SANDY SPRING BANCORP INC
Form 10-Q
May 09, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2013

OR

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

For the transition period from ___________ to ____________

Commission File Number: 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland **52-1532952**
(State of incorporation) (I.R.S. Employer Identification Number)

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

301-774-6400

(Registrant's telephone number, including area code)

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

Yes x No ¨

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

Yes x No ¨

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

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

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

Yes ¨ No x

The number of outstanding shares of common stock outstanding as of May 7, 2013.

Common stock, $1.00 par value – 24,962,021 shares

SANDY SPRING BANCORP, INC.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q, as well as other periodic reports filed with the Securities and Exchange Commission, and written or oral communications made from time to time by or on behalf of Sandy Spring Bancorp and its subsidiaries (the "Company"), may contain statements relating to future events or future results of the Company that are considered "forward-looking statements" under the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by the use of words such as "believe," "expect," "anticipate," "plan," "estimate," "intend" and "potential," or words of similar meaning, or future or conditional verbs such as "should," "could," or "may." Forward-looking statements include statements of Company 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 the Company's expectation or prediction of future conditions, events or results based on information currently available. These forward-looking statements are subject to significant risks and uncertainties that may cause actual results to differ materially from those in such statements. These risk and uncertainties include, but are not limited to, the risks identified in Item 1A of the Company's 2012 Annual Report on Form 10-K, Item 1A of Part II of this report and the following:

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

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

- the Company's liquidity requirements could be adversely affected by changes in our assets and liabilities;

- the Company's investment securities portfolio is subject to credit risk, market risk, and liquidity risk as well as changes in the estimates the Company uses to value certain of the securities in the portfolio;

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

- competitive factors among financial services companies, including product and pricing pressures and the Company's ability to attract, develop and retain qualified banking professionals;

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

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

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

PART I

Item 1. FINANCIAL STATEMENTS

Sandy spring bancorp, inc. and subsidiaries

CONDENSED Consolidated STATEMENTS OF CONDITION

(Dollars in thousands)	(Unaudited) March 31, 2013	December 31, 2012
Assets		
Cash and due from banks	$ 45,922	$ 59,540
Federal funds sold	476	466
Interest-bearing deposits with banks	38,188	26,400
Cash and cash equivalents	84,586	86,406
Residential mortgage loans held for sale (at fair value)	48,383	36,149
Investments available-for-sale (at fair value)	766,080	825,582
Investments held-to-maturity -- fair value of $216,024 and $222,024 at March 31, 2013 and December 31, 2012, respectively	211,376	215,814
Other equity securities	31,237	33,636
Total loans and leases	2,565,069	2,531,128
Less: allowance for loan and lease losses	(41,246)	(42,957)
Net loans and leases	2,523,823	2,488,171
Premises and equipment, net	47,701	48,326
Other real estate owned	5,250	5,926
Accrued interest receivable	12,926	12,392
Goodwill	84,808	84,808
Other intangible assets, net	2,702	3,163
Other assets	113,154	114,833
Total assets	$ 3,932,026	$ 3,955,206
Liabilities		
Noninterest-bearing deposits	$ 832,679	$ 847,415
Interest-bearing deposits	2,086,529	2,065,619
Total deposits	2,919,208	2,913,034
Securities sold under retail repurchase agreements and federal funds purchased	50,302	86,929
Advances from FHLB	405,000	405,058
Subordinated debentures	35,000	35,000
Accrued interest payable and other liabilities	33,569	31,673
Total liabilities	3,443,079	3,471,694
Stockholders' Equity		
Common stock -- par value $1.00; shares authorized 50,000,000; shares issued and outstanding 24,954,892 and 24,905,392 at March 31, 2013 and December 31, 2012, respectively	24,955	24,905

Additional paid in capital	191,615	191,689
Retained earnings	262,645	255,606
Accumulated other comprehensive income	9,732	11,312
Total stockholders' equity	488,947	483,512
Total liabilities and stockholders' equity	$ 3,932,026	$ 3,955,206

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries

CONDENSED Consolidated Statements of IncomE – UNAUDITED

	Three Months Ended March 31,	
(Dollars in thousands, except per share data)	2013	2012
Interest Income:		
Interest and fees on loans and leases	$ 29,646	$ 27,129
Interest on loans held for sale	353	149
Interest on deposits with banks	19	21
Interest and dividends on investment securities:		
Taxable	3,934	4,943
Exempt from federal income taxes	2,327	2,373
Total interest income	36,279	34,615
Interest Expense:		
Interest on deposits	1,455	2,013
Interest on retail repurchase agreements and federal funds purchased	49	61
Interest on advances from FHLB	3,223	3,587
Interest on subordinated debt	226	249
Total interest expense	4,953	5,910
Net interest income	31,326	28,705
Provision for loan and lease losses	78	664
Net interest income after provision for loan and lease losses	31,248	28,041
Non-interest Income:		
Investment securities gains	56	73
Total other-than-temporary impairment ("OTTI") losses	-	(64)
Portion of OTTI losses recognized in other comprehensive income, before taxes	-	-
Net OTTI recognized in earnings	-	(64)
Service charges on deposit accounts	2,069	2,200
Mortgage banking activities	1,527	1,025
Wealth management income	4,042	4,057
Insurance agency commissions	1,349	1,202
Income from bank owned life insurance	612	634
Visa check fees	957	898
Other income	1,807	949
Total non-interest income	12,419	10,974
Non-interest Expenses:		
Salaries and employee benefits	16,346	15,701
Occupancy expense of premises	3,182	2,846
Equipment expenses	1,249	1,190
Marketing	515	495
Outside data services	1,152	1,279
FDIC insurance	596	652
Amortization of intangible assets	461	461
Other expenses	4,322	4,059
Total non-interest expenses	27,823	26,683

Income before income taxes	15,844	12,332
Income tax expense	5,286	3,856
Net income	$ 10,558	$ 8,476
Net Income Per Share Amounts:		
Basic net income per share	$ 0.42	$ 0.35
Diluted net income per share	$ 0.42	$ 0.35
Dividends declared per common share	$ 0.14	$ 0.10

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries

CONDENSED Consolidated Statements of COMPREHENSIVE INCOME - UNAUDITED

	Three Months Ended March 31,	
(In thousands)	2013	2012
Net income	$ 10,558	$ 8,476
Other comprehensive income:		
Investments available-for-sale:		
Net change in unrealized gains (losses) on investments available-for-sale	**(3,046)**	(1,103)
Related income tax (expense) benefit	**1,215**	439
Net investment gains reclassified into earnings	56	73
Related income tax expense	(23)	(29)
Net effect on other comprehensive income (loss) for the period	(1,798)	(620)
Defined benefit pension plan:		
Recognition of unrealized gain (loss)	364	350
Related income tax (expense) benefit	(146)	(140)
Net effect on other comprehensive income (loss) for the period	218	210
Total other comprehensive income	(1,580)	(410)
Comprehensive income	$ 8,978	$ 8,066

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries

CONDENSED Consolidated Statements of Cash Flows – UNAUDITED

(Dollars in thousands)	Three Months Ended March 31, 2013	2012
Operating activities:		
Net income	$ 10,558	$ 8,476
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,012	1,936
Net OTTI recognized in earnings	-	64
Provision for loan and lease losses	78	664
Share based compensation expense	318	325
Deferred income tax expense	1,111	1,641
Origination of loans held for sale	(97,722)	(55,278)
Proceeds from sales of loans held for sale	87,010	63,474
Gains on sales of loans held for sale	(1,522)	(981)
Loss on sales of other real estate owned	123	334
Investment securities gains	(56)	(73)
(Gains) losses on sales of premises and equipment	-	(93)
Net decrease (increase) in accrued interest receivable	(534)	474
Net (increase) decrease in other assets	3,198	1,923
Net decrease in accrued expenses and other liabilities	(232)	(2,104)
Other – net	1,940	1,717
Net cash provided by operating activities	6,282	22,499
Investing activities:		
Purchases of other equity securities	-	(620)
Purchases of investments held-to-maturity	-	(11,032)
Purchases of investments available-for-sale	(11,470)	(46,331)
Net proceeds from redemption of Federal Home Loan Bank of Atlanta stock	2,399	-
Proceeds from sales of investment available-for-sale	-	28,519
Proceeds from maturities, calls and principal payments of investments held-to-maturity	4,269	35,920
Proceeds from maturities, calls and principal payments of investments available-for-sale	66,715	88,220
Net increase in loans and leases	(35,822)	(38,396)
Proceeds from the sales of other real estate owned	731	1,110
Expenditures for premises and equipment	(551)	(1,301)
Net cash used in investing activities	26,271	56,089
Financing activities:		
Net increase in deposits	6,174	24,555
Net (decrease) increase in retail repurchase agreements and federal funds purchased	(36,627)	(70,483)
Repayment of advances from FHLB	(58)	(87)
Proceeds from issuance of common stock	(343)	(225)
Tax benefits associated with shared based compensation	-	74
Dividends paid	(3,519)	(2,431)

Net cash provided by financing activities	(34,373)	(48,597)
Net increase in cash and cash equivalents	(1,820)	29,991
Cash and cash equivalents at beginning of period	86,406	72,314
Cash and cash equivalents at end of period	$ 84,586	$ 102,305
Supplemental Disclosures:		
Interest payments	$ 5,189	$ 5,940
Income tax payments	-	1,356
Transfers from loans to other real estate owned	92	1,667

The accompanying notes are an integral part of these statements.

Sandy Spring Bancorp, Inc. and Subsidiaries

CONDENSED Consolidated Statements of changes in stockholders' equity - UNAUDITED

(Dollars in thousands, except per share data)	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balances at January 1, 2013	$ 24,905	$ 191,689	$ 255,606	$ 11,312	$ 483,512
Net income			10,558		10,558
Other comprehensive loss, net of tax				(1,580)	(1,580)
Common stock dividends - $0.14 per share			(3,519)		(3,519)
Stock compensation expense		318			318
Common stock issued pursuant to:					-
Employee stock purchase plan - 6,349 shares	7	99			106
Restricted stock - 43,151 shares	43	(491)			(448)
Balances at March 31, 2013	$ 24,955	$ 191,615	$ 262,645	$ 9,732	$ 488,947
Balances at January 1, 2012	$ 24,091	$ 177,828	$ 230,942	$ 13,248	$ 446,109
Net income	-	-	8,476	-	8,476
Other comprehensive loss, net of tax:	-	-	-	(410)	(410)
Common stock dividends - $0.10 per share	-	-	(2,432)	-	(2,432)
Stock compensation expense	-	399	-	-	399
Common stock issued pursuant to:					
Employee stock purchase plan - 7,953 shares	8	113	-	-	121
Restricted stock - 44,990 shares	45	(391)	-	-	(346)
Balances at March 31, 2012	$ 24,144	$ 177,949	$ 236,986	$ 12,838	$ 451,917

The accompanying notes are an integral part of these statements

Sandy Spring Bancorp, Inc. and Subsidiaries

Notes to the CONDENSED Consolidated Financial Statements - UNAUDITED

Note 1 – Significant Accounting Policies

Nature of Operations

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

Basis of Presentation

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the financial services industry for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements and prevailing practices within the banking industry. The following summary of significant accounting policies of the Company is presented to assist the reader in understanding the financial and other data presented in this report. Operating results for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for any future periods or for the year ending December 31, 2013. In the opinion of management, all adjustments (comprising only normal recurring accruals) necessary for a fair presentation of the results of the interim periods have been included. Certain reclassifications have been made to prior period amounts, as necessary, to conform to the current period presentation. The Company has evaluated subsequent events through the date of the issuance of its financial statements.

These statements should be read in conjunction with the financial statements and accompanying notes included in the Company's 2012 Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") on March 18, 2013. There have been no significant changes to the Company's accounting policies as disclosed in the 2012 Annual Report on Form 10-K.

