FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C. 20429

FORM 10-K

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

For the fiscal year ended December 31, 2014

FDIC Insurance Certificate 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 Number)
5716 High Street, Portsmouth, VA	**23703**
(Address of principal executive offices)	(Zip Code)

757 638-7500

(Registrant's telephone number, including area code)

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

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $1.667 per share	The NASDAQ Global Select Market

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 aggregate market value of the common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most completed second fiscal quarter was approximately $470,421,544.

Number of Shares of Common Stock Outstanding at February 28, 2015: 51,344,236 shares

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Registrant's 2014 Annual Report to Shareholders are incorporated by reference into Parts I, II, and IV; and
(2) Portions of the Registrant's 2015 Proxy Statement for its Annual Meeting of Shareholders to be held May 20, 2015 are incorporated by reference into Part III.

TowneBank

Cross Reference Index

FORM 10-K

Part I

Part II

Part III

Part IV

PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains certain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts, but instead represent only the beliefs, expectations, or opinions of TowneBank and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward-looking statements may be identified by the use of such words as: "believe," "expect," "anticipate," "intend," "plan," "estimate," or words of similar meaning, or future or conditional terms, such as "will," "would," "should," "could," "may," "likely," "probably," or "possibly." These statements may address issues that involve significant risks, uncertainties, estimates, and assumptions made by management. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include competitive pressures in the banking industry that may increase significantly; changes in the interest rate environment that may reduce margins and/or the volumes and values of loans made or held as well as the value of other financial assets held; changes in the creditworthiness of customers and the possible impairment of the collectability of loans; general economic conditions, either nationally or regionally, that may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit or other services; changes in the legislative or regulatory environment, including changes in accounting standards, that may adversely affect our business; costs or difficulties related to the integration of the business and the businesses we have acquired may be greater than expected; expected cost savings associated with pending or recently completed acquisitions may not be fully realized or realized within the expected time frame; our competitors may have greater financial resources and develop products that enable them to compete more successfully; changes in business conditions, changes in the securities market, and changes in our local economy with regard to our market area. Any forward-looking statements made by us or on our behalf speak only as of the date they are made or as of the date indicated, and we do not undertake any obligation to update forward-looking statements as a result of new information, future events, or otherwise. For additional information on factors that could materially influence forward-looking statements included in this report, see the risk factors in "Item 1A. Risk Factors" in this report.

Item 1. BUSINESS

Overview

TowneBank began operations as a Virginia chartered bank in April 1999. We offer retail and commercial banking services to Richmond, Virginia, and the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. We place special emphasis on serving the financial needs of individuals and small- and medium-size businesses. We offer a diversified range of financial services through our banking and non-banking subsidiaries. Our principal subsidiaries include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, LLC ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; TFA Benefits; Out of Town, LLC, d/b/a Red Sky Travel Insurance ("Red Sky"); Towne Financial Services Group, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; SimonTowne Mortgage, LLC; GSH NC Resort Management, LLC, d/b/a Corolla Classic Vacations ("Corolla"); Towne 1031 Exchange, LLC ("Towne 1031 Exchange"); Towne New Markets CDE, Inc.; and Towne Realty, LLC, d/b/a Berkshire Hathaway HomeServices Towne Realty ("Towne Realty"), which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements ("Virginia Home Title"). We also have two controlled divisions: Towne Investment Group, which provides investment and asset management services, and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Unless indicated otherwise, the terms “Company,” “we,” “us,” and “our” refer to TowneBank and our consolidated subsidiaries.

Our foundation was built on providing banking services and, since inception, we have expanded to provide our members with complete residential real estate services, mortgage, personal and commercial insurance services, title-related services for both residential and commercial transactions, employee benefit services, and investment services.

Our common stock is listed on the NASDAQ Global Select Market under the symbol TOWN. Our bank’s main office is located at 5716 High Street, Portsmouth, Virginia 23703 (telephone number 757-638-7500), and our Corporate Administration and Member Service Center is located at 6001 Harbour View Boulevard, Suffolk, Virginia 23435 (telephone number 757-638-6700). We have established banking offices in Chesapeake, Chesterfield County, Hampton, Hanover County, Henrico County, James City County, Newport News, Norfolk, Portsmouth, Richmond, Suffolk, Virginia Beach, Williamsburg, and York County in Virginia, along with Corolla, Grandy, Moyock, Nags Head, Southern Shores, and Camden County in North Carolina. These locations are centrally located in core areas of each community, providing convenient access to both individual and business members.

Additional information relating to our business and our subsidiaries is included in the information on pages 15-21 and 93-96 in the 2014 Annual Report to Shareholders (“Annual Report”) filed as Exhibit 13 hereto and incorporated herein by reference.

Organization

We were organized and incorporated under the laws of the Commonwealth of Virginia on September 3, 1998, and commenced operations on April 8, 1999. We have three reportable segments: Banking, Realty, and Insurance.

Banking Segment. The Banking segment provides loan and deposit services to retail and commercial customers. We also provide commercial mortgage brokerage services and a variety of investment and asset management services. The Banking segment includes the operations of TowneBank Investment Corporation; Towne Investments, LLC; TowneBank Commercial Mortgage, LLC; Towne 1031 Exchange; Towne Investment Group; and Towne New Markets CDE, Inc.

Realty Segment. The Realty segment provides complete residential real estate services, originations of a variety of mortgage loans, resort property management, and commercial residential title insurance. It includes TowneBank Mortgage; Towne Mortgage, LLC; NewTowne Mortgage, LLC; SimonTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; Corolla; Virginia Home Title; and Towne Realty.

Insurance Segment. The Insurance segment provides property and casualty insurance as well as employee and group benefits through Towne Insurance and TFA Benefits. Through Towne Insurance, we offer a full line of commercial and consumer insurance products and financial services. Through TFA Benefits, we offer health, life dental, vision, and disability plans to employers, brokers, and individuals.

Operating Philosophy

Our operating philosophy emphasizes the making of marketing and member decisions at the local level (within centrally mandated and monitored control standards) with administrative and operational decisions at the central Company level. In order to accomplish this, we have established a “TowneBanking Group” (“Banking Group”) for each of our targeted markets.

We maintain a "hometown" banking image by providing each Banking Group with its own president, commercial loan officers, and local board of directors who are active and visible in their respective communities. It is the responsibility of each local board, acting under delegated authority of the Company's Board of Directors, to direct our overall development in their respective markets. The separate Banking Groups, with local decision-making authority, allow us to more effectively identify and respond to the financial needs of our members.

The Board of Directors believes that the separate Banking Groups strategy facilitates member service by ensuring that senior management is actively involved in each community and is available on a day-to-day basis to respond to the needs of the members in each community. From a member perspective, each TowneBanking Group is marketed as a separate bank headquartered in its respective community.

Our strategic plan places increased emphasis on developing and generating noninterest, or fee, income. Such development involves looking for opportunities to grow that income source, including acquisitions of non-bank financial service providers. Noninterest income includes income generated by our subsidiaries and divisions, as well as service charges on deposit accounts and gains on securities available for sale.

Services

We provide our members with high-quality, responsive, and technologically advanced services. Members have easy access to our decision-makers and enjoy continuity in service relationships, allowing fast response to meet their needs.

Banking and Other Financial Services. The foundation of our banking services is built on being a reliable and consistent source of credit with loans that are priced based upon the overall banking relationship. Our capitalization provides a lending capacity to meet the credit needs of our targeted market segment. Further, we have various loan participation agreements with other financial institutions should the need arise to meet the additional credit needs of our members.

Through our Banking segment, we offer a full range of deposit products, including checking accounts, Negotiable Order of Withdrawal ("NOW") accounts, savings accounts, and various types of time deposit services, which range from daily money market accounts to long-term certificates of deposit. The transaction accounts and certificates of deposit are tailored by market area at rates competitive to those offered in the area. In addition, we offer retirement account services, such as Individual Retirement Accounts. All deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC") up to the maximum amount allowed by law and are solicited from individuals, businesses, associations and organizations, and governmental authorities.

We also offer a full range of short- to medium-term personal and commercial loans. Personal loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. Commercial loans include secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and equipment and machinery purchases. Additionally, we originate fixed- and floating-rate mortgage loans, as well as real estate construction and acquisition loans. Through TowneBank Commercial Mortgage, LLC, we broker larger commercial loans that are not intended to remain in our portfolio.

Other services offered include safe deposit boxes, cash management services, travelers' checks, direct deposit of payroll and Social Security checks, and automatic drafts for various accounts. In addition, services to facilitate access to banking information, such as Internet banking, mobile banking, and on-call banking, are offered.

Through Towne 1031 Exchange, we offer the ability to serve as a qualified intermediary assisting investors with tax-deferred exchanges under Section 1031 of the Internal Revenue Code. We provide all necessary documentation to accomplish tax deferral while the investors' proceeds are safely held in accounts established at TowneBank awaiting reinvestment as required by Internal Revenue Service regulations.

Through Towne Investment Group, we offer other financial services, such as financial, retirement, and estate planning. We also offer assistance on a variety of investment options, including alternative investments, annuities, margin accounts, convertible bonds, and pension and profit-sharing plans. Towne Investment Group is a full-service financial advisor that is supported by an affiliation with Raymond James Financial, Inc., a full-service broker-dealer.

Realty Services. The full spectrum of services offered in our Realty segment allows us to realize certain operational synergies in providing quality residential real estate services, originations of a variety of residential mortgages, and title services for residential and commercial title transactions. We plan to continue to pursue economically advantageous acquisitions and other strategic opportunities to grow our businesses.

We assist customers with the process of buying or selling a home. Additionally, we also provide other realty-related services, including relocation services for individuals and families, including those in the military; and property management services for single-family homes, condominiums, townhomes, apartments, offices, vacation rentals, and retail establishments. Our vacations rentals business specializes in resort property management, offering vacation rentals with many of the most distinctive resort properties in the northern Outer Banks of North Carolina and Hilton Head, South Carolina. TowneBank Mortgage processes residential mortgage loans, from acceptance of the application to the closing of the loan and disbursement of the funds. Once finalized, they are packaged and sold principally in the secondary market through purchase commitments from investors that subject us to only *de minimis* market risk. In addition to relocation and property management services, we offer title and settlement services, perform real estate closings for residential properties, and issue title insurance policies for both residential and commercial transactions.

Insurance Services. The Insurance segment provides individual and business members with a wide array of insurance products, including life, property, casualty, and vehicle insurance. Through Red Sky we offer travel, medical, and baggage protection insurance for travelers via vacation property management companies. Through TFA Benefits, using nationally recognized carriers, we also offer employee benefit programs, including medical, dental, vision, life, and disability insurance tailored to the members' unique needs. To further meet the needs of our members, we can also serve as an administrator for health care and dependent care flexible benefit plans, allowing members' employees to pay insurance premiums, childcare expenses, and/or health care expenses with tax-free dollars.

Competition

Because we offer a wide variety of services, we compete with other financial institutions as well as other financial service providers, real estate companies, mortgage loan originators, and insurance companies. Competition is generally based on pricing and quality of products and services offered, level of service, convenience, availability of services, and the degree of expertise and personal manner in which services are offered.

Commercial banking in our market area is highly competitive. We face competition from other banks, thrift institutions, credit unions, consumer finance companies, insurance companies, real estate companies, and other financial institutions in our targeted market areas. Some of these competitors are not subject to the same degree of regulation that is imposed upon us. Many have broader geographic markets and substantially greater resources and can offer more diversified products and services.

Despite the intense level of competition, we believe that the existing and future banking and financial services market in our market areas represents excellent opportunities for a locally-owned and managed financial services company. Among other factors, the economic outlook for the area and the size and growth potential of the existing market for banking and other financial services point to a growing demand for such services. Further, in view of the continuing trend in the financial services industry toward consolidations into larger, sometimes impersonal, national institutions, our company fulfills a market for the personal and customized financial services an independent, locally run company can offer.

Market Area

Our primary service area is Richmond, Virginia and the Greater Hampton Roads region of Virginia, and northeastern North Carolina. This market includes the Virginia cities and counties of Chesapeake, Chesterfield County, Gloucester County, Hampton, Hanover County, Henrico County, James City County, Newport News, Norfolk, Poquoson, Portsmouth, Richmond, Suffolk, Virginia Beach, Williamsburg, and York County, and the North Carolina cities and counties of Corolla, Grandy, Kill Devil Hills, Moyock, Southern Shores, and Camden County. The region has a diverse, well-rounded economy supported by a solid manufacturing base, a substantial military presence in Hampton Roads, and a significant state government presence in Richmond.

The primary service area is encompassed by the Virginia Beach-Norfolk-Newport News, VA-NC Metropolitan Statistical Area, the 37th largest metropolitan area in the United States, with a population of approximately 1.71 million as of July 2013 and the Richmond, VA Metropolitan Statistical Area, the 44th largest metropolitan area in the United States, with a population of approximately 1.25 million as of July 2013. Several colleges and universities, medical centers, and arts and entertainment facilities contribute to a valued quality of life in the regions.

We also offer residential mortgages in the Virginia cities of Charlottesville, Harrisonburg, and Roanoke, the North Carolina cities of Elizabeth City, Raleigh, and Wilmington, and in Lancaster, Pennsylvania. Additionally, we have insurance offices located in Greenville, North Carolina, Raleigh, North Carolina, and Prince William County, Virginia.

Concentrations

The majority of our depositors are located and doing business in our targeted market areas, and we lend a substantial portion of our capital and deposits to individual and business borrowers in these market areas. Any factors adversely affecting the economy of Richmond or the Greater Hampton Roads area could, in turn, adversely affect our performance. A geographic concentration exists with our loan portfolio, as most of our business activity is with members in the Richmond and Hampton Roads areas. There were no significant concentrations in any one customer; however, we have a concentration in commercial real estate loans.

Governmental Monetary Policies

Our earnings and growth are affected not only by general economic conditions, but also by the monetary policies of various governmental regulatory authorities, particularly the Board of Governors of the Federal Reserve System (“Federal Reserve”). The Federal Reserve implements national monetary policy through its open market operations in United States government securities, control of the discount rate, and establishment of reserve requirements against both member and nonmember financial institutions’ deposits.

These actions have a significant effect on the overall growth and distribution of loans, investments, and deposits, and rates earned on loans or paid on deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to do so in the future. Management is unable to predict the effect of possible changes in monetary policies upon our future operating results.

Development of Business

The following is a summary of the major developments in our business since January 1, 2014:

- TowneBank moved up to second place, ahead of Bank of America, SunTrust, and BB&T, in the latest Hampton Roads Annual Deposit Market Share Report released by the FDIC. The report ranks institutions by share of FDIC-insured deposits in the Hampton Roads metropolitan area as of June 30, 2014. TowneBank had a 16.70% share of deposits in Hampton Roads and was the only community bank with a share greater than 5%.

- On June 13, 2014, TowneBank opened a new banking office in the Wards Corner shopping center in Norfolk, Virginia. The new 4,500-square-foot office provides a full array of financial services to individuals, businesses, and community organizations.

- Towne Insurance was selected as part of an elite group of independent insurance agencies around the United States to participate in the Independent Insurance Agents & Brokers of America ("IIABA") "Best Practices" Study Group. Each year the IIABA and Reagan Consulting, an Atlanta-based management consulting firm, join forces to study the country's leading agencies in six revenue categories. The agencies comprising the study groups are selected every third year through a comprehensive nomination and qualifying process and awarded a "Best Practices Agency" designation. The agency was nominated by either an IIABA-affiliated state association or an insurance company, and qualified based on its operational excellence.

- Effective May 1, 2014, TowneBank acquired Southern Insurance Agency, Inc., an independent insurance agency which is affiliated with Towne Insurance. The purchase price was $11.81 million in cash and stock.

- Effective October 1, 2014, TowneBank acquired Beach Properties of Hilton Head, Inc., a resort property management company offering vacation rentals in Hilton Head, South Carolina. The purchase price was $8.60 million in cash and stock.

- On January 2, 2015, TowneBank completed the acquisition of Franklin Financial Corporation ("Franklin") and its wholly-owned subsidiary, Franklin Federal Savings Bank, based in Richmond, Virginia. The Company acquired eight office locations, approximately $491.96 million in loans, and assumed approximately $682.95 million in deposits. The client and branch conversion process was successfully completed over the weekend of January 3-4, 2015.

- On January 7, 2015, the Company redeemed in full its $76.46 million of outstanding Series C preferred stock issued to the U.S. Department of the Treasury (the "U.S. Treasury") under the Small Business Lending Fund. The redemption price was $76.46 million plus accrued but unpaid dividends to the date of redemption.

We anticipate concentrating on the further development of each market by opening additional banking offices as business and other conditions warrant, and by expanding into new markets as opportunities arise. The regulatory approval process for the opening of additional banking offices takes into account a number of factors, including, among others, a determination that we have capital in an amount deemed necessary to warrant additional expansion, and a finding that the public interest will be served. Additionally, we will continue to place a focus on the development of noninterest income sources and will look for growth opportunities, which could include additional acquisitions of non-bank financial service providers.

Regulation

We are regulated extensively under both federal and state law. The following is a brief summary of the material statutes, acts, rules, and regulations that affect us. This summary is qualified in its entirety by reference to the full text of the statutes, acts, rules, regulations, and policies that are referenced below. Changes in statutes, acts, rules, regulations, or regulatory policies could have a material effect on our business.

