and leases decreased by 13 basis points due to the continued prevailing low interest rate environment as relatively higher rate loans were paid off and new loans were originated at comparatively lower rates. The decline in the portfolio yield was driven primarily by a combined decrease of 50 basis points in the yield in the residential mortgage portfolio together with a decrease of 7 basis points in the yield on the overall consumer loan portfolio, while the yield on the commercial loan portfolio remained level. The decrease in the yield on the mortgage loan portfolio was due to declining rates on both new and existing adjustable rate mortgage loans, which the Company does not sell but maintains in the portfolio.

The average yield on total investment securities decreased 14 basis points while the average balance of the portfolio remained virtually level in 2013 compared to 2012. The decrease in the yield on investments was due primarily to calls of securities that were replaced by lower yielding investments as a result of lower overall market rates.

2012 vs. 2011
The Company's total tax-equivalent interest income increased 3% for 2012 compared to the prior year. The previous table shows that, in 2012, the increase in average loans and leases more than offset a continued decline in earning asset yields with respect to the loan portfolio which resulted in an increase in total tax-equivalent interest income.

In 2012, the average balance of the loan portfolio, including residential mortgage loans held for sale, increased 12% compared to the prior year. This growth was primarily in the owner occupied and investor real estate, commercial business and residential construction and mortgage portfolios. These increases were driven by loans added from the CommerceFirst acquisition in the second quarter of 2012 and organic loan growth as the regional economy slowly improved. The yield on average loans and leases decreased by 18 basis points due to the continued prevailing low interest rate environment as relatively higher rate loans were paid off and new loans were originated at comparatively lower rates. The decline in the portfolio yield was driven primarily by a combined decrease of 52 basis points in the yield in the residential mortgage portfolio together with a decrease of 8 basis points in the yield in the overall commercial loan portfolio. The decrease in the yield on the mortgage loan portfolio was due to declining rates on both new and existing adjustable rate mortgage loans, which the Company does not sell but maintains in the portfolio.

The average yield on total investment securities decreased 20 basis points while the average balance of the portfolio decreased 6% or $68 million in 2012 compared to 2011. The decline in investments was necessary to fund growth in the loan portfolio and the CommerceFirst acquisition in the second quarter of 2012. The decrease in the yield on investments was due primarily to calls and maturities of securities that were replaced by lower yielding investments as a result of lower overall market rates.

Interest Expense

2013 vs. 2012

Interest expense decreased by $3.2 million or 14% in 2013 compared to 2012, primarily as a result of a 15 basis point decrease in the average rate paid on interest-bearing liabilities. Deposit activity during 2013 continued to be driven by clients' emphasis on safety and liquidity as average total deposits increased 4% for the year compared to the prior year. This increase was primarily due to increases of $161 million or 14% in average noninterest-bearing and interest-bearing checking accounts together with an increase of $26 million or 12% in regular savings accounts as clients kept funds in short-term instruments to preserve liquidity. This growth was partially offset by a decrease in average certificates of deposit of $76 million or 13% in 2013 compared to 2012. This decrease was primarily due to a decline in the rates offered on certificates in an effort to preserve the Company's net interest margin during this extended period of historically low interest rates. In addition, the average rate paid on advances from the Federal Home Loan Bank of Atlanta decreased 91 basis points for 2013 compared to 2012 due to the restructuring of $170 million of such advances into longer term, lower rate instruments during the fourth quarter of 2012 and the first half of 2013 and due to an increase in short-term advances to take advantage of current low interest rates. Average balances of money market accounts remained essentially level in 2013 compared 2012 as clients maintained liquidity as mentioned above.

2012 vs. 2011

Interest expense decreased by $3.9 million or 15% in 2012 compared to 2011, primarily as a result of a 17 basis point decrease in the average rate paid on interest-bearing liabilities. Deposit activity during 2012 was driven by the CommerceFirst acquisition and by clients' emphasis on safety and liquidity as average total deposits increased 6% for the year compared to the prior year. This increase was driven by increases of $161 million or 17% in average noninterest-bearing and interest-bearing checking accounts together with an increase of $29 million or 16% in regular savings accounts as clients kept funds in short-term instruments to preserve liquidity. This growth was partially offset by a decrease in average certificates of deposit of $45 million or 7% in 2012 compared to 2011. This decrease was primarily due to a decline in the rates offered on certificates in an effort to preserve the Company's net interest margin during this extended period of historically low interest rates. This largely offset the growth in the certificates of deposit from the CommerceFirst acquisition. In addition, the average rate paid on advances from the Federal Home Loan Bank of Atlanta decreased 6 basis points for 2012 compared to 2011 due primarily to the restructuring of $120 million of such advances into longer term, lower rate instruments during the fourth quarter of 2012 and first half of 2013. Average balances of money market accounts increased 2% in 2012 compared 2011 as clients maintained liquidity as mentioned above.

Interest Rate Performance

2013 vs. 2012

The Company's net interest margin increased to 3.63% for 2013 compared to 3.60% for 2012 while the net interest spread increased to 3.41% in 2013 compared to 3.35% in 2012. The increase in both the net interest margin and net interest spread was due in part, to the interest recoveries on previously non-performing loans previously mentioned. Excluding these recoveries, the net interest margin and net interest spread were 3.53% and 3.31%, respectively. Excluding the interest recoveries, the decrease in the net interest margin was caused by the effect of lower rates on interest-earning assets exceeding the benefit of the decline in rates on interest-bearing deposits and borrowings.

2012 vs. 2011

The Company's net interest margin increased to 3.60% for 2012 compared to 3.57% in 2011 while the net interest spread increased to 3.35% in 2012 compared to 3.31% in 2011. The increase in the net interest margin was due primarily to the combination of increased average loan balances, lower rates on money market and time deposits and higher balances of noninterest-bearing deposits.

Non-interest Income

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

(Dollars in thousands)	2013	2012	2011	2013/2012 $ Change	2013/2012 % Change		2012/2011 $ Change	2012/2011 % Change	
Securities gains	$ 115	$ 459	$ 292	$ (344)	(74.9)	%	$ 167	57.2	%
Total other-than-temporary impairment ("OTTI") losses	-	(109)	(178)	109	(100.0)		69	(38.8)	
Portion of OTTI losses recognized in other comprehensive income before taxes	-	-	18	-	-		(18)	(100.0)	
Net OTTI recognized in earnings	-	(109)	(160)	109	(100.0)		51	(31.9)	
Service charges on deposit accounts	8,533	8,910	9,527	(377)	(4.2)		(617)	(6.5)	
	3,094	6,032	3,228	(2,938)	(48.7)		2,804	86.9	

Mortgage banking activities							
Wealth management income	17,585	15,949	15,646	1,636	10.3	303	1.9
Insurance agency commissions	4,821	4,490	4,650	331	7.4	(160)	(3.4)
Income from bank owned life insurance	2,499	2,616	2,636	(117)	(4.5)	(20)	(0.8)
Visa check fees	4,165	3,887	3,637	278	7.2	250	6.9
Letter of credit fees	881	992	1,123	(111)	(11.2)	(131)	(11.7)
Extension fees	558	590	406	(32)	(5.4)	184	45.3
Other income	5,260	3,140	2,515	2,120	67.5	625	24.9
Total non-interest income	$ 47,511	$ 46,956	$ 43,500	$ 555	1.2	$ 3,456	7.9

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2013 vs. 2012

Total non-interest income was $47.5 million for 2013 compared to $47.0 million for 2012. The primary drivers of non-interest income for 2013 were increases in wealth management income, income from insurance agency commissions and other non-interest income, which were largely offset by a substantial decline in mortgage banking income.

Wealth management income is comprised of income from trust and estate services, investment management fees earned by West Financial Services, the Company's investment management subsidiary, and fees on sales on investment products and services. Trust services fees increased 8% compared to the prior year, due to an increase in assets under management. Investment management fees in West Financial Services increased 12% for 2013 compared to 2012, also due to higher assets under management. Fees on sales of investment products and services increased 12% for the year, also due to an increase in assets under management. Overall total assets under management increased to $2.5 billion at December 31, 2013 compared to $2.2 billion at December 31, 2012 as a result of positive market movements and additions from new and existing clients.

Income from mortgage banking activities decreased in 2013 compared to 2012 due primarily to the increase in interest rates during 2013, which significantly reduced loan origination volumes from refinancing activity.

Insurance agency commissions increased in 2013 compared to 2012 due primarily to higher revenues on commercial and physicians' liability lines.

Other non-interest income increased during the current year compared to the prior year due mainly to gains on sales and dispositions of loans and fixed assets, a non-recurring legal settlement and recovery of fees on non-performing loans mentioned previously.

Service charges on deposits decreased in 2013 compared to 2012 due primarily to a decline in overdraft fees.

Income from bank owned life insurance decreased in 2013 compared to the prior year due to the decline in the interest rates paid on these policies. The Company invests in bank owned life insurance products in order to manage the cost of employee benefit plans. Investments totaled $86.2 million at December 31, 2013 and $83.7 million at December 31, 2012 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 4.90% for 2013 compared to 5.29% for the prior year.

No net OTTI losses were recognized in earnings in 2013 compared to $109 thousand for the prior year. The Company recognized net securities gains, exclusive of net OTTI losses which resulted primarily from securities calls during the period.

2012 vs. 2011

Total non-interest income was $47.0 million for 2012 compared to $43.5 million for 2011. As shown on the previous table, the primary drivers of non-interest income for 2012 were increases in income from mortgage banking activities due primarily to higher loan origination volumes due to both increased refinancing activity and steadily declining rates and other non-interest income due to gains on sales of property and equipment and vendor incentive fees. During 2012, wealth management income increased 2% compared to the prior year due to increased assets under management resulting from market activity and the addition of new clients. Income from Visa check fees increased for 2012 compared to the prior year due to a higher volume of electronic transactions. These increases were somewhat offset by decreases in service charges on deposits due primarily to a decline in overdraft fees and a decrease in insurance agency commissions due to lower commercial property and casualty revenues.

Non-interest Expense

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

(Dollars in thousands)	2013	2012	2011	2013/2012 $ Change	2013/2012 % Change	2012/2011 $ Change	2012/2011 % Change
Salaries and employee benefits	$ 65,598	$ 62,509	$ 59,625	$ 3,089	4.9 %	$ 2,884	4.8 %
Occupancy expense of premises	13,171	12,010	11,519	1,161	9.7	491	4.3
Equipment expenses	4,940	4,871	4,705	69	1.4	166	3.5
Marketing	2,880	2,651	2,389	229	8.6	262	11.0
Outside data services	4,580	5,019	4,159	(439)	(8.7)	860	20.7
FDIC insurance	2,300	2,573	3,187	(273)	(10.6)	(614)	(19.3)
Amortization of intangible assets	1,845	1,881	1,845	(36)	(1.9)	36	2.0
Professional fees	4,479	6,309	4,942	(1,830)	(29.0)	1,367	27.7
Other real estate owned	(303)	905	2,412	(1,208)	(133.5)	(1,507)	(62.5)
Postage and delivery	1,299	1,255	1,257	44	3.5	(2)	(0.2)
Communications	1,606	1,596	1,433	10	0.6	163	11.4
Other expenses	9,129	8,348	7,598	781	9.4	750	9.9
Total non-interest expense	$ 111,524	$ 109,927	$ 105,071	$ 1,597	1.5	$ 4,856	4.6

2013 vs. 2012

Non-interest expenses totaled $111.5 million in 2013 compared to $109.9 million in 2012. This increase in expenses was driven primarily by increases in salaries and benefits expenses, occupancy expenses and marketing expenses. These increases were somewhat offset by the benefit of the recovery of expenses related to the resolution of problem loans and the lack of merger expenses in 2013.

Salaries and employee benefits, the largest component of non-interest expenses, increased in 2013 due primarily to higher compensation expenses as a result of a larger staff, due in part to the CommerceFirst acquisition in 2012, merit increases and higher sales incentive compensation. The average number of full-time equivalent employees was 714 in 2013 compared to 685 for 2012.

Occupancy expenses increased in 2013 compared to 2012 due to higher rental expenses from a larger branch network, which includes a full year of expense for the branches added in the CommerceFirst acquisition in 2012, and the recognition of $0.8 million in expenses for the planned 2014 closing of three branches. In addition, grounds maintenance expenses increased in 2013 compared to 2012 due to weather related expenses. Equipment expenses remained level for 2013 compared to 2012.

Marketing expenses increased in 2013 compared to 2012 due to higher advertising expenses.

Outside data services expenses and professional fees decreased in 2013 compared to the prior year due primarily to merger expenses recognized in 2012 and due to the recovery of legal and other expenses incurred with respect to loan recoveries in 2013.

FDIC insurance expense decreased in 2013 compared to 2012 as the Company’s growth in assets was more than offset by a lower assessment rate due to improving financial ratios.

Other real estate owned expenses decreased compared to the prior year due to the decline in the number of real estate owned properties and gains on the sales of several properties.

Other non-interest expenses increased in 2013 compared to the prior year due mainly to increases in various categories of operating expenses.

2012 vs. 2011

Non-interest expenses totaled $109.9 million in 2012 compared to $105.1 million in 2011, an increase of 5%. This growth in expenses was due primarily to increases in salaries and benefits expenses resulting from merit increases and higher health benefits costs and increases in outside data services costs and professional fees, largely as a result of merger expenses incurred in conjunction with the CommerceFirst acquisition. These increases were partially offset by a decrease in other real estate owned expenses due to a lower volume of sales of such properties and a reduction in FDIC expenses due primarily to a regulatory change in the calculation of such premiums that was effective with the second quarter of 2011.

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Operating Expense Performance

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

Non-GAAP Financial Measures

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

In general, the efficiency ratio is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation of the non-GAAP efficiency ratio exclude goodwill impairment losses, the amortization of intangibles, and non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. Both the GAAP and non-GAAP efficiency ratios improved in 2013 compared to the prior year due primarily to an increase in net interest income, and to a lesser extent, an increase in non-interest income.

In addition, the Company uses pre-tax, pre-provision, pre-merger expense income as a measure of the level of recurring income before taxes. Management believes this provides financial statement users with a useful metric of the run-rate of revenues and expenses which is readily comparable to other financial institutions. This measure is calculated by adding (subtracting) the provision (credit) for loan and lease losses, the provision for income taxes and merger expenses back to net income. This metric increased in 2013 compared to the prior year due primarily to higher net interest income.

