FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended March 31, 2014

FDIC Insurance Cert. Number: 35095

TOWNEBANK

(Exact name of registrant as specified in its charter)

VIRGINIA	54-1910608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5716 High Street, Portsmouth, Virginia	23703
(Address of principal executive offices)	(Zip Code)

(757) 638-7500
(Registrant's telephone number, including area code)

No Change
(Former name, former address and former fiscal year, if changed since last report)

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.
Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

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

The number of shares of the Company's common stock outstanding as of April 30, 2014 was 35,305,367 shares.

TOWNEBANK

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED BALANCE SHEETS (unaudited)

(In thousands, except share data)	March 31, 2014	March 31, 2013	December 31, 2013
	(unaudited)	(unaudited)	(audited)
ASSETS			
Cash and due from banks	$ 235,984	$ 260,493	$ 203,782
Interest bearing deposits in financial institutions	1,000	1,494	1,011
Total Cash and Cash Equivalents	236,984	261,987	204,793
Securities available for sale, at fair value	551,797	269,539	543,521
Securities held to maturity, at amortized cost	232,879	155,317	204,348
Trading account securities	—	13,383	—
Federal Home Loan Bank stock, at amortized cost	21,987	22,387	23,069
Total Securities	806,663	460,626	770,938
Mortgage loans held for sale	57,745	113,679	58,642
Loans, net of unearned income and deferred costs:			
Real estate-residential 1-4 family	810,145	756,898	797,723
Real estate-commercial	1,395,369	1,290,183	1,365,572
Real estate-construction and land development	469,841	570,005	469,679
Real estate-multi-family	50,014	62,431	53,562
Commercial and industrial business	495,576	436,578	500,755
Consumer and other loans	48,417	42,030	48,698
Loans, net of unearned income and deferred costs	3,269,362	3,158,125	3,235,989
Less: Allowance for loan losses	(37,543)	(40,649)	(38,380)
Net Loans	3,231,819	3,117,476	3,197,609
Premises and equipment, net	152,976	146,579	153,436
Goodwill	104,508	102,912	104,446
Other intangible assets, net	15,084	15,567	15,615
Bank-owned life insurance policies	57,567	55,802	57,372
Other assets	111,888	100,536	110,146
TOTAL ASSETS	$ 4,775,234	$ 4,375,164	$ 4,672,997
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 1,090,273	$ 1,012,715	$ 1,037,028
Interest-bearing:			
Demand and money market accounts	1,303,207	1,131,936	1,240,949
Savings	197,892	209,629	321,103
Certificates of deposit	1,090,337	988,653	968,024
Total Deposits	3,681,709	3,342,933	3,567,104
Advances from the Federal Home Loan Bank	394,855	380,000	395,087
Repurchase agreements and other borrowings	31,571	13,768	47,659
Total Borrowings	426,426	393,768	442,746
Other liabilities	73,693	71,562	77,828
TOTAL LIABILITIES	4,181,828	3,808,263	4,087,678
Shareholders' Equity			
Preferred stock: 2,000,000 shares authorized 76,458; 652,959; and 76,458 shares issued at March 31, 2014 and 2013 and December 31, 2013, respectively	76,458	133,809	76,458
Common stock, $1.667 par: 45,000,000 shares authorized 35,312,537; 32,093,755; and 35,306,281 shares issued at March 31, 2014 and 2013 and December 31, 2013, respectively	58,866	53,500	58,856
Capital surplus	313,272	261,217	312,812
Retained earnings	135,936	110,065	128,527
Common stock issued to deferred compensation trust, at cost 571,101; 497,109; and 558,638 shares at March 31, 2014 and 2013 and December 31, 2013, respectively	(8,782)	(7,702)	(8,595)
Deferred compensation trust	8,782	7,702	8,595
Accumulated other comprehensive income (loss)	(112)	862	(344)
TOTAL SHAREHOLDERS' EQUITY	584,420	559,453	576,309
Noncontrolling interests	8,986	7,448	9,010
TOTAL EQUITY	593,406	566,901	585,319
TOTAL LIABILITIES AND EQUITY	$ 4,775,234	$ 4,375,164	$ 4,672,997

The accompanying notes are an integral part of these financial statements.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(Dollars in thousands, except per share data)	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
INTEREST INCOME:		
Loans, including fees	$ 38,207	$ 38,551
Investment securities	2,992	2,280
Interest bearing deposits in financial institutions and federal funds sold	207	169
Mortgage loans held for sale	428	903
Total Interest Income	41,834	41,903
INTEREST EXPENSE:		
Deposits	3,342	3,496
Advances from the Federal Home Loan Bank	3,285	3,182
Repurchase agreements and other borrowings	15	15
Total Interest Expense	6,642	6,693
Net Interest Income	35,192	35,210
PROVISION FOR LOAN LOSSES	330	3,571
Net Interest Income after Provision for Loan Losses	34,862	31,639
NONINTEREST INCOME:		
Residential mortgage banking income, net	5,062	7,818
Real estate brokerage and property management income, net	3,292	3,372
Insurance commissions and other title fees and income, net	9,061	7,982
Service charges on deposit accounts	2,131	2,030
Credit card merchant fees, net	773	853
Other income	2,408	1,700
Net gain on investment securities	2	604
Total Noninterest Income	22,729	24,359
NONINTEREST EXPENSE:		
Salaries and employee benefits	23,396	23,626
Occupancy expense	4,176	3,772
Furniture and equipment	2,000	1,723
Other expenses	11,509	11,475
Total Noninterest Expense	41,081	40,596
Income before income tax expense and noncontrolling interest	16,510	15,402
Provision for income tax expense	4,905	4,366
Net income	11,605	11,036
Net income attributable to noncontrolling interest	(474)	(564)
Net income attributable to TowneBank	$ 11,131	$ 10,472
Preferred stock dividends	191	1,352
Net income available to common shareholders	$ 10,940	$ 9,120
Per common share information		
Basic earnings	$ 0.31	$ 0.29
Diluted earnings	$ 0.31	$ 0.29
Cash dividends declared	$ 0.10	$ 0.09

The accompanying notes are an integral part of these financial statements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(Dollars in thousands)	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Net income	$ 11,605	$ 11,036
Other comprehensive income		
Unrealized gains on securities		
Unrealized holding gains arising during the period	359	8
Deferred tax expense	(126)	(3)
Realized gains reclassified into earnings	(2)	—
Deferred tax benefit	1	—
Net unrealized gains	232	5
Defined benefit retirement plan		
Amortization	—	63
Deferred tax expense	—	(22)
Change in defined benefit retirement plan, net of tax	—	41
Other comprehensive income, net of tax	232	46
Comprehensive income	$ 11,837	$ 11,082

The accompanying notes are an integral part of these financial statements.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED STATEMENTS OF CASH FLOW (unaudited)

(Dollars in thousands)	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
OPERATING ACTIVITIES:		
Net income	$ 11,605	$ 11,036
Adjustments to reconcile net income to net cash from operating activities:		
Net amortization of securities	775	979
Investment securities gains	(2)	(604)
Depreciation, amortization, and other intangible amortization	3,288	3,014
Provision for loan losses	330	3,571
Bank-owned life insurance income	(487)	(423)
Deferred income tax benefit	(83)	(394)
Share-based compensation expense	580	219
Purchases of trading account securities	—	(197)
Originations of mortgage loans held for sale	(185,743)	(326,780)
Proceeds from sales of mortgage loans held for sale	192,961	359,796
Gain on sales of mortgage loans held for sale	(6,321)	(10,306)
Loss on sale and write-down of foreclosed assets	45	495
Changes in:		
Interest receivable	362	595
Other assets	(4,823)	(20,386)
Interest payable	(14)	(1,115)
Other liabilities	(3,603)	(4,137)
Net cash from operating activities	8,870	15,363
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(226,598)	(130,828)
Purchase of held-to-maturity securities	(31,792)	(6,911)
Sale of available-for-sale securities	305	—
Sale of FHLB stock	1,082	—
Proceeds from maturities, calls, and prepayments of available-for-sale securities	217,638	311,332
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	3,225	7,040
Net increase in loans	(34,540)	(27,967)
Purchase of premises and equipment	(2,322)	(4,240)
Proceeds from sales of premises and equipment	24	110
Proceeds from sales of foreclosed assets	2,862	5,541
Net cash from (used for) investing activities	(70,116)	154,077
FINANCING ACTIVITIES:		
Net increase (decrease) in deposit accounts	114,605	(37,119)
Net change in borrowings	(16,757)	1,894
Distribution of interest in joint ventures	(498)	(85)
Proceeds (payments) from issuance of common stock	(190)	(84)
Cash dividends paid	(3,723)	(1,352)
Net cash from (used for) financing activities	93,437	(36,746)
Change in cash and cash equivalents	32,191	132,694
Cash and cash equivalents at beginning of year	204,793	129,293
Cash and cash equivalents at end of period	$ 236,984	$ 261,987
Supplemental cash flow information:		
Cash paid for interest	$ 6,656	$ 7,055
Cash paid for income taxes	$ 116	$ 591
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	$ 5,230	$ 24,635
Sales of foreclosed assets financed by the Company	$ 696	$ 2,786
Net unrealized loss on available-for-sale securities	$ 232	$ 5
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 80	$ —

The accompanying notes are an integral part of these financial statements.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED STATEMENT OF EQUITY

(Dollars in thousands)	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non controlling Interests	Total
Balance, January 1, 2014	**35,306,281**	**$ 76,458**	**$ 58,856**	**$ 312,812**	**$ 128,527**	**$ 8,595**	**$ (8,595)**	**$ (344)**	**$ 9,010**	**$585,319**
Net income	—	—	—	—	11,131	—	—	—	474	11,605
Other comprehensive income, net of taxes	—	—	—	—	—	—	—	232	—	232
Cash dividends declared on common stock	—	—	—	—	(3,531)	—	—	—	—	(3,531)
Cash dividends declared on preferred stock	—	—	—	—	(191)	—	—	—	—	(191)
Director's deferred compensation	—	—	—	—	—	187	(187)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	—	(498)	(498)
Conversion of convertible debt into common stock	5,557	—	10	70	—	—	—	—	—	80
Issuance of common stock - stock compensation plans	699	—	—	390	—	—	—	—	—	390
Balance, March 31, 2014	**35,312,537**	**$ 76,458**	**$ 58,866**	**$ 313,272**	**$ 135,936**	**$ 8,782**	**$ (8,782)**	**$ (112)**	**$ 8,986**	**$593,406**

The accompanying notes are an integral part of these financial statements.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of TowneBank (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes required by accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments, which are of a normal, recurring nature, that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01 of the Securities and Exchange Commission (the "SEC"). These statements should be read in conjunction with the Company's 2013 audited Consolidated Financial Statements and the 2013 Annual Report on Form 10-K. Results of operations for the period ended March 31, 2014 are not necessarily indicative of the results of operations for the full year or any other interim periods.

Reclassifications and corrections

To maintain consistency and comparability, certain amounts from prior periods have been reclassified to conform to current period presentation with no effect on net income or shareholders' equity as previously reported. The Company has a directors' deferred compensation plan whereby all deferred compensation is invested in the Company's common stock and is held in a rabbi trust. The stock is held in nominee name of the trustee, and the principal and earnings of the trust are held separate and apart from other funds of the Company, and are used exclusively for the uses and purposes of the deferred compensation agreement. The accounts of the trust have been consolidated in the financial statements of the Company with common stock reported separately in a manner similar to treasury stock (that is, changes in fair value are not recognized) and a corresponding deferred compensation obligation shown as a separate component of shareholders, equity. Previously, the cumulative deferred compensation obligation and corresponding common stock were netted within the common stock and additional paid-in capital line items. This reclassification had no effect on total shareholders' equity.

The Company determined that a note disclosure to its previously issued consolidated financial statements for the year ended December 31, 2013 included in its Annual Report on Form 10-K for the year ended December 31, 2013 contained an immaterial error. The Company previously disclosed its estimated fair value for its industrial revenue bonds in its investment portfolio in the held-to-maturity category as $135.25 million with gross unrealized gains of $2.79 million and gross unrealized losses of $12.75 million. Due to corrections to certain cash flow attributes, the Company revised the estimated fair value of the industrial revenue bonds to $147.82 million with gross unrealized gains of $4.29 million and gross unrealized losses of $1.67 million. The revision had the effect of changing the total held-to-maturity investment portfolio estimated fair value from $195.71 million to $208.29 million. This revision had no effect on the Company's consolidated balance sheets, consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of equity or consolidated statements of cash flows as of or for the year ended December 31, 2013. Due to the immaterial nature of the correction, the Company is presenting the corrected balances prospectively in the disclosures of the fair value of its investment portfolio as of December 31, 2013.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. Under ASU No. 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income ("AOCI") by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU No. 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 was effective for the Company on January 1, 2013 and resulted in additional disclosures.

In July 2013, the FASB issued ASU N0. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The amendments in ASU 2013-11 to Topic 740, *Income Taxes*, provide guidance on the financial statement presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this ASU did not have a material impact on the Company's financial statements.

In January 2014, the FASB issued ASU No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*. The amendments in ASU No. 2014-01 to Topic 323, *Equity Investments and Joint Ventures*, permit an accounting policy election to account for investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The decision to apply the proportional amortization method of accounting is an accounting policy election that should be applied consistently to all qualifying affordable housing project investments. This guidance is effective for annual periods, and interim reporting periods within those annual periods, beginning after December 15, 2014. This guidance should be applied retrospectively to all periods presented. Early adoption is permitted. The Company early adopted this ASU as of January 1, 2014. Previously, investments in qualified affordable housing projects were accounted for under the equity method, however, the Company believes the proportional amortization method better represents the nature and economics of the investments. It is being adopted prospectively, as the retrospective adjustments were not material.

In January 2014, the FASB issued guidance within ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The objective of the amendments in ASU No. 2014-04 to Topic 310, *Receivables - Troubled Debt Restructurings by Creditors*, is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 31, 2014. An entity can elect to adopt the amendments using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

Note 2. Earnings per Share and Shareholders' Equity

Earnings per Share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share are determined by dividing net income available to common shareholders by the weighted average number of common shares outstanding, assuming all securities that could be converted to common stock have been converted or exercised. The following table summarizes the basic and diluted earnings per share calculations (dollars in thousands, except per share data):

	Three Months Ended March 31,	
	2014	**2013**
Basic		
Net income, as reported	$ 11,131	$ 10,472
Preferred stock dividends	191	1,352
Net income available to common shareholders	$ 10,940	$ 9,120
Weighted-average common shares outstanding	35,050,526	31,760,654
Basic earnings per share amount	$ 0.31	$ 0.29
Diluted		
Net income available to common shareholders, for diluted EPS	$ 10,940	$ 9,120
Weighted-average common shares outstanding	35,050,526	31,760,654
Add shares if converted:		
Stock compensation plans, net of tax benefit (1)	73,517	66,813
Weighted-average diluted shares outstanding	35,124,043	31,827,467
Diluted earnings per share amount	$ 0.31	$ 0.29

(1) Stock options and restricted stock shares totaling 3,523 and 57,800 were excluded from the computation of diluted earnings per share during the first quarter of 2014 and 2013, respectively, because their inclusion would be anti-dilutive.

