SANDY SPRING BANCORP INC
Form 10-K
March 15, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2011

Commission File Number 0-19065

SANDY SPRING BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland	52-1532952
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

301-774-6400

(Registrant's telephone number, including area code)

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

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

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

¨ Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

¨ Yes x No*

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

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

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

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

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

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

The aggregate market value of the voting common stock of the registrant held by non-affiliates on June 30, 2011, the last day of the registrant’s most recently completed second fiscal quarter was approximately $424 million, based on the closing sales price of $17.99 per share of the registrant's Common Stock on that date.

The number of outstanding shares of common stock outstanding as of March 9, 2012.

Common stock, $1.00 par value – 24,096,518 shares

Documents Incorporated By Reference

Part III: Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held on May 2, 2012 (the "Proxy Statement").

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

SANDY SPRING BANCORP, INC.

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Forward-Looking Statements

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

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

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

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

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

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

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

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

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

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

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

PART I

Item 1. BUSINESS

General

Sandy Spring Bancorp, Inc. (the “Company") is the one-bank holding company for Sandy Spring Bank (the "Bank"). The Company is registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"). As such, the Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company began operating in 1988. The Bank was founded in 1868 and is the oldest banking business based in Maryland. The Bank is independent, community oriented, and conducts a full-service commercial banking business through 43 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.

With $3.7 billion in assets, the Company is the largest publicly traded banking company headquartered and operating in Maryland. Through its subsidiaries, Sandy Spring Insurance Corporation and West Financial Services, Inc., Sandy Spring Bank also offers a comprehensive menu of insurance and investment management services.

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

Availability of Information

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

Market and Economic Overview

Sandy Spring Bank is headquartered in Montgomery County, Maryland and conducts business primarily in the Central Maryland and Northern Virginia area. The Bank’s business footprint serves one of the better performing business regions in the country. Among combined metro areas in the U.S., the Washington-Baltimore-Northern Virginia Combined Statistical Area ranked third annually in total “Effective Buying Income”, with $242 billion according to the Maryland Department of Business & Economic Development. At June 30, 2011, with $2.6 billion of deposits in Maryland, Sandy Spring Bancorp had the largest deposit market share of any bank holding company headquartered in Maryland according to SNL Financial. The Baltimore-Washington area is a regional center for federal and state government services, service oriented businesses and various industries. Both areas are accessible to a deepwater harbor, the fifth largest in the nation, and have proximity to a large network of interstate and well maintained highways, notably Interstates 95, 70, 83, 81 and 68. As a consequence, the area is also a major provider of warehouse operations for retail distribution and logistics providers. Additionally, the region also has a high concentration of third party government service providers, in addition to hosting a robust technology sector. The employment in the health and education industries is also significant. On a consolidated basis, the area possesses a diverse blue-collar to white-collar business environment.

Maryland has the highest state median household income in the country at $69,000 for 2010, according to the U.S. Census Bureau. To complement its presence in the Maryland market, the Bank is expanding its number of community offices in Northern Virginia, which is home to nearly 2.6 million people. The Baltimore-Washington area has six out of the top ten most affluent counties in the United States, as measured by median household income, according to the U.S. Census Bureau. Important to both Maryland and Northern Virginia is the accessibility to other key neighboring markets such as Philadelphia, New York City, Pittsburgh and the Richmond/Norfolk, Virginia corridor. The market area benefits from the presence and employment stability of the federal government and related service industries. In addition, management believes that the market is benefitting from stimulus spending, recent military base relocation and expansion initiatives by the general defense and homeland security industries.

While general economic decline has had an adverse impact on the local economy, the regional unemployment rate is currently below the national average according to the Bureau of Labor Statistics as of December, 2011. The workforce is relatively stable due to government and related employment opportunities and the presence of a diverse manufacturing base and service industries, and a better than average regional economic outlook. Recent activity reflects improving conditions in the market, as the Washington metro statistical area was one of only two MSAs in the country to show gains in home prices in 2011 according to the latest Case-Shiller report as of October, 2011. At year-end 2011 economic metrics on retail sales, mortgage delinquencies, office vacancies, personal income and median family income indicated generally positive economic signals when compared to the other areas of the United States. Management believes that the regional economy has begun to turn around and is now in a position for further recovery and expansion. Management believes that as the economy continues to recover, growth opportunities will present themselves that the Company can take advantage of while adequately managing credit risk.

Loan and Lease Products

The Company currently offers a complete menu of loan and lease products primarily in our identified market footprint that are discussed in detail below and on the following pages. These following sections should be read in conjunction with the section "Credit Risk" on page 37 of this report.

Residential Real Estate Loans

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

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

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

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

Commercial Loans and Leases

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

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

Included in commercial loans are credits directly originated by the Company and syndicated transactions or loan participations that are originated by other lenders. The Company's commercial lending policy requires each loan, regardless of whether it is directly originated or is purchased, to have viable repayment sources. The risks associated with syndicated loans or purchased participations are similar to those of directly originated commercial loans, although additional risk may arise from the limited ability to control actions of the primary lender. Shared National Credits (SNC), as defined by the banking regulatory agencies, represent syndicated lending arrangements with three or more participating financial institutions and credit exceeding $20.0 million in the aggregate. As of December 31, 2011, the Company had $19.3 million in SNC purchased outstanding and no SNC sold outstanding. During 2011, the Company’s primary regulator completed its annual SNC examination. As a result of this review no action was required on the Company’s SNC participations.

The Company also sells participations in loans it originates to other financial institutions in order to build long-term customer relationships or limit loan concentration. Strict policies are in place governing the degree of risk assumed and volume of loans held. At December 31, 2011, other financial institutions had $2.2 million in outstanding commercial and commercial real estate loan participations sold by the Company, and the Company had $26.8 million in outstanding commercial and commercial real estate loan participations purchased from other lenders, excluding SNC.

The Company's commercial real estate loans consist of both loans secured by owner occupied properties and non-owner occupied where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. The commercial real estate category contains mortgage loans to developers and owners of commercial real estate. Commercial real estate loans are governed by the same lending policies and subject to credit risk as previously described for commercial loans. Commercial real estate loans secured by owner-occupied properties are based upon the borrower’s financial health and the ability of the borrower and the business to repay. The Company seeks to reduce the risks associated with commercial mortgage lending by generally lending in its market area, using conservative loan-to-value ratios and obtaining periodic financial statements and tax returns from borrowers to perform loan reviews. It is also the

Company's general policy to obtain personal guarantees from the principals of the borrowers and to underwrite the business entity from a cash flow perspective. Interest rate risks are mitigated by using either floating interest rates or by fixing rates for a short period of time, generally less than three years. While loan amortizations may be approved for up to 300 months, each loan generally has a call provision (maturity date) of five years or less.

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

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

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

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

Consumer Loans

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

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

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

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

Deposit Activities

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

One of the Company's primary objectives as a community bank is to develop long-term, multi-product customer relationships from its comprehensive menu of financial products. To that end, the lead product to develop such relationships is typically a deposit product. In 2009, the Company conducted a successful campaign to grow its deposit base. The Company has succeeded in retaining a large majority of this deposit growth that will be relied upon to fund long-term future loan growth as the economy recovers.

Treasury Activities

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

The primary objective of the investment portfolio is to provide the necessary liquidity consistent with anticipated levels of deposit funding and loan demand with a minimal level of risk. The short overall average duration of 3.1 years of the investment portfolio together with the types of investments (98% of the portfolio is rated AA or above) is intended to provide sufficient cash flows to support the Company's lending goals. Liquidity is also provided by lines of credit maintained with the Federal Home Loan Bank of Atlanta ("FHLB"), the Federal Reserve, and to a lesser extent, bank lines of credit.