GAAP and Non-GAAP Efficiency Ratios

(Dollars in thousands)	Year ended December 31, 2013	2012	2011	2010	2009
Pre-tax pre-provision pre-merger expense income:					
Net income (loss)	$ 44,422	$ 36,554	$ 34,102	$ 23,520	$ (14,855)
Plus non-GAAP adjustment:					
Merger expenses	-	2,500	-	-	-
Income taxes	22,563	18,045	15,845	9,049	(15,997)
Provision for loan and lease losses	(1,084)	3,649	1,428	25,908	76,762
Pre-tax pre-provision pre-merger expense income	$ 65,901	$ 60,748	$ 51,375	$ 58,477	$ 45,910
GAAP efficiency ratio:					
Non-interest expenses	$ 111,524	$ 109,927	$ 105,071	$ 100,912	$ 101,154
Net interest income plus non-interest income	$ 177,425	$ 168,175	$ 156,446	$ 159,389	$ 147,064
GAAP efficiency ratio	62.86 %	65.36 %	67.16 %	63.31 %	68.78 %
Non-GAAP efficiency ratio:					
Non-interest expenses	$ 111,524	$ 109,927	$ 105,071	$ 100,912	$ 101,154
Less non-GAAP adjustment:					
Amortization of intangible assets	1,845	1,881	1,845	1,959	3,646
Merger expenses	-	2,500	-	-	-
Non-interest expenses - as adjusted	$ 109,679	$ 105,546	$ 103,226	$ 98,953	$ 97,508
Net interest income plus non-interest income	$ 177,425	$ 168,175	$ 156,446	$ 159,389	$ 147,064
Plus non-GAAP adjustment:					
Tax-equivalent income	5,292	5,374	5,602	4,836	4,839
Less non-GAAP adjustments:					
Securities gains	115	459	292	796	418
OTTI recognized in earnings	-	(109)	(160)	(512)	-
Net interest income plus non-interest income - as adjusted	$ 182,602	$ 173,199	$ 161,916	$ 163,941	$ 151,485
Non-GAAP efficiency ratio	60.06 %	60.94 %	63.75 %	60.36 %	64.37 %

Income Taxes

The Company had income tax expense of $22.6 million in 2013, compared to expense of $18.0 million in 2012 and $15.8 million in 2011. The resulting effective rates were 34% for 2013, 33% for 2012 and 32% for 2011. The increase in the effective tax rate in both 2013 and 2012 over their respective prior years was due primarily to a higher

proportion of income before taxes that was taxed at the full statutory rate compared to tax exempt income.

FINANCIAL CONDITION

The Company's total assets were $4.1 billion at December 31, 2013, increasing $151 million or 4% compared to $4.0 billion at December 31, 2012. Interest-earning assets increased $168 million to $3.8 billion at December 31, 2013 compared to December 31, 2012. The increase in interest-earning assets was primarily due to organic loan growth during 2013.

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

	December 31, 2013			2012			Year-to-Year Change		
(Dollars in thousands)	Amount	%		Amount	%		$ Change	% Change	
Residential real estate:									
Residential mortgage	$ 618,381	22.2	%	$ 523,364	20.7	%	$ 95,017	18.2	%
Residential construction	129,177	4.7		120,314	4.8		8,863	7.4	
Commercial real estate:									
Commercial owner occupied real estate	592,823	21.3		571,510	22.6		21,313	3.7	
Commercial investor real estate	552,178	19.8		456,888	18.0		95,290	20.9	
Commercial acquisition, development and construction	160,696	5.8		151,933	6.0		8,763	5.8	
Commercial Business	356,651	12.8		346,708	13.7		9,943	2.9	
Leases	703	-		3,421	0.1		(2,718)	(79.5)	
Consumer	373,657	13.4		356,990	14.1		16,667	4.7	
Total loans and leases	$ 2,784,266	100.0	%	$ 2,531,128	100.0	%	$ 253,138	10.0	

Total loans and leases, excluding loans held for sale, increased $253 million or 10% at December 31, 2013 compared to December 31, 2012. The commercial loan portfolio increased by $135 million to $1.7 billion at December 31, 2013 compared to the prior year end largely due to a 21% increase in commercial investor real estate loans and a 4% increase in commercial owner occupied real estate loans at December 31, 2013 compared to December 31, 2012. In addition, ADC loans increased 6% at December 31, 2013 compared to December 31, 2012. These increases reflect an improving economy and the Company's increased emphasis on growth in its commercial portfolio.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, reflected a 16% increase at December 31, 2013 compared to December 31, 2012. Permanent residential mortgages, most of which are 1-4 family, increased 18% due to higher loan origination volumes of adjustable rate mortgage loans. The Company generally retains such adjustable rate mortgages in its portfolio and sells the fixed rate mortgages that it originates in the secondary mortgage market. Residential construction loans increased 7% at December 31, 2013 compared to the balance at December 31, 2012 due to increased construction activity as a result of mild weather conditions and a slowly improving economy.

The consumer loan portfolio increased by $17 million to $374 million at December 31, 2013 compared to December 31, 2012 due to growth in home equity lines of credit as the Company aggressively promoted this product line during the past year.

Analysis of Loans and Leases
The trends in the composition of the loan and lease portfolio over the previous five years are presented in following table:

(Dollars in thousands)	December 31, 2013	%		2012	%		2011	%		2010	%		2009
Residential real estate:													
Residential mortgage	$ 618,381	22.2	%	$ 523,364	20.7	%	$ 448,662	20.0	%	$ 436,534	20.2	%	$ 457,4
Residential construction	129,177	4.7		120,314	4.8		108,699	4.9		91,273	4.2		92,28

Commercial real estate:									
Commercial mortgage*	1,145,001	41.1	1,028,398	40.6	894,024	39.9	831,068	38.6	894,9
Commercial AD&C*	160,696	5.8	151,933	6.0	160,946	7.2	151,061	7.0	131,7
Commercial business	356,651	12.8	346,708	13.7	260,327	11.6	250,255	11.6	296,2
Leases	703	-	3,421	0.1	6,954	0.3	15,551	0.7	25,70
Consumer	373,657	13.4	356,990	14.1	360,080	16.1	380,490	17.7	399,6
Total loans and leases	$ 2,784,266	100.0 %	$ 2,531,128	100.0 %	$ 2,239,692	100.0 %	$ 2,156,232	100.0 %	$ 2,298

* Prior to 2010, the commercial mortgage category included loans on raw land or for projects that had not begun any construction activities. Subsequent to December 31, 2009, these loans were included in the commercial AD&C loan portfolio.

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Loan Maturities and Interest Rate Sensitivity

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

	At December 31, 2013							
	Remaining Maturities of Selected Credits in Years							
(In thousands)	1 or less		Over 1-5		Over 5		Total	
Residential construction loans	$	102,131	$	25,664	$	1,382	$	129,177
Commercial AD&C loans		121,173		24,641		14,882		160,696
Commercial business loans [1]		230,317		115,456		10,878		356,651
Total	$	453,621	$	165,761	$	27,142	$	646,524
Rate Terms:								
Fixed	$	52,646	$	103,500	$	25,625	$	181,771
Variable or adjustable		400,975		62,261		1,517		464,753
Total	$	453,621	$	165,761	$	27,142	$	646,524

(1) Loans not secured by real estate

Investment Securities

The investment portfolio, consisting of available-for-sale, held-to-maturity and other equity securities, decreased 5% or $58 million to $1.0 billion at December 31, 2013, from $1.1 billion at December 31, 2012.

Composition of Investment Securities

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

(Dollars in thousands)	December 31, 2013		%		2012		%		2011		%	
Available-for-Sale: [1]												
U.S. government agencies and corporations	$	139,466	13.7	%	$	156,428	14.6	%	$	200,252	17.2	%
State and municipal		165,428	16.3			174,491	16.3			173,111	14.9	
Mortgage-backed [2]		442,250	43.5			490,479	45.6			570,144	48.9	
Corporate debt		2,004	0.2			1,996	0.2			1,978	0.2	
Trust preferred		1,413	0.1			1,465	0.1			5,716	0.5	
Marketable equity securities		723	-			723	-			100	-	
Total available-for-sale securities [3]		751,284	73.8			825,582	76.8			951,301	81.7	
Held-to-Maturity and Other Equity												
U.S. government agencies and corporations		64,505	6.4			64,498	6.0			54,983	4.7	
State and municipal		159,889	15.8			150,995	14.1			123,075	10.6	
Mortgage-backed [2]		244	-			321	-			407	-	
Other equity securities		40,687	4.0			33,636	3.1			34,933	3.0	
Total held-to-maturity and other		265,325	26.2			249,450	23.2			213,398	18.3	

equity securities												
Total securities [3]	$	1,016,609	100.0	%	$	1,075,032	100.0	%	$	1,164,699	100.0	%

(1) At estimated fair value.

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

(3) The outstanding balance of no single issuer, except for U.S. Government Agency securities, exceeded ten percent of stockholders' equity at December 31, 2013, 2012 or 2011.

Available-for-sale securities decreased 9% due to amortization of mortgage-backed securities and calls and maturities of other investments, while held-to-maturity securities increased due primarily to a change in management’s internal guidelines with respect to the composition of the portfolio The overall investment portfolio decreased 5% as the Company funded loan growth together with increased short-term borrowings at historically low rates to maintain the net interest margin.

The investment portfolio consists primarily of U.S. Agency securities, U.S. Agency mortgage-backed securities, U.S. Agency collateralized mortgage obligations and state and municipal securities. The duration of the portfolio was 3.9 years at December 31, 2013 and 3.4 years at December 31, 2012. The Company considers the duration of the portfolio to be adequate for liquidity purposes. This investment strategy has resulted in a portfolio with low credit risk that would provide the required liquidity needed to meet increased loan demand. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis.

At December 31, 2013, the trust preferred portfolio included one pooled trust preferred security backed by debt issued by banks and thrifts, which totaled $1.7 million, with a fair value of $1.4 million. The fair value of this security was determined by a third party valuation specialist due to the limited trading activity for this security in the marketplace. The specialist used an income valuation approach technique (present value) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The methodology, observable inputs and significant assumptions employed by the specialist to determine fair value are provided in Note 4 Investments in the Notes to the Consolidated Financial Statements.

As a result of this valuation, it was determined that the pooled trust preferred security had not incurred any credit-related OTTI for the twelve months ended December 31, 2013. Cumulative credit-related OTTI of $0.5 million has been recognized in earnings through December 31, 2013. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was $0.3 million at December 31, 2013. This non-credit related OTTI was recognized in accumulated other comprehensive income ("OCI") at December 31, 2013.

Maturities and weighted average yields for investment securities available-for-sale and held-to-maturity at December 31, 2013 are presented in the following table. Amounts appear in the table at amortized cost, without market value adjustments, by stated maturity.

Maturity of Investment Securities

	Years to Maturity at December 31, 2013								
	Within One Year or Less		After One Year Through Five years		After Five Years Through Ten Years		Over Ten Years		
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total
Available-for-Sale[1]									
U. S. government agencies and corporations	$ -	- %	$ -	- %	$ 147,688	1.85 %	$ -	- %	$ 147,688
State and municipal [2]	80	6.25	11,271	4.19	139,171	4.68	9,002	5.17	159,524
Mortgage-backed	-	-	1,495	3.92	105,530	2.72	332,029	2.54	439,054
Corporate debt	2,000	2.24	-		-	-	-	-	2,000
Trust preferred	-	-	-	-	-	-	1,701	9.24	1,701
Total	$ 2,080	2.39	$ 12,766	4.16	$ 392,389	3.09	$ 342,732	2.64	$ 749,967
Held-to-Maturity [1]									
U. S. government agencies and corporations	$ -	- %	$ -	- %	$ 64,505	2.06 %	$ -	- %	$ 64,505
State and municipal	1,720	6.30	3,249	5.89	74,507	4.42	80,413	3.61	159,889
Mortgage-backed	-	-	-	-	21	5.95	223	5.62	244
Total	$ 1,720	6.30	$ 3,249	5.89	$ 139,033	3.33	$ 80,636	3.62	$ 224,638

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

Other Earning Assets

Residential mortgage loans held for sale decreased $28 million to $8 million as of December 31, 2013 from $36 million as of December 31, 2012 due to higher market interest rates that reduced mortgage loan origination volumes from refinancing during the year. The aggregate of federal funds sold and interest-bearing deposits with banks increased $0.8 million to $28 million in 2013.

Deposits

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

	December 31, 2013		2012		Year-to-Year Change	
(Dollars in thousands)	Amount	%	Amount	%	$ Change	% change
Noninterest-bearing deposits	$ 836,198	29.1 %	$ 847,415	29.1 %	$ (11,217)	(1.3) %
Interest-bearing deposits:						
Demand	460,824	16.0	428,048	14.7	32,776	7.7
Money market savings	870,653	30.2	884,367	30.4	(13,714)	(1.6)
Regular savings	243,813	8.5	228,384	7.8	15,429	6.8
Time deposits of less than $100,000	263,636	9.2	307,445	10.5	(43,809)	(14.2)
Time deposits of $100,000 or more	202,101	7.0	217,375	7.5	(15,274)	(7.0)
Total interest-bearing deposits	2,041,027	70.9	2,065,619	70.9	(24,592)	(1.2)
Total deposits	$ 2,877,225	100.0 %	$ 2,913,034	100.0 %	$ (35,809)	(1.2)

Deposits and Borrowings

Total deposits decreased $36 million or 1% at December 31, 2013 compared to December 31, 2012. This decrease was due primarily to a decline of 11% in certificates of deposit, as the Company managed its deposit mix to improve its net interest margin. This decrease was somewhat offset by increases in combined noninterest-bearing and interest-bearing checking accounts together with regular savings accounts compared to the prior year. The activity in these deposit products can be attributed primarily to clients' emphasis on safety and liquidity considering the current extended period of low interest rates and the volatility of alternative investments. Total borrowings increased 34% at December 31, 2013 compared to December 31, 2012. This increase was due primarily to the Company's decision to take advantage of extraordinarily low short-term interest rates to fund loan originations with short-term FHLB advances.

Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on- and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. During 2013, total stockholders' equity increased $16 million to $499 million at December 31, 2013, from $484 million at December 31, 2012. This increase was due primarily to net income during the year. The ratio of average equity to average assets was 12.17% for 2013, as compared to 12.32% for 2012.

