SANDY SPRING BANCORP INC
Form 10-K
February 22, 2019

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, 2018

Commission File Number 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	**52-1532952**

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

incorporation or organization) Identification No.)

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

301-774-6400

(Registrant's telephone number, including area code)

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit such files). [X] Yes [ ] No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth 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 [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ] Emerging growth company [ ]

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

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

The aggregate market value of the voting common stock of the registrant held by non-affiliates on June 30, 2018, the last day of the registrant’s most recently completed second fiscal quarter, was approximately $1.43 billion, based on the closing sales price of $41.01 per share of the registrant's Common Stock on that date.

The number of outstanding shares of common stock outstanding as of February 19, 2019.

Common stock, $1.00 par value – 35,544,551 shares

Documents Incorporated By Reference

Part III: Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held on April 24, 2019 (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,” “estimate,” “intend” and “potential,” or words of similar meaning, or future or conditional verbs such as “should,” “could,” or “may.” Forward-looking statements include statements of our goals, intentions and expectations; statements regarding our business plans, prospects, growth and operating strategies; statements regarding the quality of our loan and investment portfolios; and estimates of our risks and future costs and benefits.

Forward-looking statements reflect our expectation or prediction of future conditions, events or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risks and uncertainties include, but are not limited to, the risks identified in Item 1A of 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;
- failure of the Administration and Congress to agree on spending priorities, which may result in temporary shutdowns of non-essential federal functions, adversely affecting the regional economy;
- competitive factors among financial services companies, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;
- acquisition integration risks, including potential deposit attrition, higher than expected costs, customer loss, business disruption and the inability to realize benefits and cost savings from, and limit any unexpected liabilities associated with, any business combinations;

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

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

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

PART I

Item 1. BUSINESS

General

Sandy Spring Bancorp, Inc. (the “Company") is the bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. Sandy Spring Bank traces its origin to 1868, making it among the oldest banking institutions in the region. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 55 community offices and 6 financial centers located in Central Maryland, Northern Virginia, and Washington D. C as of December 31, 2018. 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 their other subsidiaries are Affirmative Action/Equal Opportunity Employers.

The Company is a community banking organization that focuses its lending and other services on businesses and consumers in the local market area. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank offers a comprehensive menu of insurance and investment management services. On January 1, 2018, the Company completed its acquisition of WashingtonFirst Bankshares, Inc. (“WashingtonFirst”), the parent company for WashingtonFirst Bank, in a transaction valued at $447 million. WashingtonFirst was headquartered in Reston, Virginia, and had assets of $2.1 billion, loans of $1.7 billion and deposits of $1.6 billion as of December 31, 2017. The results of operations from the acquisition are included in the Company’s consolidated results of operations for 2018.

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

Availability of Information

This report is not part of the proxy materials; it is provided along with the annual proxy statement for convenience of use and as an expense control measure. The Company makes available through the Investor Relations area of the Company website, at *www.sandyspringbank.com*, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. Access to these reports is provided by means of a link to a third-party vendor that maintains a database of such filings. In general, the Company intends that these reports be available as

soon as practicable after they are filed with or furnished to the Securities and Exchange Commission ("SEC"). Technical and other operational obstacles or delays caused by the vendor may delay their availability. The SEC maintains a website (www.sec.gov) where these filings also are available through the SEC's EDGAR system. There is no charge for access to these filings through either the Company's site or the SEC's site.

Market and Economic Overview

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

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

The local economy that the Company operates in continued to strengthen and expand throughout 2018. While the economic improvement has resulted in many positive economic trends such as lower unemployment, high consumer confidence, increased housing starts and steady housing prices, these have been tempered by concerns such as the lack of wage growth, low inflation levels, the strength of the dollar and temporary government shutdowns. Volatility in global economic markets, domestic political issues and various episodes of geo-political unrest continue to cause a degree of uncertainty in the financial markets. Additionally, interest rate increases during 2018 have affected confidence among individual consumers and small and mid-sized businesses. Management continues to be encouraged by the overall strength of the current economic environment and the prospects for continued growth of the Company.

Loan Products

The Company currently offers a complete menu of loan products primarily in the Company's 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 49 of this report.

Residential Real Estate Loans

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

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

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

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

Commercial Loans

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

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

Included in commercial loans are credits directly originated by the Company and, to a lesser extent, syndicated transactions or loan participations that are originated by other lenders. The Company's commercial lending policy requires each loan, regardless of whether it is directly originated or is purchased, to have viable repayment sources. The risks associated with syndicated loans or purchased participations are similar to those of directly originated commercial loans, although additional risk may arise from the limited ability to control actions of the primary lender. Shared National Credits (SNC), as defined by the banking regulatory agencies, represent syndicated lending arrangements with three or more participating financial institutions and credit exceeding $100.0 million in the aggregate. At December 31, 2018, the Company had no outstanding SNC purchases or SNC sold.

The Company sells participations in loans it originates to other financial institutions in order to build long-term customer relationships or limit loan concentration. The Company also purchases whole loans and loan participations as part of its asset/liability management strategy. Strict policies are in place governing the degree of risk assumed and volume of loans held. At December 31, 2018, other financial institutions had $71.8 million in outstanding commercial and commercial real estate loan participations sold by the Company. In addition, the Company had $54.0 million in outstanding commercial and commercial real estate loan participations purchased from other lenders.

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 categories contain 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 condition and the ability of the borrower and the business to repay. The Company seeks to reduce the risks associated with commercial mortgage lending by generally lending in its market area, using conservative loan-to-value ratios and obtaining periodic financial statements and tax returns from borrowers to perform loan reviews. It is also the Company's general policy to obtain personal guarantees from the principals of the borrowers and to underwrite the business entity from a cash flow perspective. Interest rate risks are mitigated by using either floating interest rates or by fixing rates for a short period of time, generally less than three years. While loan amortizations may be approved for up to 300 months, each loan generally has a call provision (maturity date) of five to ten years or less.

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

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

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

Commercial lines of credit are granted to finance a business borrower’s short-term credit needs and/or to finance a percentage of eligible receivables and inventory. In addition to the risks inherent in term loan facilities, line of credit borrowers typically require additional monitoring to protect the lender against increasing loan volumes and

diminishing collateral values. Commercial lines of credit are generally revolving in nature and require close scrutiny. The Company generally requires at least an annual out of debt period (for seasonal borrowers) or regular financial information (monthly or quarterly financial statements, borrowing base certificates, etc.) for borrowers with more growth and greater permanent working capital financing needs. Advances against collateral value are limited. Lines of credit and term loans to the same borrowers generally are cross-defaulted and cross-collateralized. Interest rate charges on this group of loans generally float at a factor at or above the prime lending rate.

Consumer Loans

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

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

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

Deposit Activities

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

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

Treasury Activities

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

The primary objective of the investment portfolio is to provide the necessary liquidity consistent with anticipated levels of deposit funding and loan demand with a minimal level of risk. The overall average duration of 3.9 years of the investment portfolio together with the types of investments (97% of the portfolio is rated AA or above) is intended to provide sufficient cash flows to support the Company’s lending goals. Liquidity is also provided by secured lines of credit maintained with the Federal Home Loan Bank of Atlanta (“FHLB”), the Federal Reserve, and to a lesser extent, unsecured lines of credit with correspondent banks.

Borrowing Activities

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

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 932 persons, including executive officers, loan and other banking and trust officers, branch personnel, and others at December 31, 2018. None of the Company's employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers its employee relations to be excellent.

Competition

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

The banking business in Central Maryland, Northern Virginia and Washington D.C. generally, and the Bank's primary service areas specifically, are highly competitive with respect to both loans and deposits. As noted above, the Bank competes with many larger banking organizations that have offices over a wide geographic area. These larger institutions have certain inherent advantages, such as the ability to finance wide-ranging advertising campaigns and promotions and to allocate their investment assets to regions offering the highest yield and demand. They also offer services, such as international banking, that are not offered directly by the Bank (but are available indirectly through correspondent institutions), and, by virtue of their larger total capitalization, such banks have substantially higher legal

lending limits, which are based on bank capital, than does the Bank. The Bank can arrange loans in excess of its lending limit, or in excess of the level of risk it desires to take, by arranging participations with other banks. The primary factors in competing for loans are interest rates, loan origination fees, and the range of services offered by lenders. Competitors for loan originations include other commercial banks, mortgage bankers, mortgage brokers, savings associations, and insurance companies.

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

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

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

Monetary Policy

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

Regulation, Supervision, and Governmental Policy

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

Bank Holding Company Regulation

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

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

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

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

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

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

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

The Federal Reserve has adopted guidelines regarding the capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total average 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 average 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 parties. 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 1.5 to 30 basis points. No institution may pay a dividend if in default of the federal deposit insurance assessment. Deposit insurance assessments are based on total assets less tangible equity. The Federal Deposit Insurance Corporation has authority to increase insurance assessments. Management cannot predict what insurance assessment rates will be in the future.

Regulatory Capital Requirements

The Federal Reserve establishes capital and leverage requirements for the Company and the Bank. Specifically, the Company and the Bank are subject to the following minimum capital requirements: (1) a common equity Tier 1 risk-based capital ratio of 4.5%; (2) a Tier 1 risk-based capital ratio of 6%; (3) a total risk-based capital ratio of 8%; and (4) a leverage ratio of 4%.

The Company’s Common Equity Tier 1 capital consists solely of common stock plus related surplus and retained earnings, adjusted for goodwill, intangible assets and the related deferred taxes. Additional Tier 1 capital may include other perpetual instruments historically included in Tier 1 capital, such as non-cumulative perpetual preferred stock, if applicable. Capital rules also permit bank holding companies with less than $15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that previously qualified in Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a "capital conservation buffer" on top of its minimum risk-based capital requirements. Beginning January 2019, this buffer must consist solely of Tier 1 Common Equity and the buffer applies to all three measurements: Common Equity Tier 1, Tier 1 capital and total capital.

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 an “outstanding” rating as a result of its last CRA examination.

Bank Secrecy Act

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

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) established a broad range of corporate governance and accounting measures intended to increase corporate responsibility and protect investors by improving the accuracy and reliability of disclosures under federal securities laws. The Company is subject to Sarbanes-Oxley because it is required to file periodic reports with the SEC under the Securities Exchange Act of 1934. Among other things, Sarbanes-Oxley, its implementing regulations and related Nasdaq Stock Market rules have established membership requirements and additional responsibilities for the Company’s audit committee, imposed restrictions on the relationship between the

Company and its outside auditors (including restrictions on the types of non-audit services the auditors may provide to the Company), 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 its internal control over financial reporting.

Regulatory Restructuring Legislation

The Dodd-Frank Act, enacted in 2010, implements significant changes to the regulation of depository institutions. The Dodd-Frank Act created the Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve to take over the implementation of federal consumer financial protection and fair lending laws from the depository institution regulators. However, institutions of $10 billion or fewer in assets continue to be examined for compliance with such laws and regulations by, and to be subject to the primary enforcement authority of, their primary federal regulator. In addition, the Dodd-Frank Act, among other things, requires changes in the way that institutions are assessed for deposit insurance, requires that originators of securitized loans retain a percentage of the risk for the transferred loans, directs the Federal Reserve to regulate pricing of certain debit card interchange fees, and contains a number of reforms related to mortgage originations.

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 22, 2019), principal position and recent business experience of each executive officer:

R. Louis Caceres, 56, 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, 66, 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, 60, became Executive Vice President and Chief Financial Officer of the Company and the Bank in 2004. Prior to that, Mr. Mantua was Senior Vice President of Managerial Accounting.

Ronda M. McDowell, 54, 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., 55, became Executive Vice President and Chief Banking Officer on January 1, 2011. Mr. O'Brien joined the Bank in July 2007 as Executive Vice President for Commercial Banking.

John D. Sadowski, 55, 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, 54, 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.

Kevin Slane, 59, became Executive Vice President and Chief Risk Officer of the Bank on May 1, 2018. Prior to that, Mr. Slane was the Director of Enterprise Risk Management at Hancock Whitney Bank in the southeast United States.

Item 1A. RISK FACTORS

Investing in the Company's common stock involves risks, including the possibility that the value of the investment could fall substantially and that dividends or other distributions could be reduced or eliminated. Investors should carefully consider the following risk factors before making 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, which could adversely affect the value of, and return on, an investment in the Company. 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 Company's local market area. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and in the Company's market area in particular. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, low unemployment, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters; or a combination of these or other factors. Economic pressure on consumers and uncertainty regarding continuing economic improvement may result in changes in consumer and business spending, borrowing and savings habits. A return to elevated levels of unemployment, declines in the values of real estate, extended federal government shutdowns, 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 the Company's operations makes the Company susceptible to downturns in local economic conditions.

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

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

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

The Company may not be able to adequately measure and limit its credit risk, which could lead to unexpected losses.

The business of lending is inherently risky, including risks that the principal of or interest on any loan will not be repaid timely or at all or that the value of any collateral supporting the loan will be insufficient to cover the Company's outstanding exposure. These risks may be affected by the strength of the borrower's business sector and local, regional and national market and economic conditions. Many of the Company's loans are made to small to medium-sized businesses that may be less able to withstand competitive, economic and financial pressures than larger borrowers. The Company's risk management practices, such as monitoring the concentration of loans within specific industries and credit approval practices, may not adequately reduce credit risk, and credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of the loan portfolio. A failure to effectively measure and limit the credit risk associated with the Company's loan portfolio could lead to unexpected losses and have a material adverse effect on the Company's business, financial condition and results of operations.