On September 1, 2013, all outstanding shares of the TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A ("Series A preferred stock") were mandatorily converted into 3.19 million shares of TowneBank common stock reflecting a conversion price of $18.02 per share of common stock, plus cash in lieu of any fractional shares. These shares of the Series A preferred stock were not included in the computation of diluted earnings per share for the three months ended March 31, 2013 as the effect was anti-dilutive.

In conjunction with the Company's issuance of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B to the U.S. Treasury Department, the Company issued a ten-year warrant to purchase 554,330 common shares at an exercise price of $20.69 per share. These shares were not included in the computation of diluted earnings per share for the three months ended March 31, 2013 as the effect was anti-dilutive. On May 15, 2013, the Company repurchased the warrant from the U.S. Treasury Department for $1.5 million. The transaction reduced additional paid-in capital within stockholders' equity by $1.5 million. The warrant repurchase did not impact results of operations.

Note 3. Investment Securities

Available-for-sale securities

The following chart indicates the amortized cost and fair values of available-for-sale securities for the periods indicated (in thousands):

March 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 454,964	$ 109	$ (2,226)	$ 452,847
Municipal securities	29,286	679	(149)	29,816
Trust preferred and other corporate securities	7,739	516	—	8,255
Mortgage-backed securities issued by GSE	59,825	1,067	(13)	60,879
Total available-for-sale securities	$ 551,814	$ 2,371	$ (2,388)	$ 551,797

December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 235,143	$ 126	$ (1,939)	$ 233,330
U.S. Treasury notes	200,000	—	—	200,000
Municipal securities	36,845	515	(281)	37,079
Trust preferred and other corporate securities	7,805	454	(2)	8,257
Mortgage-backed securities issued by GSE	64,103	834	(82)	64,855
Total available-for-sale securities	$ 543,896	$ 1,929	$ (2,304)	$ 543,521

Held-to-maturity securities

The amortized cost and fair values of held-to-maturity investment securities for the periods indicated (in thousands):

March 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 167	$ —	$ 667
Mortgage-backed securities issued by GSE	31,699	—	(40)	$ 31,659
Municipal securities	57,259	2,446	—	59,705
Industrial revenue bonds	143,421	10,237	(268)	153,390
Total held-to-maturity securities	$ 232,879	$ 12,850	$ (308)	$ 245,421

December 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 141	$ —	$ 641
Municipal securities	58,644	1,327	(150)	59,821
Industrial revenue bonds	145,204	4,288	(1,668)	147,824
Total held-to-maturity securities	$ 204,348	$ 5,756	$ (1,818)	$ 208,286

Maturities of investment securities

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and estimated fair value of investment securities are shown by contractual maturity (including mortgage-backed securities) in the following tables (in thousands):

March 31, 2014	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 5,650	$ 5,695	$ —	$ —
Due after one year through five years	466,016	463,939	6,976	7,477
Due after five years through 10 years	19,533	19,850	62,039	62,756
Due after 10 years	59,254	60,952	163,864	175,188
	550,453	550,436	232,879	245,421
Other equity securities	1,361	1,361	—	—
	$ 551,814	$ 551,797	$ 232,879	$ 245,421

December 31, 2013	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 211,960	$ 212,018	$ —	$ —
Due after one year through five years	247,903	246,039	3,398	3,624
Due after five years through 10 years	17,968	18,194	28,505	28,490
Due after 10 years	65,994	67,199	172,445	176,171
	543,825	543,450	204,348	208,285
Other equity securities	71	71	—	—
	$ 543,896	$ 543,521	$ 204,348	$ 208,285

Trading securities

At March 31, 2013, the Company had trading securities of $13.38 million, which represented mutual fund investments in a self-directed employee deferred compensation plan, which is structured as a rabbi trust. During 2013, the Company amended its plan and due to the amendment the funds held in the plan are no longer accounted for as trading securities. Prior to the plan amendment, employees were permitted to invest in mutual fund investments that were classified as trading securities. These investments were bought and sold as employees deferred compensation, received distributions, or made changes in the funds underlying their accounts. Realized and unrealized gains or losses were recorded in noninterest income. The Company had gains of $604,000 in the three-month period ended March 31, 2013.

Unrealized losses

The following table shows the Company's gross unrealized losses and fair values, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position (in thousands):

March 31, 2014	**Less than 12 months**		**12 months or more**		**Total**	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 371,277	$ 1,917	$ 19,820	$ 309	$ 391,097	$ 2,226
Municipal securities	4,725	89	2,441	60	7,166	149
Industrial revenue bonds	5,560	213	1,437	55	6,997	268
Mortgage-backed securities issued by GSE	8,547	53	—	—	8,547	53
Total temporarily impaired securities	$ 390,109	$ 2,272	$ 23,698	$ 424	$ 413,807	$ 2,696

December 31, 2013	**Less than 12 months**		**12 months or more**		**Total**	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 221,212	$ 1,939	$ —	$ —	$ 221,212	$ 1,939
Municipal securities	17,566	340	2,425	91	19,991	431
Industrial revenue bonds	47,147	1,563	1,404	105	48,551	1,668
Mortgage-backed securities issued by GSE	11,758	82	—	—	11,758	82
Corporate Obligations	1,985	2	—	—	1,985	2
Total temporarily impaired securities	$ 299,668	$ 3,926	$ 3,829	$ 196	$ 303,497	$ 4,122

U.S. government agency securities

The Company's unrealized losses on obligations of U.S. government agencies were caused by interest rate fluctuations. At March 31, 2014, 18 securities had unrealized losses of $2.23 million, with a fair value of $391.10 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At March 31, 2014, seven securities had unrealized losses of $149,000, with a fair value of $7.17 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Government-Sponsored Enterprises ("GSE") mortgage-backed securities

The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At March 31, 2014, two securities had unrealized losses of $53,000, with a fair value of $8.55 million. The severity and duration of the unrealized loss will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the security before its anticipated recovery, the Company does not consider this investment other than temporarily impaired.

Trust preferred and other corporate securities

At March 31, 2014, the Company had no unrealized losses in trust preferred corporate securities.

Industrial revenue bonds

The Company's unrealized losses on industrial revenue bonds were caused by interest rate fluctuations. At March 31, 2014, three bond issuances had total unrealized losses of $268,000. Based on the credit quality of the issuers, and because it is the Company's intent to hold these bonds until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the bonds before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at March 31, 2014.

Federal Home Loan Bank of Atlanta ("FHLB") stock

The Company is required to maintain an investment in the capital stock of the FHLB. The FHLB stock is stated at cost, as this is a restricted security without a readily determinable fair value. The Company had $21.99 million and $23.07 million of FHLB stock at March 31, 2014 and December 31, 2013, respectively. Based on the Company's review of the credit quality of the institution, the institution's ability to repurchase shares, and the Company's carrying value in the shares, the Company does not consider this investment other than temporarily impaired.

Note 4. Loans and Allowance for Loan Losses

The Company grants commercial, real estate, and consumer loans to customers throughout our lending area. Although the Company has a diversified loan portfolio, a substantial portion of the Company's debtors' abilities to honor their contracts is dependent upon the economic environment of the lending area.

Allowance for Loan Losses

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company considers the allowance for loan losses of $37.54 million adequate to cover estimated loan losses inherent in the loan portfolio at March 31, 2014.

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three-month periods ended March 31, 2014 and 2013 (in thousands):

Three Months Ended March 31, 2014	**Construction and Land Development**	**Commercial Real Estate**	**Multi-Family Real Estate**	**1-4 Family Residential Real Estate**	**Commercial and Industrial Business**	**Consumer Loans and Other**	**Total**
Allowance for loan losses:							
Balance, beginning of period	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380
Provision charged to expense	47	383	(175)	85	(203)	193	330
Losses charged off	(226)	(386)	(1)	(707)	(142)	(164)	(1,626)
Recoveries	22	304	1	60	45	27	459
Balance, end of period	$ 7,768	$ 13,922	$ 524	$ 10,168	$ 4,411	$ 750	$ 37,543
Three Months Ended March 31, 2013							
Allowance for loan losses:							
Balance, beginning of year	$ 11,691	$ 12,521	$ 589	$ 10,722	$ 4,378	$ 526	$ 40,427
Provision charged to expense	(221)	829	150	1,944	(125)	994	3,571
Losses charged off	(1,347)	—	(14)	(2,027)	(772)	(69)	(4,229)
Recoveries	344	7	—	214	304	11	880
Balance, end of period	$ 10,467	$ 13,357	$ 725	$ 10,853	$ 3,785	$ 1,462	$ 40,649

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The following table presents, by portfolio segment, the allocation of the allowance for loan losses at March 31, 2014 and December 31, 2013 (in thousands):

March 31, 2014	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 767	$ 1,285	$ —	$ 1,617	$ 205	$ —	$ 3,874
Loans collectively evaluated for impairment	7,001	12,637	524	8,551	4,206	750	33,669
Balance, end of period	$ 7,768	$ 13,922	$ 524	$ 10,168	$ 4,411	$ 750	$ 37,543
December 31, 2013							
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 915	$ 1,440	$ 77	$ 1,994	$ 352	$ 29	$ 4,807
Loans collectively evaluated for impairment	7,010	12,181	622	8,736	4,359	665	33,573
Balance, end of year	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380

The following table presents, by portfolio segment, the Company's investment in loans (in thousands):

March 31, 2014	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 14,953	$ 20,545	$ —	$ 18,170	$ 1,103	$ 65	$ 54,836
Ending balance: collectively evaluated for impairment	453,926	1,372,437	50,014	788,498	493,602	48,352	3,206,829
Ending balance: loans acquired with deteriorated credit quality	962	2,387	—	3,477	871	—	7,697
Ending Balance	$ 469,841	$1,395,369	$ 50,014	$ 810,145	$ 495,576	$ 48,417	$3,269,362

December 31, 2013	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 15,820	$ 22,069	965	$ 19,251	$ 873	$ 189	$ 59,167
Ending balance: collectively evaluated for impairment	452,868	1,341,043	52,597	774,890	498,985	48,509	3,168,892
Ending balance: loans acquired with deteriorated credit quality	991	2,460	—	3,582	897	—	7,930
Ending Balance	$ 469,679	$1,365,572	$ 53,562	$ 797,723	$ 500,755	$ 48,698	$3,235,989

Loans acquired in a transfer, including business combinations, where there is evidence of credit deterioration since origination and it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments are accounted for as purchased impaired loans.

Purchased impaired loans are initially recorded at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, the historical allowance for credit losses related to these loans is not carried over.

Accounting for purchased impaired loans involves estimating fair value, at acquisition, using the principal and interest cash flows expected to be collected discounted at the prevailing market rate of interest. The excess of cash flows expected to be collected over the estimated fair value at acquisition date is referred to as the accretable yield and is recognized in interest income using an effective yield method over the remaining life of the loans. The difference between contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference.

Changes in the carrying amount and accretable yield for purchased impaired and nonimpaired loans were as follows for the three months ended March 31, 2014 and 2013 (in thousands):

	March 31, 2014				March 31, 2013			
	Purchased Impaired		Purchased Nonimpaired		Purchased Impaired		Purchased Nonimpaired	
	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans
Balance at beginning of period	$ 2,800	$ 7,930	$ 4,433	$ 28,165	$ 992	$ 9,613	$ 4,241	$ 33,757
Accretion	(176)	176	(445)	445	(188)	188	(568)	568
Reclassifications from nonaccretable balance, net	—	—	—	—	2,545	—	2,402	—
Payments received, net	—	(409)	—	(1,716)	—	(1,028)	—	(2,653)
Balance at end of period	$ 2,624	$ 7,697	$ 3,988	$ 26,894	$ 3,349	$ 8,773	$ 6,075	$ 31,672

At March 31, 2014, none of the purchased loans were classified as nonperforming assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased loans. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses. The outstanding unpaid principal balance for all purchased impaired loans and purchased nonimpaired loans as of March 31, 2014 was $10.41 million and $27.12 million, respectively.

Portfolio Quality Indicators

The Company's portfolio grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on numerous factors, including management's experiences with similarly graded loans. Credit risk grades are refreshed each quarter as they become available, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track loan performance.

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The Company's internally assigned grades are as follows:

- Pass – Several pass credit grades comprise loans in this category, which are assigned based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to management attention credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring.

- Special Mention – Loans in this category are considered to have potential weaknesses that deserve management's attention. The borrower's ability to repay from the primary (intended) sources is currently adequate, but threatened by potential weaknesses which may, if not corrected, result in the deterioration of the repayment prospects for the asset or in the Company's credit position loss at some future date.

- Substandard – Loans in this category are considered to have increased credit risk and servicing needs and generally require that the Company follow their performance very closely. The borrower's ability to repay is threatened by a clearly defined weakness which jeopardizes ultimate repayment of the loan.

- Doubtful – Loans in this category are considered to be doubtful or a loss to the Company in terms of principal and interest repayment. The borrower's ability to repay in full, on the basis of currently existing facts, conditions and values, is generally highly questionable and improbable.

The following tables represent credit exposures by internally assigned grades for the periods ended March 31, 2014 and December 31, 2013 (in thousands):

March 31, 2014	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Pass	$ 439,006	$ 1,358,986	$ 46,514	$ 787,575	$ 492,151	$ 48,193	$ 3,172,425
Special Mention	16,139	14,358	—	3,453	1,213	5	35,168
Substandard	14,696	22,025	3,500	18,521	2,212	219	61,173
Doubtful	—	—	—	596	—	—	596
Total	$ 469,841	$ 1,395,369	$ 50,014	$ 810,145	$ 495,576	$ 48,417	$ 3,269,362

December 31, 2013	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Pass	$ 439,403	$ 1,334,228	$ 49,456	$ 774,466	$ 496,578	$ 48,175	$ 3,142,306
Special Mention	16,194	11,276	—	3,676	1,210	5	32,361
Substandard	14,082	20,068	4,106	19,581	2,967	518	61,322
Doubtful	—	—	—	—	—	—	—
Total	$ 469,679	$ 1,365,572	$ 53,562	$ 797,723	$ 500,755	$ 48,698	$ 3,235,989

Age Analysis of Past-Due Financing Receivables by Class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of March 31, 2014 and December 31, 2013. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Purchased impaired loans are included in the aging schedule, but are excluded from the disclosure of accruing loans more than 90 days past due as they are considered to be accruing due to the existence of the accretable yield and not based on consideration given to contractual interest payments (in thousands):

March 31, 2014	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 315	$ 45	$ 23	$ 4,869	$ 5,252	$ 464,589	$ 469,841	$ —
Commercial real estate	3,243	756	—	1,843	5,842	1,389,527	1,395,369	—
Multifamily real estate	—	—	—	—	—	50,014	50,014	—
1-4 family residential real estate	7,008	1,071	576	3,338	11,993	798,152	810,145	576
Commercial and industrial business loans	10	6	—	923	939	494,637	495,576	—
Consumer loans and other	188	21	—	4	213	48,204	48,417	—
Total	$ 10,764	$ 1,899	$ 599	$ 10,977	$ 24,239	$3,245,123	$ 3,269,362	$ 576

December 31, 2013	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 113	$ —	$ 28	$ 5,687	$ 5,828	$ 463,851	$ 469,679	$ —
Commercial real estate	4,745	190	—	1,422	6,357	1,359,215	1,365,572	—
Multifamily real estate	3,611	—	—	606	4,217	49,345	53,562	—
1-4 family residential real estate	4,723	339	30	4,194	9,286	788,437	797,723	—
Commercial and industrial business loans	19	31	—	687	737	500,018	500,755	—
Consumer loans and other	77	3	—	157	237	48,461	48,698	—
Total	$ 13,288	$ 563	$ 58	$ 12,753	$ 26,662	$3,209,327	$ 3,235,989	$ —

Impaired Loans

Management considers a loan to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), impairment is recognized as a specific component to be provided for in the allowance for loan losses or the impaired balance on collateral dependent loans is charged-off if it is determined that such amount represents a confirmed loss.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost-recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

Unearned loan income was $2.52 million in excess of deferred loan costs at March 31, 2014, $2.48 million at March 31, 2013, and $2.39 million at December 31, 2013. There were $10.98 million, $17.39 million, and $12.75 million in nonaccrual loans at March 31, 2014, March 31, 2013, and December 31, 2013, respectively. The Company would have earned $73,000 in the first quarter of 2014 if interest on the loans had been accrued.