Borrowing Activities

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

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

Employees

The Company and its subsidiaries employed 713 persons, including executive officers, loan and other banking and trust officers, branch personnel, and others at December 31, 2011. None of the Company's employees is represented by a union or covered under a collective bargaining agreement. Management of the Company considers its employee relations to be excellent.

Competition

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

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

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

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

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

Monetary Policy

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

Regulation, Supervision, and Governmental Policy

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

Bank Holding Company Regulation

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

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

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

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

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

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

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

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

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

Bank Regulation

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

The Federal Reserve regularly examines the operations and condition of the Bank, including, but not limited to, its capital adequacy, reserves, loans, investments, and management practices. These examinations are for the protection of the Bank's depositors and the Deposit Insurance Fund. In addition, the Bank is required to furnish quarterly and annual reports to the Federal Reserve. The Federal Reserve's enforcement authority includes the power to remove officers and directors and the authority to issue cease-and-desist orders to prevent a bank from engaging in unsafe or unsound practices or violating laws or regulations governing its business.

The Federal Reserve has adopted regulations regarding capital adequacy, which require member banks to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See "Regulatory Capital Requirements." Federal Reserve and State regulations limit the amount of dividends that the Bank may pay to the

Company. See “Note 11–Stockholders’ Equity” in the Notes to the Consolidated Financial Statements.

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

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

Sandy Spring Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. Under the Federal Deposit Insurance Corporation's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned. Assessment rates currently range from seven to 77-1/2 basis points. No institution may pay a dividend if in default of the federal deposit insurance assessment. Deposit insurance assessments are based on total assets less tangible equity. The Federal Deposit Insurance Corporation imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital, as of June 30, 2009 (capped at ten basis points of an institution's deposit assessment base), in order to cover losses to the Deposit Insurance Fund. That special assessment was collected on September 30, 2009. The Federal Deposit Insurance Corporation provided for similar assessments during the final two quarters of 2009, if deemed necessary. However, in lieu of further special assessments, the Federal Deposit Insurance Corporation required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which include an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, a charge to earnings will be recorded for each regular assessment with an offsetting credit to the prepaid asset. The Federal Deposit Insurance Corporation has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of Sandy Spring Bank. Management cannot predict what insurance assessment rates will be in the future.

Regulatory Capital Requirements

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

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

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to depository institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital as is currently the case with bank holding companies. Instruments issued prior to May 19, 2010 will be grandfathered for companies with consolidated assets of $15 billion or less.

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

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

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

Federal banking regulations also require banks with significant trading assets or liabilities to maintain supplemental risk-based capital based upon their levels of market risk. The Bank did not have significant levels of trading assets or liabilities during 2011 and was not required to maintain such supplemental capital.

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

The Federal Reserve has established regulations that classify banks by capital levels and provide for the Federal Reserve to take various "prompt corrective actions" to resolve the problems of any bank that fails to satisfy the capital standards. Under these regulations, a well-capitalized bank is one that is not subject to any regulatory order or directive to meet any specific capital level and that has a total risk-based capital ratio of 10% or more, a Tier 1 risk-based capital ratio of 6% or more, and a leverage ratio of 5% or more. An adequately capitalized bank is one that does not qualify as well-capitalized but meets or exceeds the following capital requirements: a total risk-based capital ratio of 8%, a Tier 1 risk-based capital ratio of 4%, and a leverage ratio of either (i) 4% or (ii) 3% if the bank has the highest composite examination rating. A bank that does not meet these standards is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized, depending on its capital levels. A bank that falls within any of the three undercapitalized categories established by the prompt corrective action regulation is subject to severe regulatory sanctions. As of December 31, 2011, the Bank was well-capitalized as defined in the Federal Reserve's regulations.

For information regarding the Company's and the Bank's compliance with their respective regulatory capital requirements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital Management" of this report, and "Note 10-Subordinated Debentures," and "Note 23 – Regulatory Matters" of the Notes to the Consolidated Financial Statements of this report.

Supervision and Regulation of Mortgage Banking Operations

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

Community Reinvestment

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

Bank Secrecy Act

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

Sarbanes-Oxley Act of 2002

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

Regulatory Restructuring Legislation

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

Many of the provisions of the Dodd-Frank Act contain delayed effective dates and/or require the issuance of regulations. As a result, it will be some time before their impact on operations can be assessed by management. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in an increased regulatory burden and higher compliance, operating, and possibly, interest costs for the Company and the Bank.

Other Laws and Regulations

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

Enforcement Actions

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

Executive Officers

The following listing sets forth the name, age (as of February 28, 2011), principal position and recent business experience of each executive officer:

R. Louis Caceres, 49, Executive Vice President of the Bank. Mr. Caceres was made Executive Vice President of the Bank in 2002. Prior to that, Mr. Caceres was a Senior Vice President of the Bank.

Ronald E. Kuykendall, 59, became Executive Vice President, General Counsel and Secretary of the Company and the Bank in 2002. Prior to that, Mr. Kuykendall was General Counsel and Secretary of the Company and Senior Vice President of the Bank.

Philip J. Mantua, CPA, 53, became Executive Vice President and Chief Financial Officer of the Company and the Bank in 2004. Prior to that, Mr. Mantua was Senior Vice President of Managerial Accounting.

Joseph J. O'Brien, Jr., 48, became Executive Vice President for Commercial and Retail Banking on January 1, 2011. Mr. O’Brien joined the Bank in July 2007 as Executive Vice President for Commercial Banking. Additionally, on January 1, 2008, he became president of the Northern Virginia Market. Prior to joining the Bank, Mr. O'Brien was an Executive Vice President and senior lender for a local banking institution.

Daniel J. Schrider, 47, became President of the Company and the Bank effective March 26, 2008 and Chief Executive Officer effective January 1, 2009. Prior to that, Mr. Schrider served as an Executive Vice President and Chief Revenue Officer of the Bank.

John D. Sadowski, 48, became Executive Vice President and Chief Information Officer of the Bank on February 1, 2011. Prior to that, Mr. Sadowski served as a Senior Vice President of the Bank.

Jeffrey A. Welch, 52, became an Executive Vice President and Chief Credit Officer of the Bank in 2008. Prior to joining the Bank, Mr. Welch served as a Senior Vice President of Commerce Bank.

Item 1A. RISK FACTORS

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

Changes in U.S. or regional economic conditions could have an adverse effect on the Company’s business, financial condition or results of operations.

The Company’s business activities and earnings are affected by general business conditions in the United States and in the local market area. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and in the Company’s market area in particular. The national economy recently experienced a recession, with rising unemployment levels, declines in real estate values and erosion in consumer confidence. Dramatic declines in the U.S. housing market over the past few years, with falling home prices and increasing foreclosures, have negatively affected the performance of mortgage loans and resulted in significant write-downs of asset values by many financial institutions. Continued elevated levels of unemployment, further declines in the values of real estate, or other events that affect household and/or corporate incomes could impair the ability of the Company's borrowers to repay their loans in accordance with their terms and reduce demand for banking products and services.

The geographic concentration of our operations makes the Company susceptible to downturns in local economic conditions.