Principles of Consolidation

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

Use of Estimates

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

Cash Flows

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

Loans Acquired with Deteriorated Credit Quality

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

Adopted Accounting Pronouncements

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

NOTE 2 – ACQUISITION

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

Note 3 – Investments

Investments available-for-sale

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

	At March. 31, 2013				At December 31, 2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$130,412	$643	$(158)	$130,897	$155,442	$1,084	$(98)	$156,428
State and municipal	160,255	13,168	-	173,423	160,496	13,996	(1)	174,491
Mortgage-backed	440,287	17,607	(350)	457,544	471,527	19,080	(128)	490,479
Corporate debt	2,000	7	-	2,007	2,000	-	(4)	1,996
Trust preferred	1,701	-	(215)	1,486	1,701	-	(236)	1,465
Total debt securities	734,655	31,425	(723)	765,357	791,166	34,160	(467)	824,859
Marketable equity securities	723	-	-	723	723	-	-	723
Total investments available-for-sale	$735,378	$31,425	$(723)	$766,080	$791,889	$34,160	$(467)	$825,582

Any unrealized losses in the U.S. government agencies, state and municipal, mortgage-backed or corporate debt investment securities at March 31, 2013 are not the result of credit related events but due to changes in interest rates. These declines are considered temporary in nature and are expected to decline over time and recover as these securities approach maturity.

The mortgage-backed securities portfolio at March 31, 2013 is composed entirely of either the most senior tranches of GNMA collateralized mortgage obligations ($189.4 million), or GNMA, FNMA or FHLMC mortgage-backed securities ($268.1 million). The Company does not intend to sell these securities and has sufficient liquidity to hold these securities for an adequate period of time, which may be maturity, to allow for any anticipated recovery in fair value.

At March 31, 2013, the trust preferred portfolio consisted of one pooled trust preferred security. The pooled trust preferred security, which is backed by debt issued by banks and thrifts, totals $1.7 million with a fair value of $1.5 million. The fair value of this security was determined by a third party valuation specialist due to the limited trading activity for this security.

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

- Evaluation of the structural terms as established in the indenture;
- Detailed credit and structural evaluation for each piece of issuer collateral in the pool;
- Overall default (.40%), recovery and prepayment (2%)/amortization probabilities by issuers in the pool;
- Identification of adverse conditions specifically related to the security, industry and geographical area;
- Projection of estimated cash flows that incorporate default expectations and loss severities;
- Review of historical and implied volatility of the fair value of the security;
- Evaluation of credit risk concentrations;
- Evaluation of the length of time and the extent to which the fair value has been less than the amortized cost; and
- A discount rate of 12.3% was established using credit adjusted financial institution spreads for comparably rated institutions and a liquidity adjustment that considered the previously noted characteristics.

As a result of this evaluation, it was determined that the pooled trust preferred security had not incurred any credit-related other-than-temporary impairment (“OTTI”) for the quarter ended March 31, 2013. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was $0.2 million at March 31, 2013. This non-credit related OTTI was recognized in other comprehensive income (“OCI”) at March 31, 2013.

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

- Default rates were developed based on the financial condition of the trust preferred issuers in the pool and the payment or deferral status. Conditional default rates were estimated based on the payment characteristics of the security and the financial condition of the issuers in the pool. Near term and future defaults are estimated using third party industry data in addition to a review of key financial ratios and other pertinent data on the financial stability of the underlying issuer;
- Loss severity is forecasted based on the type of impairment using research performed by third parties;
- The security contains one level of subordination below the senior tranche, with the senior tranche receiving the spread from the subordinate bonds. Given recent performance, it is not expected that the senior tranche will receive its full interest and principal at the bond’s maturity date;
- Credit ratings of the underlying issuers are reviewed in conjunction with the development of the default rates applied to determine the credit amounts related to the credit loss; and
- Potential prepayments are estimated based on terms and rates of the underlying trust preferred securities to determine the impact of excess spread on the credit enhancement, the removal of the strongest institutions from the underlying

pool and any impact that prepayments might have on diversity and concentration.

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

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

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

	At March. 31, 2013				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	3	$ 39,840	$ 158	$ -	$ 158
Mortgage-backed	11	53,074	350	-	350
Trust preferred	1	1,486	-	215	215
Total	15	$ 94,400	$ 508	$ 215	$ 723

	At December 31, 2012				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	2	$ 29,900	$ 98	$ -	$ 98
State and municipal	1	390	1	-	1
Mortgage-backed	2	12,653	128	-	128
Corporate debt	1	1,996	4	-	4
Trust preferred	1	1,465	-	236	236
Total	7	$ 46,404	$ 231	$ 236	$ 467

The amortized cost and estimated fair values of debt securities available-for-sale by contractual maturity at the dates indicated are provided in the following table. The Company has allocated mortgage-backed securities into the four maturity groupings reflected in the following table using the expected average life of the individual securities based on

statistics provided by independent third party industry sources. Expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations with or without prepayment penalties.

	At March. 31, 2013		At December 31, 2012	
(In thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$35,467	$36,056	$35,544	$36,349
Due after one year through five years	4,382	4,463	3,957	3,994
Due after five years through ten years	349,635	364,619	382,957	399,180
Due after ten years	345,171	360,219	368,708	385,336
Total debt securities available for sale	$734,655	$765,357	$791,166	$824,859

At March 31, 2013 and December 31, 2012, investments available-for-sale with a book value of $190.3 million and $195.4 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agencies securities, exceeded ten percent of stockholders' equity at March 31, 2013 and December 31, 2012.

Investments held-to-maturity

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

	At March. 31, 2013				At December 31, 2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies	$64,500	$ 127	$ (11)	$64,616	$64,498	$ 125	$ (29)	$64,594
State and municipal	146,583	5,189	(301)	151,471	150,995	6,194	(123)	157,066
Mortgage-backed	293	40		333	321	43	-	364
Total investments held-to-maturity	$211,376	$ 5,356	$ (312)	$216,420	$215,814	$ 6,362	$ (152)	$222,024

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

	At March. 31, 2013				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	1	$ 4,987	$ 11		$ 11
State and municipal	24	25,414	301		301
Total	25	$ 30,401	$ 312	$ -	$ 312

	At December 31, 2012				
			Continuous Unrealized Losses Existing for:		
(Dollars in thousands)	Number of securities	Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses
U.S. government agencies	1	$ 9,961	$ 29	$ -	$ 29

State and municipal	13	16,868		123		-		123
Total	14	$ 26,829	$	152	$	-	$	152

The Company intends to hold these securities until they reach maturity.

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

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	At March. 31, 2013		At December 31, 2012	
		Estimated		Estimated
	Amortized	Fair	Amortized	Fair
(In thousands)	Cost	Value	Cost	Value
Due in one year or less	$5,857	$5,924	$7,431	$7,523
Due after one year through five years	2,720	2,731	4,653	4,725
Due after five years through ten years	124,771	128,382	116,735	120,074
Due after ten years	78,028	79,383	86,995	89,702
Total debt securities held-to-maturity	$211,376	$216,420	$215,814	$222,024

At March 31, 2013 and December 31, 2012, investments held-to-maturity with a book value of $151.0 million and $155.5 million, respectively, were pledged as collateral for certain government deposits and for other purposes as required or permitted by law. The outstanding balance of no single issuer, except for U.S. Agency securities, exceeded ten percent of stockholders' equity at March 31, 2013 and December 31, 2012.

Equity securities

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

(In thousands)	March 31, 2013	December 31, 2012
Federal Reserve Bank stock	$ 8,269	$ 8,269
Federal Home Loan Bank of Atlanta stock	22,968	25,367
Total equity securities	$ 31,237	$ 33,636

Note 4 – Loans and Leases

Outstanding loan balances at March 31, 2013 and December 31, 2012 are net of unearned income including net deferred loan costs of $1.1 million and $1.4 million, respectively. The loan portfolio segment balances at the dates indicated are presented in the following table:

(In thousands)	March 31, 2013	December 31, 2012
Residential real estate:		
Residential mortgage	$ 538,346	$ 523,364
Residential construction	122,698	120,314
Commercial real estate:		
Commercial owner occupied real estate	565,820	571,510
Commercial investor real estate	487,802	456,888
Commercial acquisition, development and construction	150,599	151,933
Commercial Business	344,489	346,708
Leases	1,974	3,421

Consumer	353,341	356,990
Total loans and leases	$ 2,565,069	$ 2,531,128

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Note 5 – CREDIT QUALITY ASSESSMENT

Allowance for Loan and Lease Losses

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

	Three Months Ended March 31,	
(In thousands)	2013	2012
Balance at beginning of year	$42,957	$49,426
Provision for loan and lease losses	78	664
Loan and lease charge-offs	(3,108)	(5,298)
Loan and lease recoveries	1,319	269
Net charge-offs	(1,789)	(5,029)
Balance at period end	$41,246	$45,061

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

	For the Three Months Ended March 31, 2013								
		Commercial Real Estate					Residential Real Estate		
(Dollars in thousands)	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	To
Balance at beginning of year	$6,495	$4,737	$9,583	$6,997	$332	$3,846	$8,522	$2,445	$4
Provision (credit)	2,505	(1,831)	(934)	37	(252)	535	44	(26)	7
Charge-offs	(1,857)	-	(131)	(91)#	-	(564)	(465)	-	(
Recoveries	113	1,020	100	10	-	56	18	2	1
Net charge-offs	(1,744)	1,020	(31)	(81)	-	(508)	(447)	2	(
Balance at end of period	$7,256	$3,926	$8,618	$6,953	$80	$3,873	$8,119	$2,421	$4
Total loans and leases	$344,489	$150,599	$487,802	$565,820	$1,974	$353,341	$538,346	$122,698	$2
Allowance for loans and leases to total loans and leases ratio	2.11 %	2.61 %	1.77 %	1.23 %	4.05 %	1.10 %	1.51 %	1.97 %	1
Balance of loans specifically evaluated	$7,887	$5,826	$13,205	$7,243	***na.***	$31	$4,506	$2,004	$4

for impairment									
Allowance for loans specifically evaluated for impairment	$1,940	$149	$242	$377	***na.***	***na.***	$698	$609	$4
Specific allowance to specific loans ratio	24.60 %	2.56 %	1.83 %	5.21 %	***na.***	***na.***	15.49 %	30.39 %	9
Balance of loans collectively evaluated	$336,602	$144,773	$474,597	$558,577	$1,974	$353,310	$533,840	$120,694	$2
Allowance for loans collectively evaluated	$5,316	$3,777	$8,376	$6,576	$80	$3,873	$7,421	$1,812	$3
Collective allowance to collective loans ratio	1.58 %	2.61 %	1.76 %	1.18 %	4.05 %	1.10 %	1.39 %	1.50 %	1

For the Year Ended December 31, 2012

		Commercial Real Estate					Residential Real Estate		
(Dollars in thousands)	Commercial Business	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	To
Balance at beginning of year	$6,727	$6,664	$8,248	$7,329	$795	$4,873	$10,583	$4,207	$4
Provision (credit)	(758)	826	4,928	804	(478)	44	(167)	(1,550)	3
Charge-offs	(1,022)	(3,281)	(3,690)	(1,174)	(8)	(1,298)	(2,107)	(224)	(
Recoveries	1,548	528	97	38	23	227	213	12	2
Net charge-offs	526	(2,753)	(3,593)	(1,136)	15	(1,071)	(1,894)	(212)	(
Balance at end of period	$6,495	$4,737	$9,583	$6,997	$332	$3,846	$8,522	$2,445	$4
Total loans and leases	$346,708	$151,933	$456,888	$571,510	$3,421	$356,990	$523,364	$120,314	$2
Allowance for loans and leases to total loans and leases ratio	1.87 %	3.12 %	2.10 %	1.22 %	9.70 %	1.08 %	1.63 %	2.03 %	1
Balance of loans specifically evaluated for impairment	$8,984	$6,332	$11,843	$15,184	*na.*	$31	$4,528	$1,871	$4
Allowance for loans specifically evaluated for impairment	$2,597	$-	$774	$598	*na.*	*na.*	$713	$467	$5
Specific allowance to specific loans ratio	28.91 %	0.00 %	6.54 %	3.94 %	*na.*	*na.*	15.75 %	24.96 %	1
Balance of loans collectively evaluated	$337,724	$145,601	$445,045	$556,326	$3,421	$356,959	$518,836	$118,443	$2
Allowance for loans collectively evaluated	$3,898	$4,737	$8,809	$6,399	$332	$3,846	$7,809	$1,978	$3
	1.15 %	3.25 %	1.98 %	1.15 %	9.70 %	1.08 %	1.51 %	1.67 %	1