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The following table includes the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable (in thousands):

March 31, 2014	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	QTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 9,756	$ 9,674	$ —	$ 9,781	$ 101
Commercial real estate	14,162	13,932	—	14,327	195
Multi-family real estate	—	—	—	—	—
1-4 family residential real estate	8,076	7,373	—	9,219	131
Commercial and industrial business loans	331	310	—	334	4
Consumer loans and other	67	65	—	71	1
Total	$ 32,392	$ 31,354	$ —	$ 33,732	$ 432
Loans with a specific valuation allowance					
Construction and land development	$ 5,479	$ 5,279	$ 767	$ 5,939	$ 10
Commercial real estate	6,628	6,613	1,285	6,641	67
Multi-family real estate	—	—	—	—	—
1-4 family residential real estate	11,045	10,797	1,617	11,067	110
Commercial and industrial business loans	809	793	205	841	12
Consumer loans and other	—	—	—	—	—
Total	$ 23,961	$ 23,482	$ 3,874	$ 24,488	$ 199
Total impaired loans					
Construction and land development	$ 15,235	$ 14,953	$ 767	$ 15,720	$ 111
Commercial real estate	20,790	20,545	1,285	20,968	262
Multi-family real estate	—	—	—	—	—
1-4 family residential real estate	19,121	18,170	1,617	20,286	241
Commercial and industrial business loans	1,140	1,103	205	1,175	16
Consumer loans and other	67	65	—	71	1
Total	$ 56,353	$ 54,836	$ 3,874	$ 58,220	$ 631

(1) Included in the table above are accruing TDRs of $43.86 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $4.54 million.

December 31, 2013	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 9,819	$ 9,730	$ —	$ 10,445	$ 527
Commercial real estate	16,100	15,864	—	16,166	885
Multi-family real estate	—	—	—	—	—
1-4 family residential real estate	9,307	8,864	—	9,418	422
Commercial and industrial business loans	997	521	—	1,043	49
Consumer loans and other	47	43	—	56	4
Total	$ 36,270	$ 35,022	$ —	$ 37,128	$ 1,887
Loans with a specific valuation allowance					
Construction and land development	$ 6,199	$ 6,090	$ 915	$ 6,820	$ 162
Commercial real estate	6,286	6,205	1,440	6,357	292
Multi-family real estate	965	965	77	976	59
1-4 family residential real estate	11,059	10,387	1,994	10,780	495
Commercial and industrial business loans	367	352	352	374	21
Consumer loans and other	202	146	29	204	9
Total	$ 25,078	$ 24,145	$ 4,807	$ 25,511	$ 1,038
Total impaired loans					
Construction and land development	$ 16,018	$ 15,820	$ 915	$ 17,265	$ 689
Commercial real estate	22,386	22,069	1,440	22,523	1,177
Multi-family real estate	965	965	77	976	59
1-4 family residential real estate	20,366	19,251	1,994	20,198	917
Commercial and industrial business loans	1,364	873	352	1,417	70
Consumer loans and other	249	189	29	260	13
Total	$ 61,348	$ 59,167	$ 4,807	$ 62,639	$ 2,925

(1) Included in the table above are accruing TDRs of $46.41 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $3.99 million.

Troubled Debt Restructurings

In order to maximize the collection of loan balances, the Company evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: (1) a creditor has granted a concession to the debtor, and, (2) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The following table shows the loans modified in TDRs for the three months ended March 31, 2014 and 2013 (in thousands, except number of loans):

	Three Months Ended March 31, 2014		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Consumer loans and other	1	$ 32	$ 32
Total	1	$ 32	$ 32

	Three Months Ended March 31, 2013		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial real estate	2	$ 746	$ 746
Multi-family real estate	1	365	365
1-4 family residential real estate	3	3,040	2,755
Total	6	$ 4,151	$ 3,866

The restructured loans generally include terms to reduce the interest rate and extend payment terms. We have not forgiven any principal on the above loans. There were two commercial and industrial business loans that were restructured within the last 12 months that subsequently defaulted. The loans had recorded balances of $3.02 million.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At March 31, 2014, all significant impaired loans have been determined to be collateral dependent.

Nonaccrual Loans

The Company generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach a certain number of days past due. Commercial loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 90 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. Residential mortgage loans and other consumer loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. When loans are placed on nonaccrual status, interest receivable is reversed against interest income recognized in the current period, and any prior year unpaid interest is charged off against the allowance for loan losses. Interest payments received thereafter are applied as a reduction of the remaining principal balance so long as doubt exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when the collection of principal or interest is no longer doubtful. Similarly, mortgage loans and other consumer loans are also placed on nonaccrual status when full collection of principal and interest becomes doubtful, or they become delinquent for a specified period of time.

Note 5. Other Real Estate Owned ("OREO")

The table below presents a summary of the activity related to OREO (in thousands):

	Three Months Ended March 31,	
	2014	**2013**
Beginning balance	$ 39,534	$ 30,297
Additions	5,569	25,897
Sales	(3,548)	(9,077)
Valuation allowance	(300)	(497)
Gain (loss) on sale and write-downs, net	255	2
Ending balance	$ 41,510	$ 46,622

Note 6. Segment Reporting

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Hampton Roads and northeastern North Carolina and includes the operations of TowneBank Commercial Mortgage and Towne Investment Group. The Realty segment combines the operations of Prudential Towne Realty with TowneBank Mortgage, Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements, SimonTowne Mortgage, LLC, Towne Mortgage of the Carolinas, LLC, NewTowne Mortgage, LLC, Franklin Federal Mortgage Center, LLC, Homesale Mortgage, LLC, and Corolla Classic Vacations, LLC, to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance and TFA Benefits.

All the segments are service-based. The Banking segment offers a distribution and referral network for the realty and insurance services, and the Realty and Insurance divisions offer a similar network for the Banking segment due largely to overlapping geographic markets. A major distinction is the source of income. The Realty and Insurance businesses are fee-based businesses, while the Banking segment is driven principally by net interest income.

Segment profit and loss is measured by net income after income tax. Inter-segment transactions are recorded at cost and eliminated as part of the consolidation process. Because of the interrelationships of the various segments, the information presented is not indicative of how the segments would perform if they operated as independent entities.

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The following tables provide information about reportable segments and reconciliation of such information to the consolidated financial statements (dollars in thousands):

Three Months Ended March 31, 2014	**Banking**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 34,905	$ 287	$ —	$ 35,192
Provision for loan losses	306	24	—	330
Net interest income after provision for loan losses	34,599	263	—	34,862
Residential mortgage banking income, net	(56)	5,118	—	5,062
Real estate brokerage and property management income, net	—	3,292	—	3,292
Insurance commissions and other title fees and income, net	—	345	8,716	9,061
Other noninterest income	4,740	281	293	5,314
Noninterest expense	26,845	8,922	5,314	41,081
Income before income tax, corporate allocation and noncontrolling interest	12,438	377	3,695	16,510
Corporate allocation	253	(148)	(105)	—
Income before income tax provision and noncontrolling interest	12,691	229	3,590	16,510
Provision for income tax expense	3,654	42	1,209	4,905
Net income	9,037	187	2,381	11,605
Noncontrolling interest	—	(212)	(262)	(474)
Net income (loss) attributable to TowneBank	$ 9,037	$ (25)	$ 2,119	$ 11,131
Net income (loss) as percentage of total	81.19%	(0.22)%	19.03%	100.00%
Total assets	$ 4,573,814	$ 118,501	$ 82,919	$ 4,775,234

Three Months Ended March 31, 2013	**Banking**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 34,621	$ 589	$ —	$ 35,210
Provision for loan losses	3,571	—	—	3,571
Net interest income after provision for loan losses	31,050	589	—	31,639
Residential mortgage banking income, net	(74)	7,892	—	7,818
Real estate brokerage and property management income, net	—	3,372	—	3,372
Insurance commissions and other title fees and income, net	—	426	7,556	7,982
Other noninterest income	4,736	261	190	5,187
Noninterest expense	26,900	8,477	5,219	40,596
Income before income tax, corporate allocation and noncontrolling interest	8,812	4,063	2,527	15,402
Corporate allocation	307	(133)	(174)	—
Income before income tax provision and noncontrolling interest	9,119	3,930	2,353	15,402
Provision for income tax expense	2,127	1,379	860	4,366
Net income	6,992	2,551	1,493	11,036
Noncontrolling interest	—	(341)	(223)	(564)
Net income attributable to TowneBank	$ 6,992	$ 2,210	$ 1,270	$ 10,472
Net income as percentage of total	66.77%	21.10%	12.13%	100.00%
Total Assets	$ 4,132,603	$ 168,581	$ 73,980	$ 4,375,164

Note 7. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case by case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, the total commitment amounts may not necessarily represent future cash requirements. At March 31, 2014, the amounts of off-balance sheet commitments to extend credit were $1.02 million.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At March 31, 2014, standby letters of credit and financial guarantees were $29.16 million.

Additionally, the Company had $69.14 million in mortgage loans sold to investors with various recourse and warranty provisions.

Rate lock commitments, which are designed to mitigate the Company's exposure to fluctuations in interest rates associated with rate lock commitments and loans held for sale, are related to the origination of mortgage loans held for sale and the corresponding loan sale commitments and are considered derivative instruments. Outstanding loan balances under these rate lock commitments totaled $75.08 million at March 31, 2014. The income statement impact associated with these instruments is recorded in net residential mortgage banking income in the amount of $181,000 and $564,000 for the three-month periods ended March 31, 2014 and 2013, respectively.

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Note 8. Mergers and Acquisitions

Insurance Agencies: Effective July 1, 2013, the Company acquired two insurance agencies, Hooker and Buchanon Incorporated and Yergey Insurance Agency, Inc., that are affiliated with Towne Insurance Agency ("Towne Insurance"), a wholly-owned subsidiary of TowneBank. The acquisitions were accounted for as business combinations under the acquisition method of accounting in accordance with Accounting Standards Codification Topic ("ASC") 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses are included in the Company's Consolidated Statements of Income commencing July 1, 2013. The total purchase price for the transactions was $2.73 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $110,000, goodwill of $1.61 million, other intangible assets, including customer lists of $1.16 million, and assumed liabilities of $1.30 million.

The Clement Companies: Effective December 31, 2012, the Company acquired The Clement Companies insurance agency that is affiliated with Towne Insurance. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing January 1, 2013. The purchase price was $6.30 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $616,000, goodwill of $4.76 million, other intangible assets, including customer lists of $1.53 million, and assumed liabilities of $611,000.

Note 9. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 7 – Goodwill and Intangible Assets* of the 2013 Annual Report to the Stockholders for more information on the Company's goodwill and other intangibles.

The gross carrying amount and accumulated amortization for the Company's intangible assets follows (in thousands):

	March 31,					
	2014		2013		December 31, 2013	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	$ 417	$ 172	$ 417	$ 120	$ 417	$ 159
Non-compete agreements	1,456	1,310	1,456	1,239	1,456	1,292
Trade name	211	53	772	572	211	42
Customer lists	21,119	9,815	19,450	7,828	21,119	9,326
Total intangible assets subject to amortization	23,203	11,350	22,095	9,759	23,203	10,819
Contractual agreements	3,231	—	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—	3,231	—
Total intangible assets	$ 26,434	$ 11,350	$ 25,326	$ 9,759	$ 26,434	$ 10,819

Amortization expense for intangible assets was $530,000 and $524,000 for the three-month periods ended March 31, 2014 and 2013, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2013 are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2013	$ 58,884	$ 15,825	$ 29,737	$ 104,446
Additions to goodwill	—	—	—	—
Other adjustments	—	—	62	62
Balance, March 31, 2014	$ 58,884	$ 15,825	$ 29,799	$ 104,508

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of March 31, 2014 was $57.57 million. The Company had $55.80 million and $57.37 million of BOLI at March 31, 2013 and December 31, 2013, respectively. The Company recognized BOLI income, included in other noninterest income, of $487,000 and $423,000 for the three-month periods ended March 31, 2014 and 2013, respectively. The Company has a related retirement plan, implemented in the fourth quarter of 2008, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits.

Note 11. Postretirement Benefits

The following table sets forth the Company's periodic postretirement benefit cost for the interim period identified (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Service cost	$ 396	$ 507
Interest cost	196	138
Amortization of actuarial loss	—	63
Net periodic postretirement benefit cost	$ 592	$ 708

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at March 31, 2014 and 2013 (in thousands), and changes in the three months then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the defined benefit retirement plan are a component of salaries and employee benefits expense on the consolidated statements of income.

	Unrealized Gains (Losses) on Securities (a)	Defined Benefit Retirement Plan (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2013	$ (244)	$ (100)	$ (344)
Other comprehensive income before reclassifications	233	—	233
Amounts reclassified from AOCI	(1)	—	(1)
Net change	232	—	232
Balance, March 31, 2014	$ (12)	$ (100)	$ (112)

	Unrealized Gains on Securities (a)	Defined Benefit Retirement Plan (b)	Accumulated Other Comprehensive Income, Net of Tax
Balance, December 31, 2012	$ 1,699	$ (883)	$ 816
Other comprehensive income before reclassifications	5	—	5
Amounts reclassified from AOCI	—	41	41
Net change	5	41	46
Balance, March 31, 2013	$ 1,704	$ (842)	$ 862

(a) For additional information about securities, refer to Note 3.
(b) For additional information about retirement plans, refer to Note 11.