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

At December 31, 2018, non-performing assets, which are comprised of non-accrual loans, 90 days past due loans, restructured accruing loans and other real estate owned, totaled $37.6 million, or 0.46% of total assets, compared to non-performing assets of $31.6 million, or 0.58% of total assets at December 31, 2017. Non-performing assets adversely affect net income in various ways. Interest income is not accrued on non-accrual loans or other real estate owned. The Company must record a reserve for probable losses on loans, which is established through a current period charge to the provision for loan losses, and from time to time must write-down the value of properties in the Company's other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to other real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activities. Finally, if the estimate for the recorded allowance for loan losses proves to be incorrect and the allowance is inadequate, the allowance will have to be increased and, as a result, Company earnings would be adversely affected. A downturn in the Company's market areas could increase credit risk associated with the loan portfolio, as it could have a material adverse effect on both the ability of borrowers to repay loans as well as the value of the real property or other property held as collateral for such loans.

The Company's commercial real estate lending activities expose it to increased lending risks and related loan losses.

At December 31, 2018, the Company's commercial real estate loan portfolio totaled $3.8 billion, or 58% of its total loan portfolio. Commercial real estate loans generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the properties and the income stream of the borrowers. These loans involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. To the extent that borrowers have more than one commercial real estate loan outstanding, an adverse development with respect to one loan or one credit relationship could expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four family residential real estate loan. Moreover, if loans that are collateralized by commercial real estate become troubled and the value of the real estate has been significantly impaired, then the Company may not be able to recover the full contractual amount of principal and interest that the Company anticipated at the time it originated the loan, which could cause the Company to increase its provision for loan losses and would adversely affect the Company's earnings and financial condition.

Imposition of limits by the bank regulators on commercial real estate lending activities could curtail the Company's growth and adversely affect its earnings.

In 2006, the federal banking regulators issued joint guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices," referred to herein as the CRE Guidance. Although the CRE Guidance did not establish specific lending limits, it provides that a bank's commercial real estate lending exposure could receive increased supervisory scrutiny where total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans, represent 300% or more of an institution's total risk-based capital, and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more during the preceding 36 months. Additionally, in December 2015, the federal banking regulators released a new statement on prudent risk management for commercial real estate lending, referred to herein as the 2015 Statement. In the 2015 Statement, the federal banking regulators, among other things, indicate the intent to continue "to pay special attention" to commercial real estate lending activities and concentrations going forward.

Taking into account this guidance, if the Federal Reserve, the Bank's primary federal regulator, were to impose restrictions on the amount of commercial real estate loans the Bank can hold in its portfolio, for reasons noted above or otherwise, the Company's earnings would be adversely affected.

At December 31, 2018, the Bank's total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans represented 343% of the Bank's total risk-based capital and the growth in the CRE portfolio exceeded 50% over the preceding 36 months. Management has established a CRE lending framework to monitor specific exposures and limits by types within the CRE portfolio and takes appropriate actions, as necessary.

The Company's concentration of residential mortgage loans exposes it to increased lending risks.

At December 31, 2018, 19%, of the Company's loan portfolio was secured by one-to-four family real estate, a significant majority of which is located in central Maryland, Northern Virginia and Washington, D.C. One-to-four family residential mortgage lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A decline in residential real estate values as a result of a downturn in the housing market could reduce the value of the real estate collateral securing these types of loans. Declines in real estate values could cause some of the Company's residential mortgages to be inadequately collateralized, which would expose the Company to a greater risk of loss if it seeks to recover on defaulted loans by selling the real estate collateral.

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, 2018, the Company's interest rate sensitivity simulation model projected that net interest income would increase by 2.38% if interest rates immediately rose by 200 basis points. The results of an interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that the Company will be able to successfully manage interest rate risk.

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

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

The Company is subject to liquidity risks.

Effective liquidity management is essential for the operation of the Company's business. The Company requires sufficient liquidity to meet customer loan requests, customer deposit maturities/withdrawals, payments on debt obligations as they come due and other cash commitments under both normal operating conditions and other unpredictable circumstances causing industry or general financial market stress. The Company's access to funding sources in amounts adequate to finance its activities on terms that are acceptable to the Company could be impaired by factors that affect the Company specifically or the financial services industry or economy generally. Core deposits and Federal Home Loan Bank advances are the Company's primary source of funding. A significant decrease in 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, 2018, goodwill totaled $347.1 million. Goodwill represents the excess purchase price paid over the fair value of the net assets acquired in a business combination. The estimated fair values of the acquired assets and assumed liabilities may be subject to refinement as additional information relative to closing date fair values becomes available and may result in adjustments to goodwill within the first 12 months following the closing date of the acquisition. Goodwill is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. There could be a requirement to evaluate the recoverability of goodwill prior to the normal annual assessment if there is a disruption in the Company's business, unexpected significant declines in operating results, or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill impairment charges in the future, which would adversely affect the results of operations. A goodwill impairment charge does not adversely affect regulatory capital ratios or tangible capital. Based on an analysis, it was determined that the fair value of the Company's reporting units exceeded the carrying value of their assets and liabilities and, therefore, goodwill was not considered to be impaired at December 31, 2018.

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 $29.87 and $43.56 per share during the 12 months ended December 31, 2018. The overall market and the price of the Company’s common stock may experience volatility. There may be a significant impact on the market price for the common stock due to, among other things:

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

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

Combining acquired businesses may be more difficult, costly or time consuming than expected and the anticipated benefits and cost savings of acquisitions may not be realized.

The success of the Company’s mergers and acquisitions, including anticipated benefits and cost savings, will depend, in part, on the Company’s ability to successfully combine and integrate the acquired business in a manner that permits growth opportunities and does not materially disrupt existing customer relations nor result in decreased revenues due to loss of customers. It is possible that the integration process could result in the loss of key employees, the disruption of either company’s ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect the combined company’s ability to maintain relationships with clients, customers, depositors, employees and other constituents or to achieve the anticipated benefits and cost savings of the transaction. The loss of key employees could adversely affect the Company’s ability to successfully conduct its business, which could have an adverse effect on the Company’s financial results and the value of its common stock. If the Company experiences difficulties with the integration process, the anticipated benefits of a transaction may not be realized fully or at all, or

may take longer to realize than expected. As with any merger of financial institutions, there also may be business disruptions that cause the Company to lose customers or cause customers to remove their accounts from the Company and move their business to competing financial institutions. Integration efforts will also divert management attention and resources. These integration matters could have an adverse effect on the Company during this transition period and for an undetermined period after completion of a transaction. 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.

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

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

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

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

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

The ability to pay dividends to shareholders largely depends on Sandy Spring Bancorp's receipt of dividends from Sandy Spring Bank. The amount of dividends that Sandy Spring Bank may pay to Sandy Spring Bancorp is limited by federal laws and regulations. The ability of Sandy Spring Bank to pay dividends is also subject to its profitability, financial condition and cash flow requirements. There is no assurance that Sandy Spring Bank will be able to pay dividends to Sandy Spring Bancorp in the future. In addition, as a bank holding company, the Company's ability to declare and pay dividends is dependent on federal regulatory considerations, including limits on dividends should the Company not maintain the required capital conservation buffer and guidelines of the Federal Reserve regarding capital adequacy and dividends. It is the policy of the Federal Reserve that bank holding companies should generally pay dividends on common stock only out of earnings, and only if prospective earnings retention is consistent with the organization's expected future needs, asset quality and financial condition. The Company may limit the payment of dividends, even when the legal ability to pay them exists, in order to retain earnings for other uses.

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

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

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

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

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

Changes in tax laws may negatively impact the Company's financial performance.

Changes in tax laws contained in the Tax Cuts and Jobs Act, which was enacted in December 2017, include a number of provisions that could have an impact on the banking industry, borrowers and the market for single family residential and multifamily residential real estate. Included in this legislation was a reduction of the corporate income tax rate from 35% to 21%. In addition, other changes included: lower limits on the deductibility of mortgage interest on single family residential mortgages; the elimination of interest deductions for home equity loans; a limitation on deductibility of business interest expense; and a limitation on the deductibility of property taxes and state and local income taxes. Such changes in the tax laws may have an adverse effect on the market for, and valuation of, single family residential properties and multifamily residential properties, and on the demand for such loans in the future. In addition, these changes may have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes. If home ownership or multifamily residential property ownership becomes less attractive, demand for mortgage loans would decrease. The value of the properties securing loans in the Company's portfolio may be adversely impacted as a result of the changing economics of home ownership and multifamily residential ownership, which could require an increase in the Company's provision for loan losses, which would reduce its profitability and could materially adversely affect its business, financial condition and results of operations. Additionally, certain borrowers could become less able to service their debts as a result of higher tax obligations. These changes could adversely affect the Company's business, financial condition and results of operations.

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 difficult 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.

The implementation of a new accounting standard could require the Company to increase its allowance for loan losses and may have a material adverse effect on its financial condition and results of operations.

FASB has adopted a new accounting standard that will be effective for the Company's first fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and provide for the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which the Company expects could require it to increase its allowance for loan losses, and will likely greatly increase the data the Company would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in the allowance for loan losses, or expenses incurred to determine the appropriate level of the allowance for loan losses, may have a material adverse effect on the Company's financial condition and results of operations.

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

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and engages 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 focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If the Company’s policies, procedures and systems are deemed to be deficient or the policies, procedures and systems of the financial institutions that the Company may acquire in the future are deficient, the Company would be subject to liability, including fines and regulatory actions such as restrictions on its ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, including its acquisition plans, which would negatively impact the Company’s 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 the Company.

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

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

Failure to keep up with technological change in the financial services industry could have a material adverse effect on the Company's competitive position or profitability.

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

The Company's risk management framework may not be effective in mitigating risks and/or losses to the Company.

The Company's risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which the Company is subject, including, among others, credit, market, liquidity, interest rate and compliance. The Company's framework also includes financial or other modeling methodologies that involve management assumptions and judgment. The Company's risk management framework may not be effective under all circumstances and may not adequately mitigate any risk or loss to the Company. If the Company's risk management framework is not effective, the Company could suffer unexpected losses and the Company's business, financial condition, or results of operations could be materially and adversely affected. The Company may also be subject to potentially adverse regulatory consequences.

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

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

Security breaches and other disruptions could compromise the Company's information and expose the Company to liability, which would cause its business and reputation to suffer.

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

The Company is subject to laws regarding the privacy, information security and protection of personal information and any violation of these laws or another incident involving personal, confidential or proprietary information of individuals could damage the Company's reputation and otherwise adversely affect the Company's business, financial condition and earnings. The Company's business requires the collection and retention of large volumes of customer data, including personally identifiable information in various information systems that the Company maintains and in those maintained by third parties with whom the Company contracts to provide data services. The Company also maintains important internal company data such as personally identifiable information about its employees and information relating to its operations. The Company is subject to complex and evolving laws and regulations governing the privacy and protection of personal information of individuals (including customers, employees, suppliers and other third parties). For example, the Company's business is subject to the Gramm-Leach-Bliley Act which, among other things: (i) imposes certain limitations on the Company's ability to share nonpublic personal information about its customers with nonaffiliated third parties; (ii) requires that the Company provide certain disclosures to customers about its information collection, sharing and security practices and afford customers the right to "opt out" of any information sharing by the Company with nonaffiliated third parties (with certain exceptions); and (iii) requires that the Company develop, implement and maintain a written comprehensive information security program containing appropriate safeguards based on the Company's size and complexity, the nature and scope of its activities, and the sensitivity of customer information it processes, as well as plans for responding to data security breaches. Various state and federal laws and regulations impose data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Ensuring that the Company's collection, use, transfer and storage of personal information complies with all applicable laws and regulations can increase costs.

Furthermore, the Company may not be able to ensure that all of its clients, suppliers, counterparties and other third parties have appropriate controls in place to protect the confidentiality of the information that they exchange with the Company, particularly where such information is transmitted by electronic means. If personal, confidential or proprietary information of customers or others were to be mishandled or misused (in situations where, for example, such information was erroneously provided to parties who are not permitted to have the information, or where such information was intercepted or otherwise compromised by third parties), the Company could be exposed to litigation or regulatory sanctions under personal information laws and regulations. Concerns regarding the effectiveness of the Company's measures to safeguard personal information, or even the perception that such measures are inadequate, could cause the Company to lose customers or potential customers for its products and services and thereby reduce its revenues. Accordingly, any failure or perceived failure to comply with applicable privacy or data protection laws and

regulations may subject the Company to inquiries, examinations and investigations that could result in requirements to modify or cease certain operations or practices or in significant liabilities, fines or penalties, and could damage the Company's reputation and otherwise adversely affect the Company's business, financial condition and earnings.