General. We are organized as a Virginia chartered banking corporation and are regulated and supervised by the Bureau of Financial Institutions of the Virginia State Corporation Commission ("Bureau of Financial Institutions"). In addition, we are regulated and supervised by the FDIC, which serves as our primary federal regulator. The Bureau of Financial Institutions and the FDIC conduct regular examinations of us, reviewing the adequacy of our loan loss reserves, the quality of our loans and investments, the appropriateness of management practices, compliance with laws and regulations, and other aspects of our operations. In addition to these regular examinations, we must furnish to the FDIC quarterly and annual reports containing detailed financial statements and schedules. Federal and Virginia banking laws and regulations govern all areas of our operations, including reserves, loans, mortgages, capital, issuance of securities, payment of dividends, and establishment of branches. The FDIC and the Bureau of Financial Institutions have authority to impose penalties, initiate civil and administrative actions, and take other steps intended to prevent us from engaging in unsafe or unsound practices. In this regard, the FDIC has adopted capital adequacy requirements.

2014 Capital Requirements. The federal bank regulatory agencies have adopted risk-based capital requirements for assessing bank capital adequacy. Virginia chartered banks must also satisfy the capital requirements adopted by the Bureau of Financial Institutions. The federal capital standards define capital and establish minimum capital requirements in relation to assets and off-balance-sheet exposure as adjusted for credit risk.

The risk-based capital standards that were in effect through December 31, 2014 were designed to make regulatory capital requirements more sensitive to differences in risk profile among bank holding companies and banks, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

Under the capital standards in effect through December 31, 2014, the minimum standard for the ratio of capital to risk-weighted assets (including certain off-balance-sheet obligations, such as stand-by letters of credit) was 8.0%. At least half of the risk-based capital must have consisted of common shareholders' equity, excluding unrealized gains or losses on debt securities available for sale and unrealized gains on equity securities available for sale, plus qualifying perpetual preferred stock less deductions for goodwill and various other intangibles ("Tier 1 capital"). The remainder ("Tier 2 capital") must have consisted of a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, preferred stock, and a limited amount of the general valuation allowance for loan losses. The sum of Tier 1 capital and Tier 2 capital is "total risk-based capital." The FDIC has also adopted regulations that supplement the risk-based guidelines to include a minimum leverage ratio of Tier 1 capital to quarterly average assets of 4.0%.

At December 31, 2014, we had the following risk-based capital and leverage ratios relative to regulatory minimums.

Ratio	TowneBank	Minimum	Well Capitalized
Tier 1 risk-based capital	12.73%	4.00%	6.00%
Total risk-based capital	13.67%	8.00%	10.00%
Leverage	9.94%	4.00%	5.00%

The FDIC is authorized by federal legislation and regulations to take various enforcement actions against any undercapitalized insured depository institution and any insured depository institution that fails to submit an acceptable capital restoration plan or fails to implement a plan accepted by the FDIC. These powers include, among other things, requiring a bank to be recapitalized, prohibiting asset growth, restricting interest rates paid, requiring prior approval of capital distributions, requiring divestiture by the institution of its subsidiaries, requiring new election of directors, and requiring the dismissal of directors and officers.

New Capital Rules - Basel III. In July 2013, the federal banking agencies approved final rules known as the “Basel III Capital Rules” that substantially revised the risk-based capital and leverage capital requirements applicable to bank holding companies and depository institutions, including the Company. The Basel III Capital Rules address the components of capital and other issues affecting the numerator in banking institutions’ regulatory capital ratios. Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act, as defined below, to remove references to credit ratings from the federal banking agencies’ rules. The Basel III Capital Rules went into effect for the Company on January 1, 2015 (subject to a phase-in period).

The Basel III Capital Rules, among other things, (i) introduce as a new capital measure “Common Equity Tier 1” (“CET1”), (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expand the scope of the adjustments as compared to existing regulations. CET1 capital consists of common stock instruments that meet the eligibility criteria in the final rules, retained earnings, accumulated other comprehensive income, and common equity Tier 1 minority interest.

When fully phased in on January 1, 2019, Basel III Capital Rules require banking organizations to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7.0% upon full implementation); (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation); (iii) a minimum ratio of total capital (that is, Tier 1 plus Tier 2 capital) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to adjusted average quarterly assets.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face limitations on the payment of dividends, common stock repurchases, and discretionary cash payments to executive officers based on the amount of the shortfall.

Under the Basel III Capital Rules, the initial minimum capital ratios that became effective on January 1, 2015 are as follows:

- 4.5% CET1 to risk-weighted assets.
- 6.0% Tier 1 capital to risk-weighted assets.
- 8.0% Total capital to risk-weighted assets.
- 4.0% Tier 1 capital to average quarterly assets.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income, and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under capital standards in effect as of December 31, 2014, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, banking organizations are given a one-time election to filter certain accumulated other comprehensive income components, comparable to the treatment under the current general risk-based capital rule.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, and will be phased in over a five-year period (20% per year). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The prompt corrective action rules were amended to incorporate a CET1 capital requirement and to raise the capital requirements for certain capital categories. In order to be adequately capitalized for purposes of the prompt corrective action rules, a banking organization is required to have at least an 8% total risk-based capital ratio, a 6% Tier 1 risk-based capital ratio, a 4.5% CET 1 risk-based capital ratio, and a 4% Tier 1 leverage ratio. To be well-capitalized, a banking organization is required to have at least a 10% total risk-based capital ratio, an 8% Tier 1 risk-based capital ratio, a 6.5% CET 1 risk-based capital ratio, and a 5% Tier 1 leverage ratio.

In addition, the Basel III Capital Rules revise the rules for calculating risk-weighted assets to enhance their risk sensitivity, which includes (1) a new framework under which mortgage-backed securities and other securitization exposures are subject to risk weights ranging from 20% to 1,250% and (2) adjusted risk weights for credit exposures, including multi-family and commercial real estate exposures that are 90 days or more past due or on non-accrual, which are subject to a 150% risk weight, except in situations where qualifying collateral and/or guarantees are in place. The treatment of residential mortgage exposures remains subject to either a 50% risk weight (for prudently underwritten owner-occupied first liens that are current or less than 90 days past due) or a 100% risk weight (for all other residential mortgage exposures, including 90 days or more past due exposures).

We are currently in the process of evaluating the impact of the Basel III Capital Rules; however, we believe that we would meet all capital adequacy requirements on a fully phased-in basis if such requirements were currently effective.

Dividends. The amount of dividends payable depends upon our earnings and capital position and is limited by federal and state laws, regulations, and policies. In addition, under Virginia law, the Bureau of Financial Institutions may limit the ability of the bank to pay dividends. No dividend may be declared or paid that would impair a bank's paid-in capital.

The Bureau of Financial Institutions and the FDIC have the general authority to limit dividends paid if such payments are deemed to constitute an unsafe and unsound practice. In particular, Section 38 of the Federal Deposit

Insurance Act would prohibit us from making a dividend if we were "undercapitalized" or if such dividend would result in us becoming "undercapitalized."

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act implemented significant changes to the regulation of the financial services industry and affected the lending, investment, trading, and operating activities of financial institutions. The legislation directed the federal banking regulators to implement new leverage and capital requirements. The new leverage and capital requirements take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives. The Dodd-Frank Act created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. In addition, the Dodd-Frank Act contains a wide variety of provisions affecting the regulation of depository institutions, including restrictions related to mortgage originations, risk retention requirements as to securitized loans, the establishment of the Consumer Financial Protection Bureau ("CFPB"), and restrictions on proprietary trading (the "Volcker Rule").

The Dodd-Frank Act includes provisions for, among other things:

- ***Corporate Governance.*** The Dodd-Frank Act requires publicly traded companies, like the Company, to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment, and at least every three years thereafter, and on so-called "golden parachute" payments in connection with approvals of mergers and acquisitions, unless previously voted on by shareholders. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the Securities and Exchange Commission ("SEC") authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

- ***Interstate Branching.*** The Dodd-Frank Act authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state is permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks are now able to enter new markets more freely.

- ***Limits on Derivatives.*** The Dodd-Frank Act prohibits state-chartered banks from engaging in derivatives transactions unless the loans to one borrower limits of the state in which the bank is chartered take into consideration credit exposure to derivatives transactions. For this purpose, derivative transaction includes any contract, agreement, swap, warrant, note, or option that is based in whole or in part on the value of, any interest in, or any quantitative measure, or the occurrence of any event relating to, one or more commodities securities, currencies, interest or other rates, indices, or other assets.

- ***Transactions with Affiliates and Insiders.*** The Dodd-Frank Act expands the definition of affiliate for purposes of quantitative and qualitative limitations of Section 23A of the Federal Reserve Act to include mutual funds advised by a depository institution or its affiliates. The Dodd-Frank Act applies Section 23A and Section 22(h) of the Federal Reserve Act (governing transactions with insiders) to derivative transactions, repurchase agreements, and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider. Any such transactions with affiliates must be fully secured. The previous exemption from Section 23A for transactions with financial subsidiaries has been eliminated. The Dodd-Frank Act additionally prohibits an insured depository institution from purchasing an asset from or selling an asset to an insider unless the transaction is on market terms and, if representing more than 10% of capital, is approved in advance by the disinterested directors.

- ***Debit Card Interchange Fees.*** Effective July 21, 2011, the Dodd-Frank Act required that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. The Federal Reserve issued new standards that took effect on October 1, 2011, and apply to issuers that have assets of $10 billion or more. Under the rule, the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and five basis points multiplied by the value of the transaction. The Federal Reserve rules also allow for an upward adjustment of no more than one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than $10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks.

- ***Consumer Financial Protection Bureau.*** The Dodd-Frank Act creates a new independent federal agency called the CFPB, which is granted broad rule-making, supervisory, and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes.

The Dodd-Frank Act has had, and may in the future have, a material impact on the Company's operations, particularly through increased compliance costs resulting from new and possible future consumer and fair lending regulations. Because certain of the Dodd-Frank Act provisions will be phased in over time, we cannot fully assess the impact of the Dodd-Frank Act on the Company. See Part I, Item 1A, "Risk Factors" for additional discussion of this topic.

Capital Purchase Program. On December 12, 2008, as part of the U.S. Treasury's Troubled Asset Relief Program ("TARP") Capital Purchase Program ("CPP"), TowneBank issued preferred stock and a warrant to purchase its common stock to the U.S. Treasury as a participant in the TARP CPP. As a result of our participation in TARP, we were subject to certain restrictions and direct oversight by the U.S. Treasury. Upon our repurchase of the TARP preferred stock on September 22, 2011, we are no longer subject to the TARP-related restrictions on dividends, stock repurchases, or executive compensation.

On May 15, 2013, the Company repurchased the warrant from the U.S. Treasury for $1.5 million. The transaction reduced additional paid-in capital within stockholders' equity by $1.5 million.

Small Business Lending Fund. On September 22, 2011, the Company entered into a Securities Purchase Agreement with the U.S. Treasury, pursuant to which the Company sold and issued 76,458 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C ("Series C Preferred Stock"), liquidation value of $1,000 per share, for a total purchase price of $76.46 million. The issuance was pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The holder of the Series C Preferred Stock was entitled to receive non-cumulative dividends, payable quarterly, on January 1, April 1, July 1, and October 1 of each year. The dividend rate could fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock was outstanding, based upon changes in the level of "Qualified Small Business Lending" ("QSBL") by the Company as compared to the Company's baseline QSBL level, which was established at the closing of the securities issuance. The dividend rate for the initial dividend period was at 5%. For the second through 10th calendar quarters, the dividend rate could be adjusted to between 1% and 5% per annum based upon the increase in QSBL as compared to the initial baseline. For the 11th calendar quarter through four and one-half years after issuance, the dividend rate was fixed at between 1% and 7% based upon the level of QSBL compared to the baseline. Due to the Company's loan growth, the blended rate for the period from closing through December 31, 2011 was 4.63%, with the rate reduced to 3.92% for the first quarter of 2012, and 2.28% for the second quarter of 2012. Beginning with the third quarter of 2012, the rate decreased to 1.0% and remained fixed at that rate through the date of repayment (January 7, 2015). The Series C Preferred Stock was redeemable at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of the FDIC.

On September 22, 2011, the Company used the proceeds from the sale and issuance of the Series C Preferred Stock to repurchase all 76,458 outstanding shares of its TARP preferred stock for a redemption price of $76.46 million, plus accrued but unpaid dividends.

On January 7, 2015, the Company used internally available funds to repurchase all 76,458 outstanding shares of its Series C Preferred Stock for a redemption price of $76.46 million, plus accrued but unpaid dividends.

FDIC Insurance Assessments. Substantially all of our members' deposit accounts are insured up to applicable limits by the Deposit Insurance Fund (the "DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory ratings ("CAMELS ratings"). The risk matrix utilizes four risk categories which are distinguished by capital levels and supervisory ratings.

The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions, and credit unions to $250,000 per depositor, per insured depository institution for each account ownership category.

The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act required the FDIC to increase the reserve ratio of the DIF from 1.15% to 1.35% of insured deposits by 2020, and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds.

The FDIC's risk-based premium system provides for quarterly assessments. Each insured institution is placed in one of four risk categories depending on supervisory and capital considerations. Within its risk category, an institution is assigned to an initial base assessment rate, which is then adjusted to determine its final assessment rate based on its brokered deposits, secured liabilities, and unsecured debt. Assessment rates are between 2.5 to 9 basis points for banks in the lowest risk category, and between 30 to 45 basis points for banks in the highest risk category.

FDIC insurance expense totaled $2.74 million, $2.95 million, and $3.16 million in 2014, 2013, and 2012. FDIC insurance expense includes deposit insurance assessments and Financing Corporation ("FICO") assessments related to outstanding FICO bonds. FICO is a mixed-ownership government corporation established to recapitalize a predecessor to the Deposit Insurance Fund. The current annualized FICO assessment rate is 0.60 basis points, or 0.15 basis points per quarter. These assessments will continue until the Financing Corporation bonds mature in 2019.

Community Reinvestment Act. Banks are subject to the provisions of the Community Reinvestment Act of 1977 ("CRA") that requires the appropriate federal bank regulatory agency, the FDIC in our case, to assess our record in meeting the credit needs of the communities we serve.

The CRA assessment is required by any bank that has applied to, among other things, establish a new branch office that will accept deposits, relocate an existing office, or merge, consolidate with, acquire the assets, or assume the liabilities of a federally-regulated financial institution. We received an "Outstanding" rating in our last CRA examination.

Federal Deposit Insurance Corporation Improvement Act. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") became effective July 2, 1993. FDICIA requires insured institutions with $500 million or more in total assets at the beginning of their fiscal year to submit independently audited annual reports to the FDIC and the appropriate agency.

These publicly-available reports must include: (a) annual financial statements prepared in accordance with accounting principles generally accepted in the United States and such other disclosure requirements as required by the FDIC or the appropriate agency, and (b) a management report signed by the Chief Executive Officer and the Chief Financial Officer or Chief Accounting Officer of the institution that contains a statement of management's responsibilities for: (i) preparing the annual financial statements; (ii) establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (iii) complying with the laws and regulations designated by the FDIC relating to safety and soundness, and an assessment of: (aa) the effectiveness of the system of internal control and procedures for financial reporting as of the end of the fiscal year, and (bb) the institution's compliance during the fiscal year with applicable laws and regulations designated by the FDIC relating to safety and soundness.

With respect to any internal control report, the institution's independent public accountants must attest to, and report separately on, certain assertions of the institution's management contained in such report for institutions with $1 billion or more in total assets.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 (the "Patriot Act") was enacted in response to the terrorist attacks in New York, Pennsylvania, and Washington, D.C., that occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The Patriot Act contains sweeping anti-money-laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening and rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. The continuing impact of the Patriot Act and related regulations and policies on financial institutions of all kinds is significant and wide-ranging.

Volcker Rule. On December 10, 2013, five U.S. financial regulators, including the FDIC, adopted final rules implementing the Volcker Rule. The final rules prohibit banking entities from (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds. The Volcker Rule is intended to provide greater clarity with respect to both the extent of those primary prohibitions and the related exemptions and exclusions. The final rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014, until July 21, 2015. The Federal Reserve recently granted an extension until July 21, 2016 of the conformance period for banking entities to conform investments in and relationships with covered funds that were in place prior to December 31, 2013, and announced its intention to further extend this aspect of the conformance period until July

21, 2017. The Company has evaluated the impact of the Volcker Rule and does not anticipate that it will have a material effect on our operations, as we do not engage in activities prohibited by the Volcker Rule.

Incentive Compensation. In June 2010, the federal banking agencies issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of financial institutions do not undermine the safety and soundness of such institutions by encouraging excessive risk-taking. The *Interagency Guidance on Sound Incentive Compensation Policies*, which covers all employees who have the ability to materially affect the risk profile of a financial institution, either individually or as part of a group, is based upon the key principles that a financial institution's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the institution's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the financial institution's board of directors.

Additionally, in March 2011, the federal banking agencies, along with the Federal Housing Finance Agency and the SEC, released a proposed rule intended to ensure that regulated financial institutions design their incentive compensation arrangements to account for risk. Specifically, the proposed rule would require compensation practices to be consistent with the following principles: (i) compensation arrangements appropriately balance risk and financial reward, (ii) such arrangements are compatible with effective controls and risk management, and (iii) such arrangements are supported by strong corporate governance. In addition, financial institutions with $1 billion or more in assets would be required to have policies and procedures to ensure compliance with the rule and would be required to submit annual reports to their primary federal regulator. The comment period has closed and a final rule has not yet been published.

Consumer Financial Protection

We are subject to a number of federal and state consumer protection laws that extensively govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act, laws governing flood insurance, federal and state laws prohibiting unfair and deceptive business practices, foreclosure laws ,and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans, and providing other services. If we fail to comply with these laws and regulations, we may be subject to various penalties. Failure to comply with consumer protection requirements may also result in failure to obtain any required bank regulatory approval for merger or acquisition transactions we may wish to pursue or being prohibited from engaging in such transactions even if approval is not required.