Note 13. Other Expenses

The following table shows a summary of other expenses (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Advertising and marketing	$ 1,059	$ 1,181
Other	1,988	1,624
Charitable contributions	778	919
Outside processing	863	827
Professional fees	1,188	1,139
Stationery and supplies	441	491
FDIC and other insurance	899	794
Foreclosed property expenses	804	834
Software expense	981	1,062
Telephone and postage	994	964
Amortization-intangibles	530	524
Bank franchise tax/SCC fees	513	482
Directors fees and expenses	221	299
Travel/meals/entertainment	250	335
Total other expenses	$ 11,509	$ 11,475

Note 14. Variable Interest Entities

In the normal course of business, the Company is involved with various entities that are considered to be Variable Interest Entities ("VIE"). A VIE is an entity that has either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support or whose equity investors lack the characteristics of a controlling financial interest. In accordance with existing accounting guidance, we are required to consolidate any VIE of which we are determined to be the primary beneficiary. The primary beneficiary is the entity that has (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (ii) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. We review all significant interests in the VIEs we are involved with, including the amounts and types of financial and other support, including equity investments, debt financing, and guarantees. We also consider the activities of the VIEs that most significantly impact the VIEs' economic performance and whether we have control over those activities. We assess whether or not we are the primary beneficiary of a VIE on an ongoing basis. To provide the necessary disclosures, we aggregate similar VIEs based on the nature and purpose of the entities.

Low Income Housing Tax Credit Partnerships

As part of its community reinvestment initiatives, the Company invests within its footprint in multifamily affordable housing developments as a limited partner. The Company receives tax credits for its partnership investments. The Company has determined that these partnerships are VIEs when it does not own 100% of the entity because the holders of the equity investment at risk do not have the power through voting rights or similar rights to direct the activities of the entity that most significantly impact the entity's economic performance. Accordingly, the Company's limited partner interests are variable interests that the Company evaluates for purposes of determining whether the Company is the primary beneficiary.

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $58.12 million, $46.81 million, and $57.71 million in these partnerships were not included in the Consolidated Balance Sheets at March 31, 2014, March 31, 2013, and December 31, 2013, respectively. These limited partner interests had carrying values of $15.40 million, $15.29 million, and $14.20 million at March 31, 2014, March 31, 2013, and December 31, 2013, respectively, and are recorded in other assets on the Company's Consolidated Balance Sheets. The Company's maximum exposure to loss for these limited partner investments totaled $15.40 million, $15.29 million, and $14.20 million at March 31, 2014, March 31, 2013, and December 31, 2013, respectively. As of March 31, 2014, Company has $963,000 in funding commitments that are dependent on certain contractual milestones. For the quarter ended March 31, 2014, a tax benefit totaling $262,000, net of amortization expense of $273,000, was recognized as a component of income tax expense.

Note 15. Fair Value Disclosures

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A three-level valuation hierarchy was established for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

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

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis.

Securities available for sale: Fair values are based on published market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Interest Rate Lock Commitments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall out rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three-month periods ended March 31, 2014 and 2013, and December 31, 2013, the Company used a weighted average fall out rate of 20%. The carrying value of the interest rate lock commitments was $763,000 at March 31, 2014 and $583,000 at December 31, 2013.

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	March 31, 2014			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 452,847	$ —	$ 452,847
Municipal securities	—	29,816	—	29,816
Mortgage-backed securities issued by GSEs	—	60,879	—	60,879
Trust preferred and other corporate securities	—	8,255		8,255
Interest rate lock commitments	—	—	763	763

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 233,330	$ —	$ 233,330
U.S. Treasury notes	—	200,000	—	200,000
Municipal securities	—	37,079	—	37,079
Mortgage-backed securities issued by GSEs	—	64,855	—	64,855
Trust preferred and other corporate securities	—	8,257	—	8,257
Interest rate lock commitments	—	—	583	583

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at March 31, 2014 and December 31, 2013 (in thousands):

March 31, 2014	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ —	$ —	$ 21,601	$ 21,601
Other real estate owned	$ —	$ 21,537	$ 19,973	$ 41,510

December 31, 2013	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ —	$ —	$ 19,338	$ 19,338
Other real estate owned	$ —	$ 21,437	$ 18,097	$ 39,534

The following is a description of valuation methodologies used for assets measured on a nonrecurring basis.

Loans: Impaired loans for which repayment of the loan is expected to be provided solely by the value of the underlying collateral are considered collateral dependent and are valued based on the fair value of such collateral. Collateral values are estimated using inputs based on observable market data or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 2% to 91%.

Loans held for sale: Loans held for sale are carried at the lower of cost or estimated fair value. Fair values of loans held for sale are based on commitments on hand from investors or, if commitments have not yet been obtained, prevailing market rates.

Foreclosed Property: The fair value of foreclosed property is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on upon assumptions specific to the individual property. Level 3 inputs typically include unobservable inputs such as management applied discounts used to further reduce values to a net realizable value or in situations where our appraisal date predates a likely change in market conditions. These deductions ranged from 1% to 57%.

The following methods and assumptions were used in estimating fair value for the remaining classes of our financial instruments.

Cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold: The carrying amount approximates fair value.

Securities held to maturity: Fair values are based on published market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Industrial revenue bonds are classified as Level 3 and as such use significant estimates to determine the fair value of these securities. The Company values these securities using a discounted cash flow approach based on assumptions that are generally not observable in the current markets.

Loans: For credit card and other loan receivables with short-term and/or variable characteristics, the total receivable outstanding approximates fair value. The fair value of other loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Interest receivable and interest payable: The carrying amount approximates fair value.

Deposits: The fair value of noninterest-bearing deposits and deposits with no defined maturity is estimated by discounting anticipated future cash flows using current borrowing rates. The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits would be made.

Advances from the FHLB: The fair value of advances from the FHLB is determined using the discounted cash flow method with the discount rate being equal to the rate currently offered on similar products.

Repurchase agreements: The carrying amount approximates fair value.

Federal funds purchased: The carrying amount approximates fair value.

Commitments to extend and standby letters of credit: These financial instruments are generally not sold or traded. The estimated fair values of off-balance-sheet credit commitments, including standby letters of credit and guarantees written, are not readily available due to the lack of cost-effective and reliable measurement methods for these instruments.

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The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments* are as follows (in thousands):

March 31, 2014	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 235,984	$ 235,984	$ 235,984	$ —	$ —
Interest-bearing deposits in financial institutions	1,000	1,000	1,000	—	—
Securities available for sale	551,797	551,797	—	551,797	—
Securities held to maturity	232,879	245,421	—	92,031	153,390
Mortgage loans held for sale	57,745	57,926	—	57,926	—
Net Loans	3,269,362	3,370,765	—	—	3,370,765
Interest receivable	10,824	10,824	—	10,824	—
Deposits	3,681,709	3,275,242	—	3,275,242	—
Advances from the Federal Home Loan Bank of Atlanta	394,855	419,870	—	419,870	—
Repurchase agreements and other borrowings	31,571	31,573	—	31,573	—
Interest payable	2,634	2,634	—	2,634	—

December 31, 2013	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 203,782	$ 203,782	$ 203,782	$ —	$ —
Interest-bearing deposits in financial institutions	1,011	1,011	1,011	—	—
Securities available for sale	543,521	543,521	—	543,521	—
Securities held to maturity	204,348	195,708	—	60,462	135,246
Mortgage loans held for sale	58,642	58,642	—	58,642	—
Net Loans	3,235,989	3,333,682	—	—	3,333,682
Interest receivable	11,186	11,186	—	11,186	—
Deposits	3,567,104	3,149,022	—	3,149,022	—
Advances from the Federal Home Loan Bank of Atlanta	395,087	421,754	—	421,754	—
Repurchase agreements and other borrowings	47,659	47,661	—	47,661	—
Interest payable	2,648	2,648	—	2,648	—

Note 16. Subsequent Events

On May 1, 2014, the Company acquired the Southern Insurance Agency, Inc. insurance agency, which will be affiliated with Towne Insurance Agency, a wholly-owned subsidiary of TowneBank. The purchase price was approximately $13.25 million in cash and common stock.

PART I. FINANCIAL INFORMATION
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	First Quarter 2014	Fourth Quarter 2013	Third Quarter 2013	Second Quarter 2013	First Quarter 2013
Results of Operations:					
Interest income	$ 41,834	$ 43,101	$ 42,695	$ 42,591	$ 41,903
Interest expense	6,642	6,645	6,543	6,514	6,693
Net interest income	35,192	36,456	36,152	36,077	35,210
Provision for loan losses	330	551	328	(202)	3,571
Net interest income after provision for loan losses	34,862	35,905	35,824	36,279	31,639
Noninterest income:					
Residential mortgage banking income, net	5,062	5,515	6,725	8,918	7,818
Real estate brokerage and property management income, net	3,292	1,908	3,577	3,460	3,372
Insurance commissions and other title fees and income, net	9,061	6,025	7,477	6,838	7,982
Service charges on deposit accounts	2,131	2,211	2,256	2,185	2,030
Credit card merchant fees, net	773	745	968	905	853
Other income	2,408	2,306	1,985	2,157	1,700
Gain (loss) on investment securities	2	66	150	(208)	604
Total noninterest income	22,729	18,776	23,138	24,255	24,359
Noninterest expense:					
Salaries and benefits	23,396	22,596	25,642	25,244	23,626
Occupancy expense	4,176	4,424	4,171	3,930	3,772
Furniture and equipment	2,000	1,983	1,931	1,821	1,723
Other expenses	11,509	11,997	11,635	12,822	11,475
Total noninterest expense	41,081	41,000	43,379	43,817	40,596
Income before noncontrolling interest and income tax	16,510	13,682	15,583	16,717	15,402
Provision for income tax expense	4,905	3,655	4,407	4,707	4,366
Net income	11,605	10,027	11,176	12,010	11,036
Net income from noncontrolling interest	(474)	(353)	(758)	(811)	(564)
Net income attributable to TowneBank	$ 11,131	$ 9,674	$ 10,418	$ 11,199	$ 10,472
Net income available to common shareholders	$ 10,940	$ 9,482	$ 9,078	$ 9,855	$ 9,120
Per Share Data:					
Net income:					
Basic	$ 0.31	$ 0.27	$ 0.28	$ 0.31	$ 0.29
Diluted	0.31	0.27	0.28	0.31	0.29
Book value at period end	14.38	14.16	13.95	13.38	13.26
Tangible book value at period end	11.00	10.76	10.54	9.70	9.57
Cash dividends declared	0.10	0.10	0.10	0.09	0.09
Common Stock Closing Price:					
High	15.97	15.57	17.13	15.50	16.00
Low	14.41	13.68	14.05	13.43	14.40
Close	15.51	15.39	14.42	14.72	14.97
Selected Financial Ratios (annualized):					
Return on average assets	0.96%	0.82%	0.90%	1.01%	0.98%
Return on average tangible assets	0.99%	0.85%	0.93%	1.04%	1.01%
Return on average equity	7.63%	6.57%	7.17%	7.85%	7.51%
Return on average tangible equity	9.57%	8.28%	9.08%	9.90%	9.50%
Net interest margin (tax-equivalent basis) (1)	3.44%	3.53%	3.53%	3.67%	3.72%
Daily Averages:					
Total assets	$ 4,684,881	$ 4,660,930	$ 4,580,200	$ 4,439,414	$ 4,344,104
Total tangible assets	4,565,004	4,540,448	4,459,213	4,321,112	4,225,287
Loans, net of unearned income, excluding nonaccrual loans	3,225,089	3,211,658	3,168,042	3,150,527	3,102,257
Total earning assets (1)	4,301,821	4,277,000	4,185,420	4,064,556	3,963,000
Total deposits	3,583,412	3,560,920	3,493,377	3,377,077	3,314,687
FHLB advances	394,962	392,266	389,409	382,505	380,000
Total equity	591,688	583,932	576,257	571,955	565,871
Tangible equity	471,811	463,450	455,270	453,653	447,054
Basic weighted average shares outstanding	35,050,526	35,011,817	32,791,137	31,801,102	31,760,654
Diluted weighted average shares outstanding	35,124,043	35,090,896	32,849,889	31,826,574	31,827,467

(1) Includes bank-owned life insurance.

PART I. FINANCIAL INFORMATION
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2013 audited Consolidated Financial Statements included in our 2013 Annual Report to Shareholders and our 2013 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by Dixon Hughes Goodman LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements with respect to our financial condition, results of operations, and business. These forward-looking statements involve certain risks and uncertainties and are based on the beliefs and assumptions of our management. When used in this quarterly report or future regulatory filings, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We wish to caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, competitive and legislative or regulatory factors, and other factors described in our 2013 Annual Report on Form 10-K could affect our financial performance and could cause actual results for future periods to differ materially from those anticipated or projected.*

We do not undertake and specifically disclaim any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

Overview

TowneBank ("Company," "we," "us") is a retail and commercial banking business serving the Greater Hampton Roads area in Virginia and northeastern North Carolina. We place special emphasis on serving the financial needs of small- and medium-size businesses, professionals, and individuals in our geographic footprint. We offer a full range of banking and related financial services through our controlled divisions and subsidiaries.

Since our inception, we have expanded our financial services to include banking, real estate, mortgage, title, insurance, employee benefit services, and investments. We have three reportable segments: Banking, Realty, and Insurance. Our Banking segment provides loan and deposit services to retail and commercial customers. The Realty segment offers residential real estate services, mortgage loans, and residential and commercial title insurance. Commercial and retail insurance and employee benefit services are provided through our Insurance segment.

The following is a summary of the Company's financial performance in the quarter ended March 31, 2014:

- Net income for the three months ended March 31, 2014 was $11.13 million compared with $10.47 million in the same period in 2013. Net income available to common shareholders for the first quarter of 2014 was $10.94 million after preferred dividend payments compared with $9.12 million in the same period of 2013. Fully diluted earnings rose to $0.31 per common share as compared to $0.29 per common share in the first quarter of 2013.

- Net interest income decreased $18,000, or 0.05%, in the first quarter of 2014 from the comparable period in 2013. The slight decrease was primarily due to the decline in yields in earning assets and was mostly offset by an increase in earning assets and the continued decline in funding costs.

- The provision for loan losses decreased $3.24 million, or 90.76%, from the comparative three-month period of 2013, and decreased $221,000, or 40.11% from December 31, 2013. The loan loss reserve decreased to 1.15% of loans at March 31, 2014 from 1.19% at December 31, 2013 and from 1.29% at March 31, 2013. The decrease in the provision for loan losses in the current year period from the comparative prior periods was primarily a result of continued improvements in credit quality.

- Excluding gains on investment securities, noninterest income decreased by $1.03 million, or 4.33%, over the first quarter of 2013, and increased $4.02 million, or 21.46%, from December 31, 2013. The decrease from the comparable three-month period in the prior year was related to a decrease in residential mortgage banking income, partially offset by increases in our Insurance segment related to our acquisitions of two insurance agencies on July 1, 2013. The increase from sequential quarter was related to the seasonal effects of our resort property management business and contingency income in our Insurance segment.

- For the first quarter 2014, noninterest expense increased $485,000, or 1.19%, respectively, compared to first quarter 2013, and increased $81,000, or 0.20% from December 31, 2013. The increase from the prior year comparative quarter was driven by our insurance agency acquisitions combined with growth in our operations support personnel.