Collective allowance to collective loans ratio

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

(In thousands)	March 31, 2013		December 31, 2012	
Impaired loans with a specific allowance	$	14,232	$	27,526
Impaired loans without a specific allowance		26,470		21,247
Total impaired loans	$	40,702	$	48,773
Allowance for loan and lease losses related to impaired loans	$	4,015	$	5,149
Allowance for loan and lease losses related to loans collectively evaluated		37,231		37,808
Total allowance for loan and lease losses	$	41,246	$	42,957
Average impaired loans for the period	$	44,738	$	57,438
Contractual interest income due on impaired loans during the period	$	821	$	4,433
Interest income on impaired loans recognized on a cash basis	$	1,041	$	1,121
Interest income on impaired loans recognized on an accrual basis	$	141	$	560

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

indicated:

	March 31, 2013					
		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total Recorded Investment in Impaired Loans
Impaired loans *with* a specific allowance						
Non-accruing	$2,149	$-	$ 811	$ 211	$-	$ 3,171
Restructured accruing	2,693	-	-	1,301	3,404	7,398
Restructured non-accruing	132	1,055	-	1,030	1,446	3,663
Balance	$4,974	$1,055	$ 811	$ 2,542	$4,850	$ 14,232
Allowance	$1,940	$149	$ 242	$ 377	$1,307	$ 4,015
Impaired loans *without* a specific allowance						
Non-accruing	$1,422	$3,246	$ 10,515	$ 2,028	$-	$ 17,211
Restructured accruing	1,182	-	852	596	811	3,441
Restructured non-accruing	309	1,525	1,027	2,077	880	5,818
Balance	$2,913	$4,771	$ 12,394	$ 4,701	$1,691	$ 26,470
Total impaired loans						
Non-accruing	$3,571	$3,246	$ 11,326	$ 2,239	$-	$ 20,382
Restructured accruing	3,875	-	852	1,897	4,215	10,839
Restructured non-accruing	441	2,580	1,027	3,107	2,326	9,481
Balance	$7,887	$5,826	$ 13,205	$ 7,243	$6,541	$ 40,702
Unpaid principal balance in total impaired loans	$7,932	$15,723	$ 16,206	$ 7,337	$2,821	$ 50,019

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March 31, 2013

(In thousands)	Commercial	Commercial Real Estate: Commercial AD&C	Commercial Real Estate: Commercial Investor R/E	Commercial Real Estate: Commercial Owner Occupied R/E	All Other Loans	Total Recorded Investment in Impaired Loans
Average impaired loans for the period	$8,436	$6,079	$ 12,524	$ 11,214	$6,486	$ 44,738
Contractual interest income due on impaired loans during the period	$74	$152	$ 269	$ 208	$118	
Interest income on impaired loans recognized on a cash basis	$30	$50	$ 169	$ 777	$15	
Interest income on impaired loans recognized on an accrual basis	$53	$-	$ 7	$ 30	$51	

December 31, 2012

(In thousands)	Commercial	Commercial Real Estate: Commercial AD&C	Commercial Real Estate: Commercial Investor R/E	Commercial Real Estate: Commercial Owner Occupied R/E	All Other Loans	Total Recorded Investment in Impaired Loans
Impaired loans *with* a specific allowance						
Non-accruing	$2,514	$-	$ 10,219	$ 4,319	$-	$ 17,052
Restructured accruing	2,981	-	-	1,503	3,419	7,903
Restructured non-accruing	228	-	-	1,039	1,304	2,571
Balance	$5,723	$-	$ 10,219	$ 6,861	$4,723	$ 27,526
Allowance	$2,597	$-	$ 774	$ 598	$1,180	$ 5,149
Impaired loans *without* a specific allowance						
Non-accruing	$1,846	$3,033	$ 577	$ 6,191	$-	$ 11,647
Restructured accruing	1,392	-	-	-	815	2,207
Restructured non-accruing	23	3,299	1,047	2,132	892	7,393
Balance	$3,261	$6,332	$ 1,624	$ 8,323	$1,707	$ 21,247
Total impaired loans						
Non-accruing	$4,360	$3,033	$ 10,796	$ 10,510	$-	$ 28,699
Restructured accruing	4,373	-	-	1,503	4,234	10,110
Restructured non-accruing	251	3,299	1,047	3,170	2,196	9,964
Balance	$8,984	$6,332	$ 11,843	$ 15,184	$6,430	$ 48,773
Unpaid principal balance in total impaired loans	$11,506	$21,590	$ 15,405	$ 17,928	$6,904	$ 73,333

December 31, 2012

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

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Credit Quality

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

	March 31, 2013								
		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:									
Non-accrual loans and leases	$4,012	$5,826	$ 12,353	$ 5,346	$ -	$ 2,388	$ 5,393	$ 3,258	$38,576
Loans and leases 90 days past due	-	-	-	-	-	54	-	-	54
Restructured loans and leases	3,875	-	852	1,897	-	31	4,184	-	10,839
Total non-performing loans and leases	7,887	5,826	13,205	7,243	-	2,473	9,577	3,258	49,469
Other real estate owned	1,829	-	80	2,223	-	-	1,118	-	5,250
Total non-performing assets	$9,716	$5,826	$ 13,285	$ 9,466	$ -	$ 2,473	$ 10,695	$ 3,258	$54,719

	December 31, 2012								
		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Non-performing loans and assets:									
Non-accrual loans and leases	$4,611	$6,332	$ 11,843	$ 13,681	$ 865	$ 2,410	$ 4,681	$ 3,125	$47,548
Loans and leases 90 days past due	24	-	-	209	-	14	-	-	247
Restructured loans and leases	4,373	-	-	1,503	-	31	4,203	-	10,110
Total non-performing loans and leases	9,008	6,332	11,843	15,393	865	2,455	8,884	3,125	57,905
Other real estate owned	1,829	-	220	2,396	-	-	1,401	80	5,926
	$10,837	$6,332	$ 12,063	$ 17,789	$ 865	$ 2,455	$ 10,285	$ 3,205	$63,831

Total non-performing assets

March 31, 2013

		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans and leases									
31-60 days	$5,296	$2,148	$10,997	$6,362	$-	$873	$5,459	$-	$31,135
61-90 days	-	-	-	-	-	217	61	-	278
> 90 days	-	-	-	-	-	54	-	-	54
Total past due	5,296	2,148	10,997	6,362	-	1,144	5,520	-	31,467
Non-accrual loans and leases	4,012	5,826	12,353	5,346	-	2,388	5,393	3,258	38,576
Loans aquired with deteriorated credit quality	1,996	331	2,251	4,514	-	-	-	-	9,092
Current loans	333,185	142,294	462,201	549,598	1,974	349,809	527,433	119,440	2,485,93
Total loans and leases	$344,489	$150,599	$487,802	$565,820	$1,974	$353,341	$538,346	$122,698	$2,565,06

December 31, 2012

		Commercial Real Estate					Residential Real Estate		
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Past due loans and leases									
31-60 days	$2,138	$-	$2,020	$1,556	$7	$496	$5,443	$-	$11,660
61-90 days	212	-	-	1,809	68	101	1,603	-	3,793
> 90 days	24	-	-	209	-	14	-	-	247
Total past due	2,374	-	2,020	3,574	75	611	7,046	-	15,700
Non-accrual loans and leases	4,611	6,332	11,843	13,681	865	2,410	4,681	3,125	47,548
Loans aquired with deteriorated credit quality	1,978	332	949	3,941	-	-	-	-	7,200
Current loans	337,745	145,269	442,076	550,314	2,481	353,969	511,637	117,189	2,460,68
Total loans and leases	$346,708	$151,933	$456,888	$571,510	$3,421	$356,990	$523,364	$120,314	$2,531,12

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

	March 31, 2013				
		Commercial Real Estate			
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	$293,923	$139,623	$ 431,166	$ 517,084	$1,381,796
Special Mention	18,030	374	15,775	18,966	53,145
Substandard	31,312	10,602	40,307	28,999	111,220
Doubtful	1,224	-	554	771	2,549
Total	$344,489	$150,599	$ 487,802	$ 565,820	$1,548,710

	December 31, 2012				
		Commercial Real Estate			
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	Total
Pass	$305,348	$141,802	$ 405,448	$ 520,844	$1,373,442
Special Mention	13,603	1,793	21,963	17,262	54,621
Substandard	26,091	8,338	28,885	32,613	95,927
Doubtful	1,666	-	592	791	3,049
Total	$346,708	$151,933	$ 456,888	$ 571,510	$1,527,039

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

	March 31, 2013				
			Residential Real Estate		
(In thousands)	Leasing	Consumer	Residential Mortgage	Residential Construction	Total
Performing	**$1,974**	**$350,868**	**$528,769**	**$ 119,440**	**$1,001,051**
Non-performing:					
90 days past due	-	54	-	-	54
Non-accruing	-	2,388	5,393	3,258	11,039
Restructured loans and leases	-	31	4,184	-	4,215
Total	$1,974	$353,341	$538,346	$ 122,698	$1,016,359

December 31, 2012

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

During the three months ended March 31, 2013, the Company restructured $1.4 million in loans. Modifications consisted principally of interest rate concessions. No modifications resulted in the reduction of the recorded investment in the associated loan balances. Restructured loans are subject to periodic credit reviews to determine the necessity and adequacy of a specific loan loss allowance based on the collectability of the recorded investment in the restructured loan. Loans restructured during 2013 did not require significant specific reserves at March 31, 2013. For the year ended December 31, 2012, the Company restructured $4.9 million in loans. Modifications consisted principally of interest rate concessions and no modifications resulted in the reduction of the recorded investment in the associated loan balances. Loans restructured during 2012 had specific reserves of $1.2 million at December 31, 2012. Commitments to lend additional funds on loans that have been restructured at March 31, 2013 and December 31, 2012 amounted to $5.6 million and $2.6 million, respectively.

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

	For the Three Months Ended March 31, 2013					
		Commercial Real Estate				
(In thousands)	Commercial	Commercial AD&C	Commercial Investor R/E	Commercial Owner Occupied R/E	All Other Loans	Total
Troubled debt restructurings						
Restructured accruing	$ -	$ -	$ 852	$ 402	$ -	$ 1,254
Restructured non-accruing	145	-	-	-	-	145
Balance	$ -	$ -	$ 852	$ 402	$ -	$ 1,399
Specific allowance	$ 32	$ -	$ -	$ -	$ -	$ 32
Restructured and subsequently defaulted	$ -	$ -	$ -	$ -	$ -	$ -

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

Changes in the accretable yield related to loans acquired with evidence of deteriorated credit quality are as follows:

(In thousands)	Amount
Balance at January 1, 2013	$ 693
Accretion recognized to date	(98)
Net reclassification from accretable to non-accretable	-
Balance at March 31, 2013	$ 595

Other Real Estate Owned

Other real estate owned totaled $5.3 million and $5.9 million at March 31, 2013 and December 31, 2012.

Note 6 – Goodwill and Other Intangible Assets

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

	At March. 31, 2013			Weighted	At December 31, 2012			Weighted
(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Average Remaining Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Average Remaining Life
Amortizing intangible assets:								
Core deposit intangibles	$9,716	$(8,311)	$1,405	1.0 years	$9,716	$(7,964)	$1,752	1.3 years
Other identifiable intangibles	8,611	(7,314)	1,297	2.8 years	8,611	(7,200)	1,411	3.1 years
Total amortizing intangible assets	$18,327	$(15,625)	$2,702		$18,327	$(15,164)	$3,163	
Goodwill	$84,808		$84,808		$84,808		$84,808	

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

(In thousands)	Amount
2014	818
2015	370
2016	92
2017	14
Thereafter	24
Total amortizing intangible assets	$1,318

Note 7 – Deposits

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

(In thousands)	March 31, 2013	December 31, 2012
Noninterest-bearing deposits	$ 832,679	$ 847,415
Interest-bearing deposits:		
Demand	435,635	428,048

Money market savings	902,326	884,367
Regular savings	241,790	228,384
Time deposits of less than $100,000	292,393	307,445
Time deposits of $100,000 or more	214,385	217,375
Total interest-bearing deposits	2,086,529	2,065,619
Total deposits	$ 2,919,208	$ 2,913,034

Note 8 – Stockholders' Equity

The Company approved a stock repurchase program in August 2011 that permits the repurchase of up to 3% of the Company's outstanding shares of common stock or approximately 730,000 shares. Repurchases, which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. No shares were repurchased during the first quarter of 2013.