The Dodd-Frank Act centralized responsibility for consumer financial protection by creating a new agency, the CFPB, and giving it responsibility for implementing, examining, and enforcing compliance with federal consumer protection laws. The CFPB focuses on (i) risks to consumers and compliance with the federal consumer financial laws, (ii) the markets in which firms operate and risks to consumers posed by activities in those markets., (iii) depository institutions that offer a wide variety of consumer financial products and services, and (iv) non-depository companies that offer one or more consumer financial products or services.

The CFPB has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit "unfair, deceptive or abusive" acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer's ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer's (i) lack of financial savvy, (ii) inability to protect himself in the selection or use of consumer financial products or services, or (iii) reasonable reliance on a covered entity to act in the consumer's interests. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or injunction.

Ability-to-Repay and Qualified Mortgage Rule. Pursuant to the Dodd-Frank Act, the CFPB issued a final rule on January 10, 2013 (effective January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. Alternatively, the mortgage lender can originate "qualified mortgages," which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Qualified mortgages that are "higher-priced" (e.g., subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not "higher-priced" (e.g., prime loans) are given a safe harbor of compliance. The Company is predominantly an originator of compliant qualified mortgages.

Reporting Obligation Under Securities Laws. We are subject to the periodic reporting requirements of the Securities Exchange Act of 1934 ("Exchange Act") as adopted by the FDIC, including the filing of annual, quarterly, and other reports with the FDIC. As an Exchange Act reporting bank with over $500 million in assets, we are directly affected by the Sarbanes-Oxley Act of 2002 and regulations promulgated thereunder, which are aimed at improving corporate governance and reporting procedures. We are complying with the rules and regulations implemented pursuant to the Sarbanes-Oxley Act and intend to comply with any applicable rules and regulations implemented in the future.

Employees

As of December 31, 2014, we had 1,344 full-time equivalent employees, excluding real estate agents. There were 393 real estate sales agents at December 31, 2014. Our real estate agents are independent contractors and not included as our employees. None of our employees are represented by any collective bargaining agreements, and relations with employees are considered good.

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports are filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act and are accessible at no cost on our website, www.townebank.com, as soon as reasonably practicable after those reports have been filed with or furnished to the FDIC. These materials are available free of charge in print to stockholders who request them by writing to: TowneBank, Attn: Clyde E. McFarland, Jr., 6001 Harbour View Boulevard, Suffolk, Virginia 23435. A copy of the statements of beneficial ownership of our equity securities filed by our directors, officers, and 10% or greater shareholders under Section 16 of the Exchange Act may also be obtained through our website. The information contained on our website is not a part of or included in this Form 10-K.

The public may read and copy any of the reports that are filed with the FDIC at the FDIC's Accounting and Securities Disclosure Section, Division of Supervision and Consumer Protection, 550 17th Street, N.W., Washington, D.C. 20429. The public may contact the FDIC at 202-898-8913 should they require a copy of a filing be sent directly to them.

Item 1A. RISK FACTORS

In addition to the other information contained in this report, the following risks may affect us. This listing should not be considered all-inclusive. Additional risks and uncertainties, including those not presently known to us or that we currently consider immaterial, may also impair our business, financial condition, or operating results.

Dependence on uncontrollable economic conditions could have a material adverse impact on our financial condition and results of operations.

Like all financial institutions, we are subject to the effects of any economic downturn. In recent years, the U.S. economy has faced a severe economic crisis, including a major recession from which it is slowly recovering. Business activity across a wide range of industries and regions in the U.S. remains reduced, and local governments and many businesses continue to experience financial difficulty. Our business is concentrated in the Richmond, Virginia region, the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. As a result, the financial condition and results of operations may be affected by changes in the economies of these regions. Adverse changes in economic conditions in our market areas would likely impair the ability to collect loans and could otherwise have a material adverse effect on our financial condition and results of operations. While conditions have improved since the recession, there can be no assurance that this improvement will continue, and further declines may have a negative effect on our financial conditions and results of operations.

Combining TowneBank and Franklin may be more difficult, costly, or time-consuming than we expect.

The success of our merger with Franklin will depend, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses of TowneBank and Franklin, and to combine the businesses of TowneBank and Franklin in a manner that permits growth opportunities and cost savings to be realized without materially disrupting the existing customer relationships of TowneBank or Franklin or decreasing revenues due to loss of customers. However, to realize these anticipated benefits and cost savings, we must successfully combine the businesses of TowneBank and Franklin.

TowneBank and Franklin have operated and, until the completion of the merger in January 2015, continued to operate independently. The success of the merger will depend, in part, on our ability to successfully combine the businesses of TowneBank and Franklin. To realize these anticipated benefits, TowneBank is integrating Franklin's business into its own. The integration process in the merger could result in the loss of key employees, the disruption of TowneBank's ongoing business, inconsistencies in standards, controls, procedures and policies that affect adversely our ability to maintain relationships with customers and employees or achieve the anticipated benefits of the merger. The loss of key employees could adversely affect our ability to successfully conduct our business in the markets in which Franklin operated, which could have an adverse effect on our financial results and the value of our common stock. If we experience difficulties with the integration process, the anticipated benefits of the merger may not be realized, fully or at all, or may take longer to realize than expected. As with any merger of financial institutions, there also may be disruptions that cause us to lose customers or cause customers to withdraw their deposits from our banking operations, or other unintended consequences that could have a material adverse effect on our results of operations or financial condition. These integration matters could have an adverse effect on the Company. If we are not able to achieve these objectives, the anticipated benefits and cost savings of the merger may not be realized fully, or at all, or may take longer to realize than expected.

We may have difficulty managing future growth and competition in the Richmond, Virginia market due to our previous limited operations in that market.

Our primary market area prior to the Franklin merger was the Greater Hampton Roads region in southeastern Virginia and northeastern North Carolina. Franklin's primary market area was the Richmond, Virginia market. The banking business in Richmond is extremely competitive, and the level of competition may increase further. Although we have hired a number of lending and business development officers with experience in the Richmond market, there can be no assurance that we will be able to successfully compete in this highly competitive market, or that we will be able to successfully manage additional growth in the Richmond market. Because of our limited participation in the Richmond market, there may be unexpected challenges and difficulties that could adversely affect our operations.

Changes in defense spending by the federal government as a result of congressional budget cuts could adversely impact the economy in Greater Hampton Roads, which could have an adverse effect on our results of operation and financial condition.

The U.S. military has a major presence in Greater Hampton Roads. As a result, the U.S. military is an important aspect of the Greater Hampton Roads economy in which we operate. Proposals to cut defense and other security spending could have an adverse impact on the Greater Hampton Roads economy, which could adversely affect our business, financial condition, and results of operations.

Changes in interest rates could have a negative impact on our results of operations.

Our profitability is dependent to a large extent on our net interest income, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. Our net interest income is impacted by changes in market rates of interest, changes in credit spreads, changes in the shape of the yield curve, the interest rate sensitivity of our assets and liabilities, prepayments on our loans and investments, and the mix of our funding sources and assets.

Our interest-earning assets and interest-bearing liabilities may react in different degrees to changes in market interest rates. Interest rates on some types of assets and liabilities may fluctuate prior to changes in broader market interest rates, while rates on other types may lag behind. The result of these changes to rates may cause differing spreads on interest-earning assets and interest-bearing liabilities. Any substantial, unexpected, or prolonged change in market interest rates could have a material adverse effect on our business, financial condition, and results of operations. While we take measures intended to manage risks from changes in market interest rates, we cannot control or accurately predict changes in the rates of interest or be sure our protective measures are adequate.

The repeal of federal prohibitions on payment of interest on demand deposits could increase our interest expense.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act beginning July 21, 2011. As a result, some financial institutions have commenced offering interest on demand deposits to compete for customers. Our interest expense will increase and net interest margin will decrease if we begin offering interest on demand deposits to attract additional customers or maintain current customers, which could have a material adverse effect on our financial condition and results of operations.

The value of our goodwill and other intangible assets may decline in the future.

As of December 31, 2014, we had $135.67 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates, or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our financial condition and results of operations.

Loss of any of our key personnel could disrupt our operations and result in reduced revenues.

We are a relationship-driven organization. A key aspect of our business strategy is to have our senior officers have primary contact with our customers. Our growth and development to date have been, in large part, a result of these personalized relationships with our customer base.

The senior officers have considerable experience in the banking industry and related financial services and are extremely valuable and would be difficult to replace. The loss of the services of these officers could have a material adverse effect upon future prospects. Although we have entered into employment contracts with our Chairman and Chief Executive Officer and our other senior executive officers, and purchased key man life insurance policies to mitigate the risk of an unforeseen departure or death of certain of our senior executive officers, we cannot offer any assurance that they and other key employees will remain employed by us. The unexpected loss of services of one or more of these key employees could have a material adverse effect on operations and possibly result in reduced revenues.

Reliance on certain external vendors could adversely affect our operations.

We are reliant upon certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service-level agreements. We maintain a system of comprehensive policies and a control framework designed to monitor vendor risks including, among other things, (i) changes in the vendor’s organizational structure, (ii) changes in the vendor’s financial condition, (iii) changes in the vendor’s support for existing products and services, and (iv) changes in the vendor’s strategic focus. While we believe these policies and procedures help to mitigate risk, the failure of an external vendor to perform in accordance with contracted arrangements under service-level agreements could be disruptive to our operations, which could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

We are subject to environmental liability risk associated with our lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. Remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on our ability to conduct business. In addition, such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue, and/or cause us to incur additional expenses. The occurrence of any such event in the future could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

The operational functions of business counterparties over which we may have limited or no control may experience disruptions that could adversely impact our operations.

Multiple major U.S. retailers have recently experienced data systems incursions reportedly resulting in the thefts of credit and debit card information, online account information, and other financial data of tens of millions of the retailers' customers. Retailer incursions affect cards issued and deposit accounts maintained by many banks, including the Company. Although our systems are not breached in retailer incursions, these events can cause us to reissue a significant number of cards and take other costly steps to avoid significant theft loss to us and our customers. In some cases, we may be required to reimburse customers for the losses they incur. Other possible points of intrusion or disruption not within our control include internet service providers, electronic mail portal providers, social media portals, distant-server ("cloud") service providers, electronic data security providers, telecommunications companies, and smart phone manufacturers.

Security breaches and other disruptions could compromise our information and expose us to liability, which could damage our reputation and our business.

We rely on the secure processing, storage, and transmission of confidential and other information in our computer systems and networks. While we have policies and procedures designed to prevent or limit the effect of a possible security breach, our computer systems, software, and networks may be vulnerable to unauthorized access, computer viruses or other malicious code, and other events that could have a security impact. If one or more such events occur, this potentially could jeopardize our or our customers' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our or our customers' operations. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us.

Security breaches in our Internet banking activities could further expose us to possible liability and damage our reputation. Any compromise of our security also could deter customers from using our Internet banking services that involve the transmission of confidential information. We have implemented security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from compromises or breaches of our security measures that could result in damage to our reputation and our business.

Failure of our internal and disclosure controls and procedures could have a material adverse effect on our results of operation and financial condition.

Effective internal and disclosure controls and procedures are necessary to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. Our management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our results of operations and financial condition.

Restrictions relating to the acquisition of our common stock may discourage an acquisition.

Certain provisions of our articles of incorporation and bylaws could delay or frustrate the removal of incumbent directors and could make a merger, tender offer, or proxy contest more difficult, even in instances where shareholders deem the proposed transaction to be beneficial to their interests. These provisions, among others, provide for staggered terms for the Board of Directors and that a plan of merger, share exchange, sale of all or substantially all of our assets, or similar transaction must be approved and recommended by the affirmative vote of two-thirds of the directors in office or by the affirmative vote of the holders of 80% of our outstanding shares, and limit the ability of shareholders to call a special meeting. In addition, certain provisions of state and federal law may also have the effect of discouraging or prohibiting a future takeover attempt in which our shareholders might otherwise receive a substantial premium for their shares over then-current market prices. To the extent that these provisions discourage or prevent takeover attempts, they may tend to reduce the market price for our common stock and the notes.

Liquidity could be impaired by an inability to access the capital markets or an unforeseen outflow of cash.

Liquidity is essential to our businesses. Due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or TowneBank, our liquidity could be impaired by an inability to access the capital markets or an unforeseen outflow of cash.

Continued growth may require raising additional capital, which may dilute current shareholders' ownership percentage.

In order to meet applicable regulatory capital requirements, we may, from time to time, need to raise additional capital to support continued growth. If selling our equity securities raises additional funds, the relative ownership interests of our existing shareholders would likely be diluted.

Risks associated with acquisitions and the resulting integrations may affect costs and revenue.

A component of our business strategy includes growth through acquisitions. Costs or difficulties related to integrating the acquired business with the Company might be greater than expected. Further, expected revenue and/or operational synergies and cost savings associated with pending or recently completed acquisitions may not be fully realized or realized within the expected timeframe. We cannot provide assurance that we will be successful in overcoming these risks or any other issues encountered in connection with acquisitions.

Attractive acquisition or expansion opportunities may not be available to us in the future.

We may consider acquiring other businesses or expanding into new product lines that we believe will help us fulfill our strategic objectives. We expect that other banking and financial companies, some of which have significantly greater resources, will compete with us to acquire financial services businesses. This competition could increase prices for potential acquisitions that we believe are attractive. Acquisitions may also be subject to various regulatory approvals. If we fail to receive the appropriate regulatory approvals, we will not be able to consummate acquisitions that we believe are in our best interests.

Focus on commercial loans may increase the risk of substantial credit losses.

We offer a variety of loan products, including residential mortgage, consumer, construction, and commercial loans. At December 31, 2014, approximately 58.30% of loans were commercial loans, including those secured by commercial real estate. It is expected that, as we grow, this percentage will remain fairly constant.

Commercial lending is more risky than mortgage and consumer lending because loan balances are greater, and the borrower's ability to repay is contingent on the successful operation of a business. Risk of loan defaults is unavoidable in the banking industry. We attempt to limit exposure to this risk by monitoring carefully the amount of loans in specific industries and by exercising prudent lending practices. However, the risk that substantial credit losses could result in reduced earnings or losses cannot be eliminated.

The Company's focus on lending to small to mid-sized community-based businesses may increase its credit risk.

Most of the Company's commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the market areas in which the Company operates negatively impact this important customer sector, the Company's results of operations and financial condition may be adversely affected. Moreover, a portion of these loans have been made by the Company in recent years, and the borrowers may not have experienced a complete business or economic cycle. The deterioration of the borrowers' businesses may hinder their ability to repay their loans with the Company, which could have a material adverse effect on the Company's financial condition and results of operations.

Our allowance for loan losses may prove to be insufficient to absorb potential losses in the loan portfolio.

We maintain an allowance for loan losses that is believed to be adequate to provide for any potential losses in our loan portfolio. Our management determines the amount of this allowance through a periodic review and consideration of several factors, including:

- an ongoing review of the quality, size, and diversity of the loan portfolio;
- an evaluation of present economic, political, and regulatory conditions;
- an evaluation of nonperforming loans;
- our historical loan loss experience; and
- the amount and quality of collateral, including guarantees securing the loans.

Although we believe our loan loss allowance is adequate to absorb probable losses in the loan portfolio, we cannot predict such losses or that our allowance will be adequate. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside the Company's control, may require an increase in the allowance for loan losses. Increases in loan losses could have a material adverse effect on our financial condition and results of operations.

Our credit standards and ongoing credit assessment processes might not protect us from significant credit losses.

We take credit risk by virtue of making loans and leases and extending loan commitments and letters of credit. We manage credit risk through a program of underwriting standards, the review of certain credit decisions, and an ongoing process of assessment of the quality of the credit already extended. Our exposure to credit risk is managed through the use of consistent underwriting standards that emphasize local lending while avoiding highly leveraged transactions as well as excessive industry and other concentrations. Our credit administration function employs risk management techniques to help ensure that problem loans and leases are promptly identified. While these procedures are designed to provide us with the information needed to implement policy adjustments where necessary and to take appropriate corrective actions, there can be no assurance that such measures will be effective in avoiding undue credit risk.

We rely upon independent appraisals to determine the value of the real estate that secures a significant portion of our loans, and the values indicated by such appraisals may not be realizable if we are forced to foreclose upon such loans.

A significant portion of our loan portfolio consists of loans secured by real estate. We rely upon independent appraisers to estimate the value of such real estate. Appraisals are only estimates of value, and the independent appraisers may make mistakes of fact or judgment that adversely affect the reliability of their appraisals. In addition, events occurring after the initial appraisal may cause the value of the real estate to increase or decrease. As a result of any of these factors, the real estate securing some of our loans may be more or less valuable than anticipated at the time the loans were made. If a default occurs on a loan secured by real estate that is less valuable than originally estimated, we may not be able recover the outstanding balance of the loan.

The Company depends on the accuracy and completeness of information about clients and counterparties, and its financial condition could be adversely affected if it relies on misleading information.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, the Company may rely on information furnished to it by or on behalf of clients and counterparties, including financial statements and other financial information, which the Company does not independently verify. The Company also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, the Company may assume that a customer's audited financial statements conform with accounting principles generally accepted in the United States and present fairly, in all material respects, the financial condition, results of operations, and cash flows of the customer. The Company's financial condition and results of operations could be negatively impacted to the extent it relies on financial statements that do not comply with generally accepted accounting principles in the United States or are materially misleading.