- Our effective tax rate increased to 30.58% for the first quarter of 2014, an increase from 29.43% in the comparative period of 2013 and 27.42% in the fourth quarter of 2013. The increase from the prior year periods was primarily a result of the Company's adoption of change in accounting for affordable housing projects that qualify for the low-income housing tax credit. Amortization of the initial investment cost of qualifying projects is now recorded in the provision for income taxes together with the tax credits and benefits received. Previously, the expense was recorded in other noninterest expenses.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the consolidated financial statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, other real estate owned, deferred income taxes, estimates of fair value of financial instruments, and goodwill and other intangibles to be critical accounting policies. Refer to our 2013 Annual Report to the Stockholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 0.96% for the first quarter of 2014 compared to 0.98% for the first quarter of 2013, and 0.82% for the fourth quarter of 2013. The annualized return on average tangible assets was 0.99%, 1.01%, and 0.85% for the same respective periods. In comparison to the prior year comparative quarter, ROA was negatively affected by the decrease in noninterest income related to a decline in residential mortgage banking income, while ROA was positively affected by an increase in noninterest income in the sequential quarter comparison.

The annualized return on average equity ("ROE") was 7.63% for the first quarter of 2014, 7.51% for the first quarter of 2013, and 6.57% for the fourth quarter of 2013, while the annualized return on average tangible equity was 9.57%, 9.50%, and 8.28% for the same respective periods.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $57.92 million for the quarter ended March 31, 2014, which decreased $1.05 million, or 1.77%, compared to the quarter ended March 31, 2013. Operating income was $55.17 million for the quarter ended December 31, 2013.

Basic earnings per share were $0.31 for the three months ended March 31, 2014 compared to $0.29 in comparative 2013, and $0.27 for the quarter ended December 31, 2013. Diluted earnings per share for the first quarter of 2014 were $0.31, $0.29 for the first quarter of 2013, and $0.27 for the linked quarter. Earnings per share were positively affected, as compared to the comparative prior year quarter, by the reduction of preferred dividends and corresponding increase in common shares related to the mandatory conversion of the remaining shares of TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A on September 1, 2013.

Net Interest Income. Net interest income, the major source of our earnings, is the income generated by interest earning assets reduced by the total interest cost of the funds incurred to carry them. It is impacted by the market interest rates and the mix and volume of earning assets and interest bearing liabilities. The yields and rates in this discussion and in the following tables have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 35% federal marginal tax rate for all periods shown.

TowneBank reported net interest income, on a tax-equivalent basis, of $36.45 million for the quarter ended March 31, 2014, which was $132,000, or 0.36%, higher than the year ago amount of $36.32 million. On a linked quarter basis, tax-equivalent net interest income decreased by $1.57 million, or 4.13%, from the $38.02 million reported for the fourth quarter of 2013. In comparison to the prior year comparative period, net interest income rose due to increased balances of earning assets and a lower cost of interest-bearing liabilities.

Interest income, on a tax-equivalent basis, was $43.09 million for the quarter ended March 31, 2014, which was $81,000, or 0.19%, higher than the $43.01 million reported for the period ended March 31, 2013. On a linked quarter basis, tax-equivalent interest income decreased $1.57 million, or 3.52%, from $44.67 million in the fourth quarter of 2013. Average earning assets grew to $4.30 billion in the quarter ended March 31, 2014, from $3.96 billion in the comparative prior year quarter, an increase of

$338.82 million, or 8.55%. In the linked quarter comparison, average earning assets increased by $24.82 million, or 0.58%, from $4.28 billion in the fourth quarter of 2013. The yield on earning assets was 4.06% in the quarter ended March 31, 2014, which compared to 4.40% in the comparative prior year and 4.14% in the linked period. Average loan balances, excluding nonaccrual loans, of $3.23 billion were $122.83 million, or 3.96%, higher in the first quarter of 2014 than in the same period a year ago, while loan yields declined by 23 basis points. In the linked quarter, loans grew $13.43 million or 0.42% and loan yields were 9 basis points lower. The decrease in interest income from the comparative prior year period was driven by yield declines, which were seen in all categories except for interest-bearing deposits and loans held for sale. The decrease was partially offset by higher balances on loans and taxable securities. In the linked quarter comparison, the increase in interest income was primarily due to increases in interest income from taxable investment securities resulting from a combination of an increase in balances and rate improvements. The increase was partially offset by yield declines on loans.

Interest expense for the quarter ended March 31, 2014, was $6.64 million, which was $51,000 or 0.76% below the $6.69 million amount in the year ago quarter. The average balance of interest-bearing liabilities increased to $2.98 billion in the first quarter of 2014 from $2.76 billion in the comparative prior year quarter, an increase of 8.14%. On a linked quarter basis, interest expense decreased by $3,000, or 0.05%, from $6.65 million in the fourth quarter of 2013. In the linked quarter, average interest bearing liabilities increased by $35.35 million, or 1.20%, from $2.95 billion in the quarter ended December 31, 2013. The decline in interest expense as compared to the prior year period was driven by lower costs in all deposit categories, offset by increased borrowings. In the linked quarter comparison, lower costs were mostly offset by increases in average deposits and borrowings.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.44% in the quarter ended March 31, 2014, which was 28 basis points lower than the 3.72% margin of the March 31, 2013 quarter and 9 basis points lower than the 3.53% margin of the December 31, 2013 quarter. The margin compression in comparison to both prior periods resulted from falling asset yields and growth in earning assets.

PART I. FINANCIAL INFORMATION
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following tables depict our interest income on earning assets and related average yields as well as interest expense on interest bearing liabilities and related average rates paid for the periods presented. Also presented for the three-month periods are the changes in interest income and expense caused by variations in the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to the previous three-month period (dollars in thousands):

	Three Months Ended March 31, 2014			Three Months Ended December 31, 2013			Three Months Ended March 31, 2013		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 3,225,089	$ 38,220	4.81%	$ 3,211,658	$ 39,690	4.90%	$ 3,102,257	$ 38,568	5.04%
Taxable investment securities	470,029	1,720	1.46%	415,194	1,290	1.24%	251,508	984	1.56%
Tax-exempt investment securities	172,205	1,769	4.11%	171,320	1,775	4.15%	170,031	1,737	4.09%
Interest bearing deposits	334,136	207	0.25%	367,338	233	0.25%	270,456	169	0.25%
Loans held for sale	42,849	428	4.00%	54,511	593	4.35%	113,225	903	3.19%
Bank-owned life insurance	57,514	749	5.28%	56,979	1,086	7.56%	55,523	651	4.76%
Total earning assets	4,301,822	43,093	4.06%	4,277,000	44,667	4.14%	3,963,000	43,012	4.40%
Less: allowance for loan losses	(38,596)			(38,772)			(40,807)		
Total nonearning assets	421,655			422,702			421,911		
Total Assets	$ 4,684,881			$ 4,660,930			$ 4,344,104		
Liabilities and Equity:									
Interest bearing deposits									
Demand and money market	$ 1,169,605	$ 668	0.23%	$ 1,207,070	$ 747	0.25%	$ 1,132,413	$ 881	0.32%
Savings	319,263	725	0.92%	321,752	748	0.92%	323,048	816	1.02%
Certificates of deposit	1,056,637	1,949	0.75%	973,438	1,895	0.77%	907,368	1,799	0.80%
Total interest bearing deposits	2,545,505	3,342	0.53%	2,502,260	3,390	0.54%	2,362,829	3,496	0.60%
Borrowings	435,559	3,300	3.03%	443,455	3,255	2.87%	393,963	3,197	3.25%
Total interest bearing liabilities	2,981,064	6,642	0.90%	2,945,715	6,645	0.89%	2,756,792	6,693	0.98%
Demand deposits	1,037,907			1,058,660			951,858		
Other noninterest bearing liabilities	74,222			72,623			69,583		
Total liabilities	4,093,193			4,076,998			3,778,233		
Shareholders' equity	591,688			583,932			565,871		
Total liabilities and equity	$ 4,684,881			$ 4,660,930			$ 4,344,104		
Net interest income (tax-equivalent basis)		$ 36,451			$ 38,022			$ 36,319	
Reconcilement of Non-GAAP Financial Measures									
Bank-Owned Life Insurance		(749)			(1,086)			(651)	
Tax-equivalent basis adjustment		(509)			(480)			(458)	
Net interest income (GAAP)		$ 35,193			$ 36,456			$ 35,210	
Interest rate spread (1)			3.16%			3.25%			3.42%
Interest expense as a percent of average earning assets			0.63%			0.62%			0.68%
Net interest margin (tax equivalent basis) (2)			3.44%			3.53%			3.72%
Total cost of deposits			0.38%			0.38%			0.43%

(1) Interest spread is the average yield earned on earning assets less the average rate paid on interest bearing liabilities. Fully tax equivalent.
(2) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.

(Dollars in thousands)	Increase/(Decrease) Three Months Ended March 31, 2014 Compared to Three Months Ended December 31, 2013			Increase/(Decrease) Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 11	$ (1,482)	$ (1,471)	$ 1,494	$ (1,842)	$ (348)
Taxable investment securities	183	247	430	803	(68)	735
Tax-exempt investment securities	9	(15)	(6)	22	10	32
Interest bearing deposits	(25)	—	(25)	40	(1)	39
Loans held for sale	(119)	(46)	(165)	(662)	187	(475)
Bank-owned life insurance	9	(346)	(337)	24	74	98
Total earning assets	68	(1,642)	(1,574)	1,721	(1,640)	81
Liabilities and Equity:						
Interest bearing deposits						
Demand and money market	(28)	(51)	(79)	28	(241)	(213)
Savings	(20)	(3)	(23)	(10)	(81)	(91)
Certificates of deposit	125	(71)	54	282	(132)	150
Total interest bearing deposits	77	(125)	(48)	300	(454)	(154)
Borrowings	(59)	104	45	324	(221)	103
Total interest bearing liabilities	18	(21)	(3)	624	(675)	(51)
Net interest income	$ 50	$ (1,621)	$ (1,571)	$ 1,097	$ (965)	$ 132

(1) Variances caused by the change in rate times the change in balances are allocated to rate.

Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended March 31, 2014 was $22.73 million, a decrease of $1.03 million, or 4.33%, compared to the same period in 2013 and an increase of $4.02 million, or 21.46%, compared to the fourth quarter of 2013. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for the first quarter of 2014 was 39.24%, compared with 40.29% for comparative 2013 and 33.92% for the fourth quarter of 2013.

Our noninterest income primarily consists of fee income produced by our three reportable segments, less applicable commission expenses. The following tables provide an analysis of noninterest income (dollars in thousands):

	Three Months Ended March 31,		Increase/(Decrease) 2014 over 2013	
	2014	2013	Amount	Percent
Residential mortgage banking income, net	$ 5,062	$ 7,818	$ (2,756)	(35.25)%
Real estate brokerage and property management, net	3,292	3,372	(80)	(2.37)%
Insurance commissions and other title fees and income, net	9,061	7,982	1,079	13.52 %
Service charges on deposit accounts	2,131	2,030	101	4.98 %
Credit card merchant fees, net	773	853	(80)	(9.38)%
Other income	2,408	1,700	708	41.65 %
Subtotal before gain on investment securities	22,727	23,755	(1,028)	(4.33)%
Net gain (loss) on investment securities	2	604	(602)	(99.67)%
Total noninterest income	$ 22,729	$ 24,359	$ (1,630)	(6.69)%

	Three Months Ended		Increase/(Decrease) First Quarter 2014 over Fourth Quarter 2013	
	March 31, 2014	December 31, 2013	Amount	Percent
Residential mortgage banking income, net	$ 5,062	$ 5,515	$ (453)	(8.21)%
Real estate brokerage and property management, net	3,292	1,908	1,384	72.54 %
Insurance commissions and other title fees and income, net	9,061	6,025	3,036	50.39 %
Service charges on deposit accounts	2,131	2,211	(80)	(3.62)%
Credit card merchant fees, net	773	745	28	3.76 %
Other income	2,408	2,307	101	4.38 %
Subtotal before gain on investment securities	22,727	18,711	4,016	21.46 %
Net gain (loss) on investment securities	2	66	(64)	(96.97)%
Total noninterest income	$ 22,729	$ 18,777	$ 3,952	21.05 %

For the first quarter of 2014, residential mortgage banking income, net of commission expense, was $5.06 million, reflecting a decrease of $2.76 million, or 35.25%, compared to the first quarter of 2013 and a decrease of $453,000, or 8.21%, compared to the fourth quarter of 2013. The decrease from the prior year periods was primarily due to lower revenue margins and a decrease in production volumes related to rising interest rates and weather disruptions. Also factoring in the variance from the prior year periods was an increase in mortgage banking income of $181,000 associated with an increase in the value of rate lock commitments recorded as of March 31, 2014, as compared to a decrease of $379,000 and an increase of $564,000 recognized for the quarters ended December 31, 2013 and March 31, 2013, respectively.

Real estate brokerage and property management income, net of commission expense, for the first quarter of 2014 was $3.29 million, which was $80,000 or 2.37%, lower than comparative 2013, and $1.38 million, or 72.54%, more than the fourth quarter of 2013. While results were virtually unchanged from the comparative period of the prior year, the increase from the linked prior year quarter was primarily due to the seasonal increase in our resort property management business of $1.70 million. The variance in real estate brokerage income was affected by a slight rise in total volume of units sold of $711,000, or 0.43%, from the prior year quarter, and a decrease in volume of $70.19 million, or 29.73%, from the linked quarter.

For the first quarter of 2014, insurance commissions and other title income, net of commission expense, was $9.06 million, which was $1.08 million, or 13.52%, higher than comparative 2013, and $3.04 million, or 50.39%, higher than the fourth quarter 2013. The increase from the prior year comparative quarter was largely due to the acquisition of two insurance agencies in July 2013, which contributed additional commission and fee income of $457,000 for the three-month period ended March 31, 2014. Additionally, the Company recognized contingency income of $2.54 million in the current quarter, as compared to $1.42 million in the first quarter of 2013 and $26,000 in the fourth quarter of 2013. Contingent commissions are mostly received during the first quarter of each year.

For the first quarter of 2014, credit card merchant fees totaled $773,000, which was $80,000, or 9.38%, lower than comparative 2013, and $28,000, or 3.76%, higher than the fourth quarter of 2013. The variances were primarily related to changes in transaction volumes.

Service charges on deposit accounts were $2.13 million for the first quarter of 2014, compared with $2.03 million for the comparative 2013, and $2.21 million for the fourth quarter of 2013. The increases reflect the 8.11% and 0.63% increases in average deposits from the first quarter of 2013 and the fourth quarter of 2013, respectively.

Other noninterest income for the three months ended March 31, 2014 was $2.41 million and included income generated by Towne Investment Group, net of commission expense. For the three months ended March 31, 2014, net commission income for Towne Investment Group totaled $645,000 as compared to $465,000 for the first quarter of 2013 and $649,000 for the fourth quarter of 2013.

Noninterest Expense. For the quarter ended March 31, 2014, total noninterest expense was $41.08 million, which was $485,000, or 1.19%, higher than comparative 2013 and $81,000, or 0.20%, less than the quarter ended December 31, 2013.