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

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

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

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

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

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

The Company's business is highly dependent on the successful and uninterrupted functioning of its information technology and telecommunications systems third-party servicers. The Company outsources many of its 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 the Company's operations. Because the Company's information technology and telecommunications systems interface with and depend on third-party systems, it 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 the Company's ability to provide customer service, compromise its ability to operate effectively, damage the Company's reputation, result in a loss of customer business and/or subject the Company to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

In addition, the Company provides its customers the ability to bank remotely, including online over the Internet. The secure transmission of confidential information is a critical element of remote banking. The Company's network could be vulnerable to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches. The Company 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, the Company outsources some of the data processing functions used for remote banking, and accordingly it is dependent on the expertise and performance of its third-party providers. To the extent that the Company's activities, the activities of its customers, or the activities of the Company's third-party service

providers involve the storage and transmission of confidential information, security breaches and viruses could expose the Company 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 the Company's systems and could adversely affect its reputation, results of operations and ability to attract and maintain customers and businesses. In addition, a security breach could also subject the Company to additional regulatory scrutiny, expose it to civil litigation and possible financial liability and cause reputational damage.

Regulation of the financial services industry is intense, and the Company may be adversely affected by changes in laws and regulations.

The Company is subject to extensive government regulation, supervision and examination. Such regulation, supervision and examination govern the activities in which the Company may engage, and are intended primarily for the protection of the deposit insurance fund and the Bank's depositors, rather than for stockholders.

In 2010 and 2011, in response to the financial crisis and recession that began in 2008, significant regulatory and legislative changes resulted in broad reform and increased regulation affecting financial institutions. The Dodd-Frank Act has created a significant shift in the way financial institutions operate. The Dodd-Frank Act also created the Consumer Financial Protection Bureau, or CFPB, to implement consumer protection and fair lending laws, a function that was formerly performed by the depository institution regulators. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as that which occurred in 2008 and 2009. The Dodd-Frank Act has had and may continue to have a material impact on the Company's operations, particularly through increased regulatory burden and compliance costs. On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act, or the EGRRCPA, became law. Among other things, the EGRRCPA changes certain regulatory requirements of the Dodd-Frank Act and includes provisions intended to relieve the regulatory burden on community banks. Any future legislative changes could have a material impact on the Company's profitability, the value of assets held for investment or the value of collateral for loans. Future legislative changes could also require changes to business practices and potentially expose the Company to additional costs, liabilities, enforcement action and reputational risk.

Federal regulatory agencies have the ability to take strong supervisory actions against financial institutions that have experienced increased loan production and losses and other underwriting weaknesses or have compliance weaknesses. These actions include entering into formal or informal written agreements and cease and desist orders that place certain limitations on their operations. If the Company were to become subject to a regulatory action, such action could negatively impact the Company's ability to execute its business plan, and result in operational restrictions, as well as the Company's ability to grow, pay dividends, repurchase stock or engage in mergers and acquisitions.

Federal banking agencies periodically conduct examinations of the Company's business, including compliance with laws and regulations; the failure to comply with any supervisory actions to which the Company is or becomes subject as a result of such examinations could adversely affect the Company.

As part of the bank regulatory process, the Federal Reserve and the Maryland Commissioner of Financial Regulation periodically conduct comprehensive examinations of the Company's business, including compliance with laws and regulations. If, as a result of an examination, either of these banking agencies were to determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, asset sensitivity, risk management or other aspects of any of the Company's operations had become unsatisfactory, or that the Company, the Bank or their respective management were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. The Federal Reserve may enjoin "unsafe or unsound" practices or violations of law, require affirmative actions to correct any conditions resulting from any violation or practice, issue an administrative order that can be judicially enforced, direct an increase in the Company's capital levels, restrict the Company's growth, assess civil monetary penalties against the Company, the Bank or their respective officers or directors, and remove officers and directors. The FDIC also has authority to review the Bank's financial condition, and, if the FDIC were to conclude that the Bank or its directors were engaged in unsafe or unsound practices, that the Bank was in an unsafe or unsound condition to continue operations, or that the Bank or the directors violated applicable law, the FDIC could move to terminate the Bank's deposit insurance. If the Company becomes subject to such regulatory actions, its business, financial condition, earnings and reputation could be adversely affected.

The Company is subject to numerous laws designed to protect consumers, including the Community Reinvestment Act ("CRA") and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The CRA requires the Federal Reserve to assess the Bank's performance in meeting the credit needs of the communities it serves, including low and moderate income neighborhoods, and if the Federal Reserve determines that the Bank needs to improve its performance or is in substantial non-compliance with CRA requirements, various adverse regulatory consequences may ensue. In addition, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The CFPB, the U.S. Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. The CFPB was created under the Dodd-Frank Act to centralize responsibility for consumer financial protection with broad rulemaking authority to administer and carry out the purposes and objectives of federal consumer financial laws with respect to all financial institutions that offer financial products and services to consumers. The CFPB is also authorized to prescribe rules applicable to any covered person or service provider, identifying and prohibiting acts or practices that are "unfair, deceptive, or abusive" in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The ongoing broad rulemaking powers of the CFPB have potential to have a significant impact on the operations of financial institutions offering consumer financial products or services.

A successful regulatory challenge to an institution's performance under the CRA, fair lending laws or regulations, or consumer lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on the Company's business, financial condition and results of operations.

Item 1B. Unresolved Staff Comments

None.

Item 2. PROPERTIES

The Company's headquarters is located in Olney, Maryland. As of December 31, 2018, Sandy Spring Bank owned 12 of its 55 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 February 22, 2019 there were approximately 2,200 holders of record of the Company's common stock.

Transfer Agent and Registrar

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

Share Transactions with Employees

Shares issued under the employee stock purchase plan, which was authorized on July 1, 2011, totaled 28,996 in 2018 and 17,578 in 2017, while issuances pursuant to exercises of stock options and grants of restricted stock were 59,248 and 77,631 in the respective years. No shares were issued under the director stock purchase plan in 2018 or 2017.

Issuer Purchases of Equity Securities

The Company's stock repurchase program expired on August 31, 2017. Under that program the company repurchased a total of 736,139 common shares. In December 2018, the Company's board of directors authorized the repurchase of up to 1,800,000 shares of common stock.

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 $5 billion to $10 billion. The cumulative total return on the stock or the index equals the total increase in value since December 31, 2013, 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, 2013, in the common stock and the securities included in the indexes.

The Peer Group Index includes nine publicly traded bank holding companies, other than the Company, headquartered in the Mid-Atlantic region and with assets of $5 billion to $10 billion. The companies included in this index are: ConnectOne Bancorp, Inc. (NJ); Eagle Bancorp, Inc. (MD); First Bancorp (NC); First Commonwealth Financial Corporation (PA); Lakeland Bancorp, Inc. (NJ); OceanFirst Financial Corp. (NJ); Park National Corporation (OH); S&T Bancorp, Inc. (PA); TriState Capital Holdings, Inc. (PA). Returns are weighted according to the issuer's stock market capitalization at the beginning of each year shown. The Company modified the criteria used to form the Peer Group Index to reflect the Company's asset growth.

Equity Compensation Plans

The following table presents the number of shares available for issuance under the Company's equity compensation plans at December 31, 2018.

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	81,508	$29.74	1,244,475
Equity compensation plans not approved by security holders	-	-	-
Total	81,508	$29.74	1,244,475

Item 6. SELECTED FINANCIAL DATA

Consolidated Summary of Financial Results *(Dollars in thousands, except per share data)*	**2018**	2017	2016	2015	2014
Results of Operations:					
Tax-equivalent interest income	**$ 328,797**	$ 202,258	$ 177,267	$ 164,790	$ 153,558
Interest expense	**63,637**	26,031	21,004	20,113	18,818
Tax-equivalent net interest income	**265,160**	176,227	156,236	144,677	134,740
Tax-equivalent adjustment	**4,715**	7,459	6,711	6,478	5,192
Provision (credit) for loan losses	**9,023**	2,977	5,546	5,371	(163)
Net interest income after provision (credit) for loan losses	**251,422**	165,791	144,006	132,828	129,711
Non-interest income	**61,049**	51,243	51,042	49,901	46,871
Non-interest expenses	**179,783**	129,099	123,058	115,347	120,800
Income before taxes	**132,688**	87,935	71,990	67,382	55,782
Income tax expense	**31,824**	34,726	23,740	22,027	17,582
Net income	**100,864**	53,209	48,250	45,355	38,200
Per Share Data:					
Net income - basic per share	**$ 2.82**	$ 2.20	$ 2.00	$ 1.84	$ 1.53
Net income - diluted per share	**2.82**	2.20	2.00	1.84	1.52
Dividends declared per common share	**1.10**	1.04	0.98	0.90	0.76
Book value per common share	**30.06**	23.50	22.32	21.58	20.83
Dividends declared to diluted net income per common share	**39.01%**	47.27%	49.00%	48.91%	50.00%
Period End Balances:					
Assets	**$8,243,272**	$5,446,675	$5,091,383	$4,655,380	$4,397,132
Investment securities	**1,010,724**	775,025	779,648	841,650	933,619
Loans	**6,571,634**	4,314,248	3,927,808	3,495,370	3,127,392
Deposits	**5,914,880**	3,963,662	3,577,544	3,263,730	3,066,509
Borrowings	**1,213,465**	885,192	945,119	829,145	764,432
Stockholders' equity	**1,067,903**	563,816	533,572	524,427	521,751
Average Balances:					
Assets	**$7,965,514**	$5,239,920	$4,743,375	$4,486,453	$4,194,206
Investment securities	**1,018,016**	813,601	740,519	883,143	977,730
Loans	**6,225,498**	4,097,988	3,677,662	3,276,610	2,917,514
Deposits	**5,689,601**	3,849,186	3,460,804	3,184,359	2,986,213
Borrowings	**1,190,930**	798,733	717,542	735,474	662,111
Stockholders' equity	**1,024,795**	550,926	527,524	519,671	514,207
Performance Ratios:					
Return on average assets	**1.27%**	1.02%	1.02%	1.01%	0.91%
Return on average common equity	**9.84**	9.66	9.15	8.73	7.43
Yield on average interest-earning assets	**4.47**	4.08	3.96	3.91	3.93

Rate on average interest-bearing liabilities	**1.24**	0.77	0.68	0.70	0.69
Net interest spread	**3.23**	3.31	3.28	3.21	3.24
Net interest margin	**3.60**	3.55	3.49	3.44	3.45
Efficiency ratio – GAAP[1]	**55.92**	58.68	61.35	61.32	68.47
Efficiency ratio – Non-GAAP[1]	**50.87**	54.59	58.66	61.09	62.48
Capital Ratios:					
Tier 1 leverage	**9.50%**	9.24%	10.14%	10.60%	11.26%
Common equity tier 1 capital to risk-weighted assets	**10.90**	10.84	11.01	12.17	n.a
Tier 1 capital to risk-weighted assets	**11.06**	10.84	11.74	13.13	13.95
Total regulatory capital to risk-weighted assets	**12.26**	11.85	12.80	14.25	15.06
Tangible common equity to tangible assets - Non-GAAP [2]	**9.21**	9.04	9.07	9.66	10.15
Average equity to average assets	**12.87**	10.51	11.12	11.58	12.26
Credit Quality Ratios:					
Allowance for loan losses to loans	**0.81%**	1.05%	1.12%	1.17%	1.21%
Non-performing loans to total loans	**0.55**	0.68	0.81	0.99	1.09
Non-performing assets to total assets	**0.46**	0.58	0.66	0.80	0.85
Net charge-offs to average loans	**0.01**	0.04	0.06	0.07	0.03

(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, 2018 totaled a record $100.9 million ($2.82 per diluted share). The results for 2018 included the effect of merger expenses associated with the acquisition of WashingtonFirst Bankshares totaling $11.8 million and $2.4 million in recovered interest income from previously acquired credit impaired loans. Merger expenses, net of the interest recoveries, resulted in an after-tax reduction to earnings per share of approximately $0.19 per share for 2018. Net income for 2017, which included an additional $5.5 million income tax expense from the revaluation of the deferred tax assets as a result of the reduction of the corporate tax rate under the Tax Cuts and Jobs Act and $2.6 million in post-tax merger expenses, was $53.2 million ($2.20 per share). These items reduced the prior year's earnings per share by approximately $0.34 per share.

These results reflect the impact of following events:

- The results of operations from the January 1, 2018, acquisition of WashingtonFirst are included in the Company's consolidated results of operations for 2018. At the acquisition date, WashingtonFirst had assets of $2.1 billion, loans of $1.7 billion and deposits of $1.6 billion.

- Total loans at December 31, 2018 increased 52% compared to the balance at December 31, 2017 as a result of strong organic growth and the WashingtonFirst acquisition. Compared to the post-acquisition combined portfolio at the beginning of 2018, the loan portfolio experienced 9% growth.

- The net interest margin increased to 3.60% in 2018 compared to 3.55% in 2017.
- Total deposits grew 49% year over year and achieved 6% post-acquisition growth.
- The provision for loan losses was $9.0 million for 2018 compared to $3.0 million for 2017, reflecting the impact of organic growth in the loan portfolio year over year in addition to the impact of acquired loans being re-underwritten as they reached maturity under their original lending arrangements and cease to be accounted for as acquired loans.
- Non-interest income increased 19% for 2018 compared to 2017. The increase was driven primarily by increases in income from mortgage banking activities, wealth management and insurance mortality proceeds.
- Non-interest expenses increased 39% for 2018 compared to the prior year. The current year's expenses included $11.8 million in merger expenses compared to $4.3 million for the prior year. Excluding penalties due to the prepayment of FHLB advances in 2017 in addition to the merger expenses from both years, non-interest expense increased 36% due to increases in compensation and benefit costs, occupancy costs and other operational expenses as a result of the acquisition of WashingtonFirst.