Our quarterly financial results may fluctuate as a result of seasonality, which may make it difficult to predict our future performance and may adversely affect our common stock price.

We engage in certain lines of business that are historically subject to seasonal trends. These include mortgage banking and real estate brokerage services that reflect the general patterns of housing sales, which typically peak in the spring and summer seasons. Our non-mortgage and real estate related businesses have various seasonality trends that may create further fluctuations in our quarterly operating results. Any of these seasonal trends, or the combination of them, may negatively impact the price of our common stock.

Our mortgage revenue is cyclical and is sensitive to the level of interest rates, changes in economic conditions, decreased economic activity, and slowdowns in the housing market, any of which could adversely impact our profits.

The success of our mortgage business is dependent upon our ability to originate loans and sell them to investors at or near current volumes. Loan production levels are sensitive to changes in the level of interest rates and changes in economic conditions. Loan production levels may suffer if we experience a slowdown in the housing markets in the regions in which we do business or tightening credit conditions. Any sustained period of decreased activity caused by fewer refinancing transactions, higher interest rates, housing price pressure, or loan underwriting restrictions would adversely affect our mortgage originations and, consequently, could significantly reduce our income from mortgage activities. As a result, these conditions would also adversely affect our results of operations.

Strong competition in our primary market areas may limit asset growth and profitability.

We encounter strong competition from other financial institutions in our primary market area. In addition, established financial institutions not already operating in our primary market area may open branches at future dates. In the conduct of certain aspects of our business, we also compete with savings institutions, credit unions, mortgage banking companies, consumer finance companies, insurance companies, real estate companies, and other institutions, some of which are not subject to the same degree of regulation or restrictions as are imposed upon us. Many of these competitors have substantially greater resources and lending limits than we have and offer services that we do not provide. In addition, many of these competitors have numerous branch offices located throughout their extended market areas that provide them with a competitive advantage. No assurance can be given that such competition will not have an adverse impact on the financial condition and results of operations.

Recent legislative reforms can result in our business becoming subject to significant and extensive additional regulations, which could adversely affect our results of operations and financial condition.

The Dodd-Frank Act will continue to result in significant changes in the regulation of financial institutions. As disclosed earlier in this Form 10-K, the act contains numerous provisions that affect all banks and bank holding companies, and is fundamentally changing the system of regulatory oversight. Some of these provisions under the Dodd-Frank Act have the consequence of increasing our expenses, decreasing our revenues, and changing the activities in which we choose to engage. The legislative and regulatory changes affecting capital, liquidity, supervision, permissible activities, corporate governance and compensation, changes in fiscal policy, and steps to eliminate government support for banking organizations may have long-term effects on the business model and profitability of banking organizations that cannot now be foreseen. The specific impact of the Dodd-Frank Act on our current activities or new financial activities we may consider in the future, our financial performance, and the markets in which we operate will depend on the manner in which the relevant agencies develop and implement the required rules and the reaction of market participants to these regulatory developments.

Recently enacted capital standards may have an adverse effect on our profitability, lending, and ability to pay dividends on our securities.

In July 2013, the FDIC released its interim final rules that implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. Under the Basel III Capital Rules, minimum requirements have increased for both the quality and quantity of capital held by banking organizations. Consistent with the international Basel framework, the rules include a new minimum ratio of CET1 capital to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets that apply to all supervised financial institutions. The rules also, among other things, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. The new rules became effective January 1, 2015. The potential impact of the Basel III Capital Rules includes, but is not limited to, reduced lending and negative pressure on profitability and return on equity due to higher capital requirements. To the extent the Company is required to increase capital in the future to comply with the Basel III Capital Rules, our ability to pay dividends may be reduced.

New regulations issued by the Consumer Financial Protection Bureau could adversely affect our earnings.

The CFPB has broad rule-making authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers. Pursuant to the Dodd-Frank Act, the CFPB issued a final rule effective January 10, 2014, requiring mortgage lenders to make a reasonable and good-faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms, or to originate "qualified mortgages" that meet specific requirements with respect to terms, pricing, and fees. The rule also contains new disclosure requirements at mortgage loan origination and in monthly statements. These requirements could limit our ability to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time-consuming to make these loans, which could adversely impact our profitability

Extensive government regulation and monetary policy could adversely affect operations.

As part of the financial services industry, we are subject to extensive governmental supervision, regulation, and control that have materially affected the business of financial institutions in the past and are likely to do so in the future. Regulations affecting the financial services industry and, therefore, us may be changed at any time, and the interpretation of those regulations by examining authorities of the financial services industry is also subject to change. There can be no assurance that future changes in legislation, administrative regulations, or governmental policy will not adversely affect the financial services industry and our business.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our bank's main office is located in Portsmouth, Virginia, and our Corporate Administration and Member Service Center is located in Suffolk, Virginia; we own both of these locations. As of December 31, 2014, we occupied an additional 80 properties, of which we own 27, in the cities and counties in which we operate. Additional information with respect to the amounts at which company premises and equipment are carried and commitments under long-term leases is set forth in Note 6 - Premises, Equipment, and Leases in the Annual Report and incorporated herein.

Item 3. 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 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER'S PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is listed on the NASDAQ Global Select Market under the symbol TOWN. The following chart shows the high and low quarterly closing sale prices in 2014 and 2013 for the Company's common stock.

	2014		2013	
Quarter	High	Low	High	Low
First	$ 15.97	$ 14.41	$ 16.00	$ 14.40
Second	16.47	14.85	15.50	13.43
Third	16.46	13.58	17.13	14.05
Fourth	15.83	13.51	15.57	13.68

Holders

As of December 31, 2014, we had issued and outstanding 35,785,679 shares of common stock. These shares were held by approximately 8,882 shareholders of record.

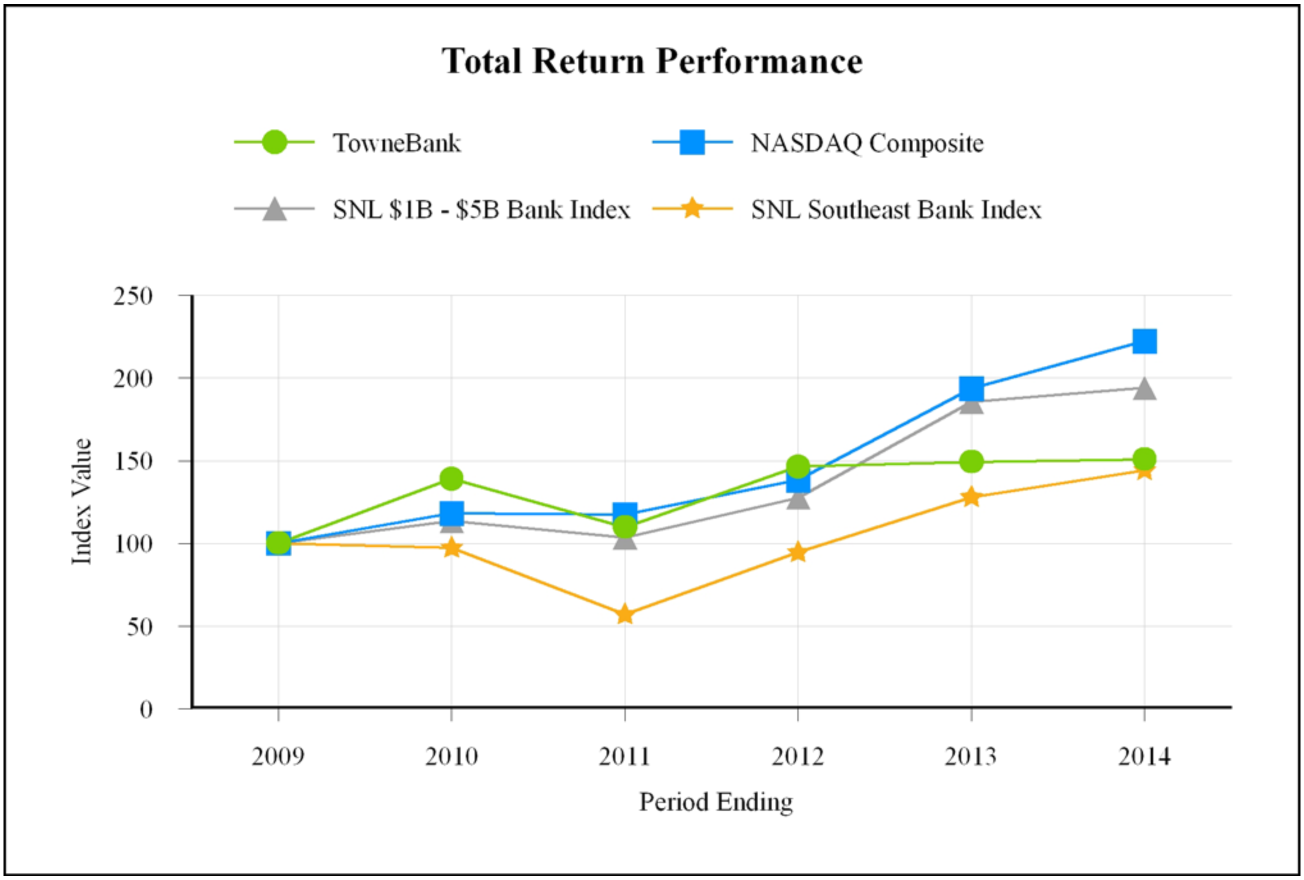
Dividends

In February and May 2013, we declared a quarterly cash dividend of $0.09 per share. In August 2013, November 2013, and February 2014, we declared quarterly cash dividends of $0.10 per common share. Beginning in the second quarter of 2014 through the fourth quarter of 2014, we paid a cash dividend of $0.11 per share. 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 guidelines.

Our future dividend policy is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. We are also subject to certain restrictions imposed by the reserve and capital requirements of federal and Virginia banking statutes and regulations.

Stock Performance Graph

The following stock performance graph presents the cumulative total return comparison through December 31, 2014, of stock appreciation for our common stock, the NASDAQ Composite Index measuring all NASDAQ domestic and international-based common type stocks listed on the NASDAQ Stock Market ("NASDAQ Composite"), the SNL Securities Index including banks between $1 billion and $5 billion in total assets ("SNL $1B-$5B Bank Index"), and the SNL Securities Index including only banks in the Southeast ("SNL Southeast Bank Index"). Returns assume an initial investment of $100 at the market close of December 31, 2008, and reinvestment of dividends.



Index		12/31/2009		12/31/2010		12/31/2011		12/31/2012		12/31/2013		12/31/2014
TowneBank	$	100.00	$	138.94	$	109.72	$	146.30	$	149.14	$	150.72
NASDAQ Composite		100.00		118.15		117.22		138.02		193.47		222.16
SNL $1B - $5B Bank Index		100.00		113.35		103.38		127.47		185.36		193.81
SNL Southeast Bank Index		100.00		97.10		56.81		94.37		127.88		144.03

Item 6. SELECTED FINANCIAL DATA

Reference is made to the information in the section entitled, "Selected Financial Highlights," of our Annual Report for the year ended December 31, 2014, which is incorporated herein by reference.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Reference is made to the information in the section entitled, "Management's Discussion and Analysis" on pages 4-36 of our Annual Report, which is incorporated herein by reference.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Reference is made to the information in the section entitled, "Management's Discussion and Analysis," under subsections "Interest Sensitivity," "Market Risk Management," "Earnings Simulation Analysis," "Market Value Simulation," and "Credit Risk Elements" on pages 33-35 of our Annual Report, which is incorporated herein by reference.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Reference is made to the information in the sections entitled, “Management’s Report on Internal Control,” “Report of Independent Registered Public Accounting Firm,” and “Consolidated Financial Statements and Notes” of our Annual Report, which is incorporated herein by reference.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) was carried out as of December 31, 2014, under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer, and several other members of our senior management. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report.

Management’s Report on Internal Control Over Financial Reporting. The annual report of management on the effectiveness of our internal control over financial reporting and the attestation report thereon issued by our independent registered public accounting firm are set forth under “Management’s Report on Internal Control” and “Report of Independent Registered Public Accounting Firm” on pages 37-40 of our Annual Report, which is incorporated herein by reference.

Changes in Internal Control Over Financial Reporting. There were no changes in our internal controls over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Reference is made to the information in the sections entitled, “Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Board of Directors and Committees: *Audit Committee”* of our Proxy Statement for the Annual Meeting of Stockholders to be held May 20, 2015 (“Proxy Statement”), which sections are incorporated herein by reference. The following information is provided, as of March 1, 2015, for those executive officers who are not directors.

Name (Age)	Principal Occupation During Past Five Years
W. Jeffrey Dyckman (64)	President of Towne Business Strategy Group since 2009.
Keith D. Horton (56)	Senior Executive Vice President and Chief Administrative Officer since January 2005; Executive Vice President of Operations from 1999 to January 2005.
William B. Littreal (44)	Senior Executive Vice President and Chief Operating Officer since April 2011; Executive Vice President and Director of Finance from April 2008 to April 2011.
Clyde E. McFarland, Jr. (60)	Senior Executive Vice President and Chief Financial Officer since January 2005; Executive Vice President and Chief Financial Officer from 1999 to January 2005.
U. Starr Oliver (63)	Senior Executive Vice President and Chief Marketing and Human Resources Officer since May 2011; Executive Vice President of Marketing and Retail Banking from 1999 to May 2011.
Philip M. Rudisill (49)	Senior Executive Vice President and Chief Credit Officer since July 2011; Senior Executive Vice President of Corporate Administration from March 2006 to May 2011.
Thomas V. Rueger (67)	Senior Executive Vice President since January 2013; President and Chief Executive Officer of SunTrust, Hampton Roads from August 2006 to May 2012.

Code of Ethical Conduct

We have adopted a Code of Ethical Conduct that applies to our Chief Executive Officer and other executive and senior financial officers, including our Chief Financial Officer, Chief Accounting Officer, Corporate Treasurer, Internal Audit members, any person Assistant Vice President and above in an Accounting/Financial position, Senior Financial Analyst, any Regulation O executive officers along with any person serving in an equivalent position regardless of whether or not they are designated as executive officers for Regulation O purposes, or any persons serving in equivalent positions within the Company. The Code of Ethical Conduct is included as Exhibit 14. Any changes in or waivers from our Code of Ethical Conduct applicable to the Chief Executive Officer and any other executive or senior financial officer shall be promptly disclosed through a filing with the FDIC on Form 8-K.

A written copy of our Code of Ethical Conduct is available free of charge to stockholders who request it by writing to: TowneBank, Attn: Clyde E. McFarland, Jr., 6001 Harbour View Boulevard, Suffolk, Virginia 23435. We also provide this information on our website, www.townebank.com, under Investor Relations, Governance Documents, Code of Conduct.

Part III

Item 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to our definitive proxy statement for our 2015 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information concerning security ownership of certain beneficial owners and management required by this item is incorporated herein by reference to our definitive proxy statement for our 2015 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

The following table summarizes information, as of December 31, 2014, relating to our stock incentive plans, pursuant to which grants of options to acquire shares of common stock may be awarded from time to time.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (A)	Weighted average exercise price of outstanding options, warrants, and rights (B)	Number of securities remaining available for future issuance under equity compensation plans [1] (C)
Equity compensation plans approved by security holders	414,005	$18.44	3,731,605
Equity compensation plans not approved by security holders	-	-	-
Total	414,005	$18.44	3,731,605

(1) Consists of shares available for future issuance under the TowneBank 2008 Stock Incentive Plan.

Item 13. CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Reference is made to the information in the sections entitled, “Related Party Transactions,” “Election of Directors,” and “Board of Directors and Committees,” of the Proxy Statement, which sections are incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Reference is made to the information in the section entitled, “Accounting Firm Fees,” of the Proxy Statement, which section is incorporated herein by reference.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

a) The following documents are filed as part of this report.

(1) Financial Statements

The following documents are included in the 2014 Annual Report to Shareholders and are incorporated by reference in this report:

Report of Independent Registered Public Accounting Firm
Management's Report on Internal Control
Consolidated Balance Sheets
Consolidated Statements of Income
Consolidated Statements of Comprehensive Income
Consolidated Statements of Equity
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

All financial statement schedules as required by Item 8 and Item 15 of Form 10-K have been omitted because the information requested is not required, not applicable, or is shown in the Consolidated Financial Statements or Notes thereto.

(3) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

Exhibit No.	Description
2.1	Agreement and Plan of Reorganization, dated as of July 14, 2014, by and among TowneBank, Franklin Financial Corporation and Franklin Federal Savings Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on July 16, 2014).
3.1	Articles of Incorporation, as amended (incorporated herein by reference to Exhibit 3.1 to our Form 10-Q, previously filed with the FDIC on June 24, 2014).
3.2	Bylaws, as amended (incorporated herein by reference to Exhibit 3.2 to our Form 8-K, previously filed with the FDIC on November 28, 2007).
	TowneBank 1999 Stock Incentive Plan, as amended and restated effective March 24, 2004 (incorporated herein by reference to Exhibit 10.1 to our 2004 Form 10-K, previously filed with the FDIC on March 22, 2005).
10.2	Employment Agreement, dated October 1, 2005, between TowneBank and Jacqueline B. Amato (incorporated herein by reference to Exhibit 10 to our Form 8-K, previously filed with the FDIC on February 15, 2006).
10.3	Form of Employment Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.5 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).