As a percentage of operating income, noninterest expense was 70.93% for the first quarter of 2014, 68.85% for comparative 2013, and 74.32% for the quarter ended December 31, 2013. The primary components of noninterest expense in the first quarter of 2014 were salaries and employee benefits of

$23.40 million, occupancy expenses of $4.18 million, furniture and equipment expenses of $2.0 million, advertising and marketing expenses of $1.06 million, and professional fees of $1.19 million. In comparison to the prior year comparative quarter, a significant portion of the increase in total noninterest expense is due to the insurance agency acquisitions in July 2013, which resulted in additional expenses of $341,000 as compared to the first quarter of 2014. The linked quarter comparison was affected by a decrease to noninterest expense in the fourth quarter of 2013 related to a $1.20 million reversal of incentive compensation recorded in previous quarters of 2013. The reversal was recorded due to a slowing of results in the fourth quarter, primarily in mortgage-related activity, which reduced the availability of funds for profit sharing.

The following table provides an analysis of quarterly total noninterest expense by line item (dollars in thousands):

	Three Months Ended			Increase/(Decrease)			
				March 31, 2014 over		March 31, 2014 over	
	March 31,		December 31,	March 31, 2013		December 31, 2013	
	2014	2013	2013	Amount	Percent	Amount	Percent
Salaries and benefits	$ 23,396	$ 23,626	$ 22,596	$ (230)	(0.97)%	$ 800	3.54 %
Occupancy expense	4,176	3,772	4,424	404	10.71 %	(248)	(5.61)%
Furniture and equipment	2,000	1,723	1,983	277	16.08 %	17	0.86 %
Other							
Advertising and marketing	1,059	1,181	991	(122)	(10.33)%	68	6.86 %
Other	1,988	1,624	1,504	364	22.41 %	484	32.18 %
Charitable contributions	778	919	1,545	(141)	(15.34)%	(767)	(49.64)%
Outside processing	863	827	848	36	4.35 %	15	1.77 %
Professional fees	1,188	1,139	1,101	49	4.30 %	87	7.90 %
Stationery and supplies	441	491	559	(50)	(10.18)%	(118)	(21.11)%
FDIC and other insurance	899	794	1,081	105	13.22 %	(182)	(16.84)%
Foreclosed property expenses	804	834	606	(30)	(3.60)%	198	32.67 %
Software expense	981	1,062	1,030	(81)	(7.63)%	(49)	(4.76)%
Telephone and postage	994	964	1,053	30	3.11 %	(59)	(5.60)%
Amortization - intangibles	530	524	558	6	1.15 %	(28)	(5.02)%
Bank franchise tax/SCC fees	513	482	477	31	6.43 %	36	7.55 %
Directors fees and expenses	221	299	303	(78)	(26.09)%	(82)	(27.06)%
Travel/meals/entertainment	250	335	341	(85)	(25.37)%	(91)	(26.69)%
Total other expenses	11,509	11,475	11,997	34	0.30 %	(488)	(4.07)%
Total noninterest expense	$ 41,081	$ 40,596	$ 41,000	$ 485	1.19 %	$ 81	0.20 %

Salary and benefits expense, the largest portion of noninterest expense, was $23.40 million, representing 56.95% of total noninterest expense for the quarter ended March 31, 2014. Salary and benefits expense decreased $230,000, or 0.97%, from the comparative period in 2013 and increased 800,000, or 3.54%, over the fourth quarter of 2013. The decrease from the first quarter of the prior year is primarily due to reductions in employee profit sharing and benefits related to cost control initiatives launched by the Company in the first quarter of 2014, partially offset by addition of staff resulting from the insurance agency acquisitions and increased operational support. The increase from the linked quarter is primarily due to the aforementioned reversal of incentive compensation in the fourth quarter of 2013.

In our Banking segment we had a total of 631 full-time equivalent employees ("FTE") at March 31, 2014, which was down from 639 at March 31, 2013 and down from 660 at December 31, 2013. In our non-Banking segments at March 31, 2014, we had a total of 680 FTEs, excluding real estate sales agents, which was up from 650 at March 31, 2013 and down from 691 at December 31, 2013. Real estate sales agents are independent contractors, and therefore not included as our employees. Total operating income per FTE was $44,000 for the quarter ended March 31, 2014, decreased from $46,000 for the three-month period ended March 31, 2013, and decreased from $45,000 for the three-month period ended December 31, 2013.

Occupancy expense for the first quarter of 2014 experienced a $404,000, or 10.71% increase from the comparative quarter of 2013, and a $248,000, or 5.61% decrease from the fourth quarter of 2013. The increase from the comparative period in the prior year was primarily driven by increases related to the opening of new banking offices in Virginia Beach and Southern Shores and increased depreciation expense. The decrease from the sequential quarter was primarily a result of lower utilities, maintenance and repair, and cleaning and grounds service expenses.

For the quarter ended March 31, 2014, furniture and equipment expense increased by $277,000 over comparative 2013, and by $17,000 compared with the fourth quarter of 2013. Increases from comparative prior periods were related to furnishing new facilities and the associated depreciation expense on the capitalized furnishings utilized in those facilities.

Other noninterest expenses for the first quarter of 2014 was relatively unchanged compared to the same period in 2013 with a slight increase of $34,000, or 0.30%, while there was a decrease of $488,000, or 4.07%, when compared to fourth quarter of 2013. The primary drivers of the decrease from the linked prior year period were reductions in expenses related to travel, stationery and supplies, director fees, and charitable contributions.

Provision for Income Taxes. We reported a provision for income tax expense of $4.91 million, representing an effective tax rate of 30.58% in the first quarter of 2014. The provision for income tax expense was $4.37 million for the first quarter of 2013, with an effective rate of 29.43%, and $3.65 million, with an effective rate of 27.42% in the fourth quarter of 2013. The increase from the prior year periods was primarily a result of the Company's adoption of change in accounting for affordable housing projects that qualify for the low-income housing tax credit. Amortization of the initial investment cost of qualifying projects is now recorded in the provision for income taxes together with the tax credits and benefits received. Previously, the expense was recorded in other noninterest expenses.

Segment Performance Summary. Our reportable segments are a traditional full service community bank, a full service realty business, and a full service insurance agency. In this section, we discuss the performance and financial results of our segments. For further financial details, see *Note 6 – Segment Reporting* of the Notes to Consolidated Financial Statements in this report.

Banking Segment. For the three months ended March 31, 2014, the Banking segment represented 81.19%, or $9.04 million, of our total consolidated net income compared to 66.77%, or $6.99 million, for comparative 2013.

Pre-tax earnings for the three months ended March 31, 2014 for the Banking segment were $12.69 million, increasing $3.57 million, or 39.17%, from comparative 2013. The increase in earnings from the comparative 2013 quarter was primarily driven by decreases in the provision for loan losses of $3.27 million. Total noninterest income remained consistent with the comparative quarter. The increase in other income of $603,000 was mainly due to an additional $256,000 gains on sales of foreclosed assets and a $180,000 increase in net commission income, which was offset by a reduction in net gains on investment securities of $602,000. Total noninterest expenses were down slightly by $55,000. Salary expense was decreased $421,000 as a result of planned cost saving initiatives, but was offset by increased occupancy and furniture and equipment expenses of $398,000 as a result of two new branches.

Pre-tax earnings were down $671,000 compared to the linked quarter ended December 31, 2013. The overall decrease was primarily driven by a $1.11 million decrease in net interest income offset by a $245,000 decrease in the provision for loan losses.

The following charts present the revenue and expenses for the Banking segment as well as changes between periods (dollars in thousands):

	Quarter Ended			Increase/(Decrease)			
	March 31,		December 31,	2014 over 2013		March over December	
	2014	2013	2013	Amount	Percent	Amount	Percent
Net interest income	$ 34,905	$ 34,621	$ 36,010	$ 284	0.82 %	$ (1,105)	(3.07)%
Service charges on deposit accounts	2,131	2,030	2,211	101	4.98 %	(80)	(3.62)%
Credit card merchant fees	773	853	745	(80)	(9.38)%	28	3.76 %
Other income	1,778	1,175	1,561	603	51.32 %	217	13.90 %
Net gain (loss) on investment securities	2	604	66	(602)	(99.67)%	(64)	(96.97)%
Total noninterest income	4,684	4,662	4,583	22	0.47 %	101	2.20 %
Total revenue	39,589	39,283	40,593	306	0.78 %	(1,004)	(2.47)%
Provision for loan losses	306	3,571	551	(3,265)	(91.43)%	(245)	(44.46)%
Salaries and employee benefits	14,572	14,993	13,825	(421)	(2.81)%	747	5.40 %
Occupancy expense	2,856	2,696	3,184	160	5.93 %	(328)	(10.30)%
Furniture and equipment	1,564	1,326	1,580	238	17.95 %	(16)	(1.01)%
Other expenses	7,853	7,885	8,334	(32)	(0.41)%	(481)	(5.77)%
Total noninterest expenses	26,845	26,900	26,923	(55)	(0.20)%	(78)	(0.29)%
Income before income tax and corporate allocation	12,438	8,812	13,119	3,626	41.15 %	(681)	(5.19)%
Corporate allocation	253	307	243	(54)	(17.59)%	10	4.12 %
Income before income tax provision	12,691	9,119	13,362	3,572	39.17 %	(671)	(5.02)%
Provision for income tax expense	3,654	2,127	3,675	1,527	71.79 %	(21)	(0.57)%
Net income	$ 9,037	$ 6,992	$ 9,687	$ 2,045	29.25 %	$ (650)	(6.71)%
Efficiency ratio (1)	67.81%	69.55%	66.43%	(1.74)%	(2.50)%	1.38%	2.08 %

(1) Excludes gain on investment securities.

Realty Segment. For the three months ended March 31, 2014, the Realty segment had income before income tax provision and noncontrolling interest of $229,000 as compared to $3.93 million for the comparative 2013 period and a loss of $333,000 for the linked quarter ended December 31, 2013. Total revenue decreased to $9.30 million in 2014 from $12.54 million in the first quarter of 2013. The $2.77 million or 35.15% decrease in residential mortgage banking income was a result of thinner margins and a significant reduction in volume primarily due to a rise in rates. There was an increase in income associated with a rise in value of rate lock commitments of $181,000 for the quarter ended March 31, 2014, compared to an increase of $564,000 in the same period in 2013. Total revenue on a linked quarter comparison increased $516,000 due to normal seasonal increases from our resort property management fees, which compensated for the previously mentioned decreases due to lower margins and volume.

Expenses for the Realty segment increased 5.25%, or $445,000, when compared to the same period in 2013, and decreased by 0.50%, or $45,000, when compared to the quarter ended December 31, 2013. The increase in salary and occupancy expense was a result of an expansion of our processing centers and expanding into the Georgia market place.

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The following charts present the revenue and expenses for the Realty segment (dollars in thousands):

	Three Months Ended			Increase/(Decrease)			
	March 31,		December 31,	March 31, 2014 March 31, 2013		March 31, 2014 December 31, 2013	
	2014	2013	2013	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	$ 5,118	$ 7,892	$ 5,652	$ (2,774)	(35.15)%	$ (534)	(9.45)%
Real estate brokerage income, net	1,140	1,082	1,452	58	5.36 %	(312)	(21.49)%
Title insurance and settlement fees	345	427	425	(82)	(19.20)%	(80)	(18.82)%
Property management fees, net	2,152	2,290	456	(138)	(6.03)%	1,696	371.93 %
Income from unconsolidated subsidiary	86	119	83	(33)	(27.73)%	3	3.61 %
Net interest and other income	458	730	715	(272)	(37.26)%	(257)	(35.94)%
Total revenue	9,299	12,540	8,783	(3,241)	(25.85)%	516	5.87 %
Salaries and employee benefits	5,415	5,065	5,375	350	6.91 %	40	0.74 %
Occupancy expense	942	783	907	159	20.31 %	35	3.86 %
Furniture and equipment	277	252	260	25	9.92 %	17	6.54 %
Amortization of intangible assets	127	133	127	(6)	(4.51)%	—	— %
Other expenses	2,161	2,244	2,298	(83)	(3.70)%	(137)	(5.96)%
Total expenses	8,922	8,477	8,967	445	5.25 %	(45)	(0.50)%
Income before income tax, corporate allocation and noncontrolling interest	377	4,063	(184)	(3,686)	(90.72)%	561	N/M
Corporate allocation	(148)	(133)	(149)	(15)	(11.28)%	1	0.67 %
Income before income tax provision and noncontrolling interest	229	3,930	(333)	(3,701)	(94.17)%	562	N/M
Provision for income tax	42	1,379	(246)	(1,337)	(96.95)%	288	N/M
Net income (loss)	187	2,551	(87)	(2,364)	(92.67)%	274	N/M
Noncontrolling interest	(212)	(341)	(320)	129	37.83 %	108	33.75 %
Net income (loss) attributable to TowneBank	$ (25)	$ 2,210	$ (407)	$ (2,235)	(101.13)%	$ 382	93.86 %
Key data:							
Efficiency ratio	95.95%	67.60%	102.09%	28.35%	41.94 %	(6.14)%	(6.01)%
Number of units sold	611	692	892	(81)	(11.71)%	(281)	(31.50)%
Volume of units sold	$165,876	$165,165	$ 236,061	$ 711	0.43 %	$(70,185)	(29.73)%
Number of real estate agents	393	357	373	36	10.08 %	20	5.36 %
Loans originated, mortgage	$ 82,698	$178,880	$ 122,016	$ (96,182)	(53.77)%	$(39,318)	(32.22)%
Loans originated, joint venture	121,069	158,083	151,663	(37,014)	(23.41)%	(30,594)	(20.17)%
Total loans originated	$203,767	$336,963	$ 273,679	$(133,196)	(39.53)%	$(69,912)	(25.55)%
Number of loans, mortgage	392	844	550	(452)	(53.55)%	(158)	(28.73)%
Number of loans, joint venture	575	761	753	(186)	(24.44)%	(178)	(23.64)%
Total number of loans	967	1,605	1,303	(638)	(39.75)%	(336)	(25.79)%
Average loan amount, mortgage	$ 211	$ 212	$ 222	$ (1)	(0.47)%	$ (11)	(4.95)%
Average loan amount, joint venture	211	208	201	$ 3	1.44 %	10	4.98 %
Average loan amount	$ 211	$ 210	$ 210	$ 1	0.48 %	$ 1	0.48 %
Average number of originators, mortgage	63	70	54	(7)	(10.00)%	9	16.67 %
Average number of originators, joint venture	60	41	61	19	46.34 %	(1)	(1.64)%
Average number of originators	123	111	115	12	10.81 %	8	6.96 %

Mortgage. The loan volume for the combined mortgage operations decreased in the quarter ended March 31, 2014 as compared to the same period in 2013. Total loans originated in the first quarter of 2014 were $203.77 million, a 39.53% decrease, or $133.20 million from $336.96 million in the comparative period of 2013. This was a $69.91 million, or 25.55%, decrease compared to the volume for the quarter ended December 31, 2013. Refinance activity comprised $28.76 million of loan volume for the quarter ended March 31, 2014, while purchases accounted for the remaining $175.01 million in loan volume for the quarter. For the quarters ended March 31, 2013 and December 31, 2013, refinance volume was $125.46 million and $54.11 million, respectively, while purchase volume was $211.50 million and $219.57 million, respectively.