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

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

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

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

At December 31, 2011, non-performing assets totaled $83.6 million, or 2.25%, of total assets, compared to non-performing assets of $97.7 million, or 2.78% of total assets at December 31, 2010. Non-performing assets adversely affect net income in various ways. Interest income is not recorded on non-accrual loans or other real estate owned. The Company must record a reserve for probable losses on loans and leases, which is established through a current period charge to the provision for loan and lease losses and from time to time and must write-down the value of properties in the Company's other real estate owned portfolio to reflect changing market values. Additionally, there are legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to other real estate owned. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from more profitable activity. Finally, if the estimate for the recorded allowance for loan and lease losses proves to be incorrect and the allowance is inadequate, the allowance will have to be increased and, as a result, Company earnings would be adversely affected. A further downturn in the Company's market areas could increase credit risk associated with the loan portfolio, as it could have a material adverse effect on both the ability of borrowers to repay loans as well as the value of the real property or other property held as collateral for such loans. There can be no assurance that non-performing loans will not experience an increase in the future, or that the Company's non-performing assets will not result in further losses in the future.

The Company may be subject to certain risks related to originating and selling mortgage loans.

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

Delays in the Company's ability to foreclose on delinquent mortgage loans may negatively impact the Company's business.

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

Changes in interest rates and other factors beyond the Company's control may adversely affect earnings and financial condition.

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

Changes in market interest rates are affected by many factors beyond the Company's control, including inflation, unemployment, money supply, international events, and events in world financial markets. The Company attempts to manage its risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest-earning assets and interest-bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on the net interest margin and results of operations. Changes in the market interest rates for types of products and services in various markets also may vary significantly from location to location and over time based upon competition and local or regional economic factors. At December 31, 2011, the Company's interest rate sensitivity simulation model projected that net interest income would decrease by 0.06% if interest rates immediately rose by 200 basis points. The results of an interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that the Company will be able to successfully manage interest rate risk.

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

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

The Company is subject to liquidity risks.

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

Potential impairment in the carrying value of goodwill could negatively impact the Company’s earnings.

At December 31, 2011, goodwill totaled $76.8 million. Goodwill is initially recorded at fair value and is not amortized, but is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. Given the current economic environment and conditions in the financial markets, there could be a requirement to evaluate the recoverability of goodwill prior to the normal annual assessment if there is a disruption in the Company’s business, unexpected significant declines in operating results, or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill impairment charges in the future, which would adversely affect the results of operations. A goodwill impairment charge does not adversely affect regulatory capital ratios or tangible capital. Based on an analyses, it was determined that the fair value of the Company’s reporting units exceeded the carrying value of their assets and liabilities and, therefore, goodwill was not considered impaired at December 31, 2011.

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

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

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

The market price for the Company's common stock has fluctuated, ranging between $13.89 and $19.64 per share during the 12 months ended December 31, 2011. The overall market and the price of the Company's common stock may experience volatility. There may be a significant impact on the market price for the common stock due to, among other things:

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

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

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

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

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

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

Competition may decrease the Company’s growth or profits.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Changes in accounting standards or interpretation of new or existing standards may affect how the Company reports its financial condition and results of operations.

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

Item 1B. Unresolved Staff Comments

None.

Item 2. PROPERTIES

The Company’s headquarters is located in Olney, Maryland. As of December 31, 2011, Sandy Spring Bank owned 13 of its 43 full-service community banking centers and leased the remaining banking centers. See Note 6 to the Notes to the Consolidated Financial Statements for additional information.

Item 3. LEGAL PROCEEDINGS

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Stock Listing

Common shares of Sandy Spring Bancorp, Inc. are listed on the NASDAQ Global Select Market under the symbol "SASR". At March 1, 2012 there were 2,480 holders of record of the Company's common stock.

Transfer Agent and Registrar

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

Dividends

The dividend amount is established by the board of directors each quarter. In making its decision on dividends, the board considers operating results, financial condition, capital adequacy, regulatory requirements, shareholder returns, and other factors. Shareholders received quarterly cash common dividends totaling $8.3 million in 2011 and $0.9 million in 2010. Dividends increased in 2011 over 2010 due to the Company's improved operating results.

Share Transactions with Employees

Shares issued under the employee stock purchase plan, which commenced on July 1, 2001, totaled 33,284 in 2011 and 33,826 in 2010, while issuances pursuant to exercises of stock options and grants of restricted stock were 32,890 and 45,975 in the respective years. Shares issued under the director stock purchase plan totaled 1,833 shares in 2011 and 3,709 shares in 2010.

Quarterly Stock Information

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

2011 Stock Price Range	Per Share	2010 Stock Price Range	Per Share

Quarter	Low	High	Dividend	Low	High	Dividend
1st	$16.19	$19.94	$ 0.08	$8.25	$15.13	$ 0.01
2nd	16.86	19.31	0.08	13.95	18.20	0.01
3rd	13.64	19.27	0.08	13.44	17.39	0.01
4th	13.96	18.78	0.10	15.27	18.75	0.01
Total			$ 0.34			$ 0.04

Issuer Purchases of Equity Securities

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. The Company repurchased 23,592 shares of common stock at an average price of $14.16 per share during the year ended December 31, 2011. The Company did not repurchase any shares of its common stock in the quarter ended December 31, 2011.

As a result of the continued participation in the TARP Capital Purchase Program during 2010, the Company was prohibited from repurchasing any shares of its common stock, other than in connection with the administration of an employee benefit plan, without the consent of the Treasury Department. Accordingly, no shares were repurchased during 2010.

Total Return Comparison

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the Standard and Poor's 500 Index or "S&P 500"), and a narrower index of Mid-Atlantic bank holding company peers with assets of $2 billion to $7 billion. The cumulative total return on the stock or the index equals the total increase in value since December 31, 2006, assuming reinvestment of all dividends paid into the stock or the index. The graph and table were prepared assuming that $100 was invested on December 31, 2006, in the common stock and the securities included in the indexes.

	December 31,					
Index	2006	2007	2008	2009	2010	2011
Sandy Spring Bancorp, Inc.	100.00	75.06	61.55	25.78	53.58	52.03
S&P 500	100.00	105.49	66.46	84.05	96.71	98.76
SASR Peer Group Index*	100.00	77.38	82.93	54.51	69.12	59.58

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

Equity Compensation Plans

The following table presents disclosure regarding equity compensation plans in existence at December 31, 2011, consisting only of the 1999 Stock Option Plan (expired but with outstanding options that may still be exercised) and the 2005 Omnibus Stock Plan, each of which was approved by the shareholders.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	635,197	$ 31.42	1,047,583
Equity compensation plans not approved by security holders	-	-	-
Total	635,197	$ 31.42	1,047,583

Item 6. Selected Financial Data

Consolidated Summary of Financial Results (Dollars in thousands, except per share data)	**2011**	2010	2009	2008	2007
Results of Operations:					
Tax-equivalent interest income	**$145,072**	$153,185	$160,069	$173,389	$186,481
Interest expense	**26,524**	32,742	51,522	60,386	76,149
Tax-equivalent net interest income	**118,548**	120,443	108,547	113,003	110,332
Tax-equivalent adjustment	**5,602**	4,836	4,839	4,544	5,506
Provision for loan and lease losses	**1,428**	25,908	76,762	33,192	4,094
Net interest income after provision for loan and lease losses	**111,518**	89,699	26,946	75,267	100,732
Non-interest income	**43,500**	43,782	43,356	45,525	44,123
Non-interest expenses	**105,071**	100,912	101,154	101,371	99,622
Income (loss) before taxes	**49,947**	32,569	(30,852)	19,421	45,233
Income tax expense (benefit)	**15,845**	9,049	(15,997)	3,642	12,971
Net income (loss)	**34,102**	23,520	(14,855)	15,779	32,262
Net income (loss) available to common stockholders	**34,102**	17,371	(19,655)	15,445	32,262
Per Share Data:					
Net income (loss) - basic per share	**$1.42**	$1.05	$(0.90)	$0.96	$2.01
Net income (loss) - basic per common share	**1.42**	0.78	(1.20)	0.94	2.01
Net income (loss) -diluted per share	**1.41**	1.05	(0.90)	0.96	2.01
Net income (loss) - diluted per common share	**1.41**	0.78	(1.20)	0.94	2.01
Dividends declared per common share	**0.34**	0.04	0.37	0.96	0.92
Book value per common share	**18.52**	16.95	17.80	19.05	19.31
Dividends declared to diluted net income per common share	**24.11%**	5.13%	(30.83)%	102.12%	45.77%
Period End Balances:					
Assets	**$3,711,370**	$3,519,388	$3,630,478	$3,313,638	$3,043,953
Investment securities	**1,164,699**	1,042,943	1,023,799	492,491	445,273
Loans and leases	**2,239,692**	2,156,232	2,298,010	2,490,646	2,277,031
Deposits	**2,656,520**	2,549,872	2,696,842	2,365,257	2,273,868
Borrowings	**584,021**	537,001	535,646	522,658	426,525
Stockholders' equity	**446,109**	407,569	373,586	391,862	315,640
Average Balances:					
Assets	**$3,581,566**	$3,612,988	$3,557,234	$3,152,586	$2,935,451
Investment securities	**1,129,981**	1,039,126	824,802	428,479	495,928