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

Risk-Based Capital Ratios

	Ratios at December 31, 2013	2012	Minimum Regulatory Requirements
Total Capital to risk-weighted assets	15.65 %	15.40 %	8.00 %

Tier 1 Capital to risk-weighted assets	14.42	%	14.15	%	4.00	%
Tier 1 Leverage	11.32	%	10.98	%	3.00	%

Tier 1 capital of $452.5 million and total qualifying capital of $491.2 million each included $35.0 million in trust preferred securities that are considered regulatory capital for purposes of determining the Company's Tier 1 capital ratio. As of December 31, 2013, the most recent notification from the Bank's primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

In July 2013, the Federal Reserve Board approved revisions to its capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called Basel III, and address relevant provisions of the Dodd-Frank Act. The rules include new risk-based capital and leverage ratios, which are effective January 1, 2015, and revise the definition of what constitutes "capital" for calculating those ratios. The new minimum capital level requirements applicable to the Company and the Bank will be: (1) a new common equity Tier 1 capital ratio of 4.5%; (2) a Tier 1 capital ratio of 6% (increased from 4%); (3) a total capital ratio of 8% (unchanged from current rules); and (4) a Tier 1 leverage ratio of 4%. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010 will be grandfathered for companies with consolidated assets of $15 billion or less. The rules also establish a "capital conservation buffer" of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses to executive officers if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Tangible Common Equity

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

Tangible Common Equity Ratio Non-GAAP

	December 31,				
(Dollars in thousands, except per share data)	2013	2012	2011	2010	2009
Tangible common equity ratio:					
Total stockholders' equity	$ 499,363	$ 483,512	$ 446,109	$ 407,569	$ 373,586
Accumulated other comprehensive income (loss)	2,970	(11,312)	(13,248)	2,620	2,652
Goodwill	(84,171)	(84,808)	(76,816)	(76,816)	(76,816)
Other intangible assets, net	(1,330)	(3,163)	(4,734)	(6,578)	(8,537)
Preferred stock	-	-	-	-	(80,095)
Tangible common equity	$ 416,832	$ 384,229	$ 351,311	$ 326,795	$ 210,790
Total assets	$ 4,106,100	$ 3,955,206	$ 3,711,370	$ 3,519,388	$ 3,630,47
Goodwill	(84,171)	(84,808)	(76,816)	(76,816)	(76,816)
Other intangible assets, net	(1,330)	(3,163)	(4,734)	(6,578)	(8,537)
Tangible assets	$ 4,020,599	$ 3,867,235	$ 3,629,820	$ 3,435,994	$ 3,545,12
Tangible common equity ratio	10.37 %	9.94 %	9.68 %	9.51 %	5.95
Tangible book value per share	$ 16.68	$ 15.43	$ 14.58	$ 13.59	$ 12.78

Credit Risk

The fundamental lending business of the Company is based on understanding, measuring and controlling the credit risk inherent in the loan portfolio. The Company's loan and lease portfolio is subject to varying degrees of credit risk. Credit risk entails both general risks, which are inherent in the process of lending, and risk specific to individual

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

Current economic data has shown that while the Mid-Atlantic region is one of the stronger markets in the nation, the Company is continuing to deal with the lingering impact of a very slowly recovering economy and its resulting effects on the Company's borrowers, particularly in the real estate sector. Total non-performing loans decreased 31% to $40 million at December 31, 2013 compared to the balance at December 31, 2012. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by the volatility being experienced in various sectors of the economy on both a regional and national level.

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

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

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

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

appraiser list. After receipt of the updated appraisal, the assigned credit officer will recommend to the Chief Credit Officer whether a specific allowance or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to insure that there are no significant time lapses during this process.

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

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

- An internal evaluation is updated quarterly to include borrower financial statements and/or cash flow projections.
- The borrower may be contacted for a meeting to discuss an updated or revised action plan which may include a request for additional collateral.
- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.
- At the monthly credit committee meeting the loan may be downgraded and a specific allowance may be decided upon in advance of the receipt of the appraisal.
- Upon receipt of the updated appraisal (or based on an updated internal financial evaluation) the loan balance is compared to the appraisal and a specific allowance is decided upon for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal net of closing costs. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

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

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

The Company may extend the maturity of a performing or current loan that may have some inherent weakness associated with the loan. However, the Company generally follows a policy of not extending maturities on

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

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

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

The Company makes provisions for loan and lease losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology previously discussed. The provision for loan and lease losses was a credit of $1.1 million in 2013 compared to a charge of $3.6 million in 2012 and a charge of $1.4 million in 2011. Historical net charge-offs represent a principal component in the application of the Company's allowance methodology. A continued decrease in the confirmed losses over the related historical period in addition to a decline in problem loans and gross recoveries of $ 8.1 million in the past year served to reduce the overall provision for the period.

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

Allowance for Loan and Lease Losses

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

	December 31,				
(In thousands)	2013	2012	2011	2010	2009
Residential real estate:					
Residential mortgage	$ 7,819	$ 8,522	$ 10,583	$ 10,396	$ 8,871
Residential construction	1,156	2,445	4,206	2,760	2,559
Total residential real estate	8,975	10,967	14,789	13,156	11,430
Commercial real estate:					
Commercial mortgage	15,571	16,580	15,578	12,970	10,978
Commercial construction	3,754	4,737	6,663	18,241	21,144
Total commercial real estate	19,325	21,317	22,241	31,211	32,122
Commercial Business	6,308	6,495	6,727	12,870	16,907

Leases		16		332		796		667		770
Consumer		4,142		3,846		4,873		4,231		3,330
Total allowance	$	38,766	$	42,957	$	49,426	$	62,135	$	64,559

During 2013, there were no changes in the Company’s methodology for assessing the appropriateness of the allowance for loan and lease losses from the prior year. Variations can occur over time in the estimation of the adequacy of the allowance as a result of the credit performance of borrowers. No portion of the allowance was unallocated at December 31, 2013 or December 31, 2012.

At December 31, 2013, total non-performing loans and leases were $40.0 million, or 1.44% of total loans and leases, compared to $57.9 million, or 2.29% of total loans and leases, at December 31, 2012. Timely recognition and aggressive management of problem credits has resulted in the significant reduction of the migration of these loans into non-accrual status during this period. The allowance represented 97% of non-performing loans and leases at December 31, 2013 as compared to 74% at December 31, 2012. The increase in this ratio was due primarily to the decline in non-performing loans and leases mentioned on the previous page. The allowance for loan and lease losses as a percent of total loans and leases was 1.39% at December 31, 2013 as compared to 1.70% at December 31, 2012. This decrease was due to a combination of a lower level of both non-performing loans and historical losses at December 31, 2013 compared to the prior year end.

Continued analysis of the actual loss history on the problem credits in 2012 and 2013 provided an indication that the coverage of the inherent losses on the problem credits was adequate. The Company continues to monitor the impact of the economic conditions on our commercial customers, the reduced inflow of non-accruals, lower inflow in criticized loans and the significant decline in early stage delinquencies. The improvement in these credit metrics supports management’s outlook for continued improved credit quality performance.

The balance of impaired loans was $32.5 million, with specific allowances of $3.1 million against those loans at December 31, 2013, as compared to $48.8 million with allowances of $5.1 million, at December 31, 2012.

The Company's borrowers are concentrated in nine counties in Maryland, three counties in Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 76% of total loans and leases at December 31, 2013 compared to 74% at December 31, 2012. Certain loan terms may create concentrations of credit risk and increase the Company’s exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

Summary of Loan and Lease Loss Experience

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

	Year Ended December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Balance, January 1	$ 42,957	$ 49,426	$ 62,135	$ 64,559	$ 50,526
Provision for loan and lease losses	(1,084)	3,649	1,428	25,908	76,762
Loan charge-offs:					
Residential real estate	(1,298)	(2,331)	(6,993)	(6,401)	(4,847)
Commercial loans and leases	(8,014)	(9,175)	(6,772)	(22,723)	(57,098)
Consumer	(1,853)	(1,298)	(2,740)	(3,492)	(1,575)
Total charge-offs	(11,165)	(12,804)	(16,505)	(32,616)	(63,520)
Loan recoveries:					
Residential real estate	173	225	226	34	41
Commercial loans and leases	7,687	2,234	1,933	4,028	640
Consumer	198	227	209	222	110
Total recoveries	8,058	2,686	2,368	4,284	791
Net charge-offs	(3,107)	(10,118)	(14,137)	(28,332)	(62,729)
Balance, period end	$ 38,766	$ 42,957	$ 49,426	$ 62,135	$ 64,559
Net charge-offs to average loans and leases	0.12 %	0.42 %	0.66 %	1.27 %	2.61 %
Allowance to total loans and leases	1.39 %	1.70 %	2.21 %	2.88 %	2.81 %

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Analysis of Credit Risk

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

	At December 31,				
(Dollars in thousands)	2013	2012	2011	2010	2009
Non-accrual loans and leases					
Residential real estate	$ 8,050	$ 7,806	$ 11,441	$ 9,251	$ 9,520
Commercial loans and leases	20,265	37,332	58,453	53,776	100,894
Consumer	2,259	2,410	1,786	300	766
Total non-accrual loans and leases (1)	30,574	47,548	71,680	63,327	111,180
Loans and leases 90 days past due					
Residential real estate	-	-	410	13,546	14,887
Commercial loans and leases	-	233	2	426	3,321
Consumer	1	14	165	182	793
Total 90 days past due loans and leases	1	247	577	14,154	19,001
Restructured loans and leases (accruing)	9,459	10,110	6,881	10,571	3,549
Total non-performing loans and leases (2)	40,034	57,905	79,138	88,052	133,730
Other real estate owned, net	1,338	5,926	4,431	9,493	7,464
Other assets owned	-	-	-	200	-
Total non-performing assets	$ 41,372	$ 63,831	$ 83,569	$ 97,745	$ 141,194
Non-performing loans to total loans and leases	1.44 %	2.29 %	3.53 %	4.08 %	5.82 %
Non-performing assets to total assets	1.01 %	1.61 %	2.25 %	2.78 %	3.89 %
Allowance for loan and leases to non-performing loans and leases	96.83 %	74.18 %	62.46 %	70.57 %	48.28 %

(1) Gross interest income that would have been recorded in 2013 if non-accrual loans and leases shown above had been current and in accordance with their original terms was $2.6 million. No interest was recorded on these loans during the year. Please see Note 1 of the Notes to Consolidated Financial Statements for a description of the Company’s policy for placing loans on non-accrual status.

(2) Performing loans considered potential problem loans, as defined and identified by management, amounted to $50.0 million at December 31, 2013. Although these are loans where known information about the borrowers' possible credit problems causes management to have concerns as to the borrowers' ability to comply with the loan repayment terms, most are current as to payment terms, well collateralized and are not believed to present significant risk of loss. Loans classified for regulatory purposes not included in either non-performing or potential problem loans consist only of "other loans especially mentioned" and do not, in management's opinion, represent or result from trends or uncertainties reasonably expected to materially impact future operating results, liquidity or capital resources, or represent material credits where known information about the borrowers' possible credit problems causes management to have doubts as to the borrowers' ability to comply with the loan repayment terms.

Market Risk Management

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

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

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

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

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

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

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

Estimated Changes in Net Interest Income

Change in Interest Rates:	+ 400 bp		+ 300 bp		+ 200 bp		+ 100 bp		- 100 bp		- 200 bp		-300 bp		-400 bp	
Policy Limit	23.50	%	17.50	%	15.00	%	10.00	%	10.00	%	15.00	%	17.50	%	23.50	%
	(7.20)	%	(4.14)	%	(1.63)	%	(0.88)	%	N/A		N/A		N/A		N/A	

December 31, 2013												
December 31, 2012	(1.02)	%	0.56	%	1.26	%	0.51	%	N/A	N/A	N/A	N/A

As shown above, measures of net interest income at risk increased from December 31, 2012 at all rising interest rate shock levels. All measures remained well within prescribed policy limits.

The increase in the risk position with respect to net interest income from December 31, 2012 to December 31, 2013 was the result of the impact of longer durations on securities, an increase in fixed rate loans and an increase in short-term FHLB borrowings of $175 million which resulted in a significant increase in interest expenses in all rising shock bands.

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

Estimated Changes in Economic Value of Equity (EVE)

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	35.00 %	25.00 %	20.00 %	10.00 %	10.00 %	20.00 %	25.00 %	35.00 %
December 31, 2013	(15.27) %	(10.86) %	(6.21) %	(2.15) %	N/A	N/A	N/A	N/A
December 31, 2012	(0.39) %	1.87 %	3.29 %	2.65 %	N/A	N/A	N/A	N/A

Measures of the economic value of equity (“EVE”) at risk increased from December 31, 2012 in all rising shock scenarios. The significant negative impact in EVE was driven by longer durations on securities, an increase in fixed rate loans and higher market rates coupled with shorter durations on FHLB Advances.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan and lease repayments, maturing investments, deposit growth, borrowed funds, capital and the sale of highly marketable assets such as investment securities and residential mortgage loans. The Company's liquidity position, considering both internal and external sources available, exceeded anticipated short-term and long-term needs at December 31, 2013. Management considers core deposits, defined to include all deposits other than time deposits of $100 thousand or more, to be a relatively stable funding source. Core deposits equaled 70% of total interest-earning assets at December 31, 2013**.** In addition, loan and lease payments, maturities, calls and pay downs of securities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements. In assessing liquidity, management considers operating requirements, the seasonality of deposit flows, investment, loan and deposit maturities and calls, expected funding of loans and deposit withdrawals, and the market values of available-for-sale investments, so that sufficient funds are available on short notice to meet obligations as they arise and to ensure that the Company is able to pursue new business opportunities.

Liquidity is measured using an approach designed to take into account, in addition to factors already discussed above, the Company’s growth and mortgage banking activities. Also considered are changes in the liquidity of the investment portfolio due to fluctuations in interest rates. Under this approach, implemented by the Funds Management Subcommittee of ALCO under formal policy guidelines, the Company’s liquidity position is measured weekly, looking forward at thirty day intervals from thirty (30) to three hundred sixty (360) days. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Resulting projections as of December 31, 2013, show short-term investments exceeding short-term borrowings by $21 million over the subsequent 360 days. This projected excess of liquidity versus requirements provides the Company with flexibility in how it funds loans and other earning assets.

The Company also has external sources of funds, which can be drawn upon when required. The main sources of external liquidity are available lines of credit with the Federal Home Loan Bank of Atlanta and the Federal Reserve. The line of credit with the Federal Home Loan Bank of Atlanta totaled $1.2 billion, of which $847 million was available for borrowing based on pledged collateral, with $615 million borrowed against it as of December 31, 2013. The line of credit at the Federal Reserve totaled $382 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of December 31, 2013. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled $55 million at December 31, 2013, against which there were no outstanding borrowings. In addition, the Company had a secured line of credit with a correspondent bank of $20 million as of December 31, 2013. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at December 31, 2013.