PART IV

Exhibits continued

10.4	Form of Employment Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, Clyde E. McFarland, Jr., and U. Starr Oliver (incorporated herein by reference to Exhibit 10.4 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).
10.5	Form of Change in Control Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.4 to our 2003 Form 10-K, previously filed with the FDIC on February 25, 2004).
10.6	Form of Change in Control Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, Clyde E. McFarland, Jr., and U. Starr Oliver. (incorporated herein by reference to Exhibit 10.5 to our 2004 Form 10-K, previously filed with the FDIC on February 23, 2005).
10.7	Employment Agreement, dated April 19, 2011, between TowneBank and William B. Littreal (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on April 20, 2011).
10.8	Form of Supplemental Executive Retirement Plan (incorporated herein by reference to Exhibit 10.7 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.9	TowneBank 2008 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.10	Securities Purchase Agreement, dated September 22, 2011, between the Company and the Secretary of the Treasury (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on September 23, 2011).
11	Statement re: Computation of Per Share Earnings (incorporated by reference to our 2014 Annual Report to Shareholders).
13	2014 Annual Report to Shareholders.
14	Code of Ethical Conduct.
21	Subsidiaries of TowneBank.
31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO 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.

b) See (a)(3) above for all exhibits filed herewith and the Exhibit Index.

c) All schedules are omitted as the required information is not applicable or the information is presented in the Consolidated Financial Statements or related Notes.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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

Registrant

March 13, 2015	/s/ G. Robert Aston, Jr.
Date	By: G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 13, 2015:

SIGNATURES

/s/ Jacqueline B. Amato Jacqueline B. Amato	Chairman and Chief Executive Officer of TowneBank Mortgage Division, Director
/s/ G. Robert Aston, Jr. G. Robert Aston, Jr.	Chairman of the Board, Chief Executive Officer
/s/ E. Lee Baynor E. Lee Baynor	Director
/s/ Richard S. Bray Richard S. Bray	Director
/s/ Thomas C. Broyles Thomas C. Broyles	Vice Chairman of the Board, Director

SIGNATURES

/s/ Bradford L. Cherry Bradford L. Cherry	Director
/s/ J. Morgan Davis J. Morgan Davis	President and Chief Banking Officer, Director
/s/ Douglas D. Ellis Douglas D. Ellis	Director
/s/ John W. Failes John W. Failes	Vice Chairman of the Board, Director
/s/ Paul J. Farrell Paul J. Farrell	Director
/s/ Andrew S. Fine Andrew S. Fine	Director
/s/ William I. Foster, III William I. Foster, III	President of TowneBank Virginia Beach, Director
/s/ Gordon L. Gentry, Jr. Gordon L. Gentry, Jr.	Chairman of TowneBank Peninsula, Director
/s/ Ernest F. Hardee Ernest F. Hardee	Vice Chairman of the Board, Director

SIGNATURES

/s/ John R. Lawson, II	
John R. Lawson, II	Director
/s/ Harry T. Lester	
Harry T. Lester	Director
/s/ W. Ashton Lewis	
W. Ashton Lewis	Vice Chairman of the Board, Director
/s/ Stephanie J. Marioneaux	
Stephanie J. Marioneaux	Director
/s/ Clyde E. McFarland, Jr.	
Clyde E. McFarland, Jr.	Senior Executive Vice President, Chief Financial Officer (principal financial officer)
/s/ Juan M. Montero, II	
Juan M. Montero, II	Director
/s/ R. Scott Morgan	
R. Scott Morgan	Director
/s/ Thomas K. Norment, Jr.	
Thomas K. Norment, Jr.	Director
/s/ R.V. Owens, III	
R.V. Owens, III	Director

SIGNATURES

/s/ David A. Patterson	
David A. Patterson	Executive Vice President, Chief Accounting Officer (principal accounting officer)
/s/ Wayne K. Sawyer	
Wayne K. Sawyer	Director
/s/ Richard B. Thurmond	
Richard B. Thurmond	Director
/s/ Richard T. Wheeler, Jr.	
Richard T. Wheeler, Jr.	Director
/s/ Alan S. Witt	
Alan S. Witt	Director
/s/ F. Lewis Wood	
F. Lewis Wood	Director

Exhibit (13)

TOWNEBANK

2014 Annual Report

TowneBank

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BUSINESS PROFILE AND CORPORATE MISSION STATEMENT

BUSINESS PROFILE

TowneBank was organized in 1998 under the laws of the Commonwealth of Virginia to engage in a general retail and commercial banking business and began operations on April 8, 1999. We place special emphasis on serving the financial needs of small- and medium-size businesses, professionals, and individuals in Richmond, Virginia and the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. We offer a full range of banking and related financial services through our controlled divisions and subsidiaries that include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, LLC ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; TFA Benefits; Out of Town, LLC, d/b/a Red Sky Travel Insurance; Towne Mortgage, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; SimonTowne Mortgage, LLC; GSH NC Resort Management, LLC, d/b/a Corolla Classic Vacations; Towne 1031 Exchange, LLC; Towne New Markets CDE, Inc.; and Towne Realty, LLC, d/b/a Berkshire Hathaway HomeServices Towne Realty, which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements, Towne Investment Group, which provides investment and asset management services; and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated 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.

CORPORATE MISSION STATEMENT

TowneBank will be a relationship and friendship-driven local bank focused on basic human values that will serve to create a warm sense of belonging and financial well-being among our family of members.

We will offer a competitive array of business and personal financial services, delivered only with the highest ethical standards. Our commitment to exquisite service for our members will lead to our ability to create a reasonable rate of return for our shareholders, a bright future for our dedicated bankers, and a leadership role for our bank in promoting the social, cultural, and economic well-being of the communities we serve.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2014	2013	2014/2013 Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 145,736	$ 143,895	$ 1,841	1.28 %
Noninterest income (1)	96,744	89,916	6,828	7.59 %
Total revenue	242,465	234,423	8,042	3.43 %
Noninterest expenses	178,864	168,792	10,072	5.97 %
Provision for loan losses	492	4,248	(3,756)	(88.42)%
Net income attributable to TowneBank	42,169	41,762	407	0.97 %
Net income per common share - basic	1.18	1.14	0.04	3.51 %
Net income per common share - diluted	1.18	1.14	0.04	3.51 %
Period End Data:				
Total assets	$ 4,982,485	$ 4,672,997	$ 309,488	6.62 %
Total assets - tangible	4,846,816	4,552,935	293,881	6.45 %
Earning assets (2)	4,610,142	4,296,486	313,656	7.30 %
Loans (net of unearned income and deferred costs)	3,397,266	3,235,989	161,277	4.98 %
Allowance for loan losses	35,917	38,380	(2,463)	(6.42)%
Goodwill and other intangibles	135,668	120,061	15,607	13.00 %
Noninterest-bearing deposits	1,224,466	1,037,028	187,438	18.07 %
Interest-bearing deposits	2,622,136	2,530,076	92,060	3.64 %
Total deposits	3,846,602	3,567,104	279,498	7.84 %
Equity	618,276	585,318	32,958	5.63 %
Equity - tangible	482,608	465,257	17,351	3.73 %
Book value per share	14.88	14.16	0.72	5.08 %
Book value per share - tangible	11.09	10.76	0.33	3.07 %
Cash dividends declared per share	0.43	0.38	0.05	13.16 %
Daily Average Balances:				
Total assets	$ 4,866,584	$ 4,507,233	$ 359,351	7.97 %
Total assets - tangible	4,738,306	4,387,578	350,728	7.99 %
Earning assets (2)	4,472,117	4,123,527	348,590	8.45 %
Loans (net of unearned income)	3,298,740	3,158,448	140,292	4.44 %
Allowance for loan losses	37,168	39,698	(2,530)	(6.37)%
Goodwill and other intangibles	128,278	119,655	8,623	7.21 %
Noninterest-bearing deposits	1,158,888	1,022,168	136,720	13.38 %
Interest-bearing deposits	2,590,162	2,415,178	174,984	7.25 %
Total deposits	3,749,050	3,437,346	311,704	9.07 %
Total equity	606,777	574,558	32,219	5.61 %
Total equity - tangible	478,499	454,903	23,596	5.19 %
Key Ratios:				
Return on average assets	0.87%	0.93%	(0.06)%	(6.45)%
Return on average tangible assets	0.93%	0.95%	(0.02)%	(2.11)%
Return on average equity	6.95%	7.27%	(0.32)%	(4.40)%
Return on average tangible equity	9.16%	9.18%	(0.02)%	(0.22)%
Net interest margin (2)(3)	3.38%	3.61%	(0.23)%	(6.37)%
Efficiency ratio (1)	73.76%	72.19%	1.57 %	2.17 %
Average earning assets/total average assets	91.89%	91.49%	0.40 %	0.44 %
Average loans/average deposits	87.99%	91.89%	(3.90)%	(4.24)%
Average noninterest deposits/total average deposits	30.91%	29.74%	1.17 %	3.93 %
Allowance for loan losses/period end loans	1.06%	1.19%	(0.13)%	(10.92)%
Period end equity/period end total assets	12.41%	12.53%	(0.12)%	(0.96)%

Notes:

(1) Excludes investment securities losses of $15,000 in 2014 and securities gains $0.61 million in 2013.

(2) Includes bank-owned life insurance.

(3) Presented on a tax-equivalent basis.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2012	2011	2010
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 144,284	$ 136,222	$ 122,635
Noninterest income (1)	81,184	64,052	60,089
Total revenue	228,473	203,955	188,685
Noninterest expenses	158,749	144,820	122,745
Provision for loan losses	16,155	13,602	22,565
Net income attributable to TowneBank	37,931	33,321	30,276
Net income per common share - basic (2)	1.03	0.77	0.72
Net income per common share - diluted (2)	1.03	0.76	0.71
Period End Data:			
Total assets	$ 4,405,923	$ 4,081,770	$ 3,871,018
Total assets - tangible	4,286,921	3,966,832	3,762,072
Earning assets (3)	4,033,813	3,712,187	3,537,322
Loans (net of unearned income and deferred costs)	3,133,507	2,793,193	2,731,352
Allowance for loan losses	40,427	39,740	38,660
Goodwill and other intangibles	119,002	114,938	108,946
Noninterest-bearing deposits	978,818	839,211	706,040
Interest-bearing deposits	2,401,234	2,351,576	2,248,474
Total deposits	3,380,052	3,190,787	2,954,514
Shareholders' equity	559,879	520,489	499,512
Shareholders' equity - tangible	440,877	405,551	390,566
Book value per share (2)	13.30	12.65	12.10
Book value per share - tangible (2)	9.52	8.82	8.44
Cash dividends declared per share (2)	0.33	0.31	0.31
Daily Average Balances:			
Total assets	$ 4,201,452	$ 3,990,783	$ 3,721,155
Total assets - tangible	4,087,602	3,877,103	3,622,944
Earning assets (3)	3,811,846	3,604,641	3,392,093
Loans (net of unearned income)	2,910,406	2,678,004	2,587,287
Allowance for loan losses	40,100	40,928	35,158
Goodwill and other intangibles	113,850	113,680	98,211
Noninterest-bearing deposits	904,512	781,992	649,840
Interest-bearing deposits	2,370,003	2,308,099	2,101,692
Total deposits	3,274,515	3,090,091	2,751,532
Shareholders' equity	545,566	511,724	490,572
Shareholders' equity - tangible	431,716	398,045	392,361
Key Ratios:			
Return on average assets	0.90%	0.83%	0.81%
Return on average tangible assets	0.93%	0.86%	0.84%
Return on average equity	6.95%	6.51%	6.17%
Return on average tangible equity	8.79%	8.37%	7.72%
Net interest margin (3)(4)	3.92%	3.94%	3.76%
Efficiency ratio (1)	70.41%	72.31%	67.18%
Average earning assets/total average assets	90.73%	90.32%	91.16%
Average loans/average deposits	88.88%	86.66%	94.03%
Average noninterest deposits/total average deposits	27.62%	25.31%	23.62%
Allowance for loan losses/period end loans	1.29%	1.42%	1.42%
Period end equity/period end total assets	12.71%	12.75%	12.90%

Notes:
(1) Excludes investment securities gains of $3.01 million, $3.68 million, and $5.96 million in 2012, 2011, and 2010, respectively.
(2) Prior period was restated to reflect 3% common stock dividend paid June 12, 2012.
(3) Includes bank-owned life insurance.
(4) Presented on a tax-equivalent basis.

OVERVIEW

TowneBank is a retail and commercial banking business serving Richmond, Virginia and the Greater Hampton Roads area in southeastern 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 2014 financial performance:

- Net income increased to $42.17 million compared with $41.76 million in 2013. Net income available to common shareholders for 2014 was $41.40 million after preferred stock dividend payments of $0.76 million. Fully diluted earnings rose to $1.18 per common share as compared to $1.14 per common share in 2013.

- Net interest income increased $1.84 million or 1.28%, primarily due to an increase in average earning assets and was partially offset by a decline in yields on earning assets.

- The provision for loan losses decreased $3.76 million, or 88.42%, from 2013. The loan loss reserve was 1.06% of loans at December 31, 2014, down from 1.19% at year-end 2013. The decrease in the provision for loan losses in the current year period from the comparative prior year was primarily a result of the reduction in historical loss ratios combined with continued improvements in credit quality.

- Excluding gains and losses on investment securities, noninterest income increased by $6.83 million, or 7.59%, over 2013. The primary driver of the increase was an increase in our Insurance segment related to our acquisition of Southern Insurance Agency, Inc. ("Southern") in the second quarter of 2014 and the acquisition of two insurance agencies in the third quarter of 2013. The increase was partially offset by a decrease in residential mortgage banking income.

- Noninterest expense increased $10.07 million, or 5.97%, compared to 2013. The increase was driven by merger expenses of $4.28 million related to the acquisition of Franklin Financial Corporation ("Franklin"), which was completed on January 2, 2015, and the acquisition of Southern in the second quarter of 2014. Also contributing to the increase were severance-related expenses of $3.55 million.

- The effective tax rate increased to 30.12% in 2014 compared to 29.09% in 2013. The effective rate increased primarily as 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 net losses on the investments were recorded in other noninterest income.

MERGER ACTIVITY

On January 2, 2015, TowneBank completed the acquisition of Franklin and its wholly-owned subsidiary, Franklin Federal Savings Bank, based in Richmond, Virginia. The Company acquired eight office locations, approximately $491.96 million in loans, and assumed approximately $682.95 million in deposits.

Effective October 1, 2014, TowneBank acquired Beach Properties of Hilton Head, Inc. ("Beach Properties"), a resort property management company offering vacation rentals in Hilton Head, South Carolina. The purchase price was $8.60 million in cash and stock.

Effective May 1, 2014, TowneBank acquired an insurance agency, Southern, which is affiliated with Towne Insurance. The total purchase price for the transaction was $11.81 million in cash and common stock.

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.

Allowance for Loan Losses: The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Increases and decreases in the allowance due to changes in the measurement of impaired loans, if applicable, are included in the provision for loan losses. We periodically evaluate the adequacy of the allowance for loan losses in order to maintain the allowance at a level that is sufficient to absorb probable credit losses. The amount of allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and external influences such as changes in economic conditions.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgments of information available to them at the time of their examination. Although management believes that we use the best information available to evaluate the adequacy of the allowance, unknown market or borrower circumstances could result in adjustments and net earnings being significantly affected if conditions differ substantially from the assumptions used by management in determining the adequacy of the allowance.

Other Real Estate Owned: Other real estate owned ("OREO"), which is included in other assets on the balance sheet, consists primarily of commercial and residential real estate that has been obtained in partial or full satisfaction of loan obligations. OREO is carried at the fair value of the property, less estimated selling costs, with any difference between the fair value of the property, less estimated selling costs, and the carrying value of the loan recorded through a charge to the allowance for loan losses upon transfer to OREO. Subsequent write-downs required for declines in value are recorded through a valuation allowance, or taken directly to the asset, charged to other noninterest expense.

Deferred Income Taxes: Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carry-forwards, and deferred tax liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred income tax expense (benefit) represents the change during the period in the deferred tax assets and deferred tax liabilities.

We use the asset and liability method in accounting for income taxes. This method recognizes the amount of taxes payable or refundable for the current year and recognizes deferred tax liabilities and assets for the expected future tax consequences of events and transactions that have been recognized in our financial statements or tax returns. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Realization of the deferred income tax asset is dependent on generating sufficient taxable income in future years, and, as such, material changes could impact our financial condition and results of operations.

Estimates of Fair Value of Financial Instruments: The estimation of fair value is significant to certain assets, including loans held for sale, available-for-sale securities, and on-balance-sheet commitments to originate loans held for sale. These assets and liabilities are recorded either at fair value or at the lower of cost or fair value, as applicable. The 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. The fair values of available-for-sale securities 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. The fair values of commitments to originate loans held for sale are based on fees currently charged to enter into similar agreements and, for fixed-rate commitments, also consider the difference between current levels of interest rates and committed rates.

Fair values can be volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, and market conditions. Since these factors can change significantly and rapidly, fair values are difficult to predict and subject to material changes that could impact our financial condition and results of operations.

Goodwill and Other Intangibles: We record all assets and liabilities acquired in purchase acquisitions, including goodwill, intangibles with indefinite lives, and other intangibles, at fair value as required by Accounting Standards Codification Topic ("ASC") 805, *Business Acquisitions*. The initial recording of goodwill and other intangibles requires subjective decisions concerning estimates of the fair value of the acquired assets and liabilities.

Goodwill is reviewed for potential impairment at the reporting unit level (one level below the business segments identified on pages 15-21) on an annual basis, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess.