Loans and leases	**2,161,759**	2,236,885	2,416,470	2,420,040	2,113,476
Deposits	**2,614,220**	2,611,009	2,599,284	2,284,648	2,253,979
Borrowings	**518,784**	534,629	535,272	513,237	361,884
Stockholders' equity	**422,681**	441,195	389,221	324,995	290,224
Performance Ratios:					
Return on average assets	**0.95 %**	0.48 %	(0.55)%	0.49 %	1.10 %
Return on average common equity	**8.07**	4.56	(6.35)	4.84	11.12
Yield on average interest-earning assets	**4.37**	4.58	4.85	6.02	6.98
Rate on average interest-bearing liabilities	**1.06**	1.27	1.97	2.56	3.50
Net interest spread	**3.31**	3.31	2.88	3.46	3.48
Net interest margin	**3.57**	3.60	3.29	3.92	4.13
Efficiency ratio – GAAP (1)	**67.16**	63.31	68.78	65.83	66.88
Efficiency ratio – Non-GAAP (1)	**63.75**	60.36	64.37	59.69	61.87
Capital Ratios:					
Tier 1 leverage	**10.84 %**	10.30 %	9.09 %	11.00 %	8.87 %
Tier 1 capital to risk-weighted assets	**14.57**	14.11	12.01	12.56	10.28
Total regulatory capital to risk-weighted assets	**15.83**	15.37	13.27	13.82	11.28
Tangible common equity to tangible assets - Non-GAAP (2)	**9.68**	9.51	5.95	7.18	7.57
Average equity to average assets	**11.80**	12.21	10.94	10.31	9.89
Credit Quality Ratios:					
Allowance for loan losses to loans and leases	**2.21 %**	2.88 %	2.81 %	2.03 %	1.10 %
Non-performing loans to total loans	**3.53**	4.08	5.82	2.79	1.51
Non-performing assets to total assets	**2.25**	2.78	3.89	2.18	1.15
Net charge-offs to average loans and leases	**0.66**	1.27	2.61	0.32	0.06

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

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

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

Overview

Net income for the Sandy Spring Bancorp, Inc. and subsidiaries (the "Company") for the year ended December 31, 2011 totaled $34.1 million ($1.41 per diluted share), compared to net income of $23.5 million ($1.05 per diluted share) for the prior year. These results reflect the following events:

- The provision for loan and lease losses was a charge of $1.4 million for 2011 compared to a charge of $25.9 million for 2010. This declining trend was due mainly to a continuing lower level of historical net charge-offs, which is a principal component in the application of the Company's allowance methodology, together with a decline in non-performing assets.
- Average deposits for the year ended December 31, 2011 remained level compared to the prior year, reflecting an 11% increase in noninterest-bearing deposits that was offset by a 3% decrease in interest-bearing deposits compared to 2010. Deposit balances at December 31, 2011 increased 4% compared to the prior year end. This increase was driven mainly by a 15% increase in noninterest-bearing deposits.
- Average total loans for the year ended December 31, 2011 declined 3% compared to the prior year due largely to decreases in commercial business and consumer loans. However, total loans at December 31, 2011 increased 4% compared to the balance at December 31, 2010. This improvement, which occurred late in 2011, was driven primarily by growth in all commercial loan lines and residential mortgage loans and was partially offset by a decline in consumer loans.
- Net interest income decreased 2% in 2011 compared to the prior year. This general downward trend was due to record low market interest rates and a decline in average interest-earning assets as a result of new loan volume for the year that was insufficient to offset increased loan payoffs.

In 2011, the nation and the mid-Atlantic region in which the Company operates began to show positive, although often slow and uneven, economic momentum. Significant volatility continued in selected areas of the economy due to concerns over the United States budget deficit and the financial stability of several countries in Western Europe. The real estate market continued to struggle in the face of credit constraints which were only partially offset by declining mortgage rates and lower prices. Unemployment rates began to decline toward the end of the year but remain at historically high levels. Together with municipal budget deficits 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 economic recovery and expansion. Despite this challenging business environment, the Company has emphasized the fundamentals of community banking as it has maintained strong levels of liquidity and capital and overall credit quality has continued to improve.

The net interest margin decreased, although at a slower pace, to 3.57% in 2011 compared to 3.60% in 2010. This decrease was driven primarily by a decline in the average rates earned on interest-earning assets, which exceeded the decline in the average rates paid on interest-bearing liabilities, as historically low interest rates inhibited the Company's ability to further reduce the rates paid on deposits. This effect was somewhat mitigated by the growth in noninterest-bearing deposits during the year, which provided funding at no cost compared to the higher cost of borrowed funds. Average total deposits remained virtually level compared with the prior year while average loans declined 3% compared to 2010 due to the economic factors mentioned above.

A strong level of liquidity continued from previous years through the borrowing lines with the Federal Home Loan Bank of Atlanta and the Federal Reserve and the size and composition of the investment portfolio.

The Company's credit quality continued to improve during 2011 as non-performing assets decreased to $83.6 million from $97.7 million in 2010. This decrease was due primarily to the Company's aggressive efforts to resolve non-performing loans together with sales of other real estate owned. In addition, reduced migration of existing loans into nonperforming status, particularly in the commercial real estate portfolio, continued to positively affect the Company's credit metrics.

At December 31, 2011, the Company remained above all "well-capitalized" regulatory requirement levels. In addition, tangible book value per common share increased 7% over the prior year end from $13.59 to $14.58.

Total assets at December 31, 2011 increased 5% to $3.7 billion compared to December 31, 2010. Loan balances increased 4% compared to the prior year due primarily to increases of 7% in commercial loans and 6% in residential mortgage loans which were somewhat offset by a 5% decrease in consumer loans. Customer funding sources, which include deposits plus other short-term borrowings from core customers, increased 3% compared to balances at December 31, 2010. This increase was due primarily to increases of 15% in noninterest-bearing deposits, 13% in regular savings accounts and 16% in interest-bearing checking accounts. These increases were partially offset by a decline of 7% in certificates of deposit while money market accounts remained at a comparable level with the prior year end. The Company continued to manage its net interest margin, primarily by reducing rates on certificates of deposit, as clients emphasized safety and short term liquidity in the face of volatile equity markets and low interest rates. During the same period, stockholders' equity increased to $446.1 million or 12% of total assets due to net income and a significant increase in accumulated comprehensive income for the year resulting from higher unrealized gains on investments available-for-sale.