Note 9 – Share Based Compensation

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

The Company's 2005 Omnibus Stock Plan ("Omnibus Plan") provides for the granting of non-qualifying stock options to the Company's directors, and incentive and non-qualifying stock options, stock appreciation rights and restricted stock grants to selected key employees on a periodic basis at the discretion of the board. The Omnibus Plan authorizes the issuance of up to 1,800,000 shares of common stock of which 981,437 are available for issuance at March 31, 2013, has a term of ten years, and is administered by a committee of at least three directors appointed by the board of directors. Options granted under the plan have an exercise price which may not be less than 100% of the fair market value of the common stock on the date of the grant and must be exercised within seven to ten years from the date of grant. The exercise price of stock options must be paid for in full in cash or shares of common stock, or a combination of both. The Stock Option Committee has the discretion when making a grant of stock options to impose restrictions on the shares to be purchased upon the exercise of such options. Options granted under the expired 1999 Stock Option Plan remain outstanding until exercised or they expire. The Company generally issues authorized but previously unissued shares to satisfy option exercises.

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

	Three Months Ended March 31,			
	2013		2012	
Dividend yield	2.80	%	2.17	%
Weighted average expected volatility	53.87	%	50.90	%
Weighted average risk-free interest rate	0.83	%	1.14	%
Weighted average expected lives (in years)	5.34		5.35	
Weighted average grant-date fair value	$ 7.99		$ 7.85	

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

Compensation expense is recognized on a straight-line basis over the vesting period of the respective stock option or restricted stock grant. The Company recognized compensation expense of $0.3 million and $0.3 million for the three months ended March 31, 2013 and 2012, respectively, related to the awards of stock options and restricted stock

grants. No stock options were exercised in the three months ended March 31, 2013 and 2012, respectively, therefore there was no intrinsic value for exercised stock options during these periods. The total of unrecognized compensation cost related to stock options was approximately $0.4 million as of March 31, 2013. That cost is expected to be recognized over a weighted average period of approximately 2.2 years. The total of unrecognized compensation cost related to restricted stock was approximately $4.6 million as of March 31, 2013. That cost is expected to be recognized over a weighted average period of approximately 3.7 years. The fair value of the options vested during the three months ended March 31, 2013 and 2012, was $0.2 million and $0.2 million, respectively.

In the first quarter of 2013, 20,229 stock options were granted, subject to a three year vesting schedule with one third of the options vesting each year on the anniversary date of the grant. Additionally, 93,770 shares of restricted stock were granted, subject to a five year vesting schedule with one fifth of the shares vesting each year on the grant date anniversary.

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

	Number of Common Shares	Weighted Average Exercise Share Price	Weighted Average Contractual Remaining Life(Years)	Aggregate Intrinsic Value (in thousands)
Balance at January 1, 2013	440,453	$ 29.17		$ 557
Granted	20,229	$ 20.26		$ -
Exercised	-	-		$ -
Forfeited or expired	(4,962)	$ 34.29		$ -
Balance at March 31, 2013	455,720	$ 28.72	2.5	$ 651
Exercisable at March 31, 2013	410,185	$ 29.74	2.0	$ 620
Weighted average fair value of options granted during the year		$ 7.99		

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

(In dollars, except share data):	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested options at January 1, 2013	54,416	$ 7.56
Granted	20,229	$ 7.99
Vested	(29,110)	$ 7.34
Forfeited or expired	-	-
Non-vested options at March 31, 2013	45,535	$ 7.89

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

(In dollars, except share data):	Number of Shares	Weighted Average Grant-Date Fair Value
Restricted stock at January 1, 2013	224,005	$ 17.40
Granted	93,770	$ 20.26
Vested	(70,133)	$ 17.06

Restricted stock at March 31, 2013	247,642	$ 18.58

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

Defined Benefit Pension Plan

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

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

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

	Three Months Ended March 31,	
(In thousands)	2013	2012
Interest cost on projected benefit obligation	$ 387	$ 388
Expected return on plan assets	(417)	(327)
Recognized net actuarial loss	364	350
Net periodic benefit cost	$ 334	$ 411

Contributions

The decision as to whether or not to make a plan contribution and the amount of any such contribution is dependent on a number of factors. Such factors include the investment performance of the plan assets in the current economy and, since the plan is currently frozen, the remaining investment horizon of the plan. Given these uncertainties, management continues to monitor the funding level of the pension plan and may make contributions as necessary during 2013.

Note 11 – Net Income per Common Share

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

	Three Months Ended March 31,	
(Dollars and amounts in thousands, except per share data)	2013	2012
Net income	$ 10,558	$ 8,476
Basic:		
Basic weighted average EPS shares	24,911	24,098
Basic net income per share	$ 0.42	$ 0.35
Diluted:		
Basic weighted average EPS shares	24,911	24,098
Dilutive common stock equivalents	92	83
Dilutive EPS shares	25,003	24,181

Diluted net income per share	$ 0.42	$ 0.35
Anti-dilutive shares	242	641

NOTE 12 – OTHER COMPREHENSIVE INCOME

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

(In thousands)	Unrealized Gains (Losses) on Investments Available-for-Sale	Defined Benefit Pension Plan	Total
Balance at January 1, 2013	$ 20,258	$ (8,946)	$11,312
Other comprehensive income before reclassification, net of tax	(1,831)	-	(1,831)
Reclassifications from accumulated other comprehensive income, net of tax	33	218	251
Current period change in other comprehensive income, net of tax	(1,798)	218	(1,580)
Balance at March 31, 2013	$ 18,460	$ (8,728)	$9,732

(In thousands)	Unrealized Gains (Losses) on Investments Available-for-Sale	Defined Benefit Pension Plan	Total
Balance at January 1, 2012	$ 20,006	$ (6,758)	$13,248
Other comprehensive income before reclassification, net of tax	(664)	-	(664)
Reclassifications from accumulated other comprehensive income, net of tax	44	210	254
Current period change in other comprehensive income, net of tax	(620)	210	(410)
Balance at March 31, 2012	$ 19,386	$ (6,548)	$12,838

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

	For the three months ended March 31,	
(In thousands)	2013	2012
Unrealized gains/(losses) on investments available-for-sale		
Affected line item in the Statements of Income:		
Investment securities gains	$ 56	$ 73
Income before taxes	56	73
Tax expense	23	29
Net income	$ 33	$ 44

Amortization of defined benefit pension plan items		
Affected line item in the Statements of Income:		
Recognized actuarial loss 1	$ 364	$ 350
Income before taxes	364	350
Tax expense	146	140
Net income	$ **218**	$ 210

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

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

The Company has entered into interest rate swaps (“swaps”) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counterparty or customer owes the Company, and results in credit risk to the Company. When the fair value of a derivative instrument contract is negative, the Company owes the customer or counterparty and therefore, has no credit risk. The notional value of commercial loan swaps outstanding was $48.5 million with a fair value of $2.4 million as of March 31, 2013 compared to $35.9 million with a fair value of $1.3 million as of December 31, 2012. The offsetting nature of the swaps results in a neutral effect on the Company’s operations. Fair values of the swaps are carried as both gross assets and gross liabilities in the condensed consolidated statements of condition. The associated net gains and losses on the swaps are recorded in other non-interest income.

Note 14 – Fair Value

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

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

Basis of Fair Value Measurement:

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

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

Level 3- Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity). Changes to interest rates may result in changes in the cash flows due to prepayments or extinguishments. Accordingly, this could result in higher or lower measurements of the fair values.

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

Assets and Liabilities

Mortgage loans held for sale

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

Investments available-for-sale

U.S. government agencies, mortgage-backed securities and corporate debt

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

State and municipal securities

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

Trust preferred securities

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

Interest rate swap agreements

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

Assets Measured at Fair Value on a Recurring Basis

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

	At March. 31, 2013			
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets				
Residential mortgage loans held for sale	$-	$ 48,383	$ -	$48,383
Investments available-for-sale:				
U.S. government agencies	-	130,897	-	130,897
State and municipal	-	173,423	-	173,423
Mortgage-backed	-	457,544	-	457,544
Corporate debt	-	2,007	-	2,007
Trust preferred	-	-	1,486	1,486
Marketable equity securities	-	723	-	723
Interest rate swap agreements	-	2,492	-	2,492
Liabilities				
Interest rate swap agreements	$-	$ (2,492)	$ -	$(2,492)

	At December 31, 2012			
(In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets				
Residential mortgage loans held for sale	$-	$ 36,149	$ -	$36,149
Investments available-for-sale:				
U.S. government agencies	-	156,428	-	156,428
State and municipal	-	174,491	-	174,491

Mortgage-backed	-	490,479	-	490,479
Corporate debt	-	1,996	-	1,996
Trust preferred	-	-	1,465	1,465
Marketable equity securities	-	723	-	723
Interest rate swap agreements	-	1,280	-	1,280
Liabilities				
Interest rate swap agreements	$-	$ (1,280)	$ -	$(1,280)

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

(In thousands)	Significant Unobservable Inputs (Level 3)
Investments available-for-sale:	
Balance at January 1, 2013	$ 1,465
Total OTTI included in earnings	-
Principal redemption	-
Total unrealized losses included in other comprehensive income (loss)	21
Balance at March 31, 2013	$ 1,486

Assets Measured at Fair Value on a Nonrecurring Basis

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

(In thousands)	At March. 31, 2013 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Total Losses
Impaired loans	$-	$ -	$ 36,687	$36,687	$ (1,599)
Other real estate owned	-	-	5,250	5,250	(102)
Total	$-	$ -	$ 41,937	$41,937	$ (1,701)

(In thousands)	At December 31, 2012 Quoted Prices in Active Markets for	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Total Losses

	Identical Assets (Level 1)								
Impaired loans	$-	$	-	$	43,624	$43,624	$	(6,730	)
Other real estate owned	-		-		5,926	5,926		(188	)
Total	$-	$	-	$	49,550	$49,550	$	(6,918	)

At March 31, 2013, impaired loans totaling $40.7 million were written down to fair value of $36.7 million as a result of specific loan loss allowances of $4.0 million associated with the impaired loans which was included in the allowance for loan losses. Impaired loans totaling $48.8 million were written down to fair value of $43.6 million at December 31, 2012 as a result of specific loan loss allowances of $5.2 million associated with the impaired loans.

Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent and are classified at a Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable collateral is based on net book value on the business' financial statements and, if necessary, discounted based on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the factors identified above. Valuation techniques are consistent with those techniques applied in prior periods.

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

Fair Value of Financial Instruments

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

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

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

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

	March 31, 2013		Fair Value Measurements		
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets					
Investments held-to-maturity and other equity securities	$242,613	$247,657	$-	$ 247,657	$ -
Loans, net of allowance	2,523,823	2,571,047	-	-	2,571,047
Other assets	84,326	84,326	-	84,326	-
Financial Liabilities					
Time Deposits	$506,778	$509,570	$-	$ 509,570	$ -
Securities sold under retail repurchase agreements and federal funds purchased	50,302	50,302	-	50,302	-
Advances from FHLB	405,000	448,119	-	448,119	-
Subordinated debentures	35,000	9,791	-	-	9,791

	December 31, 2012		Fair Value Measurements		
(In thousands)	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets					
Investments held-to-maturity and other equity securities	$249,450	$255,660	$-	$ 255,660	$ -
Loans, net of allowance	2,488,171	2,453,314	-	-	2,453,314
Other assets	83,714	83,714	-	83,714	-
Financial Liabilities					

Time Deposits	$524,820	$528,074	$-	$ 528,074	$ -
Securities sold under retail repurchase agreements and federal funds purchased	86,929	86,929	-	86,929	-
Advances from FHLB	405,058	451,408	-	451,408	-
Subordinated debentures	35,000	9,919	-	-	9,919

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

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

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

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

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

Other assets: The investment in bank-owned life insurance represents the cash surrender value of the policies at March 31, 2013 and December 31, 2012 as determined by the each insurance carrier. The carrying value of accrued interest receivable approximates fair values due to the short-term duration.

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

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

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

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

Note 15 - Segment Reporting

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

The Community Banking segment is conducted through Sandy Spring Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. Parent company income is included in the Community Banking segment, as the majority of effort of these functions is related to this segment. Major revenue sources include net interest income, gains on sales of mortgage loans, trust income, fees on sales of investment products and service charges on deposit accounts. Expenses include personnel, occupancy, marketing, equipment and other expenses. Non-cash charges associated with amortization of intangibles related to the acquired entities amounted to $0.4 million and $0.3 million in for the three months ended March 31, 2013 and 2012, respectively.