Other identifiable intangible assets are evaluated for impairment if events or changes in circumstances indicate a possible impairment. Such evaluation is based on undiscounted cash flow projections, which may extend far into the future and, by their nature, are difficult to determine over an extended timeframe. Fair value may be influenced by market prices, comparison to similar assets, market multiples, discounted cash flow analysis, and other determinants. Factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology, changes in discount rates, and specific industry or market sector conditions. Other key judgments in accounting for intangibles include useful life and classification between goodwill and intangibles with indefinite lives or other intangibles that require amortization.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Results of Operations: We reported net income for the years ended December 31, 2014, 2013, and 2012, of $42.17 million, $41.76 million, and $37.93 million, respectively. Diluted earnings per share were $1.18, $1.14, and $1.03 for the years ended December 31, 2014, 2013, and 2012, respectively. Earnings in 2014 included costs of $5.49 million on an after-tax basis related to severance and acquisition-related expenses recorded during the year. Earnings per share were positively affected in 2014 by the mandatory conversion of the remaining shares of TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A ("Series A Preferred Stock") on September 1, 2013, as preferred dividends decreased by $3.46 million from 2013.

Profitability, as measured by our return on average assets ("ROA"), was 0.87%, 0.93%, and 0.90% for the years ended December 31, 2014, 2013, and 2012, respectively. Return on average tangible assets was 0.93%, 0.95%, and 0.93% for the same respective periods. Return on average equity ("ROE") was 6.95%, 7.27%, and 6.95% for years ended December 31, 2014, 2013, and 2012, respectively; while return on average tangible equity was 9.16%, 9.18%, and 8.79% for the same respective years. The decline in ROA and ROE was primarily due to the above-mentioned severance and acquisition-related noninterest expenses incurred in 2014.

Our operating income, calculated as net interest income and noninterest income less gains on investment securities, was $242.48 million for the year ended December 31, 2014, compared to $233.81 million and $225.47 million for 2013 and 2012, respectively.

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 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 include income from bank-owned life insurance ("BOLI"), a non-GAAP measure, and 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.

Our balance sheet is currently in a liability-sensitive balance sheet position, meaning that interest-bearing liabilities generally reprice more quickly than earning assets. If we were in an asset-sensitive balance sheet position, assets such as securities would generally reprice more quickly than liabilities. We are primarily funded by core deposits, with noninterest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Company's net interest income and net interest margin in a rising interest rate environment.

Net interest income, on a tax-equivalent basis, was $151.16 million for the year ended December 31, 2014, which was $2.35 million, or 1.58%, more than the $148.81 million reported in the previous year. In comparison to the prior year, net interest income rose primarily due to higher balances of earning assets.

Interest income, on a tax-equivalent basis, was $177.94 million for the year ended December 31, 2014, which was $2.74 million, or 1.56%, greater than the $175.20 million for the year ended December 31, 2013. Average earning assets grew to $4.47 billion in 2014 from $4.12 billion in 2013, an increase of $348.59 million, or 8.45%. The yield on earning assets was 3.98% in the year ended December 31, 2014, which compared to 4.25% in the prior year. The increase in interest income was due to increased balances in earning assets, primarily in average loans held for investment and taxable investment securities. The increase was partially offset by the effects of lower yields, which was driven by the drop in loan yields as other categories of earning assets had modest yield increases.

Interest expense, for the year ended December 31, 2014, increased by $0.38 million, or 1.44%, to $26.78 million compared to $26.40 million for the year ended December 31, 2013. The balance of average interest-bearing liabilities increased to $3.02 billion in 2014 from $2.84 billion in 2013, an increase of $179.01 million, or 6.30%. The higher balance was partially offset by a drop in the average rate paid, from 0.93% in 2013 to 0.89% in 2014. The rate decline was primarily driven by modest rate improvements in savings accounts and demand and money market accounts.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.38% in the year ended December 31, 2014, which was 23 basis points lower than the 3.61% a year ago. The compression in the margin was driven by the fall in asset yields and growth in earning assets. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

The purpose of volume and rate analysis is to describe the impact on interest income resulting from changes in average balances and average interest rates from those in effect during the previous year. The following tables include average balances, interest income and expense, average yields and costs, and volume and rate analysis (dollars in thousands):

	Year Ended December 31,								
	2014			2013			2012		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans (2)	$ 3,298,740	$ 155,980	4.73%	$ 3,158,448	$ 156,652	4.96%	$ 2,910,406	$ 157,053	5.40%
Taxable investment securities	622,479	8,028	1.29%	341,279	4,263	1.25%	260,630	6,163	2.36%
Tax-exempt investment securities	173,894	7,414	4.26%	169,376	6,993	4.13%	159,322	7,248	4.55%
Interest-bearing deposits	253,416	637	0.25%	300,977	759	0.25%	309,098	783	0.25%
Mortgage loans held for sale	65,746	2,586	3.93%	97,235	3,469	3.57%	118,206	4,173	3.53%
Bank-owned life insurance	57,842	3,290	5.69%	56,212	3,066	5.45%	54,184	3,175	5.86%
Total earning assets	4,472,117	177,935	3.98%	4,123,527	175,202	4.25%	3,811,846	178,595	4.69%
Less: allowance for loan losses	(37,168)			(39,698)			(40,100)		
Total nonearning assets	431,635			423,404			429,706		
Total assets	$ 4,866,584			$ 4,507,233			$ 4,201,452		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 1,306,738	$ 3,036	0.23%	$ 1,166,510	$ 3,146	0.27%	$ 1,064,840	$ 4,242	0.40%
Savings	310,722	2,855	0.92%	323,011	3,117	0.96%	300,235	3,202	1.07%
Certificates of deposit	972,702	7,461	0.77%	925,657	7,090	0.77%	1,004,928	9,305	0.93%
Total interest-bearing deposits	2,590,162	13,352	0.52%	2,415,178	13,353	0.55%	2,370,003	16,749	0.71%
FHLB advances and repurchase agreements	429,249	13,424	3.13%	425,225	13,042	3.07%	318,494	12,236	3.84%
Convertible subordinated capital debentures	—	—	—	—	—	—	2,950	237	8.03%
Total interest-bearing liabilities	3,019,411	26,776	0.89%	2,840,403	26,395	0.93%	2,691,447	29,222	1.09%
Noninterest-bearing liabilities									
Demand deposits	1,158,888			1,022,168			904,512		
Other noninterest-bearing liabilities	81,508			70,104			59,927		
Total liabilities	4,259,807			3,932,675			3,655,886		
Shareholders' equity	606,777			574,558			545,566		
Total liabilities and equity	$ 4,866,584			$ 4,507,233			$ 4,201,452		
Net interest income (tax-equivalent basis)		$ 151,159			$ 148,807			$ 149,373	
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(3,290)			(3,066)			(3,175)	
Tax-equivalent basis adjustment		(2,133)			(1,846)			(1,914)	
Net interest income (GAAP)		$ 145,736			$ 143,895			$ 144,284	
Interest rate spread (3)			3.09%			3.32%			3.60%
Interest expense as a percent of average earning assets			0.60%			0.64%			0.77%
Net interest margin (tax-equivalent basis) (4)			3.38%			3.61%			3.92%
Total cost of deposits			0.36%			0.39%			0.51%

(1) Yields and interest income are presented on a taxable-equivalent basis using the federal statutory tax rate of 35%.
(2) Excludes average nonaccrual loans of $9.27 million in 2014, $20.23 million in 2013, and $54.44 million in 2012.
(3) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
(4) Net interest margin is net interest income expressed as a percentage of average earning assets.

(in thousands)	2014 vs 2013 Increase (Decrease) Due to Changes In			2013 vs 2012 Increase (Decrease) Due to Changes In		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 6,800	$ (7,472)	$ (672)	$ 12,829	$ (13,230)	$ (401)
Taxable investment securities	3,622	143	3,765	1,551	(3,451)	(1,900)
Tax-exempt investment securities	189	231	420	440	(695)	(255)
Interest-bearing deposits	(120)	(2)	(122)	(21)	(3)	(24)
Loans held for sale	(1,211)	328	(883)	(748)	44	(704)
Bank-owned life insurance	91	134	225	116	(225)	(109)
Total earning assets	9,371	(6,638)	2,733	14,167	(17,560)	(3,393)
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	354	(464)	(110)	375	(1,470)	(1,095)
Savings	(116)	(146)	(262)	233	(318)	(85)
Certificates of deposit	361	10	371	(694)	(1,521)	(2,215)
Total interest-bearing deposits	599	(600)	(1)	(86)	(3,309)	(3,395)
FHLB advances and repurchase agreements	124	258	382	3,584	(2,778)	806
Convertible subordinated capital debentures	—	—	—	(118)	(119)	(237)
Total interest-bearing liabilities	723	(342)	381	3,380	(6,206)	(2,826)
Net interest income (tax equivalent basis)	$ 8,648	$ (6,296)	$ 2,352	$ 10,787	$ (11,354)	$ (567)

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

Provision for Loan Losses: The provision for loan losses is charged against earnings in order to establish and maintain the allowance for loan losses at a level that reflects management's evaluation of the risk inherent in the portfolio. Management considers continuing assessments of nonperforming and "watch list" loans, analytical reviews of loan loss experience in relation to outstanding loans, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. The provisions for loan losses recorded in 2014, 2013, and 2012 were $0.49 million, $4.25 million, and $16.16 million, respectively. Net charge-offs were $2.96 million, $6.30 million, and $15.47 million for 2014, 2013, and 2012, respectively. The decrease in the provision for loan losses in the current year periods from the comparative prior periods was primarily a result of the reduction in historical loss ratios combined with continued improvements in credit quality. The allowance for loan losses as a percentage of period-end loans was 1.06% and 1.19% at December 31, 2014 and 2013, respectively. For further discussion and analysis of the loan portfolio and the allowance for loan losses, see the "Analysis of Financial Condition" section found later in this report. Also, see Note 4, "Loans and Allowance for Loan Losses," in the Notes to Consolidated Financial Statements.

Noninterest Income: Total noninterest income for the year ended December 31, 2014 was $96.73 million, or $6.20 million, and 6.85% higher than 2013. Excluding gains and losses on investment securities, total noninterest income increased by $6.83 million, or 7.59%, over 2013. Total noninterest income for the year ended December 31, 2013, was $90.53 million, representing a $6.34 million, or 7.53%, increase from 2012. Excluding gains and losses on investment securities, total noninterest income increased by $8.73 million, or 10.76%, over 2012. Included in noninterest income were losses on investment securities of $0.02 million in 2014, and gains of $0.61 million in 2013, and $3.01 million in 2012. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2014, was 39.90% of total operating income, compared with 38.46% for 2013 and 36.01% for 2012.

The following table provides an analysis of noninterest income (dollars in thousands):

				2014/2013 Increase/(Decrease)		2013/2012 Increase/(Decrease)	
For the Year Ended December 31,	**2014**	**2013**	**2012**	**Amount**	**%**	**Amount**	**%**
Residential mortgage banking income, net	$ 27,179	$ 28,977	$ 26,998	$ (1,798)	(6.20)%	$ 1,979	7.33 %
Real estate brokerage and property management income, net	12,634	12,316	11,515	318	2.58 %	801	6.96 %
Insurance commissions and other title fees and income, net	34,558	28,322	23,458	6,236	22.02 %	4,864	20.73 %
Service charges on deposit accounts	9,192	8,682	7,798	510	5.87 %	884	11.34 %
Credit card merchant fees	3,576	3,471	3,578	105	3.03 %	(107)	(2.99)%
Other income							
Other	3,539	1,662	1,885	1,877	112.94 %	(223)	(11.83)%
Towne Investment income, net	2,703	2,102	1,954	601	28.59 %	148	7.57 %
Bank-owned life insurance income	2,139	1,993	2,064	146	7.33 %	(71)	(3.44)%
Service fees on loans	282	1,214	1,026	(932)	(76.77)%	188	18.32 %
Towne Mortgage LLC income, net	415	562	527	(147)	(26.16)%	35	6.64 %
Commercial mortgage brokerage fees, net	527	616	381	(89)	(14.45)%	235	61.68 %
Total other income	9,605	8,149	7,837	1,456	17.87 %	312	3.98 %
Noninterest income before securities gain/(loss)	96,744	89,917	81,184	6,827	7.59 %	8,733	10.76 %
Gain/(loss) on securities available for sale	(15)	611	3,005	(626)	(102.45)%	(2,394)	(79.67)%
Total noninterest income	$ 96,729	$ 90,528	$ 84,189	$ 6,201	6.85 %	$ 6,339	7.53 %

For the year ended December 31, 2014, residential mortgage banking income, net of commission expense, was $27.18 million, reflecting a decrease of $1.80 million, or 6.20%, compared to 2013, which was $1.98 million, or 7.33%, higher than 2012. The decrease from the prior year was primarily due to a decrease in production volumes related to the slowdown in the mortgage market that started in late 2013. The decrease was partially offset by additional expansion of our mortgage operations into North Carolina and Georgia markets, which resulted in an additional $1.07 million in revenue over 2013 and an increase in mortgage banking income of $0.36 million in 2014 as compared to a decrease of $0.66 million in 2013 associated with the change in the value of rate lock commitments recorded as of December 31, 2014. The increase in net mortgage banking income in 2013 from 2012 was primarily due to the continued expansion of our mortgage operations, as the Company expanded into Pennsylvania in December 2012 and previously added enterprises became fully operational. Also contributing to the increase were continued improvements in the housing market, which led to a higher volume in purchase transactions in the first half of 2013. The increase in 2013 was partially offset by slowing production volumes in the second half of the year related to rising rates and lower revenue margins. Also factoring in the variance from the prior year was a reduction in mortgage banking income of $0.66 million associated with a decrease in the value of rate lock commitments recorded as of December 31, 2014. For further information, refer to our discussion of the Realty segment on page 17 of this Annual Report, which provides a comparative schedule of operations.

Real estate brokerage and property management income, net of commission expense, for the year ended December 31, 2014, was $12.63 million, an increase of $0.32 million, or 2.58%, from 2013, which was $0.80 million, or 6.96%, higher than 2012. The increase from the prior year is primarily attributable to a slight increase in real estate brokerage income related to strengthening in the housing market. The total dollar volume of units sold increased by $15.80 million, or 1.59%, while the number of units sold was 3,627, a decrease of 104 units, or 2.79%, from 2013. Also contributing were increased net property management fees associated with our purchase of Beach Properties on October 1, 2014. The increase in 2013 from 2012 was primarily attributable to an increase in real estate brokerage income, partially offset by a slight decrease in net property management fees.

For the year ended December 31, 2014, insurance commissions and other title income, net of commission expense, was $34.56 million, which was $6.24 million, or 22.02%, higher than comparative 2013. The increase from the prior year was largely due to an increase in property and casualty insurance commissions related to the acquisition of Southern in May 2014 and a full year of operations for two insurance agencies acquired in July 2013, which contributed additional commission and fee income of $3.80 million. The year ended December 31, 2013, included contingency income from property and casualty insurance of $2.91 million, compared to $1.70 million and $1.32 million for 2012 and 2011, respectively. When compared to 2012, insurance commissions for the year ended December 31, 2013 were $4.86 million, or 20.73%, higher, largely due to the acquisition of an insurance agency in December 2012 and two agencies in July 2013, which contributed additional commission and fee income of $3.37 million.

Service charges on deposit accounts were $9.19 million for 2014, compared with $8.68 million and $7.80 million for 2013 and 2012, respectively. The increases reflect the 9.07% and 4.97% increase in average deposits over the years ended December 31, 2014 and 2013, respectively.

For the year ended December 31, 2014, credit card merchant fees totaled $3.58 million, which was $0.11 million, or 3.03%, more than comparative 2013, which was $0.11 million, or 2.99%, less than 2012. For both prior year comparative periods, variances were primarily related to changes in transaction volume.

Other noninterest income for the year ended December 31, 2014 was $9.60 million, compared with $8.15 million for the year ended December 31, 2013, and $7.84 million for the year ended December 31, 2012. Other noninterest income includes income generated by Towne Investment Group, net of commission expense of $2.70 million, $2.10 million, and $1.95 million for the years ended December 31, 2014, 2013, and 2012, respectively. Also contributing to the increase in 2014 was 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 net losses on the investments were recorded in other noninterest income.

Noninterest Expense: Total noninterest expense for 2014 was $178.86 million, which was $10.07 million, or 5.97%, higher than 2013. The primary components of 2014 noninterest expense were salaries and employee benefits of $99.01 million, occupancy expenses of $17.86 million, furniture and equipment expenses of $8.18 million, advertising and marketing expenses of $5.18 million, acquisition-related expenses of $4.28 million, charitable contributions of $3.43 million, and professional fees of $5.18 million. In comparison to 2013, a significant portion of the increase in total noninterest expense is due to $4.28 million of nonrecurring merger expense related to the acquisitions of Franklin, completed January 2, 2015, and Southern in the second quarter of 2014. These merger expenses were included in the other noninterest expense category. Additionally, employee severance-related costs resulted in pre-tax salaries and benefits expenses of $2.87 million and legal fees of $0.68 million. Also contributing to the increase were operational expenses related to the Southern acquisition and a full year of operations for two insurance agencies acquired in July 2013, which resulted in additional expenses of $3.38 million, primarily in salaries and benefits. Additionally, our Realty segment had increases related to the expansion of our mortgage operations in North Carolina and our purchase of Beach Properties, which resulted in additional expenses of $2.20 million. Excluding the costs associated with the acquisitions and expansions, noninterest expense decreased $3.34 million, or 1.98%, from 2013. Noninterest expense was affected in the fourth quarter of 2014 by a reversal of incentive compensation recorded previously in 2014 of $0.90 million due to a slowing of results in the fourth quarter, primarily in acquisition and severance costs, which reduced the availability of funds for profit-sharing. A significant portion of the increase in total noninterest expense from 2012 to 2013 was due to the insurance agency acquisitions in December 2012 and July 2013, which resulted in additional expenses of $3.38 million, primarily in salaries and benefits. Also contributing to the increase from 2012 was the expansion of our mortgage operations into Pennsylvania, which resulted in additional expenses of $2.17 million. Excluding the costs associated with the acquisitions and expansions, noninterest expense increased $12.77 million, or 8.49%, from 2012. Noninterest expense was affected in the fourth quarter of 2013 by a reversal of incentive compensation recorded previously in 2013 of $1.20 million due to a slowing of results in the fourth quarter, primarily in mortgage-related activity.