In 2018, the Mid-Atlantic region in which the Company operates continued to experience improved regional economic performance. The national economy improved as well throughout the year. Consumer confidence has been bolstered by certain positive economic trends such as lower unemployment, increased housing prices and solid

performance in the financial markets. These positive trends have been tempered by international economic concerns together with concerns over a lack of wage growth, national budgetary issues and the rise in interest rates. These factors can act to constrain economic activity on the part of both large and small businesses. Despite the mixed business environment, the Company has experienced healthy loan growth while maintaining strong levels of liquidity, capital and credit quality.

Liquidity continues to remain strong due to borrowing lines with the Federal Home Loan Bank of Atlanta and the Federal Reserve and the size and composition of the investment portfolio. At December 31, 2018, the Bank remained above all "well-capitalized" regulatory requirement levels. Tangible book value per common share increased modestly by 1% to $20.45 from $20.18 at December 31, 2017 as the 28% increase in book value per share was offset by the additional goodwill recorded from the WashingtonFirst acquisition. The Company's credit quality remained strong as non-performing assets represented 0.46% of total assets at December 31, 2018 compared to 0.58% at December 31, 2017. The ratio of net charge-offs to average loans was 0.01% for 2018, compared to 0.04% for the prior year.

Total assets at December 31, 2018 increased 51% compared to December 31, 2017. This increase was primarily the result of the acquisition of WashingtonFirst's $2.1 billion of assets. Total loans at December 31, 2018, were $6.6 billion compared to $4.3 billion at December 31, 2017. Post-acquisition asset growth has been primarily the result of net loan growth in 2018. Loan balances increased 52% compared to the prior year end as a result of the acquisition with post-acquisition portfolio growth of 9% driven by the 13% post-acquisition growth in commercial loans. The growth in commercial loans was driven by double digit increases in all commercial lending categories. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 6% compared to post-acquisition balances. The increase in customer funding sources was driven by increases of 17% in certificates of deposit and 22% in money market savings accounts. The Company utilizes low cost FHLB borrowings to assist in the management of the net interest margin. The effect on the net interest margin partially mitigates the increased rates offered on certificates of deposit and money market accounts to retain these deposit relationships in the rising interest rate environment. During the same period, stockholders' equity increased to $1.1 billion at December 31, 2018 from $564 million at December 31, 2017 primarily due to the issuance of common stock to effect the acquisition of WashingtonFirst. An additional portion of the growth in capital was due to net income in 2018, which effect was partially offset by dividends paid to stockholders during 2018.

Net interest income increased 54% compared to 2017, due to the combination of the acquisition and organic loan growth. For the year ended December 31, 2018, the net interest margin was 3.60% compared to 3.55% for the prior year. Net interest income for the year ended December 31, 2018 includes $2.4 million in recovered interest income on acquired credit impaired loans. This amount compares to interest recoveries of $1.1 million for 2017. Excluding these recoveries, the net interest margin would have been 3.58% for the year ended December 31, 2018 compared to 3.53% for the year ended December 31, 2017. The amortization of the fair value adjustments for 2018 was estimated to be 13 basis points on an annual basis. This favorable margin effect was partially offset by the impact that the current year's reduction in the tax rate had on the tax-advantaged securities in the investment portfolio, which adversely affected the margin by 5 basis points. Compared to the prior year, average interest-earning assets grew 48% with an increase of 39 basis points in the yield while the rate on average interest-bearing liabilities, which grew 51% from the prior year, increased 47 basis points over the same period.

Exclusive of investment securities gains of $0.2 million in 2018 and $1.3 million in 2017, non-interest income increased 22% for 2018 compared to 2017 due to increases in income from mortgage banking activities, wealth management and mortality insurance proceeds received during 2018 as compared to 2017. Non-interest expenses for the year ended December 31, 2018 increased 39% to $179.8 million compared to $129.1 million for the prior year. The year-over-year increase in non-interest expense was 36% excluding merger expense from both years in addition to the prior year's prepayment penalties on the early pay-off of high rate FHLB advances. The majority of the increase was the result of the increase in the number of employees, additional branch and office locations and associated operating expenses that resulted from the acquisition of WashingtonFirst.

The net income for 2018 included the effect of merger expenses totaling $11.8 million and $2.4 million in recovered interest income from previously acquired credit impaired loans. The additional merger expenses, net of the interest recoveries, resulted in an after-tax reduction to earnings per share of approximately $0.19 per share for 2018. The net income for 2017 included the effects of the tax rate reduction associated with tax reform legislation passed at the end of 2017. This resulted in $5.5 million of additional income tax expense and in addition to merger expenses, net of tax, resulted in a reduction of 2017 earnings per share of approximately $0.34 per share. Pre-tax, pre-provision income

which adjusts for these items for both years, in addition to the provision for loan losses, increased 61% from full-year 2017 to full-year 2018 to a record $153.5 million.

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 more extensively 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 may warrant an impairment write-down or valuation allowance to be established. Carrying assets and liabilities at fair value inherently results in greater 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 the reported financial results:

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

Allowance for Loan Losses

The allowance for loan losses is an estimate of the probable losses that are inherent in the loan portfolio at the balance sheet date. Acquired performing loans have their fair values determined at the date of acquisition. A portion of the fair value is determined based on credit quality. Accordingly, those loans are not included in the total loan portfolio when determining the estimated allowance for probable loan losses. The Company monitors the acquired performing loans to ensure that the remaining portion of the acquisition fair value adjustment is equivalent or exceeds the estimated allowance under the Company's allowance methodology. 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 for loan losses is adequate. However, the determination of the allowance 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 composition of loans in the portfolio and changes in the financial condition of borrowers as a result of changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Company periodically review the loan portfolio and the allowance. Such reviews may result in additional provisions based on their judgments of information available at the time of each examination.

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

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

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

The general allowance comprised 91% of the total allowance at December 31, 2018 and 2017, respectively. The general allowance is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Allowances on loans considered to be "criticized" and "classified" under regulatory guidance are calculated separately from loans considered to be "pass" rated under the same guidance. This segregation allows the Company to monitor the allowance applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and ensure the sufficiency of the allowance for loan losses.

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

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

The specific allowance accounted for 9% of the total allowance at December 31, 2018 and 2017, respectively. The estimated losses on impaired loans can differ substantially from actual losses.

Goodwill and Other Intangible Asset Impairment

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

Under current accounting guidance, the Company has the option to assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it appears that the carrying value exceeds the fair value based on the qualitative assessment, the first step of the two-step process must be performed. The Company has elected this accounting guidance with respect to its Community Banking, Investment Management and Insurance segments. At December 31, 2018 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. Examples of such assets include core deposit intangibles, acquired customer lists and other identifiable intangibles. Other intangible assets have finite lives and are reviewed for impairment annually. These assets are amortized over their estimated useful lives on a straight-line or sum-of-the-years basis over varying periods that initially did not exceed 15 years.

Accounting for Income Taxes

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

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

Fair Value Measurements

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

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

The above accounting policies with respect to fair value are discussed in further detail in "Note 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.

Net Interest Income

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

2018 vs. 2017

Net interest income for 2018 was $260.4 million compared to $168.8 million for 2017, a 54% increase, due to growth in earning assets coupled with the overall increase in the associated yields on those assets. On a tax-equivalent basis, net interest income for 2018 was $265.2 million compared to $176.2 million for 2017. The following table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.60% for 2018 compared to 3.55% for 2017. Net interest income for the year ended December 31, 2018 included $2.4 million in recovered interest income on acquired credit impaired loans. This amount compares to interest recoveries of $1.1 million for 2017. Exclusive of these recoveries the net interest margin would have been 3.58% for the year ended December 31, 2018 compared to 3.53% for the year ended December 31, 2017. The amortization of the fair value adjustments in 2018 associated with the acquisition was estimated to be 13 basis points on an annual basis. This favorable margin effect was partially offset by the impact that the current year's reduction in the tax rate had on the tax-advantaged securities in the investment portfolio, which adversely affected the margin by 5 basis points. The current year's average interest-earning assets grew 48% with an increase of 39 basis points in the yield compared to the prior year while the rate on average interest-bearing liabilities, which grew 51% from the prior year, increased 47 basis points over the same period. The increase in the margin reflects the result of the proportionate mix of the interest-earning assets and associated yields as compared to the mix of interest-bearing liabilities and their associated rates.

(In thousands)	For the Year Ended December 31, 2018	
Net Interest Income Excluding Purchase Accounting Adjustments:		
Net Interest Income	$	260,445
Accretion of fair value adjustment on pools of homogeneous loans		(3,730)
Accretion of loan fair value adjustment on purchased credit impaired loans		(1,860)
Settlements of purchased credit impaired loans		(2,360)
Accretion of fair value adjustment on certificates of deposits		(2,056)
Accretion of fair value adjustment on subordinated debentures		(138)
Net Interest Income Excluding Purchase Accounting Adjustments	$	250,301

2017 vs. 2016

Net interest income for 2017 was $168.8 million compared to $149.6 million for 2016 due to growth in earning assets coupled with the overall increase in the associated yields on those assets. On a tax-equivalent basis, net interest income for 2017 was $176.2 million compared to $156.3 million for 2016. The following table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.55% for 2017 compared to 3.49% for 2016. Net interest income for 2017 included $1.1 million in interest recoveries on previously charged-off loans. Exclusive of these recoveries the net interest margin would have been 3.53%. Average interest-earning assets increased by 11% while average interest-bearing liabilities increased 10% in 2017. The growth and increased rates earned on the interest-earning assets exceeded the growth and rates paid on interest-bearing liabilities, which resulted in the 13% increase in net interest income year over year. Average noninterest-bearing deposits increased 14% in 2017 while the percentage of average noninterest-bearing deposits to total deposits increased to 33% for 2017 compared to 32% for 2016.

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

				Year Ended December 31,		
		2018			2017	
(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	**$1,115,869**	**$ 41,628**	**3.73%**	$ 873,278	$ 30,648	3.51%
Residential construction loans	**208,741**	**8,289**	**3.97**	167,664	6,292	3.75
Total mortgage loans	**1,324,610**	**49,917**	**3.77**	1,040,942	36,940	3.55
Commercial AD&C loans	**609,844**	**35,058**	**5.75**	298,563	14,844	4.97
Commercial investor real estate loans	**1,938,633**	**96,125**	**4.96**	1,040,871	46,558	4.47
Commercial owner occupied real estate loans	**1,128,836**	**53,712**	**4.76**	800,879	38,759	4.84
Commercial business loans	**694,326**	**36,499**	**5.26**	457,802	20,585	4.50
Total commercial loans	**4,371,639**	**221,394**	**5.06**	2,598,115	120,746	4.65
Consumer loans	**529,249**	**23,568**	**4.45**	458,931	16,934	3.72
Total loans (2)	**6,225,498**	**294,879**	**4.74**	4,097,988	174,620	4.26
Loans held for sale	**28,225**	**1,245**	**4.41**	6,855	279	4.06
Taxable securities	**736,054**	**21,362**	**2.90**	517,375	14,372	2.78
Tax-exempt securities (3)	**281,962**	**9,976**	**3.54**	296,226	12,550	4.24
Total investment securities	**1,018,016**	**31,338**	**3.08**	813,601	26,922	3.31
Interest-bearing deposits with banks	**74,956**	**1,304**	**1.74**	37,523	410	1.09
Federal funds sold	**2,151**	**31**	**1.42**	2,581	27	1.03
Total interest-earning assets	**7,348,846**	**328,797**	**4.47**	4,958,548	202,258	4.08
Less: allowance for loan losses	**(48,483)**			(44,557)		
Cash and due from banks	**68,183**			48,970		
Premises and equipment, net	**61,686**			53,947		
Other assets	**535,282**			223,012		
Total assets	**$7,965,514**			$5,239,920		
Liabilities and Stockholders' Equity						
Interest-bearing demand deposits	**$ 721,759**	**883**	**0.12%**	$ 616,524	507	0.08%
Regular savings deposits	**376,207**	**570**	**0.15**	322,856	216	0.07
Money market savings deposits	**1,541,142**	**18,719**	**1.21**	1,000,965	5,031	0.50
Time deposits	**1,290,626**	**18,967**	**1.47**	651,610	7,502	1.15
Total interest-bearing deposits	**3,929,734**	**39,139**	**1.00**	2,591,955	13,256	0.51
Other borrowings	**172,888**	**1,169**	**0.68**	133,356	337	0.25
Advances from FHLB	**980,541**	**21,408**	**2.18**	664,966	12,426	1.87
Subordinated debentures	**37,501**	**1,921**	**5.13**	411	12	2.94
Total interest-bearing liabilities	**5,120,664**	**63,637**	**1.24**	3,390,688	26,031	0.77
Noninterest-bearing demand deposits	**1,759,867**			1,257,231		
Other liabilities	**60,188**			41,075		
Stockholders' equity	**1,024,795**			550,926		
Total liabilities and stockholders' equity	**$7,965,514**			$5,239,920		

Net interest income and spread	**$265,160**	**3.23%**	$176,227	3.31%
Less: tax-equivalent adjustment	**4,715**		7,459	
Net interest income	**$260,445**		$168,768	
Interest income/earning assets		**4.47%**		4.08%
Interest expense/earning assets		**0.87**		0.53
Net interest margin		**3.60%**		3.55%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 26.13% for 2018 and 39.88
The annualized taxable-equivalent adjustments
utilized in the above table to compute yields aggregated to $4.7 million, $7.5 million and $6.7 million in 2018, 2017 and 20
(2) Non-accrual loans are included in the average balances.
(3) Includes only investments that are exempt from federal
taxes.