The parent company (“Bancorp”) is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Bancorp is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. Bancorp’s primary source of income is dividends received

from the Bank. The amount of dividends that the Bank may declare and pay to Bancorp in any calendar year, without the receipt of prior approval from the Federal Reserve, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. Based on this requirement, as of December 31, 2013, the Bank could have declared a dividend of $67 million to Bancorp. At December 31, 2013, Bancorp had liquid assets of $12 million.

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

The Company has various contractual obligations that affect its cash flows and liquidity. For information regarding material contractual obligations, please see “Market Risk Management” previously discussed, “Contractual Obligations” below, and “Note 7-Premises and Equipment,” “Note 10-Borrowings,” “Note 14-Pension, Profit Sharing and Other Employee Benefit Plans,” “Note 19-Financial Instruments with Off-balance Sheet Risk and Derivatives,” and “Note 21-Fair Value” of the Notes to the Consolidated Financial Statements.

Off-Balance Sheet Arrangements

With the exception of the Company’s obligations in connection with its trust preferred securities, irrevocable letters of credit, and loan commitments, the Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources, that is material to investors. The trust preferred securities were issued by Sandy Spring Capital Trust II (the “Trust”), a subsidiary of the Company created for the purpose of issuing the trust preferred securities and purchasing the Company’s junior subordinated debentures, which are its sole assets. These junior subordinated debentures bear a maturity date of October 7, 2034, which may be shortened, subject to conditions, to a date no earlier than October 7, 2009. The Company owns all of the Trust’s outstanding common securities. The Company and the Trust believe that, taken together, the Company’s obligations under the junior subordinated debentures, the Indenture, the Trust Agreement, and the Guarantee entered into in connection with the issuance of the trust preferred securities and the debentures, in the aggregate constitute a full, irrevocable and unconditional guarantee of the Trust’s obligations. For additional information on off-balance sheet arrangements, please see “Note 19-Financial Instruments with Off-balance Sheet Risk and Derivatives” and “Note 10-Borrowings” of the Notes to the Consolidated Financial Statements, and “Capital Management” and “Securities”.

Contractual Obligations

The Company enters into contractual obligations in the normal course of business. Among these obligations are FHLB advances, operating leases related to branch and administrative facilities and a long-term contract with a data processing provider. Payments required under these obligations, are set forth in the table below as of December 31, 2013.

	Projected Maturity Date or Payment Period [1]				
(In thousands)	Total	Less than 1 year	1-3 Years	3-5 Years	After 5 Years
Retail repurchase agreements	$ 53,842	$ 53,842	$ -	$ -	$ -
Advances from FHLB	615,000	210,000	-	235,000	170,000
Certificates of deposit	465,737	309,759	116,759	39,219	-
Operating lease obligations	45,668	6,256	11,508	7,958	19,946
Purchase obligations [2]	1,972	1,972	-	-	-
Total	$ 1,182,219	$ 581,829	$ 128,267	$ 282,177	$ 189,946

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

(2) Represents payments required under contract, based on average monthly charges for 2013 and assuming a growth rate of 2%, with the Company’s current data processing service provider that expires in September 2014.

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

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

PART II

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting
Internal Control Over Financial Reporting

As part of the Corporation's program to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2013 (the "Assessment"). In making this Assessment, management used the control criteria framework of the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission published in its report entitled Internal Control Integrated Framework (1992). Management's Assessment included an evaluation of the design of the Corporation's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Based on this assessment, the Company's management concluded that the Company's internal control over financial reporting was effective as of December 31, 2013.

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statement of condition of Sandy Spring Bancorp, Inc. (and subsidiaries) as of December 31, 2013, and the related consolidated statements of income, other comprehensive income, cash flows and changes in stockholders' equity for the year ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sandy Spring Bancorp, Inc. (and subsidiaries) at December 31, 2013, and the consolidated results of their operations and their cash flows for the year ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Sandy Spring Bancorp, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework), and our report dated March 14, 2014 expressed an unqualified opinion thereon.

McLean, Virginia
March 14, 2014

Report of Independent Registered Public Accounting Firm

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

We have audited Sandy Spring Bancorp, Inc. (and subsidiaries) internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Sandy Spring Bancorp, Inc. (and subsidiaries)'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Sandy Spring Bancorp, Inc. (and subsidiaries) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2013 consolidated financial statements of Sandy Spring Bancorp, Inc. (and subsidiaries) and our report dated March 14, 2014 expressed an unqualified opinion thereon.

McLean, Virginia
March 14, 2014

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Sandy Spring Bancorp, Inc.

We have audited the accompanying consolidated statement of condition of Sandy Spring Bancorp, Inc. (a Maryland corporation) and subsidiaries (the “Company”) as of December 31, 2012, and the related consolidated statements of income, other comprehensive income, changes in stockholders’ equity, and cash flows for each of the two years in the period ended December 31, 2012. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position Sandy Spring Bancorp, Inc. and subsidiaries as of December 31, 2012, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

Philadelphia, Pennsylvania
March 18, 2013

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Sandy spring bancorp, inc. and subsidiaries
Consolidated STATEMENTS OF CONDITION

(Dollars in thousands)	December 31, 2013		December 31, 2012	
Assets				
Cash and due from banks	$	46,755	$	59,540
Federal funds sold		475		466
Interest-bearing deposits with banks		27,197		26,400
Cash and cash equivalents		74,427		86,406
Residential mortgage loans held for sale (at fair value)		8,365		36,149
Investments available-for-sale (at fair value)		751,284		825,582
Investments held-to-maturity fair value of $216,007 and $222,024 at December 31, 2013 and 2012, respectively		224,638		215,814
Other equity securities		40,687		33,636
Total loans and leases		2,784,266		2,531,128
Less: allowance for loan and lease losses		(38,766)		(42,957)
Net loans and leases		2,745,500		2,488,171
Premises and equipment, net		45,916		48,326
Other real estate owned		1,338		5,926
Accrued interest receivable		12,532		12,392
Goodwill		84,171		84,808
Other intangible assets, net		1,330		3,163
Other assets		115,912		114,833
Total assets	$	4,106,100	$	3,955,206
Liabilities				
Noninterest-bearing deposits	$	836,198	$	847,415
Interest-bearing deposits		2,041,027		2,065,619
Total deposits		2,877,225		2,913,034
Securities sold under retail repurchase agreements and federal funds purchased		53,842		86,929
Advances from FHLB		615,000		405,058
Subordinated debentures		35,000		35,000
Accrued interest payable and other liabilities		25,670		31,673
Total liabilities		3,606,737		3,471,694
Stockholders' Equity				
Common stock par value $1.00; shares authorized 50,000,000; shares issued and outstanding 24,990,021 and 24,905,392 at December 31, 2013 and 2012, respectively		24,990		24,905
Additional paid in capital		193,445		191,689
Retained earnings		283,898		255,606
Accumulated other comprehensive income (loss)		(2,970)		11,312
Total stockholders' equity		499,363		483,512
Total liabilities and stockholders' equity	$	4,106,100	$	3,955,206

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries
Consolidated Statements of IncomE

	Year Ended December 31,		
(Dollars in thousands, except per share data)	2013	2012	2011
Interest Income:			
Interest and fees on loans and leases	$ 122,380	$ 115,574	$ 107,355
Interest on loans held for sale	929	841	577
Interest on deposits with banks	84	111	77
Interest and dividends on investment securities:			
Taxable	16,635	17,951	22,096
Exempt from federal income taxes	9,318	9,392	9,363
Interest on federal funds sold	1	1	2
Total interest income	149,347	143,870	139,470
Interest Expense:			
Interest on deposits	5,439	7,357	11,002
Interest on retail repurchase agreements and federal funds purchased	163	204	212
Interest on advances from FHLB	12,936	14,131	14,397
Interest on subordinated debt	895	959	913
Total interest expense	19,433	22,651	26,524
Net interest income	129,914	121,219	112,946
Provision (credit) for loan and lease losses	(1,084)	3,649	1,428
Net interest income after provision (credit) for loan and lease losses	130,998	117,570	111,518
Non-interest Income:			
Investment securities gains	115	459	292
Total other-than-temporary impairment ("OTTI") losses	-	(109)	(178)
Portion of OTTI losses recognized in other comprehensive income, before taxes	-	-	18
Net OTTI recognized in earnings	-	(109)	(160)
Service charges on deposit accounts	8,533	8,910	9,527
Mortgage banking activities	3,094	6,032	3,228
Wealth management income	17,585	15,949	15,646
Insurance agency commissions	4,821	4,490	4,650
Income from bank owned life insurance	2,499	2,616	2,636
Visa check fees	4,165	3,887	3,637
Other income	6,699	4,722	4,044
Total non-interest income	47,511	46,956	43,500
Non-interest Expenses:			
Salaries and employee benefits	65,598	62,509	59,625
Occupancy expense of premises	13,171	12,010	11,519
Equipment expenses	4,940	4,871	4,705
Marketing	2,880	2,651	2,389
Outside data services	4,580	5,019	4,159
FDIC insurance	2,300	2,573	3,187
Amortization of intangible assets	1,845	1,881	1,845
Other expenses	16,210	18,413	17,642
Total non-interest expenses	111,524	109,927	105,071

Income before income taxes	66,985	54,599	49,947
Income tax expense	22,563	18,045	15,845
Net income	$ 44,422	$ 36,554	$ 34,102
Net Income Per Share Amounts:			
Basic net income per share	$ 1.78	$ 1.49	$ 1.42
Diluted net income per share	$ 1.77	$ 1.48	$ 1.41
Dividends declared per share	$ 0.64	$ 0.48	$ 0.34

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries
Consolidated Statements of OTHER COMPREHENSIVE INCOME

	Year Ended December 31,		
(In thousands)	2013	2012	2011
Net income	$ 44,422	$ 36,554	$ 34,102
Other comprehensive income:			
Investments available-for-sale:			
Net change in unrealized gains (losses) on investments available-for-sale	(33,214)	(40)	26,722
Related income tax (expense) benefit	13,245	16	(10,656)
Net investment gains reclassified into earnings	115	459	292
Related income tax expense	(46)	(183)	(116)
Net effect on other comprehensive income (loss) for the period	(19,900)	252	16,242
Defined benefit pension plan:			
Recognition of unrealized gain (loss)	9,340	(3,639)	(622)
Related income tax (expense) benefit	(3,722)	1,451	248
Net effect on other comprehensive income (loss) for the period	5,618	(2,188)	(374)
Total other comprehensive income	(14,282)	(1,936)	15,868
Comprehensive income	$ 30,140	$ 34,618	$ 49,970

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

	Year Ended December 31,		
(Dollars in thousands)	2013	2012	2011
Operating activities:			
Net income	$ 44,422	$ 36,554	$ 34,102
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	8,021	7,847	7,488
Net OTTI recognized in earnings	-	109	160
Provision (credit) for loan and lease losses	(1,084)	3,649	1,428
Share based compensation expense	1,688	1,451	1,207
Deferred income tax expense	3,348	3,933	6,678
Origination of loans held for sale	(251,878)	(310,860)	(229,631)
Proceeds from sales of loans held for sale	284,291	305,013	230,232
Gains on sales of loans held for sale	(4,629)	(4,961)	(3,225)
Loss on sales of other real estate owned	1,064	1,595	2,078
Investment securities gains	(115)	(459)	(292)
Gains (loss) on sales of premises and equipment	20	(74)	120
Net (increase) decrease in accrued interest receivable	(140)	521	(328)
Net (increase) decrease in other assets	4,053	(2,421)	(691)
Net increase (decrease) in accrued expenses and other liabilities	(5,965)	6,939	12,491
Other net	13,046	3,954	5,893
Net cash provided by operating activities	96,142	52,790	67,710
Investing activities:			
Purchases of other equity securities	(7,051)	(6,780)	(2,910)
Purchases of investments held-to-maturity	(20,666)	(146,290)	(161,102)
Purchases of investments available-for-sale	(161,379)	(264,993)	(370,657)
Net proceeds from redemption of Federal Home Loan Bank of Atlanta stock	-	8,002	2,048
Proceeds from sales of investment available-for-sale	-	28,519	-
Proceeds from maturities, calls and principal payments of investments held-to-maturity	11,090	108,612	84,409
Proceeds from maturities, calls and principal payments of investments available-for-sale	198,410	357,144	347,864
Net increase in loans and leases	(259,008)	(140,483)	(103,994)
Proceeds from the sales of other real estate owned	7,780	4,934	8,801
Acquisition of business activity, net of cash acquired	-	(849)	-
Expenditures for premises and equipment	(2,366)	(4,381)	(4,003)
Net cash used in investing activities	(233,190)	(56,565)	(199,544)
Financing activities:			
Net increase (decrease) in deposits	(35,809)	86,593	106,648
Net increase (decrease) in retail repurchase agreements and federal funds purchased	(33,087)	(56,685)	47,370

Proceeds from advances from FHLB	1,075,000	-	-
Repayment of advances from FHLB	(865,058)	(350)	(350)
Proceeds from issuance of common stock	153	98	314
Remittances due to vesting of restricted stock	-	-	(334)
Tax benefits associated with shared based compensation	-	102	91
Redemption of stock warrant	-	-	(4,449)
Dividends paid	(16,130)	(11,891)	(8,259)
Net cash provided by financing activities	125,069	17,867	141,031
Net increase (decrease) in cash and cash equivalents	(11,979)	14,092	9,197
Cash and cash equivalents at beginning of period	86,406	72,314	63,117
Cash and cash equivalents at end of period	$ 74,427	$ 86,406	$ 72,314
Supplemental Disclosures:			
Interest payments	$ 19,610	$ 22,464	$ 20,334
Income tax payments	20,010	13,266	9,704
Transfers from loans to other real estate owned	2,764	4,810	6,398

The accompanying notes are an integral part of these statements

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Sandy Spring Bancorp, Inc. and Subsidiaries
Consolidated Statements of changes in stockholders' equity