Net interest income decreased by $2.7 million, or 2% compared to the prior year. A decline of 21 basis points in the yield on average interest-earning assets together with a 1% decrease in the related average balances more than offset the combined effect of a 21 basis point decrease in the cost of interest-bearing liabilities, growth of 15% in noninterest-bearing deposits and a $14.2 million decrease in non-performing assets.

Non-interest income remained level for 2011 compared to 2010. Trust and investment management fees increased 16% over the prior year period due to higher average assets under management resulting primarily from new client additions. Fees on sales of investment products increased 8% due to an increase in managed assets and higher sales of financial products while income from Visa check transactions increased 9% as the volume of such transactions continued to increase. These increases were largely offset by a decrease in insurance commissions of 11% brought about by a change in the timing of the recognition of renewal premiums that was implemented in the first quarter of 2010. In addition, service charges on deposits declined 8% as a result of the impact of recently enacted legislation on overdraft fees and income from mortgage banking activities decreased 12% due primarily to lower accrued gains on mortgage commitments in 2011 compared to 2010.

Non-interest expenses increased 4% compared to the prior year due largely to a 7% increase in salaries and benefits expense. Other non-interest expense increased 8% due primarily to losses on sales of other real estate owned and loan work out expenses.

Non-performing assets decreased to $83.6 million at December 31, 2011 compared to $97.7 million at December 31, 2010. Non-performing assets represented 2.25% of total assets at December 31, 2011 compared to 2.78% at December 31, 2010. The ratio of net charge-offs to average loans and leases was .66% for 2011, compared to 1.27% for 2010.

Critical Accounting Policies

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

- Allowance for loan and lease losses;
- Goodwill impairment;
- Accounting for income taxes;
- Fair value measurements, including assessment of other than temporary impairment;
- Defined benefit pension plan.

Allowance for Loan and Lease Losses

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

Management believes that the allowance is adequate. However, its determination requires significant judgment, and estimates of probable losses in the lending portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions or reductions to the allowance may be necessary based on changes in the loans and leases comprising the portfolio and changes in the financial condition of borrowers, resulting from changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, and independent consultants engaged by the Company periodically review the loan and lease portfolio and the allowance. Such reviews may result in additional provisions based on their judgments of information available at the time of each examination.

The Company's allowance for loan and lease losses has two basic components: a general allowance reflecting historical losses by loan category, as adjusted by several factors whose effects are not reflected in historical loss ratios, and specific allowances for individually identified loans. Each of these components, and the allowance methodology used to establish them, are described in detail in Note 1 and Note 5 of the Notes to the Consolidated Financial Statements included in this report. The amount of the allowance is reviewed monthly by the Credit and Investment Risk Committee of the board of directors and formally approved quarterly by that same committee of the board.

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

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

The general allowance comprised 84% of the total allowance at December 31, 2011 and 94% at December 31, 2010. The general allowance is calculated in two parts based on an internal risk classification of loans within each portfolio segment. Allowances on loans considered to be "criticized" and "classified" under regulatory guidance are calculated separately from loans considered to be "pass" rated under the same guidance. This segregation allows the Company to monitor the allowance applicable to higher risk loans separate from the remainder of the portfolio in order to better manage risk and ensure the sufficiency of the allowance for loan and lease losses.

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

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

These factors combine to estimate the probability and severity of potential losses. At December 31, 2011, the specific allowance accounted for 16% of the total allowance as compared to 6% at December 31, 2010. The severity of estimated losses on impaired loans can differ substantially from actual losses.

Goodwill and Other Intangible Asset Impairment

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

Recently amended accounting guidance that provides the Company with the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Based on the assessment of these qualitative factors, if it is determined that the fair value of a reporting unit is not less than the carrying value, then performing the two-step impairment process, previously required, is unnecessary. However, if it is determined that the carrying value exceeds the fair value the first step, described above, of the two step process must be performed. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company has elected early adoption of this guidance in performing its annual impairment testing as of October 1, 2011 with respect to its community banking and investment management reporting units. With respect to its insurance reporting unit, the Company elected to engage a third-party valuation firm to determine the fair value of this reporting unit to utilize in the “step one” test for potential goodwill impairment. The company and the valuation firm determined that a combination of the income approach and the market approach were most appropriate in valuing the fair value of this unit and determined that the “step two test” for impairment was not necessary. At December 31, 2011 there was no evidence of impairment of goodwill or intangibles in any of the Company’s reporting units.

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

Accounting for Income Taxes

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

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

Fair Value Measurements

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

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

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

Defined Benefit Pension Plan

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

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

Consolidated Average Balances, Yields and Rates

	2011			2010			2009	
(Dollars in thousands and tax-equivalent)	Average Balances	(1) Interest	Annualized Average Yield/Rate	Average Balances	(1) Interest	Annualized Average Yield/Rate	Average Balances	(1) Inte
Assets								
Residential mortgage loans (2)	$457,886	$21,971	4.80%	$464,462	$24,838	5.35%	$471,221	$27
Residential construction loans	89,823	3,410	3.80	88,729	4,037	4.55	139,197	7,
Commercial ADC loans	149,571	6,819	4.56	157,879	6,459	4.09	221,863	7,
Commercial investor real estate loans	349,447	20,213	5.78	335,141	20,174	6.02	316,870	19
Commercial owner occupied real estate loans	511,692	30,197	5.90	512,008	30,820	6.02	527,221	32
Commercial business loans	229,825	11,344	4.94	264,281	13,329	5.04	305,170	15
Leasing	10,505	707	6.73	20,682	1,460	7.06	29,923	2,
Consumer loans	363,010	13,271	3.68	393,703	15,206	3.88	405,005	16
Total loans and leases (3)	2,161,759	107,932	5.00	2,236,885	116,323	5.20	2,416,470	12
Taxable securities	885,023	23,471	2.65	875,292	25,630	2.93	662,853	20
Tax-exempt securities (4)	244,958	13,590	5.55	163,834	11,052	6.75	161,949	11
Interest-bearing deposits with banks	30,270	77	0.25	69,755	177	0.25	56,980	14
Federal funds sold	1,337	2	0.14	1,773	3	0.17	2,045	3
Total interest-earning assets	3,323,347	145,072	4.37	3,347,539	153,185	4.58	3,300,297	16
Less: allowance for loan and lease losses	(56,770)			(69,393)			(59,961)	
Cash and due from banks	45,721			44,736			45,038	
Premises and equipment, net	49,047			48,738			50,649	
Other assets	220,221			241,368			221,211	
Total assets	$3,581,566			$3,612,988			$3,557,234	
Liabilities and Stockholders' Equity								
Interest-bearing demand deposits	$340,110	364	0.11%	$292,106	324	0.11%	$254,047	42
Regular savings deposits	184,050	183	0.10	165,032	164	0.10	152,383	21
Money market savings deposits	859,608	3,547	0.41	890,187	5,015	0.56	841,336	10
Time deposits	611,192	6,908	1.13	706,487	11,431	1.62	829,817	23
Total interest-bearing deposits	1,994,960	11,002	0.55	2,053,812	16,934	0.82	2,077,583	34
Other borrowings	78,207	212	0.27	89,932	269	0.30	88,198	30
Advances from FHLB	405,577	14,397	3.55	409,697	14,599	3.56	412,074	14
Subordinated debentures	35,000	913	2.61	35,000	940	2.69	35,000	1,
Total interest-bearing liabilities	2,513,744	26,524	1.06	2,588,441	32,742	1.27	2,612,855	51
Noninterest-bearing demand deposits	619,260			557,197			521,701	
Other liabilities	25,881			26,155			33,457	
Stockholders' equity	422,681			441,195			389,221	
Total liabilities and stockholders' equity	$3,581,566			$3,612,988			$3,557,234	
Net interest income and spread		$118,548	3.31%		$120,443	3.31%		$10

Less: tax-equivalent adjustment	5,602	4,836	4,
Net interest income	$112,946	$115,607	$10
Interest income/earning assets	4.37%	4.58%	
Interest expense/earning assets	0.80	0.98	
Net interest margin	3.57%	3.60%	

(1) Tax-equivalent income has been adjusted using the combined marginal federal and state rate of 39.88% for 2011, 2010 and 2009. The annualized taxable-equivalent adjustments utilized in the above table to compute yields aggregated to $5.6 million, $4.8 million and $4.8 million in 2011, 2010 and 2009, respectively.