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:

	2018 vs. 2017			2017 vs. 2016		
	Increase Or	**Due to Change In Average:***		Increase Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	**(Decrease)**	**Volume**	**Rate**	(Decrease)	Volume	Rate
Interest income from earning assets:						
Residential mortgage loans	**$ 10,980**	**$ 8,959**	**$ 2,021**	$ 2,317	$ 1,645	$ 672
Residential construction loans	**1,997**	**1,611**	**386**	1,123	914	209
Commercial AD&C loans	**20,214**	**17,569**	**2,645**	1,645	744	901
Commercial investor real estate loans	**49,567**	**43,978**	**5,589**	9,448	10,272	(824)
Commercial owner occupied real estate loans	**14,953**	**15,604**	**(651)**	4,922	4,493	429
Commercial business loans	**15,914**	**11,993**	**3,921**	835	203	632
Consumer loans	**6,634**	**2,830**	**3,804**	1,338	271	1,067
Loans held for sale	**966**	**941**	**25**	(108)	(170)	62
Taxable securities	**6,990**	**6,342**	**648**	2,449	1,487	962
Tax-exempt securities	**(2,574)**	**(581)**	**(1,993)**	803	747	56
Interest-bearing deposits with banks	**894**	**558**	**336**	197	(19)	216
Federal funds sold	**4**	**(5)**	**9**	22	13	9
Total interest income	**126,539**	**109,799**	**16,740**	24,991	20,600	4,391
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	**376**	**95**	**281**	61	61	-
Regular savings deposits	**354**	**45**	**309**	34	11	23
Money market savings deposits	**13,688**	**3,769**	**9,919**	3,080	184	2,896
Time deposits	**11,465**	**8,931**	**2,534**	1,920	1,012	908
Other borrowings	**832**	**122**	**710**	47	34	13
Advances from FHLB	**8,982**	**6,656**	**2,326**	816	1,903	(1,087)
Subordinated debentures	**1,909**	**1,893**	**16**	(931)	(906)	(25)
Total interest expense	**37,606**	**21,511**	**16,095**	5,027	2,299	2,728
Net interest income	**$ 88,933**	**$ 88,288**	**$ 645**	$ 19,964	$ 18,301	$ 1,663

* 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

2018 vs. 2017

The Company's total tax-equivalent interest income increased 63% during 2018 compared to the prior year as average loans and investments and their associated yields increased during the year. In 2018, the average balance of the loan portfolio increased 52% and average investments increased 25% compared to the prior year.

The increase in loans was primarily the result of the WashingtonFirst acquisition coupled with the 9% post-acquisition growth of the total loan portfolio. The post-acquisition organic loan growth was the result of greater market presence and the improvement in the regional economy. The yield on average loans increased by 48 basis points compared to the prior year due to higher yields on the entire loan portfolio due to the effect of the rising interest rate environment during 2018 from the multiple rate increases by the Federal Reserve. Interest income for the year ended December 31, 2018 included $2.4 million in recovered interest income on acquired credit impaired loans. This amount compares to interest recoveries of $1.1 million for 2017. Exclusive of these recoveries, the yield on loans would have increased 46 basis points for the year ended December 31, 2018 compared to the year ended December 31, 2017.

The average yield on total investment securities decreased 23 basis points while the average balance of the portfolio increased 25% in 2018 compared to 2017. The decrease in the yield on investments was driven by the effect that the current year’s reduction in the corporate tax rate had on the tax-advantaged securities in the investment portfolio which caused a 70 basis point erosion in the yield on tax-exempt securities.

2017 vs. 2016

The Company's total tax-equivalent interest income increased 14% for 2017 compared to the prior year as average loans and investments and their associated yields increased during the year. In 2017, the average balance of the loan portfolio increased 11% and average investments increased 10% compared to the prior year.

The growth in the loan portfolio was primarily in the commercial investor real estate and owner occupied portfolios. These increases were driven by organic loan growth as the regional economy continued to improve. The yield on average loans increased by 10 basis points compared to the prior year due to higher yields on the entire loan portfolio, as the commercial portfolio increased 5 basis points compared to the prior year. The yield on the portfolio benefited from the impact of multiple rate increases by the Federal Reserve during the year. Exclusive of the $1.1 million in interest recoveries recognized during 2017, the yield on the average loan portfolio would have increased 8 basis points.

The average yield on total investment securities increased 11 basis points while the average balance of the portfolio increased 10% in 2017 compared to 2016. The increase in the yield on investments was driven primarily by the acquisition of higher yielding state and municipal securities during the year with excess available funding. As a result,

the average balance of the higher yielding state and municipal portfolio increased during the year as a percentage of the overall portfolio while the proportion of lower yielding securities had decreased due to sales and normal amortization of mortgage-backed securities in 2016.

Interest Expense

2018 vs. 2017

Interest expense increased by $37.6 million or 144% in 2018 compared to 2017. The increase in interest expense was driven by the combination of post-acquisition deposits and higher rates paid on deposits and borrowed funds. The combined growth in interest-bearing liabilities was primarily due to the acquisition of WashingtonFirst with the remaining growth driven by rate sensitive deposits and borrowings utilized to fund loan growth during the year. Average deposit growth was 48% during 2018 while average borrowed funds grew 49%. Average deposit growth was primarily the result of the 54% growth in average money market deposits and 98% growth in average time deposits. The overall increase in the rate paid on deposits increased 49 basis points and the rate paid on borrowings increase 45 basis points during 2018 compared to the prior year.

2017 vs. 2016

Interest expense increased by $5.0 million or 25% in 2017 compared to 2016. The increase in interest expense was driven by the increased cost of interest-bearing deposits due to higher rates paid on money market savings deposits and the rates offered on certificates of deposit together combined with 10% growth in the average balances. The increases in average deposits were mainly comprised of $191 million or 11% in average noninterest-bearing and interest-bearing checking accounts together with an increase of $93 million or 17% in certificates of deposit as the Company offered higher rates on certificates of deposit to fund loan growth. Additionally, average balances of money market accounts increased $81 million or 9% and average balances of regular savings accounts increased $23 million or 8% in 2017 compared to 2016. Average balances of Federal Home Loan Bank advances increased 18% and the average rates paid decreased 18 basis points in 2017 compared to 2016 due to the redemption of high-rate advances during 2017 and 2016, which had a beneficial impact on the cost of funds as the average rate decreased 18 basis points.

Interest Rate Performance

2018 vs. 2017

The Company's net interest margin increased to 3.60% for 2018 compared to 3.55% for 2017 while the net interest spread decreased to 3.23% in 2018 compared to 3.31% in 2017. The decrease in the spread was the result of the increase in the rates paid on interest-bearing liabilities exceeding the increase in the yields earned on interest-earning assets. The increase in the margin reflects the result of the proportionate mix of the interest-earning assets and associated yields as compared to the mix of interest-bearing liabilities and their associated rates.

2017 vs. 2016

The Company's net interest margin increased to 3.55% for 2017 compared to 3.49% for 2016 while the net interest spread increased to 3.31% in 2017 compared to 3.28% in 2016. This increase is the result of interest-earning asset growth at increased yields which exceeded the increased rate paid on interest-bearing liabilities that grew at a lower pace.

Non-interest Income

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

(Dollars in thousands)	**2018**	2017	2016	**2018/2017 $ Change**	**2018/2017 % Change**	2017/2016 $ Change	2017/2016 % Change
Securities gains	**$ 190**	$ 1,273	$ 1,932	**$ (1,083)**	**(85.1)** %	$ (659)	(34.1) %
Service charges on deposit accounts	**9,324**	8,298	7,953	**1,026**	**12.4**	345	4.3
Mortgage banking activities	**7,073**	2,734	4,049	**4,339**	**158.7**	(1,315)	(32.5)
Wealth management income	**21,284**	19,146	17,805	**2,138**	**11.2**	1,341	7.5

Insurance agency commissions	**6,158**	6,231	5,408	**(73)**	**(1.2)**	823	15.2
Income from bank owned life insurance	**4,327**	2,403	2,462	**1,924**	**80.1**	(59)	(2.4)
Visa check fees	**5,567**	4,827	4,674	**740**	**15.3**	153	3.3
Letter of credit fees	**611**	847	888	**(236)**	**(27.9)**	(41)	(4.6)
Extension fees	**873**	568	559	**305**	**53.7**	9	1.6
Other income	**5,642**	4,916	5,312	**726**	**14.8**	(396)	(7.5)
Total non-interest income	**$ 61,049**	$ 51,243	$ 51,042	**$ 9,806**	**19.1**	$ 201	0.4

2018 vs. 2017

Total non-interest income was $61.0 million for 2018, compared to $51.2 million for 2017. The year ended December 31, 2018, included gains of $0.2 million on sales of investment securities compared to $1.3 million in 2017. Excluding these gains, non-interest income increased 22% compared to the prior year period primarily due to increases in mortgage banking activities, wealth management income and BOLI insurance mortality proceeds. Mortgage lending operations acquired as part of the WashingtonFirst transaction resulted in significant growth in mortgage banking income for the year ended December 31, 2018 as a result of the increased volume of loan originations.

Service charges on deposits increased in 2018 compared to 2017 due to increases in commercial analysis fees, ATM and point of service fees and net commercial returned item fees. Wealth management income is comprised of income from trust and estate services and investment management fees earned by West Financial Services, the Company's investment management subsidiary. Trust services fees increased 7% compared to the prior year, due to a combination of higher recurring and estate settlement fees. Investment management fees in West Financial Services increased 16% for 2018 compared to 2017, due primarily to a 7% increase in assets under management from the WashingtonFirst acquisition and new client additions and to a lesser extent, market activity. Overall total assets under management remained level at $2.8 billion at December 31, 2018 compared to December 31, 2017. Insurance agency commissions at December 31, 2018 remained level compared to the prior year. Income from bank owned life insurance ("BOLI") increased 80% in 2018 compared to the prior year as a result of $1.6 million in mortality proceeds that were received in the first half of 2018. The Company invests in bank owned life insurance products in order to manage the cost of employee benefit plans. BOLI investments totaled $110.8 million at December 31, 2018 and $95.7 million at December 31, 2017 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 5.32% for 2018 compared to 4.21% for the prior year. The investment yield growth of these products from the prior year was the result of the acquisition of WashingtonFirst. Other non-interest income increased 13% during the current year compared to the prior year as a result of the growth in credit related fees driven by the increased size of the commercial loan portfolio.

2017 vs. 2016

Total non-interest income was $51.2 million for 2017 compared to $51.0 million for 2016. The year ended December 31, 2017, included gains of $1.3 million on sales of investment securities while the prior year included a $1.2 million gain on the extinguishment of subordinated debentures and $1.9 million in gains on the sales of investment securities. Excluding these gains, non-interest income increased 4% compared to the prior year primarily due to increases in wealth management income, insurance agency commissions and deposit service charges. Investment securities gains for the year were applied to offset penalties for prepayments of FHLB advances during the year as part of the strategic management of the interest margin.

Service charges on deposits increased in 2017 compared to 2016 due to increases in commercial analysis fees, ATM and point of service fees. Income from mortgage banking activities decreased in 2017 compared to 2016 due to lower origination volumes compared to the prior year as a result of higher average interest rates and lower bulk sales activity during the year. Wealth management income is comprised of income from trust and estate services and investment management fees earned by West Financial Services, the Company's investment management subsidiary. Trust services fees increased 10% compared to the prior year, due to higher recurring fees while assets under trust and estate management increased 14% over the prior year. Investment management fees in West Financial Services increased 12% for 2017 compared to 2016, due primarily to a 15% increase in assets under management from new client acquisitions and market activity. Overall total assets under management increased to $2.8 billion at December 31, 2017 compared to $2.4 billion at December 31, 2016. Insurance agency commissions increased 15% in 2017 compared to 2016 due primarily to higher commercial insurance income. The current year also contained a full year's income from the acquisition of an agency that occurred after mid-2016. Income from bank owned life insurance remained level in 2017 compared to the prior year. The Company invests in bank owned life insurance products in order to manage the cost of employee benefit plans. Investments totaled $95.7 million at December 31, 2017 and $93.3 million at December 31, 2016 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 4.21% for 2017 compared to 4.44% for the prior year. Other non-interest income decreased 7.5% during the current year compared to the prior year which

contained the gain of $1.2 million on the extinguishment of $5 million in subordinated debentures. The impact of the exclusion of this prior year gain was offset in the current year by increases in various miscellaneous fees and commissions.