(Dollars in thousands, except per share data)	Common Stock	Warrants	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	To St Ec
Balances at January 1, 2011	$ 24,047	$ 3,699	$ 177,344	$ 205,099	$ (2,620)	$ 40
Net income	-	-	-	34,102	-	34
Other comprehensive income, net of tax					15,868	15
Common stock dividends - $0.34 per share	-	-	-	(8,259)	-	(8
Stock compensation expense	-	-	1,207	-	-	1,2
Stock warrant redemption	-	(3,699)	(750)	-	-	(4
Common stock issued pursuant to:						
Stock option plan - 2,037 shares	2	-	23	-	-	25
Employee stock purchase plan - 33,284 shares	33	-	467	-	-	50
Director stock purchase plan - 1,833 shares	2	-	30	-	-	32
Restricted stock - 30,853 shares	31	-	(183)	-	-	(1
Purchase of treasury shares - 23,592 shares	(24)	-	(310)	-	-	(3
Balances at December 31, 2011	24,091	-	177,828	230,942	13,248	44
Net income	-	-	-	36,554	-	36
Other comprehensive income, net of tax	-	-	-	-	(1,936)	(1
Common stock dividends - $0.46 per share	-	-	-	(11,890)	-	(1
Stock compensation expense	-	-	1,451	-	-	1,4
Common stock issued pursuant to:						
Acquisition of CommerceFirst Bancorp, Inc. - 732,054 shares	732	-	12,291	-	-	13
Stock option plan - 3,906 shares	4	-	47	-	-	51
Employee stock purchase plan - 30,795 shares	31	-	447	-	-	47
Director stock purchase plan - 1,083 shares	1	-	18	-	-	19
Restricted stock - 46,512 shares	46	-	(393)	-	-	(3
Balances at December 31, 2012	24,905	-	191,689	255,606	11,312	48
Net income	-	-	-	44,422	-	44
Other comprehensive income, net of tax	-	-	-	-	(14,282)	(1
Common stock dividends - $0.64 per share	-	-	-	(16,130)	-	(1
Stock compensation expense	-	-	1,688	-	-	1,6
Common stock issued pursuant to:						
Stock option plan - 10,964 shares	11	-	128	-	-	13
Employee stock purchase plan - 24,849 shares	25	-	436	-	-	46
Restricted stock - 48,816 shares	49	-	(496)	-	-	(4
Balances at December 31, 2013	$ 24,990	$ -	$ 193,445	$ 283,898	$ (2,970)	$ 49

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries
Notes to thE Consolidated Financial Statements

Note 1 Significant Accounting Policies
Nature of Operations
Sandy Spring Bancorp (the "Company"), a Maryland corporation, is the bank holding company for Sandy Spring Bank (the "Bank"), which conducts a full-service commercial banking, mortgage banking and trust business. Services to individuals and businesses include accepting deposits, extending real estate, consumer and commercial loans and lines of credit, equipment leasing, general insurance, personal trust, and investment and wealth management services. The Company operates in the Maryland counties of Anne Arundel, Carroll, Frederick, Howard, Montgomery, and Prince George's, and in Arlington, Fairfax and Loudoun counties in Virginia. The Company offers investment and wealth management services through the Bank's subsidiary, West Financial Services. Insurance products are available to clients through Sandy Spring Insurance, and Neff & Associates, which are agencies of Sandy Spring Insurance Corporation.

Basis of Presentation
The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the financial services industry for financial information. The following summary of significant accounting policies of the Company is presented to assist the reader in understanding the financial and other data presented in this report. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

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

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

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

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

Loans Acquired with Deteriorated Credit Quality
Acquired loans with evidence of credit deterioration since their origination as of the date of the acquisition are recorded at their initial fair value. Credit deterioration is determined based on the probability of collection of all contractually required principal and interest payments. The historical allowance for loan and lease losses related to the acquired loans is not carried over to the Company. The determination of credit quality deterioration as of the purchase date may include parameters such as past due and non-accrual status, commercial risk ratings, cash flow projections, type of loan and collateral, collateral value and recent loan-to-value ratios or appraised values. For loans acquired with no evidence of credit deterioration, the fair value discount or premium is amortized over the contractual life of the loan as an adjustment to yield. For loans acquired with evidence of credit deterioration, the Company determines at the acquisition date the excess of the loan’s contractually required payments over all cash flows expected to be collected as an amount that should not be accreted into interest income (nonaccretable difference). The remaining amount, representing the difference in the expected cash flows of acquired loans and the initial investment in the acquired loans, is accreted into interest income over the remaining life of the loan or pool of loans (accretable yield) using the interest method. Subsequent to the purchase date, increases in expected cash flows over those expected at the purchase date are recognized prospectively as interest income over the remaining life of the loan as an adjustment to the accretable yield. The present value of any decreases in expected cash flows after the purchase date is recognized as an impairment through a charge to the provision for loan losses. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan and lease losses are similar to originated loans. Loans carried at fair value, mortgage loans held for sale and loans under revolving credit agreements are excluded from the scope of this guidance on loans acquired with deteriorated credit quality.

Residential Mortgage Loans Held for Sale
The Company engages in sales of residential mortgage loans originated by the Bank. Loans held for sale are carried at fair value. Fair value is derived from secondary market quotations for similar instruments. The Company measures residential mortgage loans at fair value when the Company first recognizes the loan (i.e., the fair value option), as permitted by current accounting standards. Changes in fair value of these loans are recorded in earnings as a component of mortgage banking activities in non-interest income in the Consolidated Statements of Income. The Company's current practice is to sell such loans on a servicing released basis.

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

Investments Available-for-Sale
Marketable equity securities and debt securities not classified as held-to-maturity or trading are classified as securities available-for-sale. Securities available-for-sale are acquired as part of the Company's asset/liability management strategy and may be sold in response to changes in interest rates, loan demand, changes in prepayment risk or other factors. Securities available-for-sale are carried at fair value, with unrealized gains or losses based on the difference between amortized cost and fair value, reported net of deferred tax, as accumulated other comprehensive income (loss), a separate component of stockholders' equity. The carrying values of securities available-for-sale are adjusted for premium amortization and discount accretion to the maturity date on the effective interest method. Realized gains and losses on security sales or maturities, using the specific identification method, are included as a separate

component of non-interest income. Related interest and dividends are included in interest income. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary ("OTTI") result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether other-than-temporary impairment has occurred include a downgrading of the security below investment grade by a rating agency or due to potential default, a significant deterioration in the financial condition of the issuer, or a change in management's intent and ability to hold a security for a period of time sufficient to allow for any anticipated recovery in fair value.

Other Equity Securities

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

Loans and Lease Financing Receivables

The Company's financing receivables consist primarily of loans and a minimal amount of leases that are stated at their principal balance outstanding net of any unearned income and deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Lease financing receivables, all of which are direct financing leases, include aggregate payments, net of related unearned income. Leasing income is recognized on a basis that achieves a constant periodic rate of return on the outstanding lease financing balances over the lease terms.

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

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

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

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

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

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

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

Allowance for Loan and Lease Losses

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

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

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

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

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

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

Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific allowance on an impaired credit is warranted. For the particular loan that may have potential impairment, an appraisal will be ordered depending on the time elapsed since the prior appraisal, the loan balance and/or the result of the internal evaluation. The Company typically relies on current (12 months old or less) third party appraisals of the collateral to assist in measuring impairment. In the cases in which the Company does not rely on a third party appraisal, an internal evaluation is prepared by an approved credit officer. A current appraisal on large loans is usually obtained if the appraisal on file is more than 12 months old and there has been a material change in market conditions, zoning, physical use or the adequacy of the collateral based on an internal evaluation. The Company's policy is to strictly adhere to regulatory appraisal standards. If an appraisal is ordered, no more than a 30 day turnaround is requested from the appraiser, who is selected by Credit Administration from an approved appraiser list. After receipt of the updated appraisal, the assigned credit officer will recommend to the Chief Credit Officer whether

a specific allowance or a charge-off should be taken. When losses are confirmed, a charge-off is taken that is at least in the amount of the collateral deficiency as determined by the independent third party appraisal. Any further collateral deterioration results in either further specific reserves being established or additional charge-offs. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to ensure that there are no significant time lapses during this process.

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

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

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

Premises and Equipment

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

Goodwill and Other Intangible Assets

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

Current accounting guidance provides the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it is determined that the carrying value exceeds the fair value the first step, described above, of the two-step process must be performed. The Company adopted this guidance in performing its annual impairment testing for 2013 and 2012 with respect to its community banking and investment management

reporting units. With respect to its insurance reporting unit, the Company elected to engage a third-party valuation firm to determine the fair value of this reporting unit to utilize in the “step one” test for potential goodwill impairment. The company and the valuation firm determined that a combination of the income approach and the market approach were most appropriate in valuing the fair value of this unit and determined that the “step two test” for impairment was not necessary. At December 31, 2013 and 2012 there was no evidence of impairment of goodwill or intangibles in any of the Company’s reporting units.

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

Other Real Estate Owned ("OREO")

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

Derivative Financial Instruments

Derivative Loan Commitments

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

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

Forward Loan Sale Commitments

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

Interest Rate Swap Agreements

The Company enters into interest rate swaps ("swaps") with loan customers to provide a facility to mitigate the fluctuations in the variable rate on the respective loans. These swaps are matched in exact offsetting terms to swaps that the Company enters into with an outside third party. The swaps are reported at fair value in other assets or other liabilities. The Company's swaps qualify as derivatives, but are not designated as hedging instruments, thus any net gain or loss resulting from changes in the fair value is recognized in other non-interest income. Further discussion of the Company's financial derivatives is set forth Note 19 to the Consolidated Financial Statements.

Off-Balance Sheet Credit Risk

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

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

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

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

Insurance Commissions and Fees
Commission revenue is recognized on the date the customer is billed. The Company also receives contingent commissions from insurance companies as additional incentive for achieving specified premium volume goals and/or the loss experience of the insurance placed by the Company. Contingent commissions from insurance companies are recognized when determinable, which is generally when such commissions are received.

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

Net Income per Common Share
Basic net income per common share is derived by dividing net income available to common stockholders by the weighted-average number of common shares outstanding, and does not include the impact of any potentially dilutive common stock equivalents. The diluted net income per common share is derived by dividing net income by the weighted-average number of common shares outstanding, adjusted, if applicable, for the dilutive effect of outstanding stock options as well as any adjustment to income that would result from the assumed issuance. Dilutive shares are determined using the treasury stock method. Dilutive common stock equivalents are excluded from the computation of dilutive net income per common share if the result would be anti-dilutive.

Income Taxes
Income tax expense is based on the results of operations, adjusted for permanent differences between items of income or expense reported in the financial statements and those reported for tax purposes. Deferred income tax assets and liabilities are determined using the liability method. Under the liability method, deferred income taxes are determined based on the differences between the financial statement carrying amounts and the income tax bases of assets and

liabilities and are measured at the enacted tax rates that will be in effect when these differences reverse.

The Company's policy is to recognize interest and penalties on income taxes in other non-interest expenses. The Company remains subject to examination for income tax returns by the Internal Revenue Service, as well as all of the states where it conducts business, for the years ending after December 31, 2008. There are currently no examinations in process as of December 31, 2013.

Adopted Accounting Pronouncements

In February 2013, the FASB issued a standard on the reporting of reclassifications out of accumulated other comprehensive income ("AOCI"). The guidance sets requirements for presentation for significant items reclassified to net income in their entirety during the period and for items not reclassified to net income in their entirety during the period. Information about the reclassifications out of AOCI must be contained in single location in the financial statements. The reclassifications must also be presented by each component as part of the reporting on the changes in the AOCI balances. This guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2012. This guidance did not have any impact on the financial position, results of operations or cash flows of the Company, as it only affects the presentation of the information in the financial statements.

NOTE 2 ACQUISITION

On May 31, 2012, the Company acquired CommerceFirst Bancorp, Inc. and its wholly-owned subsidiary. Under the terms of the acquisition the Company acquired 100% of the shares of CommerceFirst common stock for a combination of 50% Sandy Spring Bancorp common stock and 50% cash. Stock consideration was exchanged at a ratio of 0.8043 of the Company's shares for each CommerceFirst share resulting in the issuance of 732,054 of the Company's common stock. Total cash consideration amounted to $12.4 million or $13.60 per share.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration transferred were recorded at their estimated fair value on the acquisition date. Assets acquired amounted to $188.0 million, including loans and leases of $165.8 million. Liabilities assumed totaled $170.6 million, including $169.9 million in deposits. The acquisition resulted in the addition of $13.0 million to the Company's equity. Initially, goodwill of $8.0 million was recorded as a result of the transaction and is not deductible for tax purposes. In June, 2013 the goodwill was adjusted by $0.6 million related to a reduction in liabilities that existed at the acquisition date. The goodwill from this transaction was included in the Company's Community Banking segment. The stock portion of the consideration to CommerceFirst shareholders qualified as a tax-free transaction.

Note 3 Cash and Due from Banks

The Federal Reserve Act requires that banks maintain cash reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. At its option, the Company maintains additional balances to compensate for clearing and safekeeping services. The average balance maintained in 2013 was $33.2million and in 2012 was $42.9 million.

Note 4 Investments

Investments available-for-sale

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

	2013				2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 147,688	$ -	$ (8,222)	$ 139,466	$ 155,442	$ 1,084	$ (98)	$ 156,428
State and municipal	159,524	6,060	(156)	165,428	160,496	13,996	(1)	174,491
Mortgage-backed	439,054	10,188	(6,992)	442,250	471,527	19,080	(128)	490,479
Corporate debt	2,000	4	-	2,004	2,000	-	(4)	1,996

Trust preferred	1,701	-	(288)	1,413	1,701	-	(236)	1,465
Total debt securities	749,967	16,252	(15,658)	750,561	791,166	34,160	(467)	824,859
Marketable equity securities	723	-	-	723	723	-	-	723
Total investments available-for-sale	$ 750,690	$ 16,252	$ (15,658)	$ 751,284	$ 791,889	$ 34,160	$ (467)	$ 825,582

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at December 31, 2013 are the result of changes in interest rates. These declines are considered temporary in nature and will decline over time and recover as these securities approach maturity.

The mortgage-backed portfolio at December 31, 2013 is composed entirely of either the most senior tranches of GNMA collateralized mortgage obligations ($205.2 million), or GNMA, FNMA or FHLMC mortgage-backed securities ($237.0 million). The Company does not intend to sell these securities and has sufficient liquidity to hold these securities for an adequate period of time, which may be maturity, to allow for any anticipated recovery in fair value.

At December 31, 2013, the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security is backed by debt issued by banks and thrifts, which totals $1.7 million, with a fair value of $1.4 million. The fair value of this security was determined by management through the use of a third party valuation specialist due to the limited trading activity for this security.