Insurance Segment. The Insurance segment is comprised of property and casualty and group benefit divisions. The Insurance segment represented 19.03%, or $2.12 million, of total consolidated net income at March 31, 2014 and 12.13%, or $1.27 million, at March 31, 2013.

Earnings before income taxes and noncontrolling interests for the three months ended March 31, 2014 were $3.59 million, increasing $1.24 million, or 52.57%, from comparative 2013. The primary factors affecting earnings in both periods were the acquisitions of two insurance companies within the past year.

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The following chart presents the revenue and expenses as well as the changes for the Insurance segment (dollars in thousands):

	Three Months Ended			Increase/(Decrease) March 31, 2014 March 31, 2013		Increase/(Decrease) March 31, 2014 December 31, 2013	
	March 31, 2014	March 31, 2013	December 31, 2013	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 4,278	$ 4,227	$ 4,103	$ 51	1.21 %	$ 175	4.27 %
Specialized benefit services	133	126	132	7	5.56 %	1	0.76 %
Employee benefits	1,829	1,842	1,379	(13)	(0.71)%	450	32.63 %
Total net commissions and fees	6,240	6,195	5,614	45	0.73 %	626	11.15 %
Contingency and bonus revenue	2,609	1,487	119	1,122	75.45 %	2,490	N/M
Other income	160	64	125	96	150.00 %	35	28.00 %
Total revenues	9,009	7,746	5,858	1,263	16.31 %	3,151	53.79 %
Salaries and employee benefits	3,409	3,568	3,397	(159)	(4.46)%	12	0.35 %
Occupancy expense	378	293	333	85	29.01 %	45	13.51 %
Furniture and equipment	160	145	142	15	10.34 %	18	12.68 %
Amortization of intangible assets	388	363	415	25	6.89 %	(27)	(6.51)%
Other expenses	979	850	822	129	15.18 %	157	19.10 %
Total operating expenses	5,314	5,219	5,109	95	1.82 %	205	4.01 %
Income before income tax, corporate allocation and noncontrolling interest	3,695	2,527	749	1,168	46.22 %	2,946	393.32 %
Corporate allocation	(105)	(174)	(93)	69	(39.66)%	(12)	12.90 %
Income before income tax provision and noncontrolling interest	3,590	2,353	656	1,237	52.57 %	2,934	447.26 %
Provision for income tax	1,209	860	226	349	40.58 %	983	434.96 %
Net income	2,381	1,493	430	888	59.48 %	1,951	453.72 %
Noncontrolling interest	(262)	(223)	(34)	(39)	17.49 %	(228)	670.59 %
Net income attributable to TowneBank	$ 2,119	$ 1,270	$ 396	$ 849	66.85 %	$ 1,723	435.10 %
Efficiency ratio	58.99%	67.38%	87.21%	(8.39)%	(12.45)%	(28.22)%	(32.36)%

Total revenues for the first quarter of 2014 increased $1.26 million, or 16.31%, when compared to the same period in 2013, and increased $3.15 million, or 53.79%, when compared to the quarter ended December 31, 2013. The increase from the comparative 2013 period was impacted by two insurance agency acquisitions that led to an additional $457,000 in net commissions. The increase from the linked quarter was due to growth in our travel insurance business and normal seasonal increases in employee benefit products. Also contributing to the increase from both prior periods was an increase in contingency and bonus revenue of $1.12 million, from the first quarter of 2013, and an increase of $2.49 million, from the fourth quarter of 2013. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other things. Such commissions are seasonal in nature and are mostly received during the first quarter of each year.

Salaries and employee benefits expense decreased $159,000, or 4.46%, when comparing the three months ended March 31, 2014 to the same period for 2013. The decrease was driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $227,000, but was offset by cost reduction in benefits.

Occupancy expense increased $85,000 and 29.01%, when comparing the three months ended March 31, 2014 to the same period for 2013.

Other expenses also increased as a direct result of the insurance agency acquisitions. The increase for the three-month period ended March 31, 2014 was $129,000 when compared to the same period in 2013. The increase over the linked quarter of $157,000 was mainly due to a reduction in expenses of approximately $272,000 in the fourth quarter of 2013 from an earn-out settlement related to a previous acquisition.

ANALYSIS OF FINANCIAL CONDITION

Overview. At March 31, 2014, total assets were $4.78 billion, which is $400.07 million, or 9.14%, higher than the period end balance for comparative 2013 and $102.24 million, or 2.19%, greater than the balance at December 31, 2013. Our loan portfolio, less unearned income and deferred costs, made up 68.47% of our period end assets and totaled $3.27 billion at March 31, 2014. Average assets for the quarter ended March 31, 2014 were $4.68 billion, up $340.78 million, or 7.84%, from comparative March 31, 2013 and up $23.95 million, or 0.51%, from the quarter ended December 31, 2013.

Average earning assets increased $338.82 million, or 8.55%, from $3.96 billion for the first quarter of 2013 to $4.30 billion for the first quarter of 2014. Compared to the fourth quarter of 2013, average earning assets increased $24.82 million.

Our average total deposits were $3.58 billion for first quarter 2014, reflecting growth of $268.72 million, or 8.11%, compared to first quarter 2013. Growth continued in average noninterest bearing deposits, which increased $86.05 million, or 9.04%, from March 31, 2013.

Interest Bearing Deposits in Financial Institutions. Interest bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest bearing deposit balances at March 31, 2014 were $221.59 million and consisted mainly of overnight deposits with the Federal Reserve Bank of Richmond.

The average balance of interest bearing deposits in other banks and federal funds sold during the first quarter of 2014 was $334.14 million, or 7.77%, of average total earning assets compared with $270.46 million, or 6.82%, of average total earning assets for comparative 2013. For the fourth quarter of 2013, the average balance of interest bearing deposits in other banks was $367.34 million, or 8.59%, of average total earning assets.

Securities Available for Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The available-for-sale securities portfolio was $551.80 million at March 31, 2014 compared with $269.54 million at March 31, 2013. The average balance during the first quarter of 2014 was $396.68 million compared to the 2013 period average of $230.07 million, or 9.22% and 6.32% of average earning assets, respectively. During the three months ended March 31, 2014, we had sales, maturities and calls totaling $217.94 million, in investment securities that were classified as available for sale.

The securities are held primarily for earnings, liquidity, and asset/liability management purposes and reviewed quarterly for possible other-than-temporary impairments. During this review, we analyze the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer, and our intent and ability to hold the security to recovery or maturity. These factors are analyzed on an individual basis.

Securities Held to Maturity. Held-to-maturity securities are valued at amortized cost. Securities held to maturity were $232.88 million at March 31, 2014 and $155.32 million at March 31, 2013. The average balance during the first quarter of 2014 was $208.84 million compared with $155.42 million in the 2013 period, representing 4.85% and 3.92% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At March 31, 2014, we held $57.75 million in mortgage loans originated and intended for sale in the secondary market, as compared with $113.68 million at March 31, 2013 and $58.64 million at December 31, 2013. The decline from prior periods in the balance of loans held for sale is consistent with the decrease in mortgage origination volume in the first quarter of 2014.

Average loans held for sale were 1.00% and 2.86% of average earning assets for the quarters ended March 31, 2014 and 2013, respectively. Average loans held for sale were 1.27% of average earning assets for the quarter ended December 31, 2013. The majority of mortgage loans held for sale have been pre-committed to investors, which minimizes our interest rate risk.

Our mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate lock with the customer. The commitments are generally for periods of 60 days and are at market rates. In order to mitigate the risk from interest rate fluctuations, we enter into forward loan sale commitments on a "best efforts" basis while the loan is in the pipeline.

Rate lock commitments related to the origination of mortgage loans held for sale and the corresponding forward loan sale commitments are considered derivative instruments, which are carried at fair value. These derivative instruments do not qualify for hedge accounting. The fair value of interest rate lock commitments is based on current secondary market pricing and recognized on the income statement at the time of commitment. Gains on the sales of mortgages are recognized when the Company, the borrower and the investor enter into the loan contract.

Loan Portfolio. Loans, net of unearned income and deferred costs, were $3.27 billion at March 31, 2014, which was $111.24 million, or 3.52%, above the $3.16 billion reported at March 31, 2013 and $33.37 million, or 1.03%, above the $3.24 billion at December 31, 2013. Factors that contributed to the increase in loan demand from the prior year were the stabilization of our local economy, and the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers and directors. As a percentage of total average earning assets, average loans were 74.97% for the quarter ended March 31, 2014 compared with 78.28% for 2013 and 75.09% for the quarter ended December 31, 2013.

Allowance for Loan Losses and Asset Quality. The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on management's evaluation of the risk inherent in the loan portfolio at the balance sheet date and changes in the nature and volume of loan activity. This evaluation includes a review of loans for which collection may not be reasonably assured. It considers internal risk grades, the estimated fair value of the underlying collateral, current economic conditions, historical loan loss experience, and other current factors that warrant consideration in determining an adequate allowance.

The allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with Accounting Standards Codification ("ASC") 310, *Receivables*, based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC 450, *Contingencies*, based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

It is our policy to recommend internal risk grades to all loans as a component of the approval process. Based on the size of the loan, senior credit officers, regional credit administrators, and the chief credit officer review the classification to ensure accuracy and consistency of classifications, which are then validated by the internal loan review process. Loan classifications are internally reviewed to determine if any changes in the circumstances of the loan require a different risk grade. To determine the most appropriate risk grade classification for each loan, the credit officers examine the borrower's liquidity level, asset quality, the amount of the borrower's other indebtedness, cash flow, earnings, sources of financing, and existing lending relationships. The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are updated quarterly based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. Our pools of similar loans include groups of construction and land development loans, commercial real estate loans, commercial and industrial business loans, 1-4 family residential real estate loans, multifamily real estate loans, and consumer and other loans.

During the third quarter of 2012, management updated the look-back period for calculating historical losses for all classes of loans from eight quarters to 12 quarters. In the current economic environment, we believe the extension of our look-back period was appropriate due to the risks inherent in our loan portfolio. We believe this period remains a relevant indicator of the current credit cycle and in determining the risks in the loan portfolio. As we progress through this economic cycle, we will continue to evaluate the appropriateness of the look-back period utilized as we seek to capture the inherent risks in our portfolio. This refinement of our historical loss calculation period did not have a material impact on our allowance for loan losses or provision expense.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to TowneBank. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Company's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures, and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis to determine an appropriate general valuation allowance.

The allowance for loan losses at March 31, 2014, March 31, 2013, and December 31, 2014 was $37.54 million, $40.65 million, and $38.38 million, respectively. The allowance was equal to 1.15% of total loans outstanding at March 31, 2014, compared with 1.29% and 1.19% at March 31, 2013 and December 31, 2013, respectively. We believe the decline in the ratio is appropriate given the continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Reflective of improving credit quality, classified loans, defined as loans in the substandard and doubtful categories, were 1.89% of total loans at March 31, 2014, down from 2.30% at March 31, 2013, and unchanged from 1.89% at December 31, 2013. Additionally, while loans 60 to 89 days past due increased to $1.90 million at March 31, 2014 from $379,000 and $563,000 at March 31, 2013 and December 31, 2013, respectively, total past due and nonaccruing loans decreased to $24.24 million at March 31, 2014, from $26.57 million and $26.66 million at March 31, 2013 and December 31, 2013, respectively. Also reflecting improvement in our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 3.42x of nonperforming loans at March 31, 2014, compared with 2.34x and 3.01x at March 31, 2013 and December 31, 2013, respectively. Although overall economic conditions have continued to show improvement, the residential real estate market remains stressed and risks to a full recovery remain. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at March 31, 2014.

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The following table provides information on activity for the allowance for loan losses and nonperforming assets (dollars in thousands):

	Three Months Ended		
	March 31,		December 31,
	2014	2013	2013
Allowance for loan losses			
Balance beginning of period	$ 38,380	$ 40,427	$ 38,560
Loans charged off:			
Residential 1-4 family	(707)	(2,027)	(849)
Multifamily	(1)	(14)	—
Commercial real estate	(386)	—	(96)
Construction	(226)	(1,347)	(85)
Commercial and industrial	(142)	(772)	(109)
Consumer and other	(164)	(69)	(102)
Total	(1,626)	(4,229)	(1,241)
Loans recovered:			
Residential 1-4 family	60	214	146
Multifamily	1	—	—
Commercial real estate	304	7	311
Construction	22	344	13
Commercial and industrial	45	304	23
Consumer and other	27	11	17
Total	459	880	510
Net loans charged off	(1,167)	(3,349)	(731)
Provision for loan losses	330	3,571	551
Balance end of period	$ 37,543	$ 40,649	$ 38,380
Nonperforming assets			
Nonperforming loans	$ 10,977	$ 17,389	$ 12,753
Foreclosed property	41,511	46,622	39,534
Total nonperforming assets	$ 52,488	$ 64,011	$ 52,287
Loans past due 90 days and still accruing interest	$ 576	$ —	$ —
Asset Quality Ratios			
Allowance for loan losses to nonperforming loans	3.42x	2.34x	3.01x
Allowance for loan losses to period end loans	1.15%	1.29%	1.19%
Nonperforming loans to period end loans	0.34%	0.55%	0.39%
Nonperforming assets to period end assets	1.10%	1.46%	1.12%
Net charge-offs to average loans (annualized)	0.15%	0.43%	0.09%

Nonperforming assets consist of nonaccrual loans, foreclosed real estate, and other repossessed collateral. It is our policy to place commercial loans on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 90 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. When loans are placed on nonaccrual status, interest receivable is reversed against interest income recognized in the current period, and any prior year unpaid interest is charged off against the allowance for loan losses. Interest payments received thereafter are applied as a reduction of the remaining principal balance so long as doubt exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when the collection of principal or interest is no longer doubtful. Similarly, residential mortgage loans and other consumer loans are also placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection.

At March 31, 2014, we had $52.49 million in nonperforming assets, which amounted to 1.10% of total assets. Additionally, there were $576,000 in loans past due 90 days or more that were accruing interest. Nonperforming assets consist of $10.98 million in nonperforming loans as well as $41.51 million in foreclosed property. Nonperforming loans decreased by $1.78 million from December 31, 2013, as transfers to other real estate owned ("OREO"), charge-offs, and payments received outpaced additions to nonaccrual loans during the first quarter of 2014. The majority of the change was in nonperforming 1-4 family residential real estate loans which decreased by $856,000, with paydowns of $209,000, charge-offs of $707,000, and transfers to OREO of $1.32 million, which outpaced new nonperforming loans. Additionally, nonperforming construction and land development loans decreased by $817,000, with paydowns of $687,000 and charge-offs of $193,000, which outpaced new nonperforming loans of $62,000. At March 31, 2014, foreclosed property totaled $41.51 million, an increase from $39.53 million at December 31, 2013 and a decrease from $46.62 million at March 31, 2013. The five largest foreclosed property developments represented approximately 70% of total foreclosed property at March 31, 2014, with the largest development representing approximately 43%. Foreclosed property consists of 43 residential properties, 33 construction and development properties, and eight commercial properties.