Non-interest Expense

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

(Dollars in thousands)	**2018**	2017	2016	**2018/2017 $ Change**	**2018/2017 % Change**	2017/2016 $ Change	2017/2016 % Change
Salaries and employee benefits	**$ 96,998**	$ 73,132	$ 71,354	**$ 23,866**	**32.6 %**	$ 1,778	2.5 %
Occupancy expense of premises	**18,352**	13,053	12,960	**5,299**	**40.6**	93	0.7
Equipment expenses	**9,335**	7,015	6,883	**2,320**	**33.1**	132	1.9
Marketing	**3,924**	3,119	2,851	**805**	**25.8**	268	9.4
Outside data services	**6,603**	5,486	5,377	**1,117**	**20.4**	109	2.0
FDIC insurance	**5,095**	3,305	2,741	**1,790**	**54.2**	564	20.6
Amortization of intangible assets	**2,162**	101	130	**2,061**	**N/M**	(29)	(22.3)
Merger expenses	**11,766**	4,252	-	**7,514**	**176.7**	4,252	N/M
Professional fees	**6,056**	4,492	4,840	**1,564**	**34.8**	(348)	(7.2)
Other real estate owned	**162**	17	19	**145**	**N/M**	(2)	(10.5)
Postage and delivery	**1,439**	1,179	1,155	**260**	**22.1**	24	2.1
Communications	**2,610**	1,502	1,583	**1,108**	**73.8**	(81)	(5.1)
Loss on FHLB redemption	**-**	1,275	3,167	**(1,275)**	**(100.0)**	(1,892)	(59.7)
Other expenses	**15,281**	11,171	9,998	**4,110**	**36.8**	1,173	11.7
Total non-interest expense	**$ 179,783**	$ 129,099	$ 123,058	**$ 50,684**	**39.3**	$ 6,041	4.9

2018 vs. 2017

Non-interest expenses totaled $179.8 million in 2018 compared to $129.1 million in 2017. This increase in expenses was driven by merger expenses and the increased costs necessary to operate the larger post-acquisition entity.

Salaries and employee benefits, the largest component of non-interest expenses, increased in 2018 due principally to higher compensation expenses primarily as a result of the increased number of employees. The average number of full-time equivalent employees increased to 922 in 2018 compared to 729 for 2017. The majority of the increase occurred due to the increase in the number of branches and additional loan origination associates.

Occupancy expenses increased in 2018 compared to 2017 due to increased rental and operations expense from the addition of WashingtonFirst branches. This cost was slightly tempered by savings realized from the consolidation of six branches in mid-2018. Equipment expenses also increased in 2018 compared to 2017 due to the effects of the larger post-acquisition company. Marketing expense for 2018 increased compared to 2017 as a result of increased focused advertising campaigns. Outside data services expense increased in 2018 compared to 2017 due to the increased cost of contractual services with volume-based components. FDIC insurance expense increased in 2018 compared to 2017 due to the increased size of the total asset assessment base. Merger expenses associated with the acquisition of WashingtonFirst totaled $11.8 million in 2018 as compared to $4.3 million in the prior year. Amortization of intangibles increased from the prior year as a result of the amortization of the core deposit intangible that was recognized in the acquisition. Other non-interest expenses increased in 2018 compared to 2017 driven by increased professional and consulting fees, communication costs, volume based external fees and franchise taxes. Non-interest expense for the year ended December 31, 2017 included $1.3 million in prepayment penalties on the

early pay-off of high rate FHLB advances. Excluding merger expenses from both years and the prepayment penalties from the prior year, the year-over-year increase in non-interest expense was 36%.

2017 vs. 2016

Non-interest expenses totaled $129.1 million in 2017 compared to $123.1 million in 2016. This increase in expenses was driven by merger expenses and increased compensation costs. Salaries and employee benefits, the largest component of non-interest expenses, increased in 2017 due principally to higher compensation expenses as a result of merit increases. The average number of full-time equivalent employees was 729 in 2017 compared to 728 for 2016. Occupancy expenses remained stable in 2017 compared to 2016 as increased rental expense was offset by lower building and grounds maintenance costs during the year. Equipment expenses increased in 2017 compared to 2016 due to an increase in equipment service costs. Marketing expense for 2017 increased compared to 2016 as a result of focused marketing initiatives. Outside data services expense increased in 2017 compared to 2016 due to the increased cost of contractual services. FDIC insurance expense increased in 2017 compared to 2016 due to loan growth during the year. Merger expenses associated with the acquisition of WashingtonFirst totaled $4.3 million in 2017. Other non-interest expenses increased in 2017 compared to 2016 driven by the impact of asset dispositions related to the closure of two branch locations that occurred in late 2017. Expenses for postage, communications and other real estate owned expenses remained relatively stable for 2017 compared to the prior year.

Operating Expense Performance

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

Non-GAAP Financial Measures

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

In general, the efficiency ratio is non-interest expenses as a percentage of net interest income plus non-interest income. Non-interest expenses used in the calculation of the non-GAAP efficiency ratio exclude merger expenses, goodwill impairment losses, litigation expenses, the amortization of intangibles, and other non-recurring expenses. Income for the non-GAAP ratio includes the favorable effect of tax-exempt income, and excludes securities gains and losses, which vary widely from period to period without appreciably affecting operating expenses, and non-recurring gains. The measure is different from the GAAP efficiency ratio, which also is presented in this report. The GAAP measure is calculated using non-interest expense and income amounts as shown on the face of the Consolidated Statements of Income. The GAAP and non-GAAP efficiency ratios are reconciled and provided in the following table. The GAAP efficiency ratio improved for 2018 compared to the prior year as a direct result of the increase in net interest income. The non-GAAP efficiency ratio also improved in 2018 compared to the prior year as a result of the 54% growth in net interest income while non-interest expense increased 39%.

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

GAAP and Non-GAAP Efficiency Ratios

(Dollars in thousands)	Year ended December 31, **2018**	2017	2016	2015	2014
Pre-tax pre-provision pre-merger expense income:					
Net income	**$ 100,864**	$ 53,209	$ 48,250	$ 45,355	$ 38,200
Plus Non-GAAP adjustments:					
Litigation expenses	**-**	-	-	(3,869)	6,519
Merger expenses	**11,766**	4,252	-	-	-
Income taxes	**31,824**	34,726	23,740	22,027	17,582
Provision (credit) for loan losses	**9,023**	2,977	5,546	5,371	(163)
Pre-tax pre-provision income	**$ 153,477**	$ 95,164	$ 77,536	$ 68,884	$ 62,138
Efficiency ratio - GAAP basis:					
Non-interest expenses	**$ 179,783**	$ 129,099	$ 123,058	$ 115,347	$ 120,800
Net interest income plus non-interest income	**$ 321,494**	$ 220,011	$ 200,594	$ 188,100	$ 176,419
Efficiency ratio - GAAP basis	**55.92%**	58.68%	61.35%	61.32%	68.47%
Efficiency ratio - Non-GAAP basis:					
Non-interest expenses	**$ 179,783**	$ 129,099	$ 123,058	$ 115,347	$ 120,800
Less Non-GAAP adjustments:					
Amortization of intangible assets	**2,162**	101	130	372	821
Loss on FHLB redemption	**-**	1,275	3,167	-	-
Litigation expenses	**-**	-	-	(3,869)	6,519
Merger expenses	**11,766**	4,252	-	-	-
Non-interest expenses - as adjusted	**$ 165,855**	$ 123,471	$ 119,761	$ 118,844	$ 113,460
Net interest income plus non-interest income	**$ 321,494**	$ 220,011	$ 200,594	$ 188,100	$ 176,419
Plus Non-GAAP adjustment:					
Tax-equivalent income	**4,715**	7,459	6,711	6,478	5,192
Less Non-GAAP adjustments:					
Securities gains	**190**	1,273	1,932	36	5
Gain on redemption of subordinated debentures	**-**	-	1,200	-	-
Net interest income plus non-interest income - as adjusted	**$ 326,019**	$ 226,197	$ 204,173	$ 194,542	$ 181,606
Efficiency ratio - Non-GAAP basis	**50.87%**	54.59%	58.66%	61.09%	62.48%

(Dollars in thousands)	Year ended December 31, **2018**	2017
Supplemental Non-GAAP Performance Measurements:		
Net income - GAAP	**$ 100,864**	$ 53,209
Plus non-GAAP adjustments:		
Merger expenses - net of tax	**8,692**	2,556
Income taxes - Incremental impact of revaluation of deferred tax assets	**-**	5,544
Less non-GAAP adjustment:		
Acquisition fair value marks - net of tax	**7,493**	77
Net income - Non-GAAP	**$ 102,063**	$ 61,232
Diluted net income per share - Non-GAAP	**$ 2.86**	$ 2.53
Return on average assets - Non-GAAP	**1.28%**	1.17%
Return on average common equity - Non-GAAP	**9.96%**	11.11%

Income Taxes

The Company had income tax expense of $31.8 million in 2018, compared to $34.7 million in 2017 and $23.7 million in 2016. The current year's tax expense reflects the impact of the reduced corporate tax rate under the Tax Cuts and Jobs Act that was enacted at the end of 2017. The prior year's tax expense included $5.5 million in additional income tax expense from the revaluation of deferred tax assets as a result of that tax act. The resulting effective rates were 24% for 2018, 39% for 2017 and 33% for 2016. Exclusive of the impact of the additional tax expense, the effective tax rate for 2017 would have been 33%.

FINANCIAL CONDITION

At December 31, 2018, the Company's total assets amounted to $8.2 billion compared to $5.4 billion at December 31, 2017. This 51% increase was primarily the result of the acquisition of WashingtonFirst's $2.1 billion of assets. Total loans at December 31, 2018, were $6.6 billion compared to $4.3 billion at December 31, 2017. Post-acquisition asset growth has been primarily the result of net loan growth in 2018. The investment securities portfolio also grew 30% during this period. Interest-bearing liabilities experienced 50% growth year-over-year with the majority of the growth occurring in deposits.

Loans

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

	December 31,					
	2018		2017		Year-to-Year Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$ Change	% Change
Residential real estate:						
Residential mortgage	**$1,228,247**	**18.7%**	$ 921,435	21.4%	$ 306,812	33.3%
Residential construction	**186,785**	**2.8**	176,687	4.1	10,098	5.7
Commercial real estate:						
Commercial owner occupied real estate	**1,202,903**	**18.3**	857,196	19.9	345,707	40.3
Commercial investor real estate	**1,958,395**	**29.8**	1,112,710	25.8	845,685	76.0
Commercial AD&C	**681,201**	**10.4**	292,443	6.8	388,758	132.9
Commercial Business	**796,264**	**12.1**	497,948	11.5	298,316	59.9
Consumer	**517,839**	**7.9**	455,829	10.5	62,010	13.6
Total loans	**$6,571,634**	**100.0%**	$4,314,248	100.0%	$2,257,386	52.3

Total loans, excluding loans held for sale, increased $2.3 billion or 52% at December 31, 2018 compared to December 31, 2017 as a result of strong organic loan growth and the WashingtonFirst acquisition. The majority of the organic loan growth occurred in the commercial loan portfolio. Overall, the commercial loan portfolio increased by 68% to $4.6 billion at December 31, 2018 compared to the prior year end. The post-acquisition commercial loan portfolio experienced double digit organic growth in each respective category of commercial loans. The organic growth reflected the improving economy and the Company's increased emphasis on growth in its commercial portfolio.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, increased 29% at December 31, 2018 compared to December 31, 2017. Permanent residential mortgages, most of which are 1-4 family, increased 33% from period to period. The Company generally retains adjustable rate mortgages in its portfolio. The Company also retains a substantial portion of its fixed rate mortgage originations to low and moderate income borrowers in its portfolio. The Company elected to sell $60 million and $40 million of residential mortgage loans during 2018 and 2017, respectively. Residential construction loans increased 6% at December 31, 2018 compared to the balance at December 31, 2017 due to a higher volume of such loans. The consumer loan portfolio increased 14% at December 31, 2018 compared to December 31, 2017, predominantly in the home equity loan portfolio.

Analysis of Loans

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

	December 31,							
(Dollars in thousands)	**2018**	*%*	2017	*%*	2016	*%*	2015	*%*
Residential real estate:								
Residential mortgage	**$1,228,247**	**18.7 %**	$ 921,435	21.4 %	$ 841,692	21.4 %	$ 796,358	22.8 %
Residential construction	**186,785**	**2.8**	176,687	4.1	150,229	3.8	129,281	3.7
Commercial real estate:								
Commercial owner occupied	**1,202,903**	**18.3**	857,196	19.9	775,552	19.8	678,027	19.4
Commercial investor	**1,958,395**	**29.8**	1,112,710	25.8	928,113	23.6	719,084	20.6
Commercial AD&C loans	**681,201**	**10.4**	292,443	6.8	308,279	7.9	255,980	7.3
Commercial business	**796,264**	**12.1**	497,948	11.5	467,286	11.9	465,765	13.3
Leases	**-**	**-**	-	-	-	-	-	-
Consumer	**517,839**	**7.9**	455,829	10.5	456,657	11.6	450,875	12.9
Total loans	**$6,571,634**	**100.0 %**	$4,314,248	100.0 %	$3,927,808	100.0 %	$3,495,370	100.0 %

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, 2018 Remaining Maturities of Selected Credits in Years			
(In thousands)	1 or less	Over 1-5	Over 5	Total
Residential construction loans	$ 162,991	$ 21,837	$ 1,957	$ 186,785
Commercial AD&C loans	603,986	51,764	25,451	681,201
Commercial business loans [(1)]	467,289	226,695	102,280	796,264
Total	$ 1,234,266	$ 300,296	$ 129,688	$ 1,664,250
Rate Terms:				
Fixed	$ 149,013	$ 214,472	$ 79,887	$ 443,372
Variable or adjustable	1,085,253	85,824	49,801	1,220,878
Total	$ 1,234,266	$ 300,296	$ 129,688	$ 1,664,250

(1) Loans not secured by real estate

Investment Securities

The investment portfolio, consisting of available-for-sale and other equity securities, increased 30% to $1.0 billion at December 31, 2018, from $775 million at December 31, 2017. The increase was primarily the result of the additional securities acquired from WashingtonFirst.