Total noninterest expense to total operating revenue, excluding securities gains and losses, was 73.76% for the year ended December 31, 2014, compared with 72.19% for 2013 and 70.41% for 2012. The following table provides an analysis of noninterest expense (dollars in thousands):

				2014/2013 Increase/(Decrease)		2013/2012 Increase/(Decrease)	
For the year ended December 31,	**2014**	**2013**	**2012**	**Amount**	**%**	**Amount**	**%**
Salaries and benefits	$ 99,007	$ 97,108	$ 89,669	$ 1,899	1.96 %	$ 7,439	8.30 %
Occupancy	17,863	16,298	14,384	1,565	9.60 %	1,914	13.31 %
Furniture and equipment	8,183	7,458	6,467	725	9.72 %	991	15.32 %
Other expenses							
Advertising and marketing	5,178	5,374	4,818	(196)	(3.65)%	556	11.54 %
Acquisition-related expenses	4,280	(19)	768	4,299	N/M	(787)	N/M
Charitable contributions	3,430	4,209	3,574	(779)	(18.51)%	635	17.77 %
Telephone and postage	4,184	3,937	3,527	247	6.27 %	410	11.62 %
Outside processing	3,631	3,425	3,019	206	6.01 %	406	13.45 %
Professional fees	5,178	4,325	4,606	853	19.72 %	(281)	(6.10)%
Other	6,855	7,514	7,019	(659)	(8.77)%	495	7.05 %
Stationery and office supplies	2,132	2,291	2,048	(159)	(6.94)%	243	11.87 %
Amortization expense of intangibles	2,623	2,145	2,251	478	22.28 %	(106)	(4.71)%
Foreclosed property expenses	3,397	2,020	4,612	1,377	68.17 %	(2,592)	(56.20)%
FDIC and other insurance	3,885	3,974	3,729	(89)	(2.24)%	245	6.57 %
Software expense	4,615	4,217	4,227	398	9.44 %	(10)	(0.24)%
Travel/Meals/Entertainment	1,133	1,424	981	(291)	(20.44)%	443	45.16 %
Directors' expense	1,099	1,187	1,179	(88)	(7.41)%	8	0.68 %
Bank franchise tax/SCC fees	2,191	1,905	1,871	286	15.01 %	34	1.82 %
Total other expenses	53,811	47,928	48,229	5,883	12.27 %	(301)	(0.62)%
Total noninterest expense	$ 178,864	$ 168,792	$ 158,749	$ 10,072	5.97 %	$ 10,043	6.33 %

Salaries and employee benefits, the largest portion of noninterest expense, were $99.01 million, representing 55.35% of total noninterest expense for the year ended December 31, 2014. This was a $1.90 million, or 1.96%, increase over comparative 2013. The increase from prior year is primarily due to the addition of staff resulting from the expansion of our Insurance and Realty segment businesses, which resulted in an increase of $3.65 million, combined with salaries and benefits expenses of $2.87 million related to the above-mentioned severance costs. The increase was partially offset by a decrease of $2.46 million in employee profit-sharing, incentive compensation, and matching contributions to employee retirement plans. Salaries and benefits expense for the year ended December 31, 2013 was $97.11 million, up 8.30%, or $7.44 million, over 2012. The increase was due to the addition of staff resulting from the expansion of our insurance and mortgage businesses, increased operational support staffing, and an increase in payroll taxes. The increase was partially offset by a decrease in profit-sharing and incentive compensation for employees and a reduction in matching contributions made by the Company to employee retirement plans.

In our Banking segment, we had a total of 622 full-time equivalent employees (“FTE”) at December 31, 2014, which was down from 660 and 637 at December 31, 2013 and 2012, respectively. In our non-Banking segments at December 31, 2014, we had a total of 722 FTEs, excluding real estate sales agents, which was up from 691 and 584 at December 31, 2013 and 2012, respectively. Real estate agents are independent contractors and, therefore, not included as the Company’s employees. There were 393 real estate agents at December 31, 2014. Total operating revenue, excluding securities gains, per FTE was approximately $180,000, $173,000, and $185,000 for the years ended December 31, 2014, 2013, and 2012, respectively.

For the year ended December 31, 2014, occupancy expense totaled $17.86 million, representing an increase of $1.57 million, or 9.60%, over comparative 2013. Occupancy expense for 2013 was $1.91 million, or 13.31%, over the 2012 amount of $14.38 million. The increase from 2013 was primarily driven by increases related to the opening of a new banking office in Norfolk, a full year of operations for banking offices opened in 2013 in Virginia Beach and Southern Shores, expenses related to the relocation of a banking office from Kill Devil Hills, North Carolina, to Nags Head, North Carolina, and expansions in our Realty and Insurance segments. The increases in occupancy expense in 2013 were related to our mortgage operations, the opening of new banking offices in Virginia Beach and Southern Shores, higher maintenance and repair expenses, and increased depreciation expense.

Furniture and equipment expense was $8.18 million for 2014, or $0.73 million and 9.72% higher than 2013. Furniture and equipment expense was $7.46 million for 2013, or $0.99 million and 15.32% higher than comparative 2012. Increases in both comparative periods were related to furnishing new facilities and the associated depreciation expense on the capitalized furnishings utilized in those facilities.

Other expenses for 2014 were $53.81 million, which was $5.88 million, or 12.27%, higher than the 2013 amount of $47.93 million. The primary drivers of the increase were acquisition-related expenses, which increased by $4.30 million, and expenses related to foreclosed properties, which increased by $1.38 million. The increase was partially offset by a decrease in expenses related to advertising and marketing, which declined by $0.20 million, a decrease in charitable contributions of $0.78 million, and a decrease in travel, meals, and entertainment of $0.29 million. Other expenses for 2013 were $47.93 million, or 0.62%, less than the 2012 amount of $48.23 million due to decreases in expenses related to foreclosed properties, which declined by $2.59 million. The decrease was mostly offset by increases in expenses related to advertising and marketing, which were higher by $0.56 million, an increase in charitable contributions of $0.64 million, and an increase in travel, meals, and entertainment of $0.44 million.

Income Taxes: Income taxes for the year ended December 31, 2014 were $18.18 million. This was $1.05 million higher than the 2013 amount of $17.13 million, which was $3.17 million higher than the 2012 amount of $13.96 million. The effective tax rate for 2014 was 30.12% versus 29.09% for 2013 and 26.91% for 2012. The rate increase in 2014 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 net losses on the investments were recorded in other noninterest income. The rate increase in 2013 was primarily due to higher taxable income, which more than offset the increase in federal tax credits from community reinvestment activity. Refer to Note 19 in the Notes to Consolidated Financial Statements for a discussion regarding the components of the statutory rate and the deferred tax composition.

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 24 in the Notes to Consolidated Financial Statements.

Banking Segment: For the year ended December 31, 2014, the Banking segment represented 82.33%, or $34.72 million, of our total consolidated net income, compared to 82.36% and 76.29% for 2013 and 2012.

Pre-tax earnings for the year ended December 31, 2014 for the Banking segment were $47.82 million, increasing $0.74 million, or 1.57%, from comparative 2013. The increase in earnings was driven by a $4.19 million, or 2.62%, increase in total revenues coupled with a $3.85 million, or 90.68%, decrease in the provision for loan losses, which was offset by a $7.41 million, or 6.79%, increase in expenses.

The increase in net interest income for the year ended December 31, 2014 of $2.46 million, or 1.74%, was due to a combination of lower interest income on loans, higher interest income on investments, and higher interest expense. Although average loans increased to $3.30 billion for the year ended December 31, 2014, from $3.16 billion in 2013, total interest income was down $0.70 million due to historically low interest rates. The increase in investment interest income of $3.92 million was driven by average investment balances increasing to $796.37 million, or 55.95%, over the comparative period in 2013. Interest expense was up slightly for the year ended December 31, 2014 by $0.67 million mainly due to an increase in our Federal Home Loan Bank of Atlanta ("FHLB") borrowings resulting in an additional $0.38 million of interest expense.

The increase in other income of $1.74 million, or 33.17%, was due to a combination of lower service charges on loans of $0.93 million, offset with increases in investment commission income of $0.60 million, BOLI income of $0.14 million, gains on the sale of foreclosed properties of $0.58 million, and a change in accounting policy related to low income housing tax credit investments whereby current year losses of $1.87 million are included in the tax expense provision under the proportional amortization method as compared to prior year losses of $1.39 million, which were included in other noninterest income.

Noninterest expense for the year ended December 31, 2014 increased $7.41 million, or 6.79%, over 2013. Primary factors resulting in the increase were additional salaries and employee benefits of $0.77 million, or 1.28%, occupancy expense of $0.90 million, or 7.83%, furniture and equipment expense of $0.51 million, or 8.70%, foreclosed property expense of $0.94 million, or 31.00%, professional fees of $0.71 million, or 23.96%, other expenses of $4.64 million, or 47.70%, which were partially offset by a decrease in advertising and marketing of $0.31 million, or 10.09% and charitable contributions of $0.87 million, or 21.02%.

The increase in salaries and employee benefits was primarily due to nonrecurring employee severance costs of approximately $2.87 million, which was partially offset by a decrease in employee expenses related to employee profit-sharing, incentive compensation, and matching contributions to employee retirement plans totaling approximately $1.67 million.

The total increase in occupancy and furniture and equipment expense was primarily related to the addition of two new branches, one relocation of a branch, and one full year of expenses related to a branch that was opened in the fall of 2013. The total increase in relation to additional branch costs was approximately $0.86 million.

The decrease in advertising and marketing, as well as charitable contributions, was also a result of the aforementioned cost-control initiatives.

The increase in foreclosed property expense was due to a $1.08 million increase in the valuation allowance and was partially offset by a reduction in expenses from a lower foreclosed property balance.

Total costs relating to mergers and acquisitions, including increases in legal and professional fees, totaled $4.28 million, which were the most significant factors in the overall increases in professional fees and other expenses.

Pre-tax earnings for the year ended December 31, 2013, for the Banking segment were $47.08 million, increasing $9.67 million, or 25.85%, over 2012. The increase was primarily due to a $0.03 million, or 0.02%, increase in net interest income and an increase in service charges on deposit accounts and credit card merchant fees.

For the year ended December 31, 2013, noninterest expenses increased $0.94 million, or 0.87%, over 2012. The primary factors in the increase were increases in salaries and benefits of $1.57 million and an increase in charitable contributions of $0.67 million, which were partially offset by a decrease in foreclosed property expenses of $1.57 million.

The following chart presents revenue and expenses for the Banking segment (dollars in thousands):

	Year Ended December 31,			Increase/(Decrease) 2014 over 2013		Increase/(Decrease) 2013 over 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 143,999	$ 141,543	$ 141,517	$ 2,456	1.74 %	$ 26	0.02 %
Noninterest income							
Service charges on deposit accounts	9,192	8,682	7,798	510	5.87 %	884	11.34 %
Credit card merchant fees	3,576	3,471	3,578	105	3.03 %	(107)	(2.99)%
Other income	6,993	5,251	5,297	1,742	33.17 %	(46)	(0.87)%
Subtotal	19,761	17,404	16,673	2,357	13.54 %	731	4.38 %
Gain on investment securities	(15)	611	3,005	(626)	(102.45)%	(2,394)	(79.67)%
Total noninterest income	19,746	18,015	19,678	1,731	9.61 %	(1,663)	(8.45)%
Total revenue	163,745	159,558	161,195	4,187	2.62 %	(1,637)	(1.02)%
Provision for loan losses	396	4,248	16,155	(3,852)	(90.68)%	(11,907)	(73.70)%
Expenses							
Salaries and employee benefits	61,031	60,259	58,685	772	1.28 %	1,574	2.68 %
Occupancy expense	12,369	11,471	10,891	898	7.83 %	580	5.33 %
Furniture and equipment	6,358	5,849	5,194	509	8.70 %	655	12.61 %
Advertising and marketing	2,737	3,044	3,099	(307)	(10.09)%	(55)	(1.77)%
Charitable contributions	3,257	4,124	3,452	(867)	(21.02)%	672	19.47 %
Outside processing	2,523	2,443	2,193	80	3.27 %	250	11.40 %
Foreclosed property expenses	3,981	3,039	4,612	942	31.00 %	(1,573)	(34.11)%
FDIC and other insurance	3,660	3,784	3,757	(124)	(3.28)%	27	0.72 %
Professional fees	3,678	2,967	2,911	711	23.96 %	56	1.92 %
Telephone and postage	2,583	2,428	2,259	155	6.38 %	169	7.48 %
Other expenses	14,371	9,730	11,146	4,641	47.70 %	(1,416)	(12.70)%
Total expenses	116,548	109,138	108,199	7,410	6.79 %	939	0.87 %
Income before income tax expense and corporate allocation	46,801	46,172	36,841	629	1.36 %	9,331	25.33 %
Corporate allocation	1,014	904	565	110	12.17 %	339	60.00 %
Income before income tax provision	47,815	47,076	37,406	739	1.57 %	9,670	25.85 %
Provision for income tax expense	(13,098)	(12,680)	(8,468)	(418)	3.30 %	(4,212)	49.74 %
Net income	$ 34,717	$ 34,396	$ 28,938	$ 321	0.93 %	$ 5,458	18.86 %

Realty Segment: For the year ended December 31, 2014, the Realty segment represented 6.42%, or $2.71 million, of our total consolidated net income, compared to 9.73%, or $4.06 million, for 2013, and 17.78%, or $6.74 million, for 2012.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2014, for the Realty segment were $6.64 million, decreasing 22.33% from 2013. Total revenue decreased to $44.70 million in 2014 from $47.43 million in 2013.

Net residential mortgage banking income decreased by $1.93 million to $27.49 million from 2013. Approximately $4.03 million of the decrease was due to significant decreases in volume, which was partially offset by a $1.07 million increase from expanded operations and a $1.03 million change in the rate lock commitment. The decrease in title insurance and settlement fees and net interest and other income were also a result of lower volume from 2013. The modest increase in net property management fees was a direct result of the Beach Properties acquisition that occurred during the fourth quarter of 2014.

Expenses for the Realty segment decreased 2.17%, or $0.83 million, when compared to 2013. For the year ended December 31, 2014, the expansion of our mortgage operations has resulted in additional expenses of $2.20 million. The increase in expenses relating to expanding our market footprint and processing centers were more than offset by the effects of company-wide cost-control initiatives.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2013, for the Realty segment were $8.55 million, decreasing 30.04% from 2012. Total revenue increased to $47.43 million in 2013 from $44.92 million in 2012. The expansion of our mortgage operations resulted in an increase in net mortgage banking income of $3.14 million in 2013 and $10.37 million in 2012. Additionally, there was a decrease in income associated with a decline in value of rate lock commitments of $0.66 million in 2013 compared to an increase of $1.24 million in 2012. Strengthening in the housing market resulted in an increase in net real estate brokerage income of $0.96 million, compared to a relatively flat year in 2012.

Expenses for the Realty segment increased 18.60%, or $6.01 million, when compared to 2012, which increased 29.53%, or $7.37 million. For the year ended December 31, 2013, the expansion of our mortgage operations has resulted in additional expenses of $4.01 million.