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

- Evaluation of the structural terms as established in the indenture;
- Detailed credit and structural evaluation for each piece of issuer collateral in the pool;
- Overall default (.50%), recovery and prepayment (2%) amortization probabilities by issuers in the pool;
- Identification of adverse conditions specifically related to the security, industry and geographical area;
- Projection of estimated cash flows that incorporate default expectations and loss severities;
- Review of historical and implied volatility of the fair value of the security;
- Evaluation of credit risk concentrations;
- Evaluation of the length of time and the extent to which the fair value has been less than the amortized cost; and
- A discount rate of 13.0% was established using credit adjusted financial institution spreads for comparably rated institutions and a liquidity adjustment that considered the previously noted characteristics.

As a result of this evaluation, it was determined that the pooled trust preferred security had not incurred any credit-related other-than-temporary impairment ("OTTI") for the year ended December 31, 2013. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was $0.3 million at December 31, 2013. This non-credit related OTTI was recognized in other accumulated comprehensive income ("OCI") at December 31, 2013.

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

- Default rates were developed based on the financial condition of the trust preferred issuers in the pool and the payment or deferral status. Conditional default rates were estimated based on the payment characteristics of the security and the financial condition of the issuers in the pool. Near term and future defaults are estimated using third party industry data in addition to a review of key financial ratios and other pertinent data on the financial stability of the underlying issuer;
- Loss severity is forecasted based on the type of impairment using research performed by third parties;
- The security contains one level of subordination below the senior tranche, with the senior tranche receiving the spread from the subordinate bonds;
- Credit ratings of the underlying issuers are reviewed in conjunction with the development of the default rates applied to determine the credit amounts related to the credit loss; and
- Potential prepayments are estimated based on terms and rates of the underlying trust preferred securities to determine the impact of excess spread on the credit enhancement, the removal of the strongest institutions from the underlying pool and any impact that prepayments might have on diversity and concentration.

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

(In thousands)	OTTI Losses
Cumulative credit losses on investment securities, through December 31, 2011	$ 422
Additions for credit losses not previously recognized	109
Cumulative credit losses on investment securities, through December 31, 2012	531
Additions for credit losses not previously recognized	-
Cumulative credit losses on investment securities, through December 31, 2013	$ 531

71

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

	2013				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	15	$ 139,466	$ 8,222	$ -	$ 8,222
State and municipal	12	11,680	156	-	156
Mortgage-backed	30	169,377	6,865	127	6,992
Trust preferred	1	1,413	-	288	288
Total	58	$ 321,936	$ 15,243	$ 415	$ 15,658

	2012				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	2	$ 29,900	$ 98	$ -	$ 98
State and municipal	1	390	1	-	1
Mortgage-backed	2	12,653	128	-	128
Corporate debt	1	1,996	4	-	4
Trust preferred	1	1,465	-	236	236
Total	7	$ 46,404	$ 231	$ 236	$ 467

The amortized cost and estimated fair values of debt securities available-for-sale by contractual maturity at December 31 are provided in the following table. The Company has allocated mortgage-backed securities into the four maturity groupings reflected in the following table using the expected average life of the individual securities based on statistics provided by independent third party industry sources. Expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations with or without prepayment penalties.

	2013		2012	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 2,080	$ 2,085	$ 35,544	$ 36,349
Due after one year through five years	12,766	13,285	3,957	3,994
Due after five years through ten years	392,389	392,339	382,957	399,180
Due after ten years	342,732	342,852	368,708	385,336
Total debt securities available for sale	$ 749,967	$ 750,561	$ 791,166	$ 824,859

At December 31, 2013 and 2012, investments available-for-sale with a book value of $186.6 million and $195.4 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agencies securities, exceeded ten percent of stockholders' equity at December 31, 2013 and 2012.

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Investments held-to-maturity

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

	2013				2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$ 64,505	$ -	$ (4,827)	$ 59,678	$ 64,498	$ 125	$ (29)	$ 64,594
State and municipal	159,889	1,920	(5,753)	156,056	150,995	6,194	(123)	157,066
Mortgage-backed	244	29	-	273	321	43	-	364
Total investments held-to-maturity	$ 224,638	$ 1,949	$ (10,580)	$ 216,007	$ 215,814	$ 6,362	$ (152)	$ 222,024

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

	2013				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	8	$ 59,678	$ 4,827	$ -	$ 4,827
State and municipal	113	94,243	5,366	387	5,753
Total	121	$ 153,921	$ 10,193	$ 387	$ 10,580

	2012				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	1	$ 9,961	$ 29	$ -	$ 29
State and municipal	13	16,868	123	-	123
Total	14	$ 26,829	$ 152	$ -	$ 152

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

The amortized cost and estimated fair values of debt securities held-to-maturity by contractual maturity at December 31 are reflected in the following table. Expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations with or without prepayment penalties.

	2013		2012	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 1,720	$ 1,725	$ 7,431	$ 7,523
Due after one year through five years	3,249	3,269	4,653	4,725
Due after five years through ten years	139,033	135,074	116,735	120,074
Due after ten years	80,636	75,939	86,995	89,702
Total debt securities held-to-maturity	$ 224,638	$ 216,007	$ 215,814	$ 222,024

At December 31, 2013 and 2012, investments held-to-maturity with a book value of $165.8 million and $155.5 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agency securities, exceeded ten percent of stockholders' equity at December 31, 2013 and 2012.

Equity securities

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

(In thousands)	2013	2012
Federal Reserve Bank stock	$ 8,269	$ 8,269
Federal Home Loan Bank of Atlanta stock	32,418	25,367
Total equity securities	$ 40,687	$ 33,636

Securities gains

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

(In thousands)	2013	2012	2011
Gross realized gains from sales of investments available-for-sale	$ -	$ 56	$ -
Gross realized losses from sales of investments available-for-sale	(3)	-	-
Net gains or (losses) from calls of investments available-for-sale	44	294	205
Net gains or (losses) from calls of investments held-to-maturity	74	109	87
Net securities gains	$ 115	$ 459	$ 292

Note 5 Loans and Leases

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

Outstanding loan balances at December 31, 2013 and 2012 are net of unearned income including net deferred loan costs of $0.7 million and $1.4 million, respectively, and $1.6 million and $2.5 million of acquired loan discounts associated with the acquisition of CommerceFirst at December 31, 2013 and 2012, respectively. The loan portfolio segment balances at December 31 are presented in the following table:

(In thousands)	2013	2012
Residential real estate:		
Residential mortgage	$ 618,381	$ 523,364
Residential construction	129,177	120,314
Commercial real estate:		
Commercial owner occupied real estate	592,823	571,510
Commercial investor real estate	552,178	456,888
Commercial acquisition, development and construction	160,696	151,933
Commercial Business	356,651	346,708
Leases	703	3,421
Consumer	373,657	356,990
Total loans and leases	$ 2,784,266	$ 2,531,128

Portfolio Segments

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

- ***Commercial business loans*** Commercial loans are made to provide funds for equipment and general corporate needs. Repayment of a loan primarily uses the funds obtained from the operation of the borrower's business. Commercial loans also include lines of credit that are utilized to finance a borrower's short-term credit needs and/or to finance a percentage of eligible receivables and inventory.
- ***Commercial acquisition, development and construction loans*** Commercial acquisition, development and construction loans are intended to finance the construction of commercial properties and include loans for the acquisition and development of land. Construction loans represent a higher degree of risk than permanent real estate loans and may be affected by a variety of factors such as the borrower's ability to control costs and adhere to time schedules and the risk that constructed units may not be absorbed by the market within the anticipated time frame or at the anticipated price. The loan commitment on these loans often includes an interest reserve that allows the lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan.
- ***Commercial owner occupied real estate loans -*** Commercial owned-occupied real estate loans consist of commercial mortgage loans secured by owner occupied properties where an established banking relationship exists and involves a variety of property types to conduct the borrower's operations. The primary source of repayment for this type of loan is the cash flow from the business and is based upon the borrower's financial health and the ability of the borrower and the business to repay.
- ***Commercial investor real estate loans -*** Commercial investor real estate loans consist of loans secured by non-owner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. This commercial real estate category contains mortgage loans to the developers and owners of commercial real estate where the borrower intends to operate or sell the property at a profit and use the income stream or proceeds from the sale(s) to repay the loan.
- ***Leases -*** The Company's loan portfolio also includes a small portfolio of equipment leases, which consists of leases for essential commercial equipment used by small to medium sized businesses.
- ***Consumer loans -*** This category of loans includes primarily home equity loans and lines, installment loans, personal lines of credit and marine loans. The home equity category consists mainly of revolving lines of credit to consumers which are secured by residential real estate. These loans are typically secured with second mortgages on the homes. Other consumer loans include installment loans used by customers to purchase automobiles, boats and recreational vehicles.
- ***Residential mortgage loans*** The residential real estate category contains permanent mortgage loans principally to consumers secured by residential real estate. Residential real estate loans are evaluated for the adequacy of

repayment sources at the time of approval, based upon measures including credit scores, debt-to-income ratios, and collateral values. Loans may be either conforming or non-conforming.

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

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Loans to Related Parties

Certain directors and executive officers have loan transactions with the Company. Such loans were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outsiders. The following schedule summarizes changes in amounts of loans outstanding, both direct and indirect, to these persons during the periods indicated:

(In thousands)	2013		2012	
Balance at January 1	$	20,494	$	20,235
Additions		886		847
Repayments		(2,459)		(588)
Balance at December 31	$	18,921	$	20,494

Note 6 CREDIT QUALITY ASSESSMENT

Allowance for Loan and Lease Losses

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

Management has an internal credit process in place to maintain credit standards. This process along with an in-house loan administration, accompanied by oversight and review procedures, combines to control and manage credit risk. The primary purpose of loan underwriting is the evaluation of specific lending risks that involves the analysis of the borrower's ability to service the debt as well as the assessment of the value of the underlying collateral. Oversight and review procedures include the monitoring of the portfolio credit quality, early identification of potential problem credits and the management of the problem credits. As part of the oversight and review process, the Company maintains an allowance for loan and lease losses (the "allowance") to absorb estimated and probable losses in the loan and lease portfolio. The allowance is based on consistent, periodic review and evaluation of the loan and lease portfolio, along with ongoing, monthly assessments of the probable losses and problem credits in each portfolio. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio.

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

(In thousands)	2013		2012		2011	
Balance at beginning of year	$	42,957	$	49,426	$	62,135
Provision (credit) for loan and lease losses		(1,084)		3,649		1,428
Loan and lease charge-offs		(11,165)		(12,804)		(16,505)
Loan and lease recoveries		8,058		2,686		2,368
Net charge-offs		(3,107)		(10,118)		(14,137)
Balance at period end	$	38,766	$	42,957	$	49,426

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

2013							
		Commercial Real Estate					Residential
(Dollars in thousands)	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage
Balance at beginning of year	$ 6,495	$ 4,737	$ 9,583	$ 6,997	$ 332	$ 3,846	$ 8,522
Provision (credit)	1,910	(3,978)	1,100	(874)	(326)	1,951	329
Charge-offs	(2,915)	(85)	(4,774)	(240)	-	(1,853)	(1,194)
Recoveries	818	3,080	3,354	425	10	198	162
Net charge-offs	(2,097)	2,995	(1,420)	185	10	(1,655)	(1,032)
Balance at end of period	$ 6,308	$ 3,754	$ 9,263	$ 6,308	$ 16	$ 4,142	$ 7,819
Total loans and leases	$ 356,651	$ 160,696	$ 552,178	$ 592,823	$ 703	$ 373,657	$ 618,381
Allowance for loans and leases to total loans and leases ratio	1.77 %	2.34 %	1.68 %	1.06 %	2.28 %	1.11 %	1.26 %
Balance of loans specifically evaluated for impairment	$ 5,608	$ 4,128	$ 7,654	$ 7,111	na.	$ 29	$ 6,141
Allowance for loans specifically evaluated for impairment	$ 849	$ 1,031	$ 126	$ 426	na.	na.	$ 626
Specific allowance to specific loans ratio	15.14 %	24.98 %	1.65 %	5.99 %	na.	na.	10.19 %
Balance of loans collectively evaluated	$ 351,043	$ 156,568	$ 544,524	$ 585,712	$ 703	$ 373,628	$ 612,240
Allowance for loans collectively evaluated	$ 5,459	$ 2,723	$ 9,137	$ 5,882	$ 16	$ 4,142	$ 7,193
Collective allowance to collective loans ratio	1.56 %	1.74 %	1.68 %	1.00 %	2.28 %	1.11 %	1.17 %

2012							
		Commercial Real Estate					Residential
(Dollars in thousands)	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage
Balance at beginning of year	$ 6,727	$ 6,664	$ 8,248	$ 7,329	$ 795	$ 4,873	$ 10,583
Provision (credit)	(758)	826	4,928	804	(478)	44	(167)
Charge-offs	(1,022)	(3,281)	(3,690)	(1,174)	(8)	(1,298)	(2,107)
Recoveries	1,548	528	97	38	23	227	213
Net charge-offs	526	(2,753)	(3,593)	(1,136)	15	(1,071)	(1,894)

Balance at end of period	$ 6,495	$ 4,737	$ 9,583	$ 6,997	$ 332	$ 3,846	$ 8,522
Total loans and leases	$ 346,708	$ 151,933	$ 456,888	$ 571,510	$ 3,421	$ 356,990	$ 523,364
Allowance for loans and leases to total loans and leases ratio	1.87 %	3.12 %	2.10 %	1.22 %	9.70 %	1.08 %	1.63 %
Balance of loans specifically evaluated for impairment	$ 8,984	$ 6,332	$ 11,843	$ 15,184	na.	$ 31	$ 4,528
Allowance for loans specifically evaluated for impairment	$ 2,597	$ -	$ 774	$ 598	na.	na.	$ 713
Specific allowance to specific loans ratio	28.91 %	-	6.54 %	3.94 %	na.	na.	15.75 %
Balance of loans collectively evaluated	$ 337,724	$ 145,601	$ 445,045	$ 556,326	$ 3,421	$ 356,959	$ 518,836
Allowance for loans collectively evaluated	$ 3,898	$ 4,737	$ 8,809	$ 6,399	$ 332	$ 3,846	$ 7,809
Collective allowance to collective loans ratio	1.15 %	3.25 %	1.98 %	1.15 %	9.70 %	1.08 %	1.51 %

The Company's methodology for evaluating whether a loan is impaired begins with risk-rating credits on an individual basis and includes consideration of the borrower's overall financial condition, payment record and available cash resources that may include the collateral value and, in a select few cases, verifiable support from financial guarantors. In measuring impairment, the Company looks primarily to the discounted cash flows of the project itself or to the value of the collateral as the primary sources of repayment of the loan. Collateral values or estimates of discounted cash flows (inclusive of any potential cash flow from guarantees) are evaluated to estimate the probability and severity of potential losses. The actual occurrence and severity of losses involving impaired credits can differ substantially from estimates.