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

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

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

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Net Interest Income

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

2011 vs. 2010

Net interest income for 2011 was $112.9 million compared to $115.6 million for 2010. On a tax-equivalent basis, net interest income decreased by 2% for 2011 to $118.5 million from $120.4 million for 2010. The preceding table provides an analysis of net interest income performance that reflects a net interest margin that decreased to 3.57% for 2011 compared to 3.60% for 2010. Average interest-earning assets decreased by 1% while average interest-bearing liabilities decreased 3% in 2011. Average noninterest-bearing deposits increased 11% in 2011 while the percentage of average noninterest-bearing deposits to total deposits also increased to 25% in 2011 compared to 23% in 2010.

2010 vs. 2009

Net interest income for 2010 was $115.6 million, representing an increase of $11.9 million or 11% from 2010. The increase in tax-equivalent net interest margin in 2010 resulted from declining rates paid on deposits which more than offset the decrease in yields on earning assets which was partially affected by a decrease in non-accrual loans. Average noninterest-bearing deposits increased 7% in 2010 while the percentage of average noninterest-bearing deposits to total deposits also increased to 23% in 2010 compared to 20% in 2009. On a tax-equivalent basis, net interest income increased by 11% in 2010 to $120.4 million from $108.5 million in 2009.

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:

	2011 vs. 2010			2010 vs. 2009		
	Increase Or	Due to Change In Average:*		Increase Or	Due to Change In Average:*	
(Dollars in thousands and tax equivalent)	(Decrease)	Volume	Rate	(Decrease)	Volume	Rate
Interest income from earning assets:						
Loans and leases	$(8,391)	$ (3,860)	$ (4,531)	$(11,343)	$ (9,360)	$ (1,983)
Securities	379	3,095	(2,716)	4,431	7,787	(3,356)

Other earning assets	(101)	(102)	1	28	32	(4)
Total interest income	(8,113)	(867)	(7,246)	(6,884)	(1,541)	(5,343)
Interest expense on funding of earning assets:						
Interest-bearing demand deposits	40	49	(9)	(96)	57	(153)
Regular savings deposits	19	20	(1)	(46)	16	(62)
Money market savings deposits	(1,468)	(170)	(1,298)	(5,710)	584	(6,294)
Time deposits	(4,523)	(1,395)	(3,128)	(12,135)	(3,115)	(9,020)
Total borrowings	(286)	(480)	194	(793)	(20)	(773)
Total interest expense	(6,218)	(1,976)	(4,242)	(18,780)	(2,478)	(16,302)
Net interest income	$(1,895)	$ 1,109	$ (3,004)	$11,896	$ 937	$ 10,959

* 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

2011 vs. 2010

The Company's total tax-equivalent interest income decreased by $8.1 million or 5% in 2011 compared to 2010. The previous table shows that, in 2011, the decrease in interest income resulted primarily from a decline in earning asset yields with respect to both the loan and investment portfolios and to some extent, a decrease in average loans and leases.

During 2011, the yield on average loans and leases decreased by 20 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. In addition, the average balance of the loan portfolio declined 3% in 2011 compared to the prior year as the volume of quality loan demand remained low due to the struggling economy. The decline in the portfolio yield was driven by decreases of 20 basis points in the yield on the consumer loan portfolio and 60 basis points on the residential mortgage loan portfolio together with a decrease of 6 basis points in the yield on the commercial loan portfolio. The decrease in the average balance of the loan portfolio was driven by declines in several segments of the portfolio, particularly commercial business loans, due to soft market demand, and consumer loans, due to pay downs of conventional second mortgage loans and installment loans.

The average yield on investment securities decreased 25 basis points while the average balance of the portfolio increased 9% or $90 million in 2011 compared to the prior year. The growth in investments was due to liquidity provided primarily by the decline in loan balances mentioned above. The decrease in the yield on investments was due to the fact that a significant portion of the portfolio is invested in amortizing securities that were replaced by lower yielding investments as a result of lower overall market rates.

2010 vs. 2009

Interest income decreased by $6.9 million or 4% in 2010 compared to 2009 due to a decrease in interest income resulting primarily from a decline in average interest-earning asset yields. This was partially offset by growth in average interest-earning assets. Average loans and leases, yielding 5.20% versus 5.28% a year earlier, decreased $179.6 million or 7%. The average residential real estate portfolio decreased 9% due mainly to a 36% decrease in residential construction loans while the average commercial loans and leases portfolio decreased 8% due largely to a 29% decrease in commercial ADC loans. The average consumer loan portfolio decreased 3% due to declines of 23% in installment loans and 20% in conventional second mortgage loans. In 2010, average loans and leases comprised 67% of average earning assets compared to a ratio of 73% in 2009. Average total investment securities, yielding 3.53% in 2010 versus 3.91% in the prior year, increased 26% to $1.0 billion. Average total investment securities comprised 31% of average earning assets in 2010 compared to 25% in 2009. The growth in average investment securities in 2010 was due mainly to the growth in deposits throughout 2009 resulting from the Company’s strategy to grow market share, and the decline in loans was due primarily to soft loan demand during 2010.

Interest Expense

2011 vs. 2010

Interest expense decreased by $6.2 million or 19% in 2011 compared to 2010, primarily as a result of a 21 basis point decrease in the average rate paid on deposits and borrowings, which decreased to 1.06% from 1.27%. Deposit activity during 2011 continued to be affected by a very slowly recovering economy and historically low interest rates. Average deposits remained virtually level as average certificates of deposit decreased $95 million or 13% compared to the prior year. This decrease was offset by an increase of $110 million or 13% in average noninterest-bearing and interest-bearing checking accounts as clients redeployed funds into short-term instruments to preserve liquidity. Average balances of money market accounts remained level during 2011 compared to the prior year. During 2011, the Company continued to preserve its net interest margin in the face of reduced loan volumes as it reduced rates on higher cost certificates of deposit thus prompting growth in noninterest-bearing checking accounts. Much of this decrease, particularly in time deposits, was incurred with single product clients, and thus did not significantly affect clients with multiple product relationships.

2010 vs. 2009

Interest expense decreased by 36% or $18.8 million in 2010, compared to 2009, primarily as a result of a 70 basis point decrease in the average rate paid on deposits and borrowings, which decreased to 1.27% from 1.97%. Deposit and borrowing activity during 2010 continued to be driven by challenging market conditions as both the national and regional economy began a very slow and uneven recovery. Through a major deposit growth campaign in 2009, the Company saw strong growth in its deposit market share. During 2010, the Company experienced a planned decline in deposits as it managed its net interest margin through reductions in rates. Much of this decrease, particularly in time deposits, was incurred with single product clients, and thus did not significantly affect clients with multiple product relationships. Most of this growth in deposits was deployed into investment securities to provide the necessary liquidity should loan demand increase in the future.

Interest Rate Performance

2011 vs. 2010

The declining trend in the net interest margin narrowed to a decrease of only 3 basis points in 2011 compared to 2010, as the net interest spread remained even in 2011 compared to 2010. These two indicators of interest rate performance reflected a decline of 21 basis points in both the yield on interest-earning assets and the rates paid on interest-bearing liabilities.