The Insurance segment is conducted through Sandy Spring Insurance Corporation, a subsidiary of the Bank, and offers annuities as an alternative to traditional deposit accounts. Sandy Spring Insurance Corporation operates Sandy Spring Insurance, a general insurance agency located in Annapolis, Maryland, and Neff and Associates, located in Ocean City, Maryland. Major sources of revenue are insurance commissions from commercial lines, personal lines, and medical liability lines. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three ended March 31, 2013 and 2012, respectively.

The Investment Management segment is conducted through West Financial Services, Inc., a subsidiary of the Bank. This asset management and financial planning firm, located in McLean, Virginia, provides comprehensive investment management and financial planning to individuals, families, small businesses and associations including cash flow analysis, investment review, tax planning, retirement planning, insurance analysis and estate planning. West Financial currently has approximately $865 million in assets under management. Major revenue sources include non-interest income earned on the above services. Expenses include personnel and support charges. Non-cash charges associated with amortization of intangibles related to the acquired entities was not significant for the three ended March 31, 2013 and 2012, respectively.

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

	Three Months Ended March 31, 2013				
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$36,279	$2	$3	$(5)	$36,279
Interest expense	4,958	-	-	(5)	4,953
Provision for loan and lease losses	78	-	-	-	78
Noninterest income	9,706	1,407	1,509	(203)	12,419
Noninterest expenses	26,044	1,126	856	(203)	27,823
Income before income taxes	14,905	283	656	-	15,844
Income tax expense	4,915	115	256	-	5,286
Net income	$9,990	$168	$400	$-	$10,558
Assets	$3,976,665	$13,659	$17,889	$(76,187)	$3,932,026

	Three Months Ended March 31, 2012				
(In thousands)	Community Banking	Insurance	Investment Mgmt.	Inter-Segment Elimination	Total
Interest income	$34,615	$1	$3	$(4)	$34,615
Interest expense	5,914	-	-	(4)	5,910
Provision (credit) for loan and lease losses	664	-	-	-	664
Noninterest income	8,494	1,286	1,397	(203)	10,974
Noninterest expenses	24,867	1,214	805	(203)	26,683
Income before income taxes	11,664	73	595	-	12,332
Income tax expense	3,594	30	232	-	3,856
Net income	$8,070	$43	$363	$-	$8,476
Assets	$3,680,127	$13,051	$15,145	$(40,050)	$3,668,273

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

The Company

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

Overview

Net income for the Company for first quarter of 2013 totaled $10.6 million ($0.42 per diluted share), compared to net income of $8.5 million ($0.35 per diluted share) for the first quarter of 2012. These results reflect the following events:

- Net interest income increased 9% in 2013 compared to 2012. This increase was due primarily to growth in average interest-earning assets, largely resulting from higher-earning commercial loans added in the May 2012 acquisition of CommerceFirst Bancorp, Inc. (“CommerceFirst”) and organic loan growth. Combined with a decrease in funding costs on deposits and borrowings, these factors more than offset lower overall earning asset yields.
- The provision for loan and lease losses totaled $0.1 million for the first quarter of 2013 compared to $0.7 million for the first quarter of 2012 and $1.2 million for the fourth quarter of 2012. The decrease in the provision for the first quarter of 2013 compared to the prior year quarter was due primarily to a decline in historical losses in 2013 combined with a lower level of nonperforming loans and leases.
- Non-interest income increased $1.4 million or 13% for the first quarter of 2013 compared to the first quarter of 2012 due largely to growth in income from mortgage banking activities due to a higher volume of refinancing activity together with an increase in other noninterest income.
- Average total loans for the first quarter of 2013 increased 14% compared to the first quarter of 2012 due primarily to the CommerceFirst acquisition in the second quarter of 2012 and to organic growth in commercial loans.

In the first quarter of 2013, the region in which the Company operates continued to show slow but steady economic improvement. Concerns over a struggling national economy, tax increases and possible large federal government spending cuts (sequestration) continued to impede both the regional and national economic outlook. While the housing markets have improved, this sector is still significantly below levels experienced in prior economic

recoveries. The positive trends in housing and consumer spending have been offset by a contraction in manufacturing and relatively high unemployment which have caused uncertainty on the part of both large and small businesses and limited economic expansion. The financial stability of the European Union also continues to be an underlying volatility factor. Together with state and municipal budget challenges across the country, these factors have caused enough economic uncertainty, particularly among individual consumers and small and medium-sized businesses, to suppress confidence and thus constrain the pace of economic expansion and lending. Despite this challenging business environment, the Company has emphasized the fundamentals of community banking as it has maintained strong levels of liquidity and capital while overall credit quality has continued to improve.

The net interest margin increased to 3.59% in the first quarter of 2013 compared to 3.56% for the first quarter of 2012 and 3.53% for the fourth quarter of 2012. During the first quarter, the growth in average noninterest-bearing deposits largely offset a decline in the average rates earned on interest-earning assets. In addition, the first quarter reflects the benefit of the Company’s restructuring of $160 million in FHLB advances during the fourth quarter of 2012 and the first quarter of 2013 which resulted in a 100 basis points reduction in the average cost for these specific borrowings. Average total deposits increased 8%, for the quarter compared with the prior year period, while average loans increased 14% compared to 2012.

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

The Company's credit quality continued to improve as non-performing assets decreased to $54.7 million at March 31, 2013 from $77.0 million at March 31, 2012 and $63.8 million at December 31, 2012. This decrease was primarily the result of the combination of the Company's continuing efforts to resolve non-performing loans and reduced migration of existing loans into nonperforming status, particularly in the commercial real estate portfolio. Non-performing assets represented 1.39% of total assets at March 31, 2013 compared to 2.10% at March 31, 2012. The ratio of net charge-offs to average loans and leases was .28% for the first quarter of 2013 compared to .89% for the prior year period.

At December 31, 2012, the Bank remained above all "well-capitalized" regulatory requirement levels. In addition, tangible book value per common share increased 6% to $15.70 at March 31, 2013 from $14.83 at March 31, 2012.

Total assets at March 31, 2013 decreased 1% compared to December 31, 2012 primarily due to the pay off of selected borrowings during the quarter. Loan balances increased 1% compared to the prior year end due primarily to increases of 3% in residential mortgage and construction loans and 1% in commercial loans, which were somewhat offset by a 1% decrease in consumer loans. The increase in commercial loans was due to organic loan growth during the quarter, particularly in the investor real estate segment of the portfolio. Customer funding sources, which include deposits plus other short-term borrowings from core customers, remained level compared to balances at December 31, 2012. Customer funding sources reflected increases of 6% in regular savings accounts and 2% in money market accounts. These increases were somewhat offset by decreases of 2% in noninterest-bearing deposits and 3% in certificates of deposit. The Company continued to manage its net interest margin, primarily by reducing rates on certificates of deposit and borrowings during this extended period of historically low interest rates. During the same period, stockholders' equity increased to $489 million due to net income during the first quarter.

Net interest income increased by 9% compared to the prior year. The effects of an 18 basis point decrease in the cost of interest-bearing liabilities, growth of 24% in average noninterest-bearing deposits, 8% growth in average interest-earning assets and a 29% decrease in non-performing assets more than offset a decline of 13 basis points in the yield on average interest-earning assets.

Non-interest income increased 13% in the first quarter of 2013 compared to the first quarter of 2012. Income from mortgage banking activities increased 49% due to higher volumes and increased average gains from refinancing activity in the first quarter of 2013. In addition, other non-interest income increased over the prior year due to a non-recurring collection of a legal judgment and gains on the sales of SBA loans. These increases were somewhat offset by a decrease of 6% in service charges on deposits due to lower overdraft fees.

Non-interest expenses increased 4% in the first quarter of 2013 compared to the prior year period due primarily to higher salaries and incentive compensation and occupancy expenses.

Critical Accounting Policies

The Company’s critical accounting policies involving the significant judgments and assumptions used in the preparation of the Consolidated Financial Statements as of March 31, 2013 have remained unchanged from the disclosures presented in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 under the section “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Consolidated Average Balances, Yields and Rates

Sandy Spring Bancorp, Inc. and Subsidiaries

CONSOLIDATED AVERAGE BALANCES, YIELDS AND RATES - UNAUDITED

	Three Months Ended March 31,					
	2013			2012		
(Dollars in thousands and tax-equivalent)	Average Balances	(1) Interest	Annualized Average Yield/Rate	Average Balances	(1) Interest	Annualized Average Yield/Rate
Assets						
Residential mortgage loans (2)	$575,889	$5,376	3.73 %	$474,149	$5,360	4.55 %
Residential construction loans	120,283	1,004	3.38	116,630	1,101	3.80
Commercial ADC loans	148,749	1,996	5.44	159,769	1,968	4.96
Commercial investor real estate loans	474,062	6,135	5.25	377,072	5,148	5.49
Commercial owner occupied real estate loans	567,723	7,801	5.71	518,763	7,260	5.69
Commercial business loans	347,569	4,586	5.21	258,099	3,151	4.80
Leasing	2,510	38	6.07	6,325	103	6.52
Consumer loans	357,366	3,063	3.51	358,783	3,187	3.60
Total loans and leases (3)	2,594,151	29,999	4.71	2,269,590	27,278	4.84
Taxable securities	754,112	4,305	2.28	809,939	5,273	2.60
Tax-exempt securities (4)	297,657	3,267	4.39	276,356	3,419	4.95
Interest-bearing deposits with banks	31,050	19	0.25	32,871	21	0.25
Federal funds sold	474	-	0.22	1,087	-	0.14
Total interest-earning assets	3,677,444	37,590	4.13	3,389,843	35,991	4.26
Less: allowance for loan and lease losses	(43,705)			(49,567)		
Cash and due from banks	46,888			45,058		
Premises and equipment, net	48,167			48,554		
Other assets	217,784			203,786		
Total assets	$3,946,578			$3,637,674		
Liabilities and Stockholders' Equity						
Interest-bearing demand deposits	$423,485	92	0.09 %	$362,730	87	0.10 %
Regular savings deposits	234,492	48	0.08	200,604	46	0.09
Money market savings deposits	892,343	411	0.19	859,121	512	0.24
Time deposits	512,205	904	0.72	578,702	1,368	0.95
Total interest-bearing deposits	2,062,525	1,455	0.29	2,001,157	2,013	0.40
Other borrowings	65,601	49	0.30	81,878	61	0.30
Advances from FHLB	468,072	3,223	2.79	405,359	3,587	3.56
Subordinated debentures	35,000	226	2.58	35,000	249	2.85
Total interest-bearing liabilities	2,631,198	4,953	0.76	2,523,394	5,910	0.94

Noninterest-bearing demand deposits	797,926				641,477			
Other liabilities	33,790				24,397			
Stockholders' equity	483,664				448,406			
Total liabilities and stockholders' equity	$3,946,578				$3,637,674			
Net interest income and spread		$32,637	3.37	%		$30,081	3.32	%
Less: tax-equivalent adjustment		**1,311**				1,376		
Net interest income		$31,326				$28,705		
Interest income/earning assets			4.13	%			4.26	%
Interest expense/earning assets			0.54				0.70	
Net interest margin			3.59	%			3.56	%

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2013 and 2012. The annualized taxable-equivalent adjustments utilized in the above table to compute yields aggregated to $1.3 million and $1.4 million in 2013 and 2012, respectively.

(2) Includes residential mortgage loans held for sale. Home equity loans and lines are classified as consumer loans.

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

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

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Results of Operations

For the Three Months Ended March 31, 2013 Compared to the Three Months Ended March 31, 2012

Net income for the Company for the first three months of 2013 totaled $10.6 million ($0.42 per diluted share) compared to net income of $8.5 million ($0.35 per diluted share) for the first three months of 2012.

Net Interest Income

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

Net interest income for the first three months of 2013 was $31.3 million compared to $28.7 million for the same period of 2012, an increase of 9%. On a tax-equivalent basis, net interest income increased by 8% for the quarter ended March 31, 2013 to $32.6 million from $30.1 million for the prior year period. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that increased to 3.59% for the first quarter of 2013 compared to 3.56% for the first quarter of 2012. Average interest-earning assets increased by 8% while average interest-bearing liabilities increased 4% in 2013. Average noninterest-bearing deposits increased 24% in the first three months of 2013 compared to the first three months of 2012 while the percentage of average noninterest-bearing deposits to total deposits also increased to 28% for the first three months of 2013 compared to 24% for the same period in 2012.