Composition of Investment Securities

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

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(Dollars in thousands)	December 31, **2018**	**%**	2017	%	2016	%
Available-for-Sale: [1]						
U.S. treasuries and government agencies	**$ 296,678**	**29.4 %**	$ 106,568	13.8 %	$ 121,790	15.6%
State and municipal	**282,024**	**27.9**	312,253	40.3	287,684	36.9
Mortgage-backed and asset-backed[2]	**348,515**	**34.4**	300,040	38.7	312,711	40.1
Corporate debt	**9,240**	**0.9**	9,432	1.2	9,134	1.2
Trust preferred	**310**	**-**	1,002	0.1	1,012	0.1
Marketable equity securities	**568**	**0.1**	212	-	1,223	0.2
Total available-for-sale securities[3]	**937,335**	**92.7**	729,507	94.1	733,554	94.1
Held-to-Maturity and Other Equity:						
Other equity securities	**73,389**	**7.3**	45,518	5.9	46,094	5.9
Total held-to-maturity and other equity	**73,389**	**7.3**	45,518	5.9	46,094	5.9
Total Securities[3]	**$ 1,010,724**	**100.0 %**	$ 775,025	100.0 %	$ 779,648	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, 2018, 2017 or 2016.

The investment portfolio grew 30% from December 31, 2017 to December 31, 2018 even as the Company funded double digit loan growth. The ability to maintain the size of the investment portfolio was possible due to post-acquisition deposit growth during 2018 and the cash flows associated with this deposit growth. A result of the growth in the investment portfolio was a shift in the allocation of the portfolio to a greater proportion being placed in U.S. treasuries and government agencies. The tax legislation that became effective at the end of 2017 had the effect of reducing the tax-advantages associated with the earnings streams for state and municipal securities. Accordingly, the effective yield on tax-advantaged securities in the portfolio and on the portfolio as a whole was reduced. The Company intends to continue to retain a significant portion of the portfolio in these securities.

The investment portfolio consists primarily of U.S. Treasuries, U.S. Agency securities, U.S. Agency mortgage-backed and asset-backed securities and collateralized mortgage obligations and state and municipal securities. At December 31, 2018, 97% of the investment portfolio was invested in Aa/AA or Aaa/AAA rated securities. The duration of the portfolio increased to 3.9 years at December 31, 2018 compared to 3.7 years at December 31, 2017 as a result of the rising interest rate environment. The composition and duration of the investment portfolio has resulted in a portfolio with low credit risk that is expected to provide the required liquidity needed to meet increased loan and liquidity demands. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis.

Maturities and weighted average yields for investment securities available-for-sale at December 31, 2018 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, 2018									
	Within One Year or Less		After One Year Through Five years		After Five Years Through Ten Years		Over Ten Years			
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
Available-for-Sale [1]										
U. S. treasuries and government agencies	$ 6,987	1.98%	$ 161,189	2.40%	$ 52,258	2.30%	$ 79,904	3.19%	$ 300,338	2.58%
State and municipal [2]	56,353	5.04	103,166	4.40	98,531	3.62	22,675	4.54	280,725	4.27
Mortgage-backed	142	4.05	12,942	3.25	52,936	2.89	289,247	2.64	355,267	2.69
Corporate debt	-	-	-	-	9,100	5.94	-	-	9,100	5.94
Trust preferred	-	-	-	-	-	-	310	5.27	310	5.27
Total	$ 63,482	4.70	$ 277,297	3.19	$ 212,825	3.22	$ 392,136	2.86	$ 945,740	3.16

(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 21%.

Other Earning Assets

Residential mortgage loans held for sale increased $13 million to $23 million at December 31, 2018 compared to $10 million as of December 31, 2017 due to the increase in volume of originations. Mortgage lending operations acquired as part of the WashingtonFirst transaction resulted in an increased volume of loan originations during 2018. The aggregate of federal funds sold and interest-bearing deposits with banks decreased by $22 million to $34 million in 2018.

Deposits

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

	December 31,					
	2018		2017		Year-to-Year Change	
(Dollars in thousands)	**Amount**	**%**	Amount	%	$ Change	% Change
Noninterest-bearing deposits	**$1,750,319**	**29.6%**	$1,264,392	31.9%	$ 485,927	38.4%
Interest-bearing deposits:						
Demand	**703,145**	**11.9**	658,716	16.6	44,429	6.7
Money market savings	**1,605,024**	**27.1**	1,030,432	26.0	574,592	55.8
Regular savings	**330,231**	**5.6**	321,171	8.1	9,060	2.8
Time deposits of less than $100,000	**427,421**	**7.2**	293,201	7.4	134,220	45.8
Time deposits of $100,000 or more	**1,098,740**	**18.6**	395,750	10.0	702,990	177.6
Total interest-bearing deposits	**4,164,561**	**70.4**	2,699,270	68.1	1,465,291	54.3
Total deposits	**$5,914,880**	**100.0%**	$3,963,662	100.0%	$1,951,218	49.2

Deposits and Borrowings

Total deposits increased by $2.0 billion or 49% at December 31, 2018 compared to December 31, 2017 as a result of the acquisition of WashingtonFirst, with post-acquisition deposit growth of 6%. Excluding the initial impact of the acquisition, money market accounts grew 23%, time deposits grew 21%, non-interest bearing deposits grew 4%, while demand and regular savings deposits experienced double digit declines during 2018. The decrease in these deposit segments were expected based on pricing decisions. The increases in the money market deposit products can be attributed to clients' emphasis on liquidity and safety in addition to rates becoming more attractive due to rising rates during the year and volatility in the equity markets. The increase in certificates of deposit occurred as the Company began to offer higher rates to manage its funding of the growth in the loan portfolio and to maintain multiple product relationships. The relative composition of the deposit portfolio was not significantly altered by the acquisition. Interest-bearing deposits represented 70% of total deposits with the remaining 30% in noninterest-bearing balances at December 31, 2018. At December 31, 2017, interest-bearing deposits represented 68% of total deposits while 32% represented noninterest-bearing deposits. Total borrowings increased 37% at December 31, 2018 compared to December 31, 2017. This growth was a combination of the effects of the acquisition in addition to FHLB borrowing supplementing the deposit funding of loan growth during 2018.

Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. Total stockholders' equity was $1.1 billion at December 31, 2018 compared to $564 million at December 31, 2017. The growth in stockholders' equity was the result of the $447 million in equity issued in connection with the WashingtonFirst acquisition in addition to net income during the period exceeding the payment of dividends. The ratio of average equity to average assets was 12.87% for the year ended December 31, 2018, as compared to 10.51% for the year ended December 31, 2017.

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

Risk-Based Capital Ratios

	Ratios at December 31,		Minimum Regulatory
	2018	2017	Requirements
Total Capital to risk-weighted assets	**12.26%**	11.85%	8.00%
Tier 1 Capital to risk-weighted assets	**11.06%**	10.84%	6.00%
Common Equity Tier 1 Capital to risk-weighted assets	**10.90%**	10.84%	4.50%
Tier 1 Leverage	**9.50%**	9.24%	4.00%

Regulatory capital at December 31, 2018 is comprised of tier 1 capital of $738 million and total qualifying capital of $818 million. As of December 31, 2018, the most recent notification from the Bank’s primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

The minimum capital level requirements applicable to the Company and the Bank are: (1) a common equity Tier 1 capital ratio of 4.5%; (2) a Tier 1 capital ratio of 6%; (3) a total capital ratio of 8%; and (4) a Tier 1 leverage ratio of 4%. The rules also establish a “capital conservation buffer” of 2.5% above the regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. 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.

Tangible common equity totaled $727 million at December 31, 2018, compared to $484 million at December 31, 2017. At December 31, 2018, the ratio of tangible common equity to tangible assets has increased to 9.21% compared to 9.04% at December 31, 2017. The initial impact on tangible common equity of the growth in intangible assets associated with the WashingtonFirst acquisition has been substantially offset during 2018 by increased net earnings.

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)	**2018**	2017	2016	2015	2014
Tangible common equity ratio:					
Total stockholders' equity	**$ 1,067,903**	$ 563,816	$ 533,572	$ 524,427	$ 521,751
Accumulated other comprehensive loss	**15,754**	6,857	6,614	1,297	823
Goodwill	**(347,149)**	(85,768)	(85,768)	(84,171)	(84,171)
Other intangible assets, net	**(9,788)**	(580)	(680)	(138)	(510)
Tangible common equity	**$ 726,720**	$ 484,325	$ 453,738	$ 441,415	$ 437,893
Total assets	**$ 8,243,272**	$ 5,446,675	$ 5,091,383	$ 4,655,380	$ 4,397,132
Goodwill	**(347,149)**	(85,768)	(85,768)	(84,171)	(84,171)
Other intangible assets, net	**(9,788)**	(580)	(680)	(138)	(510)
Tangible assets	**$ 7,886,335**	$ 5,360,327	$ 5,004,935	$ 4,571,071	$ 4,312,451
Tangible common equity ratio	**9.21%**	9.04%	9.07%	9.66%	10.15%
Tangible book value per share	**$20.45**	$20.18	$18.98	$18.17	$17.48

Credit Risk

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

Loans acquired with evidence of credit deterioration since their origination as of the date of the acquisition are recorded at their initial fair value. Credit deterioration is determined based on the probability of collection of all contractually required principal and interest payments. These loans are not considered non-performing for reporting purposes but are managed and monitored in the same manner and using the same techniques and strategies as organically generated loans. In accordance with GAAP, the historical allowance for loan losses related to the acquired loans is not carried over to the Company's financial statements. The following credit related sections should be read in conjunction with the section "Loans Acquired with Deteriorated Credit Quality" in "Note 1 – Significant Accounting

Policies" of the Notes to the Consolidated Financial Statements.

Total non-performing loans, which exclude acquired non-performing loans, increased 23% to $36.0 million at December 31, 2018 compared to $29.3 million at December 31, 2017. This increase is the direct result of the acquisition of the WashingtonFirst loan portfolio, as several performing loans as of the acquisition date have experienced post-acquisition credit deterioration. While the balance of non-performing loans increased, the ratio of non-performing loans to total loans decreased to 0.55% at December 31, 2018 from 0.68% at December 31, 2017 due to the increase in the size of the loan portfolio. 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. The local economic conditions and levels of non-performing loans can be influenced by any volatility being experienced in various sectors of the economy on both a regional and national level. Management monitors the performance within various sectors of the portfolio.

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

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

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

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

a specific allowance or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to ensure that there are no significant time lapses during this process.

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

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

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

- The borrower may be contacted for a meeting to discuss an updated or revised action plan which may include a request for additional collateral.

- Re-verification of the documentation supporting the Company's position with respect to the collateral securing the loan.

- At the monthly credit committee meeting the loan status is examined and the loan may be downgraded and a specific allowance may be decided upon in advance of the receipt of the appraisal.

- Upon receipt of the updated appraisal (or based on an updated internal financial evaluation) the loan balance is compared to the appraisal and a specific allowance is decided upon for the particular loan, typically for the amount of the difference between the appraisal and the loan balance, net of estimated cost to sell.

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

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

Loans considered to be troubled debt restructurings ("TDRs") are loans that have their terms restructured (e.g., interest rates, loan maturity date, payment and amortization period, etc.) in circumstances that provide payment relief to a borrower experiencing financial difficulty. All restructured loans are considered impaired loans and may either be in accruing status or non-accruing status. Non-accruing restructured loans may return to accruing status provided doubt has been removed concerning the collectability of principal and interest as evidenced by a sufficient period of payment performance in accordance with the restructured terms. Loans may be removed from the restructured category if the borrower is no longer experiencing financial difficulty, a re-underwriting event took place and the revised loan terms of the subsequent restructuring agreement are considered to be consistent with terms that can be obtained in the credit market for loans with comparable risk.

The Company may extend the maturity of a performing or current loan that may have some inherent weakness associated with the loan. However, the Company generally follows a policy of not extending maturities on non-performing loans under existing terms. Maturity date extensions only occur under revised terms that clearly place the Company in a position to increase the likelihood of or assure full collection of the loan under the contractual terms and /or terms at the time of the extension that may eliminate or mitigate the inherent weakness in the loan. These terms may incorporate, but are not limited to additional assignment of collateral, significant balance

curtailments/liquidations and assignments of additional project cash flows. Guarantees may be a consideration in the extension of loan maturities. As a general matter, the Company does not view extension of a loan to be a satisfactory approach to resolving non-performing credits. On an exception basis, certain performing loans that have displayed some inherent weakness in the underlying collateral values, an inability to comply with certain loan covenants which are not affecting the performance of the credit or other identified weakness may be extended.

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

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

The Company makes provisions for loan losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology previously discussed. The provision for loan losses was $9.0 million in 2018, $3.0 million in 2017 and $5.5 million in 2016. The increase in the provision for 2018 as compared to 2017 reflects the organic growth in the loan portfolio year over year in addition to the impact of acquired loans being re-underwritten as they reached maturity under their original lending arrangements and ceased to be accounted for as acquired loans. The provision for 2017 compared to compared to 2016 decreased due to the effect of the improvement in loan quality and a reduction in non-performing loans, which offset the impact of loan growth during 2017.