2010 vs. 2009

The net interest margin increased by 31 basis points in 2010 compared to 2009, as compared to an increase in net interest spread of 43 basis points in 2010 compared to 2009. The increase in these two indicators of interest rate performance was due primarily to the decrease in rates paid on interest-bearing liabilities of 70 basis points which more than offset the decline in yield on interest-earning assets of 27 basis points together with an increase in noninterest-bearing demand deposits.

Non-interest Income

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

(Dollars in thousands)	2011	2010	2009	2011/2010 $ Change	**2011/2010 % Change**	2010/2009 $ Change	2010/2009 % Change
Securities gains	$292	$796	$418	$(504)	**(63.3)%**	$378	90.2%
Total other-than-temporary impairment ("OTTI") losses	(178)	(1,505)	-	1,327	**(88.2)**	(1,505)	-
Portion of OTTI losses recognized in other comprehensive income	18	993	-	(975)	**(98.2)**	993	-
before taxes Net OTTI recognized in earnings	(160)	(512)	-	352	**(68.8)**	(512)	-
Service charges on deposit accounts	9,527	10,326	11,433	(799)	**(7.7)**	(1,107)	(9.7)
Gains on sales of mortgage loans	3,228	3,664	3,473	(436)	**(11.9)**	191	5.5
Fees on sales of investment products	3,703	3,438	2,823	265	**7.7**	615	21.8
Trust and investment management fees	11,943	10,287	9,421	1,656	**16.1**	866	9.2
Insurance agency commissions	4,650	5,229	5,236	(579)	**(11.1)**	(7)	(0.1)
Income from bank owned life insurance	2,636	2,800	2,906	(164)	**(5.9)**	(106)	(3.6)
Visa check fees	3,637	3,325	2,920	312	**9.4**	405	13.9
Letter of credit fees	1,123	1,019	567	104	**10.2**	452	79.7
Extension fees	406	594	793	(188)	**(31.6)**	(199)	(25.1)
Other income	2,515	2,816	3,366	(301)	**(10.7)**	(550)	(16.3)
Total non-interest income	$43,500	$43,782	$43,356	$(282)	**(0.6)**	$426	1.0

2011 vs. 2010

Total non-interest income was $43.5 million in 2011 compared to $43.8 million in 2010. As shown in the table above, the primary drivers of non-interest income for 2011 were decreases in service charges on deposits, insurance agency commissions and income from mortgage banking activities, which were largely offset by increases in wealth management revenues, comprised of trust and investment management fees and fees on sales on investment products, together with a continued increase in Visa check fees.

Service charges on deposits declined due primarily to a decrease in overdraft fees due in large part to the impact of recently enacted legislation on overdraft and other fees. Insurance agency commission revenue declined in 2011 compared to 2010 due mainly to a change in the timing of the recognition of renewal premiums that was implemented in the first quarter of 2010. Income from mortgage banking activities decreased compared to the prior year due primarily to lower accrued gains on mortgage commitments in 2011 compared to 2010.

Income from bank owned life insurance decreased 6% in 2011 compared to 2010 due primarily to declining market interest rates. The Company invests in bank owned life insurance products in order to better manage the cost of employee benefit plans. Investments totaled $81.1 million at December 31, 2011 and $78.5 million at December 31, 2010 and were well diversified by carrier in accordance with defined policies and practices. The average tax-equivalent yield on these insurance contract assets was 5.50% for 2011 compared to 6.05% for 2010.

Wealth management revenues increased compared to the prior year due to increases in both trust and investment management fees and fees on sales of investment products. During 2011, investment management fees in West Financial Services increased 7% to $5.4 million due to higher average assets under management as a result of market activity and new client additions. Trust services fees increased 25% to $6.5 million compared to the prior year due also to an increase in average assets under management, largely from new client additions. Total assets under management for West Financial Services, trust and investment services increased $157.7 million or 8% to $2.1 billion at December 31, 2011 compared to $1.9 billion at December 31, 2010.

Net OTTI losses recognized in earnings in 2011 declined compared to 2010 due largely to improved performance by the banks and thrifts whose debt backs one pooled trust preferred security which was solely responsible for all OTTI charges during 2011 and 2010. The Company recognized net securities gains of $0.3 million in 2011 compared to $0.8 million in 2010, exclusive of net OTTI losses mentioned above.

2010 vs. 2009

Total non-interest income was $43.8 million in 2010, a 1% increase from 2009. The primary reasons for the increase in non-interest income for 2010, as compared to 2009 were a 12% increase in wealth management revenues due to increased assets under management and a 14% increase in Visa check fees due to a higher volume of electronic transactions. These increases were somewhat offset by a 10% decrease in service charges on deposits due to lower commercial analysis fees and return check charges. The Company recognized securities gains of $0.8 million in 2010 compared to $0.4 million in 2009, exclusive of other-than-temporary impairment recognized in earnings.

Non-interest Expense

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

(Dollars in thousands)	2011	2010	2009	2011/2010 $ Change	2011/2010 % Change	2010/2009 $ Change	2010/2009 % Change
Salaries and employee benefits	$59,625	$55,470	$54,460	$ 4,155	7.5 %	$ 1,010	1.9 %
Occupancy expense of premises	11,519	11,477	10,710	42	0.4	767	7.2
Equipment expenses	4,705	4,808	5,691	(103)	(2.1)	(883)	(15.5)
Marketing	2,389	2,359	2,166	30	1.3	193	8.9
Outside data services	4,159	3,992	3,721	167	4.2	271	7.3
FDIC insurance	3,187	4,497	6,092	(1,310)	(29.1)	(1,595)	(26.2)
Amortization of intangible assets	1,845	1,959	3,646	(114)	(5.8)	(1,687)	(46.3)
Professional fees	4,942	5,586	4,863	(644)	(11.5)	723	14.9
Other real estate owned	2,412	976	46	1,436	147.1	930	-
Postage and delivery	1,257	1,328	1,373	(71)	(5.3)	(45)	(3.3)
Communications	1,433	1,433	1,270	-	-	163	12.8
Other expenses	7,598	7,027	7,116	571	8.1	(89)	(1.3)
Total non-interest expense	$105,071	$100,912	$101,154	$ 4,159	4.1	$ (242)	(0.2)

2011 vs. 2010

Non-interest expenses totaled $105.1 million in 2011 compared to $100.9 million in the prior year, an increase of 4%. This growth in expenses was due primarily to an increase in salaries and benefits expenses resulting from higher salary and incentive compensation expenses and other real estate owned expenses. These increases were partially offset by a reduction in FDIC expenses due primarily to a regulatory change in the calculation of such premiums that was effective with the second quarter of 2011.

Salaries and employee benefits, the largest component of non-interest expenses, increased in 2011 due primarily to higher compensation expenses as a result of specific targeted staff additions, merit increases and higher incentive compensation expenses related to organic growth in specific product offerings compared to the prior year. Average full-time equivalent employees remained relatively constant from 2010 to 2011.

Occupancy, equipment and marketing expenses all remained virtually level in 2011 compared to 2010, while outside data services expenses increased in 2011 due primarily to increased transaction volumes.

Amortization of intangible assets decreased due to intangibles that became fully amortized during the year. The Company's intangible assets are being amortized over relatively short amortization periods averaging approximately three years at December 31, 2011.

FDIC insurance expense decreased in 2011 compared to 2010 due to a regulatory change in the calculation of such premiums that was effective with the second quarter of 2011.

Professional fees declined in the current year as the Company completed the staffing of its internal audit function which had previously been outsourced.