Effect of Volume and Rate Changes on Net Interest Income

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

	2013 vs. 2012			2012 vs. 2011		
	Increase			Increase		
	Or	Due to Change In Average:*		Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate
Interest income from earning assets:						
Loans and leases	$2,721	$ 3,475	$ (754)	$166	$ 1,513	$ (1,347)

Securities	(1,120)	(270)	(850)	(234)	260	(494)
Other earning assets	(2)	(1)	(1)	2	2	-
Total interest income	1,599	3,203	(1,604)	(66)	1,775	(1,841)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	5	13	(8)	15	12	3
Regular savings deposits	2	7	(5)	4	5	(1)
Money market savings deposits	(101)	18	(119)	(422)	14	(436)
Time deposits	(464)	(147)	(317)	(497)	(130)	(367)
Total borrowings	(399)	313	(712)	70	32	38
Total interest expense	(957)	204	(1,161)	(830)	(67)	(763)
Net interest income	$2,556	$ 2,999	$ (443)	$764	$ 1,842	$ (1,078)

* 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.

Interest Income

The Company's total tax-equivalent interest income increased 4% for the first three months of 2013 compared to the prior year period. The previous table shows that, in 2013, the increase in average loans and leases more than offset a continued decline in earning asset yields with respect to the loan portfolio which resulted in an increase in total tax-equivalent interest income.

In the first three months of 2013, the average balance of the loan portfolio, including residential mortgage loans held for sale, increased 14% compared to the prior year period. This growth was primarily in the owner occupied and investor real estate, commercial business and residential mortgage portfolios. These increases were driven by loans added from the CommerceFirst acquisition in the second quarter of 2012 and organic loan growth as the regional economy slowly improved. The yield on average loans and leases decreased by 13 basis points due to the continued prevailing low interest rate environment as relatively higher rate loans were paid off and new loans were originated at comparatively lower rates. The decline in the portfolio yield was driven primarily by a decrease of 70 basis points in the yield in the residential mortgage portfolio which was partially offset by an increase of 6 basis points in the yield in the overall commercial loan portfolio. The decrease in the yield on the mortgage loan portfolio was due to declining rates on both new and existing adjustable rate mortgage loans, which the Company does not sell but maintains in the portfolio.

The average yield on total investment securities decreased 32 basis points while the average balance of the portfolio decreased 3% or $35 million in the first quarter of 2013 compared to the first quarter of 2012. The decline in investments was necessary to fund growth in the loan portfolio and the pay down of short-term borrowings. The decrease in the yield on investments was due primarily to calls of securities that were replaced by lower yielding investments as a result of lower overall market rates.

Interest Expense

Interest expense decreased by $1.0 million or 16% in the first quarter of 2013 compared to the first quarter of 2012, primarily as a result of an 18 basis point decrease in the average rate paid on interest-bearing liabilities. Deposit average balances during the first three months of 2013 compared to the prior year period were driven by the CommerceFirst acquisition in the second quarter of 2012 and by clients' continued emphasis on safety and liquidity as average total deposits increased 8% for the quarter compared to the prior year quarter. This increase was driven by increases of $217 million or 22% in average noninterest-bearing and interest-bearing checking accounts together with increases of $34 million or 17% in regular savings accounts and $33 million or 4% in money market accounts as clients kept funds in short-term instruments to preserve liquidity. This growth was partially offset by a decrease in average certificates of deposit of $66 million or 11% in the first quarter of 2013 compared to 2012. This decrease was primarily due to a decline in the rates offered on certificates in an effort to preserve the Company's net interest margin during this extended period of historically low interest rates. In addition, the average rate paid on advances from the Federal Home Loan Bank of Atlanta decreased 77 basis points for the first quarter of 2013 compared to the prior year period due primarily to the restructuring of $160 million of such advances into longer term lower rate instruments during the fourth quarter of 2012 and in the first quarter of 2013.

Interest Rate Performance

The Company’s net interest margin increased to 3.59% for the first quarter of 2013 compared to 3.56% for the first quarter of 2012 while the net interest spread increased to 3.37% in 2013 compared to 3.32% in 2012. The increase in the net interest margin was due primarily to the combination of increased average loan balances, lower rates on interest-bearing deposits and borrowings and higher balances of noninterest-bearing deposits.

Non-interest Income

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

	Three Months Ended March 31,		2013/2012	2013/2012
(Dollars in thousands)	2013	2012	$ Change	% Change
Securities gains	$ 56	$ 73	$ (17)	(23.3)%
Total other-than-temporary impairment ("OTTI") losses	-	(64)	64	(100.0)
Portion of OTTI losses recognized in other comprehensive income before taxes	-	-	-	-
Net OTTI recognized in earnings	-	(64)	64	(100.0)
Service charges on deposit accounts	2,069	2,200	(131)	(6.0)
Mortgage banking activities	1,527	1,025	502	49.0
Wealth management income	4,042	4,057	(15)	(0.4)
Insurance agency commissions	1,349	1,202	147	12.2
Income from bank owned life insurance	612	634	(22)	(3.5)
Visa check fees	957	898	59	6.6
Other income	1,807	949	858	90.4
Total non-interest income	$ 12,419	$ 10,974	$ 1,445	13.2

Total non-interest income was $12.4 million for the first quarter of 2013 compared to $11.0 million for the first quarter of 2012. As shown in the table above, the primary drivers of non-interest income for the first three months of 2013 were increases in income from mortgage banking activities and other non-interest income.

Income from mortgage banking activities increased in the first three months of 2013 compared to the first three months of 2012 due primarily to higher loan origination volumes and higher average gains on sales, due to both increased refinancing activity and continued historically low rates during the period. Other non-interest income increased during the quarter compared to the prior year period due mainly to a non-recurring legal settlement and miscellaneous gains on loan sales.

Insurance agency commissions increased 12% in the first three months of 2013 compared to the first three months of 2012 due primarily to higher revenues on physicians' liability and commercial and personal lines. Service charges on deposits decreased in the first quarter of 2013 compared to the first quarter of 2012 due primarily to a decline in overdraft fees.

Income from bank owned life insurance decreased in the first quarter of 2013 compared to the prior year period due to the decline in interest rates paid on such policies. The Company invests in bank owned life insurance products in order

to better manage the cost of employee benefit plans. Investments totaled $84.3 million at March 31, 2013 and $81.7 million at March 31, 2012 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 4.92% for the first quarter of 2013 compared to 5.20% for the prior year period.

Wealth management income is comprised of income from trust and estate services, investment management fees earned by West Financial Services, the Company's investment management subsidiary, and fees on sales on investment products and services. During the first quarter of 2013, wealth management remained level compared to the prior year quarter. Trust services fees increased 5% compared to the prior year period, due to an increase in assets under management. Investment management fees in West Financial Services increased 8% for the first quarter of 2013 compared to 2012, also due to higher assets under management. Fees on sales of investment products and services decreased 21% for the year as assets under management declined due to financial advisor turnover in this group. Overall total assets under management increased to $2.3 billion at March 31, 2013 compared to $2.2 billion at March 31, 2012.

No net OTTI losses were recognized in earnings in the first quarter of 2013 compared to $64 thousand for the prior year period. The Company recognized net securities gains, exclusive of net OTTI losses which resulted primarily from securities calls during the period.

Non-interest Expense

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

	Three Months Ended March 31,		2013/2012	2013/2012
(Dollars in thousands)	2013	2012	$ Change	% Change
Salaries and employee benefits	$ 16,346	$ 15,701	$ 645	4.1 %
Occupancy expense of premises	3,182	2,846	336	11.8
Equipment expenses	1,249	1,190	59	5.0
Marketing	515	495	20	4.0
Outside data services	1,152	1,279	(127)	(9.9)
FDIC insurance	596	652	(56)	(8.6)
Amortization of intangible assets	461	461	-	-
Professional fees	1,287	1,287	-	-
Other real estate owned	37	64	(27)	(42.2)
Other expenses	2,998	2,708	290	10.7
Total non-interest expense	$ 27,823	$ 26,683	$ 1,140	4.3

Non-interest expenses totaled $27.8 million in the first quarter of 2013 compared to $26.7 million in the first quarter of 2012, an increase of 4%. This growth in expenses was driven primarily by increases in salaries, incentive compensation and occupancy expenses.

Salaries and employee benefits, the largest component of non-interest expenses, increased in the first quarter of 2013 due primarily to higher compensation expenses as a result of a larger staff, due in part, to the CommerceFirst acquisition and due to merit increases, both of which occurred in the second quarter of 2012. The average number of full-time equivalent employees was 699 in the first quarter of 2013 compared to 677 for the first quarter of 2012.

Occupancy expenses increased for the first quarter of 2013 compared to 2012 due to higher rental expenses due to a larger branch network. In addition, grounds maintenance expenses increased in the first quarter of 2013 compared to the first quarter of 2012 due to weather related expenses. Outside data services expenses decreased in the first three months of 2013 compared to the prior year period due primarily to merger expenses recognized in the first quarter of 2012 related to the CommerceFirst acquisition. Equipment and marketing expenses and amortization of intangible assets remained level for the first quarter of 2013 compared to the first quarter of 2012. The Company’s intangible assets are being amortized over relatively short amortization periods averaging approximately two years at March 31, 2013.

FDIC insurance expense decreased 9% in the first quarter of 2013 compared to the first quarter of 2012 as the Company’s growth in assets was more than offset by a lower assessment rate due to improving financial ratios. Professional fees and other real estate owned expenses were level in the first quarter of 2013 compared to the first

quarter of 2012. Other non-interest expenses increased in the first quarter of 2013 compared to the first quarter of 2012 due mainly to increased strategic giving and miscellaneous losses.

Income Taxes

The Company had income tax expense of $5.3 million in the first quarter of 2013, compared to $3.9 million in the first quarter of 2012. The resulting effective rates were 33% for the first quarter of 2013 and 31% for the first quarter of 2012. The increase in the effective tax rate in the first quarter of 2013 was due primarily to a higher proportion of income before taxes that was taxed at the full statutory rate compared to tax exempt income.

Operating Expense Performance

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

Non-GAAP Financial Measures

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

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

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

GAAP and Non-GAAP Financial Measures

	Three Months Ended March 31,	
(Dollars in thousands)	2013	2012
Pre-tax pre-provision pre-merger expense income:		
Net income	$10,558	$8,476
Plus non-GAAP adjustment:		
Merger expenses	-	374
Income taxes	5,286	3,856
Provision for loan and lease losses	78	664
Pre-tax pre-provision pre-merger expense income	$15,922	$13,370
GAAP efficiency ratio:		
Non-interest expenses	$27,823	$26,683
Net interest income plus non-interest income	$43,745	$39,679
GAAP Efficiency ratio	63.60 %	67.25 %
Non-GAAP efficiency ratio:		
Non-interest expenses	$27,823	$26,683
Less non-GAAP adjustment:		
Amortization of intangible assets	461	461
Merger expenses	-	374
Non-interest expenses - as adjusted	$27,362	$25,848
Net interest income plus non-interest income	$43,745	$39,679
Plus non-GAAP adjustment:		
Tax-equivalent income	1,311	1,376
Less non-GAAP adjustments:		
Securities gains	56	73
OTTI recognized in earnings	-	(64)
Net interest income plus non-interest income - as adjusted	$45,000	$41,046
Non-GAAP Efficiency ratio	60.80 %	62.97 %

FINANCIAL CONDITION

The Company's total assets were $3.9 billion at March 31, 2013, decreasing $23 million or 1% compared to $4.0 billion at December 31, 2012. Interest-earning assets increased $38 million to $3.7 billion at March 31, 2013 compared to December 31, 2012. The increase in interest-earning assets was primarily due to organic growth in the loan portfolio.