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

The Company periodically engages in whole loan sale transactions of its residential mortgage loans as a part its interest rate risk management strategy. The Company sold $60.0 million and $39.7 million of loans on a servicing-retained basis during 2018 and 2017, respectively. Gains on these transactions were not significant for either year. The servicing asset associated with these sales during 2018 and 2017 was $0.5 million and $0.3 million, respectively. Income earned by the Company on its loan servicing rights is derived primarily from contractually specified servicing fees and other ancillary fees. Such income earned for 2018 and 2017 was not significant.

Mortgage loan servicing rights are accounted for at amortized cost and are monitored for impairment on an ongoing basis. At December 31, 2018, and December 31, 2017, the amortized cost of the Company's mortgage loan servicing rights was $1.1 million and $697 thousand, respectively. The Company did not incur any impairment losses during 2018.

Allowance for Loan Losses

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

	December 31,				
(In thousands)	**2018**	2017	2016	2015	2014
Residential real estate:					
Residential mortgage	**$ 8,881**	$ 7,273	$ 7,261	$ 6,901	$ 6,232
Residential construction	**1,261**	1,243	963	894	923
Total residential real estate	**10,142**	8,516	8,224	7,795	7,155
Commercial real estate:					
Commercial investor	**17,603**	14,438	12,939	10,440	9,784
Commercial owner occupied	**6,307**	6,931	7,885	7,984	7,143
Commercial AD&C	**5,944**	3,839	4,652	4,691	4,267
Total commercial real estate	**29,854**	25,208	25,476	23,115	21,194
Commercial Business	**11,377**	9,161	7,539	6,529	5,852
Leases	**-**	-	-	-	9
Consumer	**2,113**	2,372	2,828	3,456	3,592
Total allowance	**$ 53,486**	$ 45,257	$ 44,067	$ 40,895	$ 37,802

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

At December 31, 2018, total non-performing loans were $36.0 million, or 0.55% of total loans, compared to $29.3 million, or 0.68% of total loans, at December 31, 2017. The allowance represented 149% of non-performing loans at December 31, 2018 as compared to 154% at December 31, 2017. The decrease in this ratio was due primarily to the increase in the size of the loan portfolio. The allowance for loan losses as a percent of total loans was 0.81% at December 31, 2018 as compared to 1.05% at December 31, 2017.

Continued analysis of the actual loss history on problem credits in 2018 and 2017 provided an indication that the coverage of the inherent losses on problem credits was adequate. The Company continues to monitor the impact of the economic conditions on its commercial customers, the status of the underlying collateral of non-accruals, inflow in criticized loans and early stage delinquencies. These credit metrics support management's outlook for credit quality performance and supports the assessment of the adequacy of the allowance for loan losses.

The balance of impaired loans was $22.2 million with specific allowances of $4.9 million against those loans at December 31, 2018, as compared to $20.8 million with specific allowances of $4.0 million, at December 31, 2017.

The Company's borrowers are concentrated in central Maryland, Northern Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 87% of total loans at December 31, 2018 and 77% of total loans at December 31, 2017. Certain loan terms may create concentrations of

credit risk and increase the Company’s exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

Summary of Loan Loss Experience

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

	Year Ended December 31,				
(Dollars in thousands)	**2018**	2017	2016	2015	2014
Balance, January 1	**$ 45,257**	$ 44,067	$ 40,895	$ 37,802	$ 38,766
Provision (credit) for loan losses	**9,023**	2,977	5,546	5,371	(163)
Loan charge-offs:					
Residential real estate:					
Residential mortgage	**(225)**	(87)	(1,404)	(614)	(323)
Residential construction	**-**	-	-	-	(4)
Commercial real estate:					
Commercial investor	**(131)**	-	(197)	(91)	(3)
Commercial owner occupied	**-**	(248)	-	(1,043)	(265)
Commercial AD&C	**-**	-	(48)	(739)	(529)
Commercial business	**(449)**	(1,538)	(597)	(306)	(729)
Leases	**-**	-	-	(4)	-
Consumer	**(611)**	(693)	(888)	(998)	(834)
Total charge-offs	**(1,416)**	(2,566)	(3,134)	(3,795)	(2,687)
Loan recoveries:					
Residential real estate:					
Residential mortgage	**62**	150	358	145	121
Residential construction	**15**	26	32	51	79
Commercial real estate:					
Commercial investor	**87**	101	133	20	38
Commercial owner occupied	**-**	-	5	3	6
Commercial AD&C	**62**	103	40	580	-
Commercial business	**258**	94	44	475	1,477
Leases	**-**	-	-	-	-
Consumer	**138**	305	148	243	165
Total recoveries	**622**	779	760	1,517	1,886
Net charge-offs	**(794)**	(1,787)	(2,374)	(2,278)	(801)
Balance, period end	$ **53,486**	$ 45,257	$ 44,067	$ 40,895	$ 37,802
Net charge-offs to average loans	**0.01%**	0.04%	0.06%	0.07%	0.03%
Allowance to total loans	**0.81%**	1.05%	1.12%	1.17%	1.21%

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)	**2018**	2017	2016	2015	2014
Non-accrual loans					
Residential real estate					
Residential mortgage	**$ 9,336**	$ 7,196	$ 7,257	$ 8,822	$ 3,012
Residential construction	**159**	177	195	418	1,105
Commercial real estate:					
Commercial investor	**5,355**	5,575	8,107	8,368	8,156
Commercial owner occupied	**4,234**	3,582	4,823	6,340	8,941
Commercial AD&C	**3,306**	136	137	194	2,464
Commercial business	**7,086**	6,703	5,833	3,696	3,184
Consumer	**4,107**	2,967	2,859	2,193	1,668
Total non-accrual loans[1]	**33,583**	26,336	29,211	30,031	28,530
Loans 90 days past due					
Residential real estate:					
Residential mortgage	**221**	225	232	-	-
Residential construction	**-**	-	-	-	-
Commercial real estate:					
Commercial investor	**-**	-	-	-	-
Commercial owner occupied	**-**	-	-	-	-
Commercial AD&C	**-**	-	-	-	-
Commercial business	**49**	-	-	-	-
Consumer	**219**	-	-	-	-
Total 90 days past due loans	**489**	225	232	-	-
Restructured loans (accruing)	**1,942**	2,788	2,489	4,467	5,497
Total non-performing loans[2], [3]	**36,014**	29,349	31,932	34,498	34,027
Other real estate owned, net	**1,584**	2,253	1,911	2,742	3,195
Total non-performing assets	$ **37,598**	$ 31,602	$ 33,843	$ 37,240	$ 37,222
Non-performing loans to total loans	**0.55%**	0.68%	0.81%	0.99%	1.09%
Non-performing assets to total assets	**0.46%**	0.58%	0.66%	0.80%	0.85%
Allowance for loan losses to non-performing loans	**148.51%**	154.20%	138.00%	118.54%	111.09%

(1) Gross interest income that would have been recorded in 2018 if non-accrual loans shown above had been current and in accordance with their original terms was $2.5 million. No interest income was accrued 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 $9.0 million at December 31, 2018. 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.

(3) Purchased credit impaired loans are not included in non-performing loans disclosure. As of December 31, 2018 these loans totaled $26.0 million.

Market Risk Management

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

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

The Company’s board of directors has established a comprehensive interest rate risk management policy, which is administered by management’s Asset Liability Management Committee (“ALCO”). The policy establishes limits on risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity or “EVE” at risk) resulting from a hypothetical change in U.S. Treasury interest rates for maturities from one day to thirty years. The Company measures the potential adverse impacts that changing interest rates may have on its short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by the Company. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. As an example, certain money market deposit accounts are assumed to reprice at 40% of the interest rate change in each of the up rate shock scenarios even though this is not a contractual requirement. As a practical matter, management would likely lag the impact of any upward movement in market rates on these accounts as a mechanism to manage the Bank’s net interest margin. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan customers’ ability to service their debts, or the impact of rate changes on demand for loan, lease, and deposit products.

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

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

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

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

Estimated Changes in Net Interest Income

Change in Interest Rates:	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	23.50%	17.50%	15.00%	10.00%	10.00%	15.00%	17.50%	23.50%
December 31, 2018	**2.74%**	**2.29%**	**2.38%**	**1.15%**	**(1.74%)**	**(3.15%)**	**N/A**	**N/A**
December 31, 2017	(7.36%)	(4.93%)	(2.82%)	(1.13%)	(2.24%)	N/A	N/A	N/A

As shown above, measures of net interest income at risk at December 31, 2018 had improved in every interest rate change scenario from December 31, 2017. All measures remained well within prescribed policy limits. The significant improvement in the risk position from December 31, 2017 to December 31, 2018 was driven by the reduction in the assumed sensitivity of the Bank's premier money market product to interest rate changes. Durations of loans and deposits lengthened while securities and borrowing experience shortened durations. Loan duration grew due to the impact of fixed loans in the loan portfolio while deposit duration grew due to the impact of a reduced decay rate.

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, 2018	**(10.23%)**	**(7.18%)**	**(3.61%)**	**(1.70%)**	**(0.77%)**	**(2.80%)**	**N/A**	**N/A**
December 31, 2017	(21.09%)	(14.75%)	(8.58%)	(3.39%)	(0.98%)	N/A	N/A	N/A

The measure of the economic value of equity ("EVE") at risk improved at December 31, 2018 compared to December 31, 2017 in every interest rate change scenario. The primary driver of the improvement in the EVE risk position was a result that higher market interest rates had on deposit decay assumptions, which had the effect of lengthening the durations on core deposits. The risk position also benefited from the decreased assumed sensitivity of the bank's premier money market deposits to changes in market rates.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan repayments, maturing investments, deposit growth, borrowed funds, capital and the sale of highly marketable assets such as investment securities and residential mortgage loans. The Company's liquidity position, considering both internal and external sources available, exceeded anticipated short-term and long-term needs at December 31, 2018. Management considers core deposits, defined to include all deposits other than time deposits of $100 thousand or more, to be a relatively stable funding source. Core deposits equaled 63% of total interest-earning assets at December 31, 2018. In addition, loan payments, maturities, calls and pay downs of securities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements. In assessing liquidity, management considers operating requirements, the seasonality of deposit flows, investment, loan and deposit maturities and calls, expected funding of loans and deposit withdrawals,

and the market values of available-for-sale investments, so that sufficient funds are available on short notice to meet obligations as they arise and to ensure that the Company is able to pursue new business opportunities.

In addition to factors discussed above that can affect liquidity, the Company's growth, mortgage banking activities and changes in the liquidity of the investment portfolio due to fluctuations in interest rates are also taken into consideration. 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, 2018, provides an indication of liquidity versus requirements that the Company utilizes to determine how it will fund loans and other earning assets.

The Company has external sources of funds that can be drawn upon when required. The main sources of external liquidity are available lines of credit with the Federal Home Loan Bank of Atlanta and the Federal Reserve. The line of credit with the Federal Home Loan Bank of Atlanta totaled $2.2 billion, all of which was available for borrowing based on pledged collateral, with $1.0 billion borrowed against it as of December 31, 2018. The Company also had lines of credit available from the Federal Reserve and correspondent banks of $274.9 million and $359.7 million at December 31, 2018 and 2017, respectively, collateralized by loans. In addition, the Company had unsecured lines of credit with correspondent banks of $590.0 million and $70.0 million at December 31, 2018 and 2017. At December 31, 2018 there were no outstanding borrowings against these lines of credit. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at December 31, 2018.

The parent company ("Bancorp") is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Bancorp is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. Bancorp's primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Bancorp in any calendar year, without the receipt of prior approval from the Federal Reserve, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. Based on this requirement, as of December 31, 2018, the Bank could have declared a dividend of $95 million to Bancorp. At December 31, 2018, Bancorp had liquid assets of $23 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 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 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".

Contractual Obligations

The Company enters into contractual obligations in the normal course of business. Among these obligations are FHLB advances, operating leases related to branch and administrative facilities and a long-term contract with a data processing provider. Payments required under these obligations, are set forth in the table following as of December 31, 2018.

		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	$ 327,429	$ 327,429	$ -	$ -	$ -
Advances from FHLB	848,611	625,969	150,142	72,500	-
Certificates of deposit	1,526,161	1,009,041	497,006	20,114	-
Operating lease obligations	61,740	11,263	29,115	16,464	4,898
Purchase obligations [2]	5,352	3,409	1,943	-	-
Total	$ 2,769,293	$ 1,977,111	$ 678,206	$ 109,078	$ 4,898

[1] Assumed a seven year term for purposes of this table.

[2] Represents payments required under contract, based on average monthly charges for 2018 with the Company's current data processing service provider that expires in September 2020.

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

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

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

Internal Control Over Financial Reporting

As part of the Company's program to comply with Section 404 of the Sarbanes-Oxley Act of 2002, our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018 (the "Assessment"). In making this Assessment, management used the control criteria framework of the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission published in its report entitled Internal Control — Integrated Framework (2013). Management's Assessment included an evaluation of the design of the Company'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, 2018.

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

To the Stockholders and Board of Directors of Sandy Spring Bancorp, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of condition of Sandy Spring Bancorp, Inc. and subsidiaries (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, 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) (PCAOB), the Company's