The Company may consider the existence of guarantees and the financial strength and wherewithal of the guarantors involved in any loan relationship. Guarantees may be considered as a source of repayment based on the guarantor's financial condition and respective payment capacity. Accordingly, absent a verifiable payment capacity, a guarantee alone would not be sufficient to avoid classifying the loan as impaired.

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

- An internal evaluation is updated quarterly to include borrower financial statements and/or cash flow projections.
- The borrower may be contacted for a meeting to discuss an updated or revised action plan which may include a request for additional collateral.
- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.
- At the monthly credit committee meeting the loan may be downgraded.
- Upon receipt of the updated appraisal or based on an updated internal financial evaluation, the loan balance is compared to the appraisal and a specific allowance is determined for the particular loan, typically for the amount of the difference between the appraisal and the loan balance.
- The Company will specifically reserve for or charge-off the excess of the loan amount over the amount of the appraisal. In certain cases the Company may establish a larger reserve due to knowledge of current market conditions or the existence of an offer for the collateral that will facilitate a more timely resolution of the loan.

The Company generally follows a policy of not extending maturities on non-performing loans under existing terms. Certain performing loans that have displayed some inherent weakness in the underlying collateral values, an inability to comply with certain loan covenants which do not affect the performance of the credit or other identified weakness may have their terms extended on an exception basis. Maturity date extensions only occur under revised terms that place the Company in a better position to fully collect the loan under the contractual terms and /or terms at the time of the extension that may eliminate or mitigate the inherent weakness in the loan. These terms may incorporate, but are not limited to additional assignment of collateral, significant balance curtailments/liquidations and assignments of additional project cash flows. Documented or demonstrated guarantees may be a consideration in the extension of loan maturities. As a general matter, the Company does not view extension of a loan to be a satisfactory approach to resolving non-performing credits.

Loans that have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief or other concessions to a borrower experiencing financial difficulty are considered trouble debt restructured loans. All restructurings that constitute concessions to a troubled borrower are considered impaired loans that may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided there is a sufficient period of payment performance in accordance with the restructure terms. Loans may be removed from the restructured category in the year subsequent to the restructuring if their revised loans terms are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk. At December 31, 2013, restructured loans totaled $20.0 million, of which $9.5 million were accruing and $10.5 million were non-accruing. The Company has commitments to lend $5.5 million in additional funds on loans that have been restructured at December 31, 2013. Restructured loans at December 31, 2012 totaled $20.0 million, of which $10.1 million were accruing and $9.9 million were non-accruing. Commitments to lend additional funds on loans that have been restructured at December 31, 2012 amounted to $5.1 million.

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

(In thousands)	2013	2012	2011
Impaired loans with a specific allowance	$ 12,217	$ 27,526	$ 36,742
Impaired loans without a specific allowance	20,306	21,247	30,833
Total impaired loans	$ 32,523	$ 48,773	$ 67,575
Allowance for loan and lease losses related to impaired loans	$ 3,058	$ 5,149	$ 7,791
Allowance for loan and lease losses related to loans collectively evaluated	35,708	37,808	41,635
Total allowance for loan and lease losses	$ 38,766	$ 42,957	$ 49,426
Average impaired loans for the period	$ 38,379	$ 57,438	$ 68,377
Contractual interest income due on impaired loans during the period	$ 2,612	$ 4,433	$ 4,973
Interest income on impaired loans recognized on a cash basis	$ 1,374	$ 1,121	$ 1,523
Interest income on impaired loans recognized on an accrual basis	$ 473	$ 560	$ 325

The following tables present the recorded investment with respect to impaired loans, the associated allowance by the applicable portfolio segment and the principal balance of the impaired loans prior to amounts charged-off at December 31 for the years indicated:

	2013					
		Commercial Real Estate				Total Recorded
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Investment in Impaired Loans
Impaired loans with a specific allowance						
Non-accruing	$ 374	$ 1,360	$ 749	$ 2,022	$ -	$ 4,505
Restructured accruing	790	-	-	1,174	2,365	4,329
Restructured non-accruing	349	1,122	-	1,274	638	3,383
Balance	$ 1,513	$ 2,482	$ 749	$ 4,470	$ 3,003	$ 12,217
Allowance	$ 849	$ 1,031	$ 126	$ 426	$ 626	$ 3,058
Impaired loans without a specific allowance						
Non-accruing	$ 1,532	$ 382	$ 5,440	$ 646	$ -	$ 8,000
Restructured accruing	1,417	-	852	-	2,861	5,130
Restructured non-accruing	1,146	1,264	613	1,995	2,158	7,176
Balance	$ 4,095	$ 1,646	$ 6,905	$ 2,641	$ 5,019	$ 20,306
Total impaired loans						
Non-accruing	$ 1,906	$ 1,742	$ 6,189	$ 2,668	$ -	$ 12,505
Restructured accruing	2,207	-	852	1,174	5,226	9,459
Restructured non-accruing	1,495	2,386	613	3,269	2,796	10,559

Balance	$ 5,608	$ 4,128	$ 7,654	$ 7,111	$ 8,022	$ 32,523
Unpaid principal balance in total impaired loans	$ 7,943	$ 10,318	$ 12,351	$ 8,684	$ 8,650	$ 47,946

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	2013					
		Commercial Real Estate				Total Recorded
				Commercial	All	Investment in
		Commercial	Commercial	Owner	Other	Impaired
(In thousands)	Commercial	AD&C	Investor R/E	Occupied R/E	Loans	Loans
Average impaired loans for the period	$ 7,153	$ 5,451	$ 10,605	$ 8,386	$ 6,784	$ 38,379
Contractual interest income due on impaired loans during the period	$ 452	$ 654	$ 587	$ 692	$ 227	
Interest income on impaired loans recognized on a cash basis	$ 238	$ 253	$ 75	$ 725	$ 83	
Interest income on impaired loans recognized on an accrual basis	$ 133	$ -	$ 30	$ 77	$ 233	

	2012					
		Commercial Real Estate				Total Recorded
				Commercial	All	Investment in
		Commercial	Commercial	Owner	Other	Impaired
(In thousands)	Commercial	AD&C	Investor R/E	Occupied R/E	Loans	Loans
Impaired loans with a specific allowance						
Non-accruing	$ 2,514	$ -	$ 10,219	$ 4,319	$ -	$ 17,052
Restructured accruing	2,981	-	-	1,503	3,419	7,903
Restructured non-accruing	228	-	-	1,039	1,304	2,571
Balance	$ 5,723	$ -	$ 10,219	$ 6,861	$ 4,723	$ 27,526
Allowance	$ 2,597	$ -	$ 774	$ 598	$ 1,180	$ 5,149
Impaired loans without a specific allowance						
Non-accruing	$ 1,846	$ 3,033	$ 577	$ 6,191	$ -	$ 11,647
Restructured accruing	1,392	-	-	-	815	2,207
Restructured non-accruing	23	3,299	1,047	2,132	892	7,393
Balance	$ 3,261	$ 6,332	$ 1,624	$ 8,323	$ 1,707	$ 21,247
Total impaired loans						
Non-accruing	$ 4,360	$ 3,033	$ 10,796	$ 10,510	$ -	$ 28,699
Restructured accruing	4,373	-	-	1,503	4,234	10,110
Restructured non-accruing	251	3,299	1,047	3,171	2,196	9,964
Balance	$ 8,984	$ 6,332	$ 11,843	$ 15,184	$ 6,430	$ 48,773
Unpaid principal balance in total impaired loans	$ 11,506	$ 21,590	$ 15,405	$ 17,928	$ 6,904	$ 73,333

	2012					
		Commercial Real Estate				Total Recorded

(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Investment in Impaired Loans
Average impaired loans for the period	$ 8,659	$ 12,270	$ 13,838	$ 16,172	$ 6,499	$ 57,438
Contractual interest income due on impaired loans during the period	$ 527	$ 1,222	$ 1,181	$ 1,391	$ 112	
Interest income on impaired loans recognized on a cash basis	$ 121	$ 323	$ 175	$ 420	$ 82	
Interest income on impaired loans recognized on an accrual basis	$ 257	$ -	$ -	$ 102	$ 201	

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Credit Quality

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

2013

		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:									
Non-accrual loans and leases	$ 3,400	$ 4,127	$ 6,802	$ 5,936	$ -	$ 2,259	$ 5,735	$ 2,315	$ 30,574
Loans and leases 90 days past due	-	-	-	-	-	1	-	-	1
Restructured loans and leases	2,207	-	852	1,174	-	29	5,197	-	9,459
Total non-performing loans and leases	5,607	4,127	7,654	7,110	-	2,289	10,932	2,315	40,034
Other real estate owned	54	365	-	-	-	-	919	-	1,338
Total non-performing assets	$ 5,661	$ 4,492	$ 7,654	$ 7,110	$ -	$ 2,289	$ 11,851	$ 2,315	$ 41,372

2012

		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:									
Non-accrual loans and leases	$ 4,611	$ 6,332	$ 11,843	$ 13,681	$ 865	$ 2,410	$ 4,681	$ 3,125	$ 47,548
Loans and leases 90 days past due	24	-	-	209	-	14	-	-	247
Restructured loans and leases	4,373	-	-	1,503	-	31	4,203	-	10,110
Total non-performing loans and leases	9,008	6,332	11,843	15,393	865	2,455	8,884	3,125	57,905
Other real estate owned	1,829	-	220	2,396	-	-	1,401	80	5,926
Total non-performing assets	$ 10,837	$ 6,332	$ 12,063	$ 17,789	$ 865	$ 2,455	$ 10,285	$ 3,205	$ 63,831

2013

	Commercial Real Estate		Residential Real Estate

(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans and leases									
31-60 days	$ 382	$ -	$ 5,826	$ 876	$ 4	$ 716	$ 4,119	$ -	$ 11,923
61-90 days	1,142	-	-	2,540	-	176	208	-	4,066
> 90 days	-	-	-	-	-	1	-	-	1
Total past due	1,524	-	5,826	3,416	4	893	4,327	-	15,990
Non-accrual loans and leases	3,400	4,127	6,802	5,936	-	2,259	5,735	2,315	30,574
Loans aquired with deteriorated credit quality	1,363	-	571	2,366	-	-	-	-	4,300
Current loans	350,364	156,569	538,979	581,105	699	370,505	608,319	126,862	2,733,402
Total loans and leases	$ 356,651	$ 160,696	$ 552,178	$ 592,823	$ 703	$ 373,657	$ 618,381	$ 129,177	$ 2,784,266

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2012									
		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans and leases									
31-60 days	$ 2,138	$ -	$ 2,020	$ 1,556	$ 7	$ 496	$ 5,443	$ -	$ 11,660
61-90 days	212	-	-	1,809	68	101	1,603	-	3,793
> 90 days	24	-	-	209	-	14	-	-	247
Total past due	2,374	-	2,020	3,574	75	611	7,046	-	15,700
Non-accrual loans and leases	4,611	6,332	11,843	13,681	865	2,410	4,681	3,125	47,548
Loans aquired with deteriorated credit quality	1,978	332	949	3,941	-	-	-	-	7,200
Current loans	337,745	145,269	442,076	550,314	2,481	353,969	511,637	117,189	2,460,680
Total loans and leases	$ 346,708	$ 151,933	$ 456,888	$ 571,510	$ 3,421	$ 356,990	$ 523,364	$ 120,314	$ 2,531,128

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

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

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

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

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

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

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

future.

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

	2013				
		Commercial Real Estate			
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	$ 324,941	$ 154,869	$ 523,901	$ 553,604	$ 1,557,315
Special Mention	16,166	-	2,944	15,702	34,812
Substandard	15,274	5,827	25,333	23,517	69,951
Doubtful	270	-	-	-	270
Total	$ 356,651	$ 160,696	$ 552,178	$ 592,823	$ 1,662,348

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	2012				
		Commercial Real Estate			
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	$ 305,348	$ 141,802	$ 405,448	$ 520,844	$ 1,373,442
Special Mention	13,603	1,793	21,963	17,262	54,621
Substandard	26,091	8,338	28,885	32,613	95,927
Doubtful	1,666	-	592	791	3,049
Total	$ 346,708	$ 151,933	$ 456,888	$ 571,510	$ 1,527,039

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

	2013				
			Residential Real Estate		
(In thousands)	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Performing	$ 703	$ 371,368	$ 607,449	$ 126,862	$ 1,106,382
Non-performing:					
90 days past due	-	1	-	-	1
Non-accruing	-	2,259	5,735	2,315	10,309
Restructured loans and leases	-	29	5,197	-	5,226
Total	$ 703	$ 373,657	$ 618,381	$ 129,177	$ 1,121,918

	2012				
			Residential Real Estate		
(In thousands)	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Performing	$ 2,556	$ 354,535	$ 514,480	$ 117,189	$ 988,760
Non-performing:					
90 days past due	-	14	-	-	14
Non-accruing	865	2,410	4,681	3,125	11,081
Restructured loans and leases	-	31	4,203	-	4,234
Total	$ 3,421	$ 356,990	$ 523,364	$ 120,314	$ 1,004,089

During the year ended December 31, 2013, the Company restructured $3.4 million in loans that were designated as troubled debt restructurings. Modifications consisted principally of interest rate concessions. No modifications resulted in the reduction of the principal in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2013 have specific reserves of $0.3 million at December 31, 2013. For the year ended December 31, 2012, the Company restructured $4.9 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 2012 had specific reserves of $1.2 million thousand at December 31, 2012.

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

	For the Year Ended December 31, 2013					
		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total
Troubled debt restructurings						
Restructured accruing	$ 87	$ -	$ 852	$ -	$ 2,064	$ 3,003
Restructured non-accruing	425	-	-	-	-	425
Balance	$ 512	$ -	$ 852	$ -	$ 2,064	$ 3,428
Specific allowance	$ 141	$ -	$ -	$ -	$ -	$ 141
Restructured and subsequently defaulted	$ -	$ -	$ -	$ -	$ -	$ -

	For the Year Ended December 31, 2012					
		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total
Troubled debt restructurings						
Restructured accruing	$ 2,600	$ -	$ -	$ 1,014	$ -	$ 3,614
Restructured non-accruing	-	-	-	-	1,304	1,304
Balance	$ 2,600	$ -	$ -	$ 1,014	$ 1,304	$ 4,918
Specific allowance	$ 552	$ -	$ -	$ 204	$ 467	$ 1,223
Restructured and subsequently defaulted	$ -	$ -	$ -	$ -	$ -	$ -

Other Real Estate Owned

Other real estate owned totaled $1.3 million and $5.9 million at December 31, 2013 and 2012, respectively.