Analysis of Loans and Leases

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

	March 31, 2013		December 31, 2012		Period-to-Period Change	
(Dollars in thousands)	Amount	%	Amount	%	$ Change	% Change
Residential real estate:						
Residential mortgage	$538,346	21.0 %	$523,364	20.7 %	$ 14,982	2.9 %
Residential construction	122,698	4.8	120,314	4.8	2,384	2.0
Commercial real estate:						
Commercial owner occupied real estate	565,820	22.1	571,510	22.6	(5,690)	(1.0)
Commercial investor real estate	487,802	19.0	456,888	18.0	30,914	6.8
Commercial acquisition, development and construction	150,599	5.9	151,933	6.0	(1,334)	(0.9)
Commercial Business	344,489	13.4	346,708	13.7	(2,219)	(0.6)
Leases	1,974	0.1	3,421	0.1	(1,447)	(42.3)
Consumer	353,341	13.7	356,990	14.1	(3,649)	(1.0)
Total loans and leases	$2,565,069	100.0%	$2,531,128	100.0%	$ 33,941	1.3

Total loans and leases, excluding loans held for sale, increased $34 million or 1% during the first quarter of 2013 compared to December 31, 2012. The commercial loan portfolio increased by $21 million to $1.5 billion at March 31, 2013 compared to the prior year end largely due to growth in the investor real estate segment of the portfolio. Commercial owner occupied, business, and ADC loans remained relatively level compared to December 31, 2012.

The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, reflected a 3% increase at March 31, 2013 compared to December 31, 2012. Permanent residential mortgages, most of which are 1-4 family, increased 3% due to higher loan origination volumes of adjustable rate mortgage loans. The Company generally retains such adjustable rate mortgages in its portfolio and sells the fixed rate mortgages that it originates in the secondary mortgage market. Residential construction loans increased 2% at March 31, 2013 compared to the balance at December 31, 2012 due to increased construction activity as a result of mild weather conditions and low interest rates.

The consumer loan portfolio remained virtually level at $353 million at March 31, 2013 compared to December 31, 2012 due to weak consumer demand as a result of the state of the regional and national economy.

Analysis of Investment Securities

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

	March 31, 2013		December 31, 2012		Period-to-Period Change	
(Dollars in thousands)	Amount	%	Amount	%	$ Change	% change
Available-for-Sale:						
U.S. government agencies and corporations	$130,897	13.0 %	$156,428	14.6 %	$ (25,531)	(16.3)%
State and municipal	173,423	17.2	174,491	16.3	(1,068)	(0.6)
Mortgage-backed	457,544	45.4	490,479	45.6	(32,935)	(6.7)
Corporate debt	2,007	0.2	1,996	0.2	11	0.6
Trust preferred	1,486	0.1	1,465	0.1	21	1.4
Marketable equity securities	723	-	723	-	-	-
Total available-for-sale	766,080	75.9	825,582	76.8	(59,502)	(7.2)
Held-to-Maturity and Other Equity						
U.S. government agencies and corporations	64,500	6.4	64,498	6.0	2	-
State and municipal	146,583	14.6	150,995	14.1	(4,412)	(2.9)
Mortgage-backed	293	-	321	-	(28)	(8.7)
Other equity securities	31,237	3.1	33,636	3.1	(2,399)	(7.1)
Total held-to-maturity and other equity	242,613	24.1	249,450	23.2	(6,837)	(2.7)
Total securities	$1,008,693	100.0%	$1,075,032	100.0%	$ (66,339)	(6.2)

The investment portfolio, consisting of available-for-sale, held-to-maturity and other equity securities, decreased 6% or $66 million to $1.0 billion at March 31, 2013, from $1.1 billion at December 31, 2012.

During the first quarter of 2013, the decrease in the investment portfolio was due primarily to maturities and calls of securities, the proceeds of which were used to fund the organic growth in the loan portfolio and to pay down short-term borrowings.

The investment portfolio consists primarily of U.S. Agency securities, U.S. Agency mortgage-backed securities, U.S. Agency collateralized mortgage obligations and state and municipal securities. The duration of the portfolio was 3.5 years at March 31, 2013 and 3.4 years at December 31, 2012. The Company considers the duration of the portfolio to be adequate for liquidity purposes. This investment strategy has resulted in a portfolio with low credit risk that would provide the required liquidity needed to meet increased loan demand. The portfolio is monitored on a continuing basis with consideration given to interest rate trends and the structure of the yield curve and with constant assessment of economic projections and analysis.

At March 31, 2013, the trust preferred portfolio included one pooled trust preferred security backed by debt issued by banks and thrifts, which totaled $1.7 million, with a fair value of $1.5 million. The fair value of this security was determined by a third party valuation specialist due to the limited trading activity for this security in the marketplace. The specialist used an income valuation approach technique (present value) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The methodology, observable inputs and significant assumptions employed by the specialist to determine fair value are provided in Note 3 – Investment Securities in the Notes to the Consolidated Financial Statements.

As a result of this valuation, it was determined that the pooled trust preferred security had not incurred any credit-related OTTI for the three months ended March 31, 2013. Non-credit related OTTI on this security, which is not expected to be sold and which the Company has the ability to hold until maturity, was $0.2 million at March 31, 2013. This non-credit related OTTI was recognized in accumulated other comprehensive income (“OCI”) at March 31, 2013.

Other Earning Assets

Residential mortgage loans held for sale increased $12 million to $48 million as of March 31, 2013 from $36 million as of December 31, 2012. The aggregate of federal funds sold and interest-bearing deposits with banks increased $12 million to $39 million at March 31, 2013.

Deposits

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

	March 31, 2013		December 31, 2012		Period-to-Period Change	
(Dollars in thousands)	Amount	%	Amount	%	$ Change	% change
Noninterest-bearing deposits	$832,679	28.5 %	$847,415	29.1 %	$ (14,736)	(1.7)%
Interest-bearing deposits:						
Demand	435,635	14.9	428,048	14.7	7,587	1.8
Money market savings	902,326	30.9	884,367	30.4	17,959	2.0
Regular savings	241,790	8.3	228,384	7.8	13,406	5.9
Time deposits of less than $100,000	292,393	10.0	307,445	10.5	(15,052)	(4.9)
Time deposits of $100,000 or more	214,385	7.4	217,375	7.5	(2,990)	(1.4)
Total interest-bearing deposits	2,086,529	71.5	2,065,619	70.9	20,910	1.0
Total deposits	$2,919,208	100.0%	$2,913,034	100.0%	$ 6,174	0.2

Total deposits remained virtually level at March 31, 2013 compared to December 31, 2012. The total of noninterest-bearing and interest-bearing checking accounts also remained level at March 31, 2013 compared to the prior year end. Regular savings and money market accounts increased 6% and 2% respectively at March 31, 2013. The activity in these deposit products can be attributed primarily to clients' emphasis on safety and liquidity considering the current extended period of low interest rates and the volatility of alternative investments. Certificates of deposit decreased 3% compared to the prior year end, as the Company managed its deposit mix to improve its net interest margin. Total borrowings decreased 7% at March 31, 2013 compared to December 31, 2012. This decrease was due primarily to a reduction of $35 million in short-term borrowings. Such borrowings were utilized primarily to temporarily fund, at very low interest rates, increases in loans late in the fourth quarter of 2012.

Capital Management

Management monitors historical and projected earnings, dividends and asset growth, as well as risks associated with the various types of on- and off-balance sheet assets and liabilities, in order to determine appropriate capital levels. During the first quarter of 2013, total stockholders' equity increased to $489 million at March 31, 2013, from $484 million at December 31, 2012. This increase was due primarily to net income earned during the period. The ratio of average equity to average assets was 12.26% for the first quarter of 2013 as compared to 12.33% for the first quarter of 2012.

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

Risk-Based Capital Ratios

	Ratios at March 31, 2013	December 31, 2012	Minimum Regulatory Requirements
Total Capital to risk-weighted assets	15.48 %	15.40 %	8.00 %
Tier 1 Capital to risk-weighted assets	14.23 %	14.15 %	4.00 %
Tier 1 Leverage	11.07 %	10.98 %	3.00 %

Tier 1 capital of $427.2 million and total qualifying capital of $464.7 million each included $35.0 million in trust preferred securities that are considered regulatory capital for purposes of determining the Company’s Tier 1 capital ratio. As of March 31, 2013, the most recent notification from the Bank’s primary regulator categorized the Bank as a "well-capitalized" institution under the prompt corrective action rules of the Federal Deposit Insurance Act. Designation as a well-capitalized institution under these regulations is not a recommendation or endorsement of the Company or the Bank by federal bank regulators.

In June 2012, the Federal Reserve, FDIC and OCC issued three joint Notices of Proposed Rulemaking ("NPRs") to address the implementation of the proposed Basel III regulatory capital framework for U.S. financial institutions, including proposed minimum capital requirements, definitions of qualifying capital instruments, and risk-weighted asset calculations. As proposed, it appears that the Company's risk-weighted assets may increase primarily due to changes in the ranges of risk-weightings for residential mortgages and home equity loans. However, the effect of this change may be offset by revised definitions of qualifying capital instruments. The Company has analyzed the possible effect of the proposed NPRs and currently estimates that our risk-based capital ratios will exceed the proposed requirements on a fully phased-in basis. The regulatory agencies have asked financial institutions to comment on the NPRs and are expected to review the feedback and draft final rules, which could take some time to complete. As a result, the final rules may differ from the current NPRs, which currently provide for an extended phase-in over several years. The Company will continue to analyze the proposed NPRs as changes are communicated by the regulatory agencies.

Tangible Common Equity

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

Tangible Common Equity Ratio – Non-GAAP

(Dollars in thousands, except per share data)	March 31, 2013	December 31,2012
Tangible common equity ratio:		
Total stockholders' equity	$ 488,947	$ 483,512
Accumulated other comprehensive income (loss)	(9,732)	(11,312)
Goodwill	(84,808)	(84,808)
Other intangible assets, net	(2,702)	(3,163)
Tangible common equity	$ 391,705	$ 384,229
Total assets	$ 3,932,026	$ 3,955,206
Goodwill	(84,808)	(84,808)
Other intangible assets, net	(2,702)	(3,163)
Tangible assets	$ 3,844,516	$ 3,867,235
Tangible common equity ratio	10.19 %	9.94 %

Credit Risk

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

Current economic data has shown that while the Mid-Atlantic region is one of the stronger markets in the nation, the Company is continuing to deal with the lingering impact of a very slowly recovering economy and its resulting effects on the Company's borrowers, particularly in the real estate sector. Total non-performing loans decreased 15% to $49 million at March 31, 2013 compared to the balance at December 31, 2012. While the diversification of the lending portfolio among different commercial, residential and consumer product lines along with different market conditions of the D.C. suburbs, Northern Virginia and Baltimore metropolitan area has mitigated some of the risks in the portfolio, local economic conditions and levels of non-performing loans may continue to be influenced by the current slow and uneven economic recovery on both a regional and national level.

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

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

The methodology for assessing the appropriateness of the allowance includes: (1) a general allowance that reflects historical losses, as adjusted, by credit category, and (2) a specific allowance for impaired credits on an individual or portfolio basis. This methodology is further described in the section entitled "Critical Accounting Policies" and in "Note 1 – Significant Accounting Policies" of the Notes to the Consolidated Financial Statements of the Company's 2012 Form 10-K. The amount of the allowance is reviewed monthly and approved quarterly by the Credit and Investment Risk Committee of the board of directors.

The Company recognizes a collateral dependent lending relationship as non-performing when either the loan becomes 90 days delinquent or as a result of factors (such as bankruptcy, interruption of cash flows, etc.) considered at the monthly credit committee meeting. When a commercial loan is placed on non-accrual status, it is considered to be impaired and all accrued but unpaid interest is reversed. Classification as an impaired loan is based on a determination that the Company may not collect all principal and interest payments according to contractual terms. Impaired loans exclude large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment such as leases, residential real estate and consumer loans. Typically, all payments received on non-accrual loans are applied to

the remaining principal balance of the loans. Integral to the assessment of the allowance process is an evaluation that is performed to determine whether a specific allowance on an impaired loan is warranted and, when losses are confirmed, a charge-off is taken to reduce the loan to its net realizable value. Any further collateral deterioration results in either further specific allowances being established or additional charge-offs. At such time an action plan is agreed upon for the particular loan and an appraisal will be ordered depending on the time elapsed since the prior appraisal, the loan balance and/or the result of the internal evaluation. A current appraisal on large loans is usually obtained if the appraisal on file is more than 12 months old and there has been a material change in market conditions, zoning, physical use or the adequacy of the collateral based on an internal evaluation. The Company's policy is to strictly adhere to regulatory appraisal standards. If an appraisal is ordered, no more than a 30 day turnaround is requested from the appraiser, who is selected by Credit Administration from an approved appraiser list. After receipt of the updated appraisal, the assigned credit officer will recommend to the Chief Credit Officer whether a specific allowance or a charge-off should be taken. The Chief Credit Officer has the authority to approve a specific allowance or charge-off between monthly credit committee meetings to insure that there are no significant time lapses during this process.