At March 31, 2014, loans 60-89 days past due, excluding nonperforming loans, totaled $1.90 million. Additionally, there are other performing loans, totaling $48.95 million, that are current but have certain documentation deficiencies or other potential weaknesses that management has determined warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

In order to maximize the collection of loan balances, we evaluate troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. We may pursue loan modifications when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. Because some troubled debt restructurings ("TDRs") may not ultimately result in the complete collection of principal and interest (as modified by the terms of the restructuring), additional incremental losses could result. These potential incremental losses have been factored into our overall allowance for loan losses estimate.

At March 31, 2014, nonaccruing TDRs, which are included in nonperforming loans, totaled $4.54 million and accruing TDRs totaled $43.86 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following table provides information on the composition of nonperforming loans by loan type (in thousands):

	March 31, 2014	December 31, 2013
Construction and land development	$ 4,869	$ 5,687
Commercial real estate	1,843	1,422
Multi-family real estate	—	606
1-4 family residential real estate	3,338	4,194
Commercial and industrial business loans	923	687
Consumer loans and other	4	157
Total nonperforming loans	$ 10,977	$ 12,753

Allocation of the Allowance for Loan Losses. The following table provides a breakdown of the allowance for loan losses among the various loan types for the periods indicated (in thousands):

	March 31,		December 31,
	2014	2013	2013
Real estate loans:			
Residential 1-4 family	$ 10,168	$ 10,853	$ 10,730
Commercial	13,922	13,357	13,621
Construction	7,768	10,467	7,925
Multi-family	524	725	699
Total real estate loans	32,382	35,402	32,975
Commercial and industrial loans	4,411	3,785	4,711
Consumer loans and other	750	1,462	694
Total	$ 37,543	$ 40,649	$ 38,380

Deposits. Total deposits at March 31, 2014 were $3.68 billion, representing an increase of 10.13%, or $338.78 million, over March 31, 2013, and an increase of $114.61 million, or 3.21%, compared to December 31, 2013. Overall growth in deposits from the first quarter of 2013 is primarily attributed to an increase in the Banking segment customer base and in the number of accounts. Total average deposits were $3.58 billion during the first quarter of 2014 compared to $3.31 billion during the first quarter of 2013 and $3.56 billion during the fourth quarter of 2013.

Average noninterest bearing demand deposits as a percentage of average total deposits were 28.96% during the first quarter of 2014 and 28.72% during the same period in 2013. Average noninterest bearing demand deposits were 29.73% of average total deposits for the fourth quarter of 2013. The cost of interest bearing deposits was 0.53% for the first quarter of 2014 compared with 0.60% for the first quarter of 2013 and 0.54% for the fourth quarter of 2013.

PART I. FINANCIAL INFORMATION
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following tables set forth a summary of our various deposit categories and their respective cost rates (dollars in thousands):

	Average Balance/Cost Rate					
	Three Months Ended					
	March 31,				December 31,	
	2014		2013		2013	
Interest bearing demand and money market accounts	$ 1,169,605	0.23%	$ 1,132,413	0.32%	$ 1,207,070	0.25%
Regular savings	319,263	0.92%	323,048	1.02%	321,752	0.92%
Certificates of deposit	1,056,637	0.75%	907,368	0.80%	973,438	0.77%
Total interest bearing	2,545,505	0.53%	2,362,829	0.60%	2,502,260	0.54%
Noninterest bearing	1,037,907		951,858		1,058,660	
Total	$ 3,583,412	0.38%	$ 3,314,687	0.43%	$ 3,560,920	0.38%

The following table provides the average balance and composition of our deposits by major classification (dollars in thousands):

	Average Balance and Composition					
	Three Months Ended					
	March 31,				December 31,	
	2014		2013		2013	
Interest bearing demand and money market accounts	$ 1,169,605	32.64%	$ 1,132,413	34.16%	$ 1,207,070	33.90%
Regular savings	319,263	8.91%	323,048	9.75%	321,752	9.04%
Certificates of deposit	1,056,637	29.49%	907,368	27.37%	973,438	27.34%
Total interest bearing	2,545,505	71.04%	2,362,829	71.28%	2,502,260	70.27%
Noninterest bearing	1,037,907	28.96%	951,858	28.72%	1,058,660	29.73%
Total	$ 3,583,412	100.00%	$ 3,314,687	100.00%	$ 3,560,920	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the Federal Home Loan Bank of Atlanta ("FHLB") as of March 31, 2014 were $394.85 million, compared to $380.00 million at March 31, 2013 and $389.50 million at December 31, 2013. The average borrowing cost for the first quarter of 2014 was 3.33%, compared to 3.35% for the same period in 2013 and 3.33% for the fourth quarter of 2013. The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at March 31, 2014 are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call Date	Outstanding Amount
03/06/2017	4.08%	06/06/2014	$ 100,000
05/18/2017	4.35%	05/19/2014	80,000
05/18/2017	4.48%	05/19/2014	80,000
01/29/2018	3.05%	—	13,000
01/29/2018	3.05%	—	7,000
09/28/2015	0.55%	—	33,000
09/28/2017	0.95%	—	34,000
09/30/2019	1.44%	—	33,000
06/08/2026	2.38%	—	9,030
11/15/2028	3.43%	—	5,825
		Total FHLB Loans	**$ 394,855**

At March 31, 2014, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $799.88 million collateralized the advances from the FHLB. At March 31, 2013, certain loans with carrying values of $775.92 million collateralized the advances from the FHLB. At December 31, 2013, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $769.71 million collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of March 31, 2014, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the first quarter of 2014 were $435.56 million compared with $393.96 million for the first quarter of 2013 and $443.45 million for the fourth quarter of 2013, while the average cost of these funds was 3.03%, 3.25% and 2.87%, respectively.

Convertible Subordinated Capital Debentures. The Company had no convertible subordinated capital debentures at March 31, 2014 or December 31, 2013. During the first quarter of 2012, the Company announced the mandatory conversion of its outstanding Series III notes. At the close of business on March 19, 2012, all $13.60 million of outstanding Series III notes were converted into shares of the Company's common stock at the conversion price of $13.38 per share (equal to a conversion rate of 149.48 shares per $2,000 principal amount of notes).

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* on page 37 in this report.

PART I. FINANCIAL INFORMATION

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

On February 26, 2014, we declared a quarterly shareholder cash dividend of $0.10 per common share. The dividend was paid on April 11, 2014 to shareholders of record on March 28, 2014.

All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

Liquidity and Capital Structure. Liquidity represents our ability to provide funds to meet customer demands for loan and deposit withdrawals without impairing profitability. Our liquid assets consist of cash, interest bearing deposits in financial institutions, federal funds sold, and investments and loans maturing within one year. Asset liquidity is also provided by managing both loan and security maturities.

Risk-based capital guidelines for United States banking organizations have been issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency. Per these guidelines, we consider our sources of liquidity to be adequate to meet our estimated needs and have sufficient alternative sources of liquidity to meet our funding commitments and growth plans.

An additional measure of capital adequacy is risk-based capital ratios. As indicated below, our risk-based capital ratios are 12.95% for Tier I and 13.97% for total capital, which are both well above the required minimums of 4.00% and 8.00%, respectively. Under the FDIC rules, we are considered "well capitalized" as of March 31, 2014.

The following table provides information on our risk-based capital position (dollars in thousands):

	March 31,		December 31,
	2014	**2013**	**2013**
Tier I Capital:			
Shareholders' equity (1)(2)	$ 593,519	$ 566,039	$ 585,662
Less: goodwill and intangible assets, net of deferred tax	117,816	117,150	118,399
Total Tier I	475,703	448,889	467,263
Tier II Capital:			
Qualifying allowance for loan losses (3)	37,543	40,649	38,380
Total Tier II	37,543	40,649	38,380
Total Risk Based Capital	$ 513,246	$ 489,538	$ 505,643
Total Assets	$ 4,775,234	$ 4,375,164	$ 4,672,998
Total risk weighted assets	3,673,660	3,551,605	3,612,825
Average assets for leverage capital purposes	4,567,065	4,226,953	4,542,531
Risk Weighted Assets to Total Assets	76.93%	81.18%	77.31%
Risk Based Capital Ratios:			
Tier I (4% minimum requirement)	12.95%	12.64%	12.93%
Total (8% minimum requirement)	13.97%	13.78%	14.00%
Tier I Leverage Ratio (4% minimum requirement)	10.42%	10.62%	10.29%

(1) Excludes unrealized gains/losses on securities available for sale.
(2) Includes adjustments per regulatory guidelines.
(3) Limited to 1.25% of risk weighted assets.

Non-GAAP Reconciliations. The Company presents return on average assets, return on average tangible assets, return on average equity, and return on average tangible equity. Management excludes the balance of average goodwill and other intangible assets from the Company's calculation of return on average tangible assets and return on average tangible equity. This adjustment allows management to review the Company's core operating result and core capital position.

	Three Months Ended March 31,	
	2014	2013
Return on average assets (GAAP basis)	0.96%	0.98%
Impact of excluding average goodwill and other intangibles and amortization	0.03%	0.03%
Return on average tangible assets	0.99%	1.01%

	Three Months Ended March 31,	
	2014	2013
Return on average equity (GAAP basis)	7.63%	7.51%
Impact of excluding average goodwill and other intangibles and amortization	1.94%	1.99%
Return on average tangible equity	9.57%	9.50%

The Company presents book value (period ended shareholders' equity divided by the period ended common shares outstanding) and tangible book value. In calculating tangible book value, goodwill and other intangible assets are excluded allowing management to review the Company's core capital position.

	Three Months Ended March 31,	
	2014	2013
Book value (GAAP basis)	$ 14.38	$ 13.26
Impact of excluding goodwill and other intangibles and amortization	3.38	3.69
Tangible book value	$ 11.00	$ 9.57

PART I. FINANCIAL INFORMATION
Item 3. Quantitative and Qualitative Disclosures About Market Risk

Disclosures About Market Risk. Our Asset/Liability Management Committee ("ALCO") monitors loan, investment, and liability portfolios to ensure comprehensive management of interest rate risk. These portfolios are analyzed for proper fixed-rate and variable-rate mixes under various interest rate scenarios.

The asset/liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities, or repricing opportunities of earning assets, deposits, and borrowed funds. It is the responsibility of the ALCO to determine and achieve the most appropriate volume and mix of earning assets and interest-bearing liabilities, as well as ensure an adequate level of liquidity and capital within the context of corporate performance goals. The ALCO also sets policy guidelines and establishes long-term strategies with respect to interest rate risk exposure and liquidity. The ALCO meets regularly to review our interest rate risk and liquidity positions in relation to present and prospective market and business conditions and adopts funding and balance sheet management strategies that are intended to ensure that the potential impact on earnings and liquidity as a result of fluctuations in interest rates is within acceptable standards.

Market Risk. The effective management of market risk is essential to achieving our strategic objectives. As a financial institution, our most significant market risk exposure is interest rate risk. The primary objective of interest rate risk management is to minimize the effect that changes in interest rates have on net interest income. This is accomplished through active management of asset and liability portfolios with a focus on the strategic pricing of asset and liability accounts and management of appropriate maturity mixes of assets and liabilities. The goal of these activities is the development of appropriate maturity and repricing opportunities in our portfolios of assets and liabilities that will produce consistent net interest income during periods of changing interest rates.

Prudent balance sheet management requires processes that monitor and protect us against unanticipated or significant changes in the level of market interest rates. Net interest income stability should be maintained in changing rate environments by ensuring that interest rate risk is kept to an acceptable level.

The ability to reprice our interest-sensitive assets and liabilities over various time intervals is of critical importance. An asset-sensitive balance sheet structure implies that assets, such as loans and securities, will reprice faster than liabilities; consequently, net interest income should be positively affected in an increasing interest rate environment. Conversely, a liability-sensitive balance sheet structure implies that liabilities, such as deposits, will reprice faster than assets; consequently, net interest income should be positively affected in a decreasing interest rate environment.

Interest Rate Risk. We utilize a variety of measurement techniques to identify and manage our exposure to interest rates. We do not use off-balance sheet financial instruments to manage interest rate sensitivity and net interest income. We do, however, use a variety of traditional and on-balance sheet tools to manage our interest rate risk. Gap analysis, which monitors the "gap" between interest-sensitive assets and liabilities, is one such tool. In addition, we use simulation modeling to forecast future balance sheet and income statement behavior. By studying the effects on net interest income of rising, stable, and falling interest rate scenarios, we can position ourselves to take advantage of anticipated interest rate movement and to protect ourselves from unanticipated rate movements by understanding the dynamic nature of our balance sheet components.

At March 31, 2014, we had $398.81 million more liabilities than assets subject to repricing within one year, and therefore, were in a liability-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

Item 4. Controls and Procedures

Controls and Procedures. As of March 31, 2014, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2014. There were no changes that occurred during the period covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of operations, we are a party to various legal proceedings. Based upon information currently available, management believes that such legal proceedings, in the aggregate, will not have a material adverse effect on our business, financial condition, or results of operations.

Item 1A. Risk Factors

For information regarding factors that could affect the Company's results of operations, financial condition or liquidity, see the risk factors discussed in Part I, Item 1A of TowneBank's 2013 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2 of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2013 Annual Report on Form 10-K.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No.	Description
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
(99)	Independent Accountants' Report by Dixon Hughes Goodman LLP, dated May 8, 2014

Signatures

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

TOWNEBANK

May 8, 2014	By: /s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
May 8, 2014	By: /s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

Exhibit (31.1)

CERTIFICATIONS

I, G. Robert Aston, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2014 of TowneBank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors, and the audit committee of the registrant’s board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 8, 2014	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to TowneBank and will be retained by TowneBank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.

Exhibit (31.2)

CERTIFICATIONS

I, Clyde E. McFarland, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2014 of TowneBank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors, and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 8, 2014	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to TowneBank and will be retained by TowneBank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.

Exhibit (32)

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350, as adopted by §906 of the Sarbanes-Oxley Act of 2002, the undersigned officers of TowneBank do hereby certify, to such officer's knowledge, that:

1. Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, our financial condition and result of operations as of and for the period covered by the Report.

May 8, 2014	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
May 8, 2014	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to TowneBank and will be retained by TowneBank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.

DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of *TowneBank*

We have reviewed the accompanying consolidated balance sheets of *TowneBank* and subsidiaries (the Company) as of March 31, 2014 and 2013, the related consolidated statement of equity for the three months ended March 31, 2014, and the related consolidated statements of income, comprehensive income and cash flows for the three months ended March 31, 2014 and 2013. This condensed financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with the standards established by the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed financial information referred to above for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated balance sheet of *TowneBank* and subsidiaries as of December 31, 2013, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated March 12, 2014, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2013, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Dixon Hughes Goodman LLP

Norfolk, Virginia
May 8, 2014