Note 7 Premises and Equipment

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

(In thousands)	2013	2012
Land	$ 9,954	$ 9,954
Buildings and leasehold improvements	60,939	61,456
Equipment	39,756	38,510
Total premises and equipment	110,649	109,920
Less: accumulated depreciation and amortization	(64,733)	(61,594)
Net premises and equipment	$ 45,916	$ 48,326

Depreciation and amortization expense for premises and equipment amounted to $4.6 million, $4.5 million and $4.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Total rental expense of premises and equipment, net of rental income, for the years ended December 31, 2013, 2012 and 2011 was $7.4 million, $6.6 million and $5.9 million, respectively. Lease commitments entered into by the Company bear initial terms varying from 3 to 15 years, or they are 20-year ground leases, and are associated with premises.

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

(In thousands)	Operating Leases
2014	$ 6,256
2015	6,177
2016	5,331
2017	4,462
2018	3,496
Thereafter	19,946
Total minimum lease payments	$ 45,668

Note 8 Goodwill and Other Intangible Assets

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

(Dollars in thousands)	2013 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life	2012 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life
Amortizing intangible assets:								
Core deposit intangibles	$ 9,716	$ (9,352)	$ 364	0.3 years	$ 9,716	$ (7,964)	$ 1,752	1.3 years
Other identifiable intangibles	8,623	(7,657)	966	2.1 years	8,611	(7,200)	1,411	3.1 years
Total amortizing intangible assets	$ 18,339	$ (17,009)	$ 1,330		$ 18,327	$ (15,164)	$ 3,163	
Goodwill	$ 84,171		$ 84,171		$ 84,808		$ 84,808	

During the second quarter of 2013, goodwill associated with the 2012 acquisition of CommerceFirst Bancorp, Inc. was reduced by $0.6 million relating to a reduction in the liabilities which existed as of the acquisition date.

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

(In thousands)	Community Banking	Insurance	Investment Management	Total
Balance December 31, 2011	$ 62,636	$ 5,191	$ 8,989	$ 76,816
CommerceFirst acquisition	7,992	-	-	7,992
Balance December 31, 2012	70,628	5,191	8,989	84,808
Acquisition fair value adjustment	(637)	-	-	(637)
Balance December 31, 2013	$ 69,991	$ 5,191	$ 8,989	$ 84,171

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

(In thousands)	Amount
2014	$ 821
2015	372
2016	94
2017	16
Thereafter	27
Total amortizing intangible assets	$ 1,330

Note 9 Deposits

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

(In thousands)	2013	2012
Noninterest-bearing deposits	$ 836,198	$ 847,415
Interest-bearing deposits:		
Demand	460,824	428,048
Money market savings	870,653	884,367
Regular savings	243,813	228,384
Time deposits of less than $100,000	263,636	307,445
Time deposits of $100,000 or more	202,101	217,375
Total interest-bearing deposits	2,041,027	2,065,619
Total deposits	$ 2,877,225	$ 2,913,034

Demand deposit overdrafts reclassified as loan balances were $1.3 million and $2.0 million at December 31, 2013 and 2012, respectively. Overdraft charge-offs and recoveries are reflected in the allowance for loan and lease losses.

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

(In thousands)	Amount
2014	$ 309,759
2015	87,668
2016	29,091
2017	21,640
2018	17,579
Total time deposits	$ 465,737

The Company's time deposits of $100,000 or more represented 7.0% of total deposits at December 31, 2013 and are presented by maturity in the following table:

	Months to Maturity				
(In thousands)	3 or Less	Over 3 to 6	Over 6 to 12	Over 12	Total
Time deposits $100 thousand or more	$ 34,110	$ 26,547	$ 70,020	$ 71,424	$ 202,101

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Interest expense on time deposits of $100,000 or more amounted to $1.7 million, $2.4 million and $3.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Note 10 Borrowings

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

	2013			2012			2011		
(Dollars in thousands)	Amount	Rate		Amount	Rate		Amount	Rate	
Retail repurchase agreements	$ 53,842	0.20	%	$ 51,929	0.20	%	$ 63,613	0.20	%
Average for the Year:									
Retail repurchase agreements	$ 55,769	0.26	%	$ 63,864	0.28	%	$ 73,543	0.26	%
Maximum Month-end Balance:									
Retail repurchase agreements	$ 59,410			$ 73,130			$ 79,529		

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

At December 31, 2013, the Company has an available line of credit for $1.2 billion with the Federal Home Loan Bank of Atlanta (the "FHLB") under which its borrowings are limited to $847.2 million based on pledged collateral at prevailing market interest rates with $615 million borrowed against it at December 31, 2013. At December 31, 2012, lines of credit totaled $1.2 billion under which $699.1 million was available based on pledged collateral with $440 million borrowed against it as of December 31, 2012. Under a blanket lien, the Company has pledged qualifying residential mortgage loans amounting to $500.1 million, commercial loans amounting to $653.6 million, home equity lines of credit (“HELOC”) amounting to $309.2 million and multifamily loans amounting to $9.3 million at December 31, 2013 as collateral under the borrowing agreement with the FHLB. At December 31, 2012 the Company had pledged collateral of qualifying mortgage loans of $399.1 million, commercial loans of $552.6 million, HELOC loans of $313.6 million and multifamily loans of $8.0 million under the FHLB borrowing agreement. The Company also had lines of credit available from the Federal Reserve and correspondent banks of $401.7 million and $411.6 million at December 31, 2013 and 2012, respectively, collateralized by loans and state and municipal securities. In addition, the Company had unsecured lines of credit with correspondent banks of $55.0 million and $55.0 million at December 31, 2013 and 2012, respectively. At December 31, 2013 there were no outstanding borrowings against these lines of credit.

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

	2013			2012		
(Dollars in thousands)	Amounts	Weighted Average Rate		Amounts	Weighted Average Rate	
Maturity:						
One year	$ 210,000	0.18	%	$ 35,058	0.36	%
Two years	-	-		-	-	
Three years	-	-		-	-	
Four years	75,000	3.48		40,000	4.47	

Five years		160,000	2.45		85,000	3.57
After five years		170,000	3.52		280,000	2.91
Total advances from FHLB	$	615,000	2.09	$	440,058	2.97

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Note 11 SUBORDINATED DEBENTURES

The Company formed Sandy Spring Capital Trust II (“Capital Trust”) to facilitate the pooled placement issuance of $35.0 million of trust preferred securities on August 10, 2004. In conjunction with this issuance, the Company issued subordinated debt to the Capital Trust. The subordinated debt converted from a fixed rate interest of 6.35% at July 7, 2009 to a variable rate, adjusted quarterly, equal to 225 basis points over the three month Libor. At December 31, 2013, the rate on the subordinated debt was 2.49%. The obligations of the Company under the debt are subordinated to all other debt except other trust preferred securities, which may have equal subordination. The debt has a maturity date of October 7, 2034, but may be called by the Company at any time subsequent to October 7, 2009 on each respective quarterly distribution date.

Note 12 Stockholders’ Equity

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

The Company has a director stock purchase plan (the “Director Plan”) which commenced on May 1, 2004. Under the Director Plan, members of the board of directors may elect to use a portion (minimum 50%) of their annual retainer fee to purchase shares of Company stock. The Company has reserved 45,000 authorized but unissued shares of common stock for purchase under the plan. Purchases are made at the fair market value of the stock on the purchase date. At December 31, 2013, there were 26,386 shares available for issuance under the plan.

The Company has an employee stock purchase plan (the “Purchase Plan”) which was authorized on July 1, 2011. The Company has reserved 300,000 authorized but unissued shares of common stock for purchase under the current version of the plan. Shares are purchased at 85% of the fair market value on the exercise date through monthly payroll deductions of not less than 1% or more than 10% of cash compensation paid in the month. The Purchase Plan is administered by a committee of at least three directors appointed by the board of directors. At December 31, 2013, there were 229,909 shares available for issuance under this plan.

The Company re-approved the stock repurchase program in August 2013. The current program permits the repurchase of up to 5% of the Company’s outstanding shares of common stock or approximately 1,260,000 shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. No shares were repurchased during 2013. The stock repurchase program in effect prior to August 2013 permitted the repurchase of up to 3% of the Company’s outstanding shares of common stock or approximately 730,000 shares. No shares were repurchased during 2012. During 2011, the Company repurchased 23,592 shares of common stock at an average price of $14.16 per share.

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

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company. At December 31, 2013, the Bank could have paid additional dividends of $67.2 million to its parent company without regulatory approval. In conjunction with the Company’s long-term borrowing from Capital Trust, the Bank issued a note to Bancorp for $35.0 million which was outstanding at December 31, 2013. There were no other loans outstanding between the Bank and the Company at December 31, 2013 and 2012, respectively.

In 2008, as part of the Troubled Asset Relief Program (“TARP”) Capital Purchase Program, the Company entered into a Purchase Agreement with the United States Department of the Treasury (the “Treasury”), pursuant to which the

Company sold Fixed Rate Cumulative Perpetual Preferred Stock that contained a liquidation preference and a warrant to purchase 651,547 shares of the Company's common stock. The company completely redeemed the preferred shares in 2010. Under the stock sale agreement, the warrant was issued with an initial exercise price of $19.13 and a ten year term and was exercisable immediately, in whole or in part. The value of the warrant was allocated a portion of the $83.1 million in stock issuance proceeds based on the relative fair value of the preferred shares and the warrant to the combined fair value. Accordingly, the value of the warrant was determined to be $3.7 million and was recorded in additional paid-in capital in the consolidated statements of condition. On February 23, 2011, the Company completed the redemption of the warrant issued for $4.5 million. The redemption of the warrant resulted in a net reduction of additional paid-in capital of $0.8 million during the first quarter of 2011.

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Note 13 Share Based Compensation

At December 31, 2013, the Company had two share based compensation plans in existence, the 1999 Stock Option Plan (expired but having outstanding options that may still be exercised) and the 2005 Omnibus Stock Plan ("Omnibus Plan"), which is described below.

The Omnibus Plan provides for the granting of non-qualifying stock options to the Company's directors, and incentive and non-qualifying stock options, stock appreciation rights and restricted stock grants to selected key employees on a periodic basis at the discretion of the board of directors. The plan authorizes the issuance of up to 1,800,000 shares of common stock of which 1,050,038 are available for issuance at December 31, 2013, 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. Options granted under the expired 1999 Stock Option Plan remain outstanding until exercised or they expire. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

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

	2013		2012		2011	
Dividend yield	2.80	%	2.17	%	1.72	%
Weighted average expected volatility	53.87	%	50.90	%	46.87	%
Weighted average risk-free interest rate	0.83	%	1.14	%	2.58	%
Weighted average expected lives (in years)	5.34		5.35		5.70	
Weighted average grant-date fair value	$ 7.99		$ 7.85		$ 7.76	

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

Compensation expense is recognized on a straight-line basis over the vesting period of the respective stock option or restricted stock grant. Compensation expense of $1.5 million, $1.6 million and $1.3 million was recognized for the years ended December 31, 2013, 2012 and 2011, respectively, related to the awards of stock options and restricted stock grants. The intrinsic value for the stock options exercised in the years ended December 31, 2013, 2012 and 2011, respectively, was not significant. The total of unrecognized compensation cost related to stock options was approximately $0.2 million as of December 31, 2013. That cost is expected to be recognized over a weighted average period of approximately 1.4 years. The total of unrecognized compensation cost related to restricted stock was approximately $3.2 million as of December 31, 2013. That cost is expected to be recognized over a weighted average period of approximately 2.9 years. The fair value of the options vested during the years ended December 31, 2013, 2012 and 2011, was $0.2 million, $0.2 million and $0.3 million, respectively.

In the first quarter of 2013, 20,229 stock options were granted, subject to a three year vesting schedule with one third of the options vesting each year on the anniversary date of the grant. Additionally, 93,770 shares of restricted stock were granted, subject to a five year vesting schedule with one fifth of the shares vesting each year on the grant date anniversary. There were no additional stock options or shares of restricted stock granted during the remainder of 2013.

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

	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life(Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2013	440,453	$ 29.17		$ 557
Granted	20,229	$ 20.26		$ 160
Exercised	(10,964)	$ 12.70		$ 118
Forfeited or expired	(141,917)	$ 37.72		$ 13
Balance at December 31, 2013	307,801	$ 25.23	2.4	$ 1,768
Exercisable at December 31, 2013	263,657	$ 26.19	1.9	$ 1,384
Weighted average fair value of options granted during the year		$ 7.99		

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

(In dollars, except share data):	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested options at January 1, 2013	54,416	$ 7.56
Granted	20,229	$ 7.99
Vested	(29,110)	$ 7.34
Forfeited or expired	(1,391)	$ 7.85
Non-vested options at December 31, 2013	44,144	$ 7.89

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

(In dollars, except share data):	Number of Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2013	224,005	$ 17.40
Granted	93,770	$ 20.26
Vested	(71,043)	$ 17.10
Forfeited	(19,668)	$ 18.20
Restricted stock at December 31, 2013	227,064	$ 18.61

Note 14 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 future salary increases and additional years of service will no longer affect the defined benefit provided by the plan although additional vesting may continue to occur.

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

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

(In thousands)	2013		2012	
Reconciliation of Projected Benefit Obligation:				
Projected obligation at January 1	$	38,839	$	32,387
Interest cost		1,550		1,534
Actuarial loss (gain)		(827)		137
Benefit payments		(524)		(702)
Payments due to settlements		(1,380)		-
Increase (decrease) related to discount rate change		(4,099)		5,483
Projected obligation at December 31		33,559		38,839
Reconciliation of Fair Value of Plan Assets:				
Fair value of plan assets at January 1		30,590		29,341
Actual return on plan assets		4,812		1,951
Contribution		-		-
Benefit payments		(2,158)		(702)
Fair value of plan assets at December 31		33,244		30,590
Funded status at December 31	$	(315)	$	(8,249)
Accumulated benefit obligation at December 31	$	33,559	$	38,839
Unrecognized net actuarial loss	$	5,539	$	14,879
Net periodic pension cost not yet recognized	$	5,539	$	14,879

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

	2013		2012	2011
Discount rate	4.77	%		