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

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

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

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

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

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

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

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

The Company makes provisions for loan and lease losses in amounts necessary to maintain the allowance at an appropriate level, as established by use of the allowance methodology discussed above. The provision for loan and lease losses was $0.1 million in the first quarter of 2013 compared to $0.7 million in the first quarter of 2012. Historical net charge-offs represent a principal component in the application of the Company’s allowance methodology. A continued decrease in the confirmed losses over the related historical period in addition to a decline in problem loans, served to reduce the overall provision for the quarter.

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

Allowance for Loan and Lease Losses

During the first quarter of 2013, there were no changes in the Company’s methodology for assessing the appropriateness of the allowance for loan and lease losses from the prior year. Variations can occur over time in the estimation of the adequacy of the allowance as a result of the credit performance of borrowers.

At March 31, 2013, total non-performing loans and leases were $49 million, or 1.93% of total loans and leases, compared to $58 million, or 2.29% of total loans and leases, at December 31, 2012. Timely recognition and aggressive management of problem credits has resulted in the significant reduction of the migration of these loans into non-accrual status during this period. The allowance represented 83% of non-performing loans and leases at March 31, 2013 as compared to 74% at December 31, 2012. The increase in this ratio was due primarily to the decline in non-performing loans and leases mentioned above. The allowance for loan and lease losses as a percent of total loans and leases was 1.61% at March 31, 2013 as compared to 1.70% at December 31, 2012. This decrease was due to a combination of a lower level of both non-performing loans and historical losses at March 31, 2013 compared to the prior year end.

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

The balance of impaired loans was $43.7 million, with specific allowances of $4.0 million against those loans at March 31, 2013, as compared to $48.8 million with allowances of $5.1 million, at December 31, 2012.

The Company's borrowers are concentrated in six counties in Maryland, three counties in Virginia and in Washington D.C. Commercial and residential mortgages, including home equity loans and lines, represented 75% of total loans and leases at March 31, 2013 compared to 74% at December 31, 2012. Certain loan terms may create concentrations of credit risk and increase the Company’s exposure to loss. These include terms that permit the deferral of principal payments or payments that are smaller than normal interest accruals (negative amortization); loans with high loan-to-value ratios; loans, such as option adjustable-rate mortgages, that may expose the borrower to future increases in repayments that are in excess of increases that would result solely from increases in market interest rates; and interest-only loans. The Company does not make loans that provide for negative amortization or option adjustable-rate mortgages.

Summary of Loan and Lease Loss Experience

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

(Dollars in thousands)	Three Months Ended March 31, 2013		Year Ended December 31, 2012	
Analysis of Allowance for Loan Losses:				
Balance, January 1	$ 42,957		$ 49,426	
Provision (credit) for loan and lease losses	78		3,649	
Charge-offs:				
Commercial business	1,857		(1,022	)
Commercial real estate:				
Commercial acquisition, development and construction	-		(3,281	)
Commercial investor real estate	131		(3,690	)
Commercial owner occupied real estate	91		(1,174	)
Leasing	-		(8	)
Consumer	564		(1,298	)
Residential real estate:				
Residential mortgage	465		(2,107	)
Residential construction	-		(224	)
Total charge-offs	3,108		(12,804	)
Recoveries:				
Commercial business	113		1,548	
Commercial real estate:				
Commercial acquisition, development and construction	1,020		528	
Commercial investor real estate	100		97	
Commercial owner occupied real estate	10		38	
Leasing	-		23	
Consumer	56		227	
Residential real estate:				
Residential mortgage	18		213	
Residential construction	2		12	
Total recoveries	1,319		2,686	
Net charge-offs	(1,789	)	(10,118	)
Balance at end of period	$ 41,246		$ 42,957	
Allowance for loan losses to loans	1.61	%	1.70	%
Annualized net charge-offs to average loans and leases	0.28	%	0.42	%

Analysis of Credit Risk

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

(Dollars in thousands)	March 31, 2013	December 31, 2012
Non-Performing Assets:		
Loans and leases 90 days past due:		
Commercial business	$ -	$ 24
Commercial real estate:		
Commercial AD&C	-	-
Commercial investor real estate	-	-
Commercial owner occupied real estate	-	209
Leasing	-	-
Consumer	54	14
Residential real estate:		
Residential mortgage	-	-
Residential construction	-	-
Total loans and leases 90 days past due	54	247
Non-accrual loans and leases:		
Commercial business	4,012	4,611
Commercial real estate:		
Commercial AD&C	5,826	6,332
Commercial investor real estate	12,353	11,843
Commercial owner occupied real estate	5,346	13,681
Leasing	-	865
Consumer	2,388	2,410
Residential real estate:		
Residential mortgage	5,393	4,681
Residential construction	3,258	3,125
Total non-accrual loans and lease	38,576	47,548
Total restructured loans - accruing	10,839	10,110
Total non-performing loans and leases	49,469	57,905
Other assets and real estate owned (OREO)	5,250	5,926
Total non-performing assets	$ 54,719	$ 63,831

Market Risk Management

The Company's net income is largely dependent on its net interest income. Net interest income is susceptible to interest rate risk to the extent that interest-bearing liabilities mature or re-price on a different basis than interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly,

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

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

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

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

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

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

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

Estimated Changes in Net Interest Income
Change in Interest Rates:

	+ 400 bp	+ 300 bp	+ 200 bp	+ 100 bp	- 100 bp	- 200 bp	-300 bp	-400 bp
Policy Limit	23.50 %	17.50 %	15.00 %	10.00 %	10.00 %	15.00 %	17.50 %	23.50 %
March 31, 2013	1.01 %	2.10 %	2.35 %	0.93 %	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2012	(1.02)%	0.56 %	1.26 %	0.51 %	N/A	N/A	N/A	N/A

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

The improved risk position with respect to net interest income from December 31, 2012 to March 31, 2013 was the result of the payoff of $35 million in short-term borrowings and the increase in highly liquid earning assets of $24 million. The combination of these factors results in higher interest income as rates are shocked up.

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 %
March 31, 2013	(1.99)%	0.32 %	1.93 %	1.80 %	**N/A**	**N/A**	**N/A**	**N/A**
December 31, 2012	(0.39)%	1.87 %	3.29 %	2.65 %	N/A	N/A	N/A	N/A

Measures of the economic value of equity ("EVE") at risk decreased compared to year-end 2012 in most rising interest rate shock levels. The negative change in EVE was driven by shorter durations in demand, savings and money market accounts. The negative impact on EVE was slightly mitigated by the restructuring of an additional $40 million in FHLB advances which generates more benefit as market rates increase in the shock scenarios.

Liquidity Management

Liquidity is measured by a financial institution's ability to raise funds through loan and lease repayments, maturing investments, deposit growth, borrowed funds, capital and the sale of highly marketable assets such as investment securities and residential mortgage loans. The Company's liquidity position, considering both internal and external sources available, exceeded anticipated short-term and long-term needs at March 31, 2013. Management considers core deposits, defined to include all deposits other than time deposits of $100 thousand or more, to be a relatively stable funding source. Core deposits equaled 74% of total interest-earning assets at March 31, 2013**.** In addition, loan and lease payments, maturities, calls and pay downs of securities, deposit growth and earnings contribute a flow of funds available to meet liquidity requirements. In assessing liquidity, management considers operating requirements, the seasonality of deposit flows, investment, loan and deposit maturities and calls, expected funding of loans and deposit withdrawals, and the market values of available-for-sale investments, so that sufficient funds are available on short notice to meet obligations as they arise and to ensure that the Company is able to pursue new business opportunities.

Liquidity is measured using an approach designed to take into account, in addition to factors already discussed above, the Company's growth and mortgage banking activities. Also considered are changes in the liquidity of the investment portfolio due to fluctuations in interest rates. Under this approach, implemented by the Funds Management Subcommittee of ALCO under formal policy guidelines, the Company's liquidity position is measured weekly, looking forward at thirty day intervals from thirty (30) to three hundred sixty (360) days. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Resulting projections as of March 31, 2013, show short-term investments exceeding short-term borrowings by $23 million over the subsequent 360 days. This projected excess of liquidity versus requirements provides the Company with flexibility in how it funds loans and other earning assets.

The Company also has external sources of funds, which can be drawn upon when required. The main sources of external liquidity are available lines of credit with the Federal Home Loan Bank of Atlanta and the Federal Reserve. The line of credit with the Federal Home Loan Bank of Atlanta totaled $1.2 billion, of which $721 million was available for borrowing based on pledged collateral, with $405 million borrowed against it as of March 31, 2013. The line of credit at the Federal Reserve totaled $367 million, all of which was available for borrowing based on pledged collateral, with no borrowings against it as of March 31, 2013. Other external sources of liquidity available to the Company in the form of unsecured lines of credit granted by correspondent banks totaled $55 million at March 31, 2013, against which there were no outstanding borrowings. In addition, the Company had a secured line of credit with a correspondent bank of $20 million as of March 31, 2013. Based upon its liquidity analysis, including external sources of liquidity available, management believes the liquidity position was appropriate at March 31, 2013.

The parent company ("Bancorp") is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Bancorp is responsible for paying any dividends declared to its common shareholders and interest and principal on outstanding debt. Bancorp's primary source of income is dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Bancorp in any calendar year, without the receipt of prior approval from the Federal Reserve, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. Based on this requirement, as of March 31, 2013, the Bank could have declared a dividend of $65 million to Bancorp. At March 31, 2013, Bancorp had liquid assets of $10 million.

Arrangements to fund credit products or guarantee financing take the form of loans 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.

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

(In thousands)	March 31, 2013	December 31, 2012
Commercial	$168,406	$ 186,014
Real estate-development and construction	80,368	79,480
Real estate-residential mortgage	48,817	56,445
Lines of credit, principally home equity and business lines	672,570	667,186
Standby letters of credit	78,343	72,008
Total Commitments to extend credit and available credit lines	$1,048,504	$ 1,061,133

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Item 4. CONTROLS AND PROCEDURES

The Company’s management, under the supervision and with the participation of the Company’s Chief Executive Officer and Chief Financial Officer, evaluated as of the last day of the period covered by this report, the effectiveness of the design and operation of the Company’s disclosure controls and procedures, as defined in Rule 13a-15 under the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective. There were no changes in the Company’s internal controls over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the three months ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

results or liquidity.

Item 1A. Risk Factors

There have been no material changes in the risk factors as discussed in the 2012 Annual Report on Form 10-K.

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

The Company approved a stock repurchase program in August 2011 that permits the repurchase of up to 3% of the Company’s outstanding shares of common stock or approximately 730,000 shares. Repurchases which will be conducted through open market purchases or privately negotiated transactions, will be made depending on market conditions and other factors. There were no repurchase transactions executed during the quarter ended March 31, 2013.

Item 3. Defaults Upon Senior Securities – None

Item 4. Mine Safety Disclosures – Not applicable

Item 5. Other Information - None

Item 6. Exhibits

Exhibit 31(a) Certification of Chief Executive Officer

Exhibit 31(b)	Certification of Chief Financial Officer
Exhibit 32 (a)	Certification of Chief Executive Officer pursuant to 18 U.S. Section 1350
Exhibit 32 (b)	Certification of Chief Financial Officer pursuant to 18 U.S. Section 1350
Exhibit 101	The following materials from the Sandy Spring Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter end March 31, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Condition; (ii) The Condensed Consolidated Statements of Income; (iii) The Condensed Consolidated Statements of Comprehensive Income; (iv) The Condensed Consolidated Statements of Cash Flows; (v) The Condensed Consolidated Statements of Changes in Stockholders' Equity; (vi) related notes.

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Signatures

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

SANDY SPRING BANCORP, INC.

(Registrant)

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

Date: May 10, 2013

By: /s/ Philip J. Mantua
Philip J. Mantua
Executive Vice President
and Chief Financial
Officer

Date: May 10, 2013