Other real estate owned expenses increased in 2011 compared to 2010 due to losses on sales of other real estate owned as the Company made a concerted effort to dispose of such nonperforming assets. Other non-interest expenses increased compared to 2010 due mainly to higher personnel recruiting expenses and increased state franchise taxes.

2010 vs. 2009

Non-interest expenses remained virtually level for the year ended December 31, 2010 compared to 2009. Salaries and benefits expenses increased in 2010 due primarily to higher salary expenses as a result of merit increases and severance payments. Average full-time equivalent employees remained relatively constant from 2009 to 2010. Occupancy expense increased in 2010 compared to the prior year due mainly to higher rent and maintenance expenses. Marketing expenses also increased in 2010 compared to 2009 due primarily to higher advertising expenses. Outside data services expenses increased in 2010 due to increased transaction volumes. Professional fees increased over 2009 due to higher legal fees from loan workouts. Other real estate owned expense increased due primarily to higher losses on sales of other real estate owned as the Company disposed of such nonperforming assets. Other non-interest expenses remained virtually level in 2010 compared to 2009.

The above increases were offset by decreases in equipment expenses due primarily to reductions in depreciation expense and servicing expenses on equipment and a decrease in FDIC insurance expense due to a one-time special assessment in 2009. Amortization of intangible assets decreased in 2010 compared to 2009 due to certain intangibles from branch acquisitions that had fully amortized as of September, 2009.

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 Measure

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 efficiency ratios increased in 2011 as a result of increasing non-interest expenses and a decline in net interest income.

GAAP and Non-GAAP Efficiency Ratios

	Year ended December 31,				
(Dollars in thousands)	2011	2010	2009	2008	2007
GAAP efficiency ratio:					
Non-interest expenses	$105,071	$100,912	$101,154	$101,371	$99,622
Net interest income plus non-interest income	$156,446	$159,389	$147,064	$153,984	$148,949
Efficiency ratio–GAAP	67.16 %	63.31 %	68.78 %	65.83 %	66.88 %
Non-GAAP efficiency ratio:					
Non-interest expenses	$105,071	$100,912	$101,154	$101,371	$99,622
Less non-GAAP adjustment:					

Amortization of intangible assets	1,845	1,959	3,646	4,447	4,080
Goodwill impairment loss	-	-	-	4,159	-
Plus non-GAAP adjustment:					
Pension prior service credit	-	-	-	1,473	-
Non-interest expenses as adjusted	$103,226	$98,953	$97,508	$94,238	$95,542
Net interest income plus non-interest income	$156,446	$159,389	$147,064	$153,984	$148,949
Plus non-GAAP adjustment:					
Tax-equivalent income	5,602	4,836	4,839	4,544	5,506
Less non-GAAP adjustments:					
Securities gains	292	796	418	663	43
OTTI recognized in earnings	(160)	(512)	-	-	-
Net interest income plus non-interest income - as adjusted	$161,916	$163,941	$151,485	$157,865	$154,412
Efficiency ratio–Non-GAAP	63.75 %	60.36 %	64.37 %	59.70 %	61.87 %

Income Taxes

The Company had income tax expense of $15.8 million in 2011, compared to expense of $9.0 million in 2010 and an income tax benefit of $16.0 million in 2009. The resulting effective rates were 32% for 2011, 28% for 2010 and 52% for 2009.The increase in the effective tax rate in 2011 was due primarily to a higher proportion of income before taxes in 2011 that was taxed at the full statutory rate compared to tax exempt income, together with an income tax benefit on a loss before income taxes in the first quarter of 2010. The change in the effective rate for 2010 compared to 2009 was due mainly to the change in the proportion of tax exempt income to total income before taxes caused by the Company's return to profitability in 2010 and the loss incurred in 2009, primarily related to the provision for loan and lease losses, coupled with tax advantaged income from investment securities and bank owned life insurance policies.

FINANCIAL CONDITION

The Company's total assets were $3.7 billion at December 31, 2011, increasing $192 million or 5% compared to $3.5 billion at December 31, 2010. Interest-earning assets increased $212 million to $3.5 billion at December 31, 2011 compared to December 31, 2010. Asset growth, which was primarily due to growth in the loan and investment portfolios, was funded by increases in demand deposits and temporary short-term borrowings.

Loans and Leases

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

	December 31, 2011		December 31, 2010		2011/2010 Change	
(Dollars in thousands)	Amount	%	Amount	%	$ Change	% Change
Residential real estate:						
Residential mortgage	$448,662	20.0 %	$436,534	20.3 %	$12,128	2.8 %
Residential construction	108,699	4.9	91,273	4.2	17,426	19.1
Commercial real estate:						
Commercial owner occupied real estate	522,076	23.3	503,286	23.4	18,790	3.7
Commercial investor real estate	371,948	16.6	327,782	15.2	44,166	13.5
Commercial acquisition, development and construction	160,946	7.2	151,061	7.0	9,885	6.5
Commercial Business	260,327	11.6	250,255	11.6	10,072	4.0
Leases	6,954	0.3	15,551	0.7	(8,597)	(55.3)
Consumer	360,080	16.1	380,490	17.6	(20,410)	(5.4)
Total loans and leases	$2,239,692	100.0%	$2,156,232	100.0%	$83,460	3.9

Total loans and leases, excluding loans held for sale, increased 4% at December 31, 2011 compared to December 31, 2010. The residential real estate portfolio, which is comprised of residential construction and permanent residential mortgage loans, reflected a 6% increase to $557.4 million at December 31, 2011 from $527.8 million at December 31,

2010. Permanent residential mortgages, most of which are 1-4 family, increased $12.1 million to $448.7 million due to higher loan origination volumes of adjustable rate mortgage loans and the reclassification to this portfolio of $11 million of loans from the conventional second mortgage portfolio in early 2011. 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 $17.4 million to $108.7 million at December 31, 2011.

The commercial loan portfolio increased by $82.9 million to $1.3 billion at December 31, 2011 compared to the prior year end. Continued soft loan demand resulting from weak market conditions in both the national and regional economies have limited growth in commercial loan balances as pay-offs of performing credits outpaced new originations for much of the year, although substantial loan growth did occur during the fourth quarter of 2011. Activity in the commercial loan portfolio reflects the uneven recovery in the regional economy in which the Company operates. The increase in commercial loans compared to the prior year was due primarily to an increase of $44.2 million or 13% in commercial investor real estate loans while commercial owner occupied real estate loans reflected a more limited increase of $18.8 million or 4% for the year. In addition, commercial business loans increased $10.1 million or 4% for the twelve months while commercial ADC loans increased $9.9 million or 7% at December 31, 2011 compared to December 31, 2010.

The consumer loan portfolio decreased 5% or $20.4 million, to $360.1 million at December 31, 2011. This decline was driven largely by a decrease of $22.1 million or 43% in conventional second mortgage loans during the year resulting in a balance of $29.4 million at December 31, 2011 due largely to weak consumer demand and the reclassification of loans to the residential mortgage portfolio mentioned previously.

Analysis of Loans and Leases

The following table presents the trends in the composition of the loan and lease portfolio over the previous five years.

	December 31,									
(Dollars in thousands)	2011	%	2010	%	2009	%	2008	%	2007	%
Residential real estate:										
Residential mortgage	$448,662	**20.0**%	$436,534	20.2%	$457,414	19.9%	$457,571	18.4%	$456,305	20.0%
Residential construction	108,699	4.9	91,273	4.2	92,283	4.0	189,249	7.6	166,981	7.4
Commercial real estate:										
Commercial mortgage*	894,024	39.9	831,068	38.6	894,951	39.0	847,452	34.0	662,837	29.1
Commercial AD&C*	160,946									