The following chart presents revenue and expenses for the Realty segment (dollars in thousands):

	Year Ended December 31,			Increase/(Decrease) 2014 over 2013		Increase/(Decrease) 2013 over 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage banking income, net	$ 27,492	$ 29,425	$ 27,546	$ (1,933)	(6.57)%	$ 1,879	6.82 %
Real estate brokerage income, net	6,439	6,330	5,367	109	1.72 %	963	17.94 %
Title insurance and settlement fees	1,516	1,921	1,830	(405)	(21.08)%	91	4.97 %
Property management fees, net	6,195	5,986	6,148	209	3.49 %	(162)	(2.64)%
Income from unconsolidated subsidiary	516	562	578	(46)	(8.19)%	(16)	(2.77)%
Net interest and other income	2,538	3,206	3,455	(668)	(20.84)%	(249)	(7.21)%
Total revenue	44,696	47,430	44,924	(2,734)	(5.76)%	2,506	5.58 %
Expenses							
Salaries and employee benefits	21,903	22,603	18,973	(700)	(3.10)%	3,630	19.13 %
Occupancy expense	3,806	3,557	2,547	249	7.00 %	1,010	39.65 %
Furniture and equipment	1,088	1,010	778	78	7.72 %	232	29.82 %
Amortization of intangible assets	685	515	663	170	33.01 %	(148)	(22.32)%
Other expenses	10,001	10,631	9,346	(630)	(5.93)%	1,285	13.75 %
Total expenses	37,483	38,316	32,307	(833)	(2.17)%	6,009	18.60 %
Income before income tax, corporate allocation, and noncontrolling interest	7,213	9,114	12,617	(1,901)	(20.86)%	(3,503)	(27.76)%
Corporate allocation	(575)	(568)	(402)	(7)	1.23 %	(166)	41.29 %
Income before income tax provision and noncontrolling interest	6,638	8,546	12,215	(1,908)	(22.33)%	(3,669)	(30.04)%
Provision for income tax	(1,874)	(2,384)	(3,995)	510	(21.39)%	1,611	(40.33)%
Net income	4,764	6,162	8,220	(1,398)	(22.69)%	(2,058)	(25.04)%
Noncontrolling interest	(2,056)	(2,099)	(1,475)	43	(2.05)%	(624)	42.31 %
Net income attributable to TowneBank	$ 2,708	$ 4,063	$ 6,745	$ (1,355)	(33.35)%	$ (2,682)	(39.76)%

The following chart shows the key data for the Realty segment (dollars in thousands):

	Year Ended December 31,			Increase/(Decrease) 2014 over 2013		2013 over 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent
Key data							
Number of units sold	3,627	3,731	3,224	(104)	(2.79)%	507	15.73 %
Volume of units sold	$ 1,009,539	$ 993,739	$ 849,986	$ 15,800	1.59 %	$ 143,753	16.91 %
Number of real estate agents	376	373	378	3	0.80 %	(5)	(1.32)%
Loans originated, mortgage	$ 540,470	$ 673,148	$ 655,386	$ (132,678)	(19.71)%	$ 17,762	2.71 %
Loans originated, joint ventures	682,023	760,426	671,664	(78,403)	(10.31)%	88,762	13.22 %
Total loans originated	$ 1,222,493	$ 1,433,574	$ 1,327,050	$ (211,081)	(14.72)%	$ 106,524	8.03 %
Number of loans, mortgage	2,405	3,162	2,931	(757)	(23.94)%	231	7.88 %
Number of loans, joint ventures	3,248	3,654	3,125	(406)	(11.11)%	529	16.93 %
Total number of loans	5,653	6,816	6,056	(1,163)	(17.06)%	760	12.55 %
Average loan amount, mortgage	$ 225	$ 213	$ 224	$ 12	5.63 %	$ (11)	(4.91)%
Average loan amount, joint ventures	210	208	215	2	0.96 %	(7)	(3.26)%
Average loan amount	$ 216	$ 210	$ 219	$ 6	2.86 %	$ (9)	(4.11)%
Average number of originators, mortgage	67	62	52	5	8.06 %	10	19.23 %
Average number of originators, joint ventures	61	52	37	9	17.31 %	15	40.54 %
Average number of originators	128	114	89	14	12.28 %	25	28.09 %

Mortgage. The loan volume for combined mortgage operations showed decreases during the year ended December 31, 2014, as compared to 2013. Total loans originated in 2014 were $1.22 billion, a 14.72%, or $211.08 million, decrease from $1.43 billion in 2013, which was a $106.52 million, or 8.03%, increase compared to the 2012 volume of $1.33 billion. Refinance activity comprised $164.44 million of loan volume for the year ended December 31, 2014, while purchases accounted for the remaining $1.06 billion in loan volume for the year. For the years ended December 31, 2013 and 2012, refinance volume was $368.54 million and $466.11 million, respectively, while purchase volume was $1.06 billion and $860.94 million, respectively.

Insurance Segment: The Insurance segment comprises property and casualty and group benefits divisions. The Insurance segment represented 11.25%, or $4.74 million, of our total consolidated net income in 2014, up from 7.91%, or $3.30 million, in 2013.

Earnings before taxes and noncontrolling interest for the Insurance segment were $8.66 million in 2014, increasing $2.90 million, or 50.25%, from 2013. The primary factors affecting earnings were the acquisitions of two insurance agencies in July 2013 and one agency in May 2014. Net commission and fee income for the year ended December 31, 2014 increased $4.61 million, or 19.68%. The increase from the prior period was positively impacted by the recent acquisitions, which resulted in an additional $3.80 million in commission and fee income. Also contributing to the increase was higher contingency and bonus revenue and other income of $1.20 million and $0.69 million, respectively. 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. The increase in other income was primarily due to additional revenue from our travel insurance product lines, which was $0.85 million above 2013.

Earnings before taxes and noncontrolling interest for the Insurance segment were $5.76 million in 2013, increasing $1.81 million, or 45.92%, from 2012. The primary factors affecting earnings were the acquisitions of two insurance agencies in July 2013 and one agency in December 2012. Net commission and fee income for the year ended December 31, 2013 increased $3.80 million, or 19.41%. The increase from the prior period was positively impacted by the acquisitions, which resulted in an additional $3.37 million in commission and fee income. Also contributing to the increase was higher contingency and bonus revenue and other income of $0.39 million and $0.89 million, respectively. The increase in other income was primarily due to additional revenue from our travel insurance product lines. Factors contributing to the decrease included an increase in noninterest expenses of $0.35 million at our travel insurance company due to salaries for new employees and increased professional fees, and a one-time $0.50 million charge related to the final settlement of the 2009 W. Taylor Johnson Insurance Inc. purchase agreement. Also contributing to the variance from the prior year were the effects of the Stan Taylor Agency, Inc. acquisition, which resulted in additional net commission income of $0.90 million and additional noninterest expense of $0.88 million.

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

	Year Ended December 31,			Increase/(Decrease)			
				2014 over 2013		2013 over 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent
Revenue							
Net commission and fee income							
Property and casualty	$ 20,076	$ 16,060	$ 13,548	$ 4,016	25.01%	$ 2,512	18.54%
Group benefits	7,382	6,807	5,533	575	8.45%	1,274	23.03%
Specialized benefit services	543	529	512	14	2.65%	17	3.32%
Total net commissions and fees	28,001	23,396	19,593	4,605	19.68%	3,803	19.41%
Contingency and bonus revenue	3,231	2,031	1,639	1,200	59.08%	392	23.92%
Other income	2,696	2,009	1,122	687	34.20%	887	79.06%
Total revenue	33,928	27,436	22,354	6,492	23.66%	5,082	22.73%
Expenses							
Salaries and employee benefits	16,073	14,246	12,010	1,827	12.82%	2,236	18.62%
Occupancy expense	1,688	1,270	946	418	32.91%	324	34.25%
Furniture and equipment	737	599	495	138	23.04%	104	21.01%
Amortization of intangible assets	1,879	1,558	1,245	321	20.60%	313	25.14%
Other expenses	4,456	3,666	3,547	790	21.55%	119	3.35%
Total expenses	24,833	21,339	18,243	3,494	16.37%	3,096	16.97%
Income before income tax, corporate allocation, and noncontrolling interest	9,095	6,097	4,111	2,998	49.17%	1,986	48.31%
Corporate allocation	(439)	(336)	(163)	(103)	30.65%	(173)	106.13%
Income before income tax provision and noncontrolling interest	8,656	5,761	3,948	2,895	50.25%	1,813	45.92%
Provision for income tax expense	(3,207)	(2,071)	(1,501)	(1,136)	54.85%	(570)	37.97%
Net income	5,449	3,690	2,447	1,759	47.67%	1,243	50.80%
Noncontrolling interest	(705)	(387)	(199)	(318)	82.17%	(188)	94.47%
Net income attributable to TowneBank	$ 4,744	$ 3,303	$ 2,248	$ 1,441	43.63%	$ 1,055	46.93%

Salaries and employee benefits expense increased $1.83 million, or 12.82%, when comparing 2014 to 2013, and increased $2.24 million, or 18.62%, when comparing 2013 to 2012. The increases were mainly driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $2.08 million and $2.05 million for 2014 and 2013, respectively.

Occupancy expense increased $0.42 million, or 32.91%, when comparing 2014 to 2013, and increased $0.32 million, or 34.25%, when comparing 2013 to 2012 as a result of the insurance agency acquisitions.

Amortization of intangible assets increased $0.32 million, or 20.60%, during the year ended December 31, 2014, compared to 2013, and increased $0.31 million, or 25.14%, comparing 2013 to 2012, which was also a result of the acquisitions.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $309.49 million, or 6.62%, to $4.98 billion at December 31, 2014, from $4.67 billion at December 31, 2013. Our loan portfolio grew by a rate of 4.98%, or $161.28 million, to $3.40 billion at December 31, 2014, from $3.24 billion at December 31, 2013.

Our total average assets were $4.87 billion for 2014, reflecting an increase of $359.35 million, or 7.97%, compared to the 2013 average of $4.51 billion. Total average assets for 2013 increased $305.78 million, or 7.28%, compared to the 2012 average of $4.20 billion. Average earning assets were $4.47 billion, including BOLI assets, in 2014, reflecting an increase of $348.59 million, or 8.45%, compared to 2013.

Our average total deposits were $3.75 billion in 2014, reflecting growth of $311.70 million, or 9.07%, compared to 2013. Average noninterest-bearing deposits, which increased $136.72 million, or 13.38%, grew at a significantly higher rate than interest-bearing deposits in 2014, which grew $174.98 million, or 7.25%.

Securities: Our securities consist of available-for-sale securities and held-to-maturity securities. Our available-for-sale securities portfolio, which is held primarily for earnings, liquidity, and asset/liability management purposes, is reported at fair value based on market prices for similar instruments. Our held-to-maturity securities portfolio, which is held primarily for yield and pledging purposes, is valued at amortized cost. Our investment portfolio totaled $878.43 million as of December 31, 2014, with a balance of $603.91 million in available-for-sale, $252.37 million in held-to-maturity, and $22.16 million in Federal Home Loan Bank stock. Average yield on available-for-sale securities was 1.10% at December 31, 2014, compared with 0.87% at December 31, 2013, and 0.88% at December 31, 2012. Average yield on held-to-maturity securities was 2.97% at December 31, 2014, compared to 3.13% at December 31, 2013, and 3.46% at December 31, 2012.

Our available-for-sale securities portfolio consists of U.S. agency securities, municipal securities, mortgage-backed securities, and trust preferred corporate obligations. Our held-to-maturity portfolio consists of municipal securities, trust preferred corporate obligations, and industrial revenue bonds. Our investment activities are governed internally by a written and Board-approved investment policy, which is administered by our Asset-Liability Committee ("ALCO"). The ALCO generally meets quarterly to review the economic environment, to assess current activities for appropriateness, and to establish investment strategies.

Investment strategies are established by the ALCO in consideration of the interest rate cycle, balance sheet mix, actual and anticipated loan demand, funding options, and our overall interest rate sensitivity. In general, the investment portfolio is managed in a manner appropriate with the attainment of the following goals: (i) to provide a sufficient margin of liquid assets to cover unanticipated deposit and loan fluctuations, seasonal funds flow variations, and overall funds management objectives; (ii) to provide eligible securities to secure public funds, trust deposits, and repurchase agreements as prescribed by law; and (iii) to earn the maximum return on funds invested that is commensurate with meeting the requirements of (i) and (ii).

The following table provides information regarding the composition of our securities portfolio, showing selected maturities and yields (dollars in thousands). For more information, refer to Note 3 of the Notes to Consolidated Financial Statements.

	Year Ended December 31,								
	2014			2013			2012		
	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Securities Available for Sale:									
U.S. agency securities	$ 512,762	$ 512,441	0.81%	$ 235,143	$ 233,330	0.75%	$ 3,219	$ 3,306	2.83%
U.S. Treasury notes	—	—	—	200,000	200,000	—	300,000	300,000	—
Municipal securities	24,148	24,719	3.12%	36,845	37,079	2.70%	38,854	40,084	3.10%
Trust preferred corporate securities	6,327	7,063	3.47%	6,396	6,848	3.45%	4,480	4,889	4.61%
Other corporate securities	1,393	1,393	1.30%	1,409	1,409	2.61%	488	488	0.67%
Mortgage-backed securities	57,240	58,292	2.52%	64,103	64,855	2.70%	100,490	101,377	2.42%
Total securities available for sale	601,870	603,908	1.10%	543,896	543,521	0.87%	447,531	450,144	0.88%
Securities Held to Maturity:									
Trust preferred corporate securities	500	722	8.75%	500	641	8.75%	500	688	8.75%
Municipal securities	56,923	60,888	3.92%	58,644	59,821	3.91%	62,062	67,409	3.92%
Mortgage-backed securities	27,823	27,942	1.58%	—	—	—	—	—	—
Industrial revenue bonds	167,124	178,712	2.86%	145,204	147,824	2.80%	92,919	97,587	3.12%
Total securities held to maturity	252,370	268,264	2.97%	204,348	208,286	3.13%	155,481	165,684	3.46%
Total Portfolio	$ 854,240	$ 872,172	1.65%	$ 748,244	$ 751,807	1.49%	$ 603,012	$ 615,828	1.54%

The following table indicates the maturities of securities at December 31, 2014 (dollars in thousands):

	Available for Sale			Held to Maturity		
	Amortized Cost	Fair Market Value	Weighted Average Yield	Amortized Cost	Fair Market Value	Weighted Average Yield
U.S. Treasury & U.S. agency securities						
Due in one year or less	$ 30,275	$ 30,295	0.41%	$ —	$ —	—
After one year through five years	481,003	480,586	0.83%	—	—	—
After five years through ten years	1,484	1,560	3.77%	—	—	—
After ten years	—	—	—	—	—	—
Municipal securities						
Due in one year or less	1,996	2,005	2.08%	—	—	—
After one year through five years	7,968	8,048	2.26%	2,100	2,273	4.54%
After five years through ten years	6,611	6,651	3.01%	20,591	21,523	3.36%
After ten years	7,574	8,016	4.38%	34,232	37,092	4.23%
Mortgage-backed securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	—	—	—	—	—	—
After five years through ten years	30,027	30,360	2.25%	27,823	27,942	1.58%
After ten years	27,213	27,932	2.81%	—	—	—
Trust preferred corporate securities						
Due in one year or less	2,358	2,376	1.87%	—	—	—
After one year through five years	1,992	1,993	0.79%	—	—	—
After five years through ten years	—	—	—	—	—	—
After ten years	1,976	2,693	8.09%	500	722	8.75%
Industrial revenue bonds						
Due in one year or less	—	—	—	—	—	—
After one year through five years	—	—	—	1,233	1,333	4.55%
After five years through ten years	—	—	—	16,252	16,853	2.88%
After ten years	—	—	—	149,639	160,526	2.84%
Other securities						
Due in one year or less	993	993	—	—	—	—
After one year through five years	250	250	1.30%	—	—	—
After five years through ten years	150	150	—	—	—	—
After ten years	—	—	—	—	—	—
No stated maturity	—	—	—	—	—	—
Total Portfolio	$ 601,870	$ 603,908	1.10%	$ 252,370	$ 268,264	2.97%

Loans Held for Sale: At December 31, 2014, we held $71.39 million in mortgage loans originated and intended for sale in the secondary market, compared with $58.64 million at December 31, 2013. Average loans held for sale were 1.47% and 2.36% of average earning assets for the years ended December 31, 2014 and 2013, respectively. The majority of loans held for sale have been pre-committed to investors, minimizing 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: Our loan portfolio, net of the allowance for loan losses, totaled $3.36 billion on December 31, 2014. As a percentage of total average earning assets, average loans were 73.76% in 2014, compared with 76.60% in 2013 and 76.35% in 2012. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were continued improvements in our local economy and the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers and directors. The following tables provide the balance and composition of the loan portfolio by major classification for the periods indicated (dollars in thousands):

Year Ended December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Real estate loans					
1-4 family residential	$ 837,370	$ 797,723	$ 754,593	$ 709,129	$ 714,122
Commercial	1,447,078	1,365,572	1,231,819	1,072,187	952,727
Construction and land development	452,481	469,679	618,562	557,630	657,341
Multifamily	51,472	53,562	57,831	48,321	41,441
Total real estate loans	2,788,401	2,686,536	2,662,805	2,387,267	2,365,631
Commercial and industrial loans	533,500	500,755	427,994	362,830	322,027
Consumer loans and other	75,365	48,698	42,708	43,096	43,694
Loans, net of unearned income and deferred costs	$ 3,397,266	$ 3,235,989	$ 3,133,507	$ 2,793,193	$ 2,731,352

Year Ended December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Real estate loans					
1-4 family residential	24.65%	24.65%	24.08%	25.39%	26.14%
Commercial	42.60%	42.20%	39.31%	38.39%	34.88%
Construction and land development	13.32%	14.51%	19.74%	19.96%	24.07%
Multifamily	1.51%	1.66%	1.85%	1.73%	1.52%
Total real estate loans	82.08%	83.02%	84.98%	85.47%	86.61%
Commercial and industrial loans	15.70%	15.47%	13.66%	12.99%	11.79%
Consumer loans and other	2.22%	1.51%	1.36%	1.54%	1.60%
Loans, net of unearned income and deferred costs	100.00%	100.00%	100.00%	100.00%	100.00%

The table below provides the maturity and sensitivity of the loan portfolio at December 31, 2014 (in thousands):

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Totals	Due After One Year	
					Fixed Rates	Adjustable Rates
Real estate loans						
1-4 family residential	$ 72,743	$ 79,000	$ 685,627	$ 837,370	$ 308,135	$ 456,492
Commercial	111,065	117,093	1,218,920	1,447,078	1,137,370	198,643
Construction and land development	278,278	105,541	68,662	452,481	79,123	95,080
Multifamily	2,332	4,104	45,036	51,472	45,013	4,127
Total real estate loans	464,418	305,738	2,018,245	2,788,401	1,569,641	754,342
Commercial and industrial loans	276,505	130,433	126,562	533,500	184,218	72,777
Consumer loans and other	23,386	19,680	32,299	75,365	50,309	1,670
Loans, net of unearned income and deferred costs	$ 764,309	$ 455,851	$ 2,177,106	$ 3,397,266	$ 1,804,168	$ 828,789

Allowance for Loan Losses: 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 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.

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 December 31, 2014, 2013, and 2012 was $35.92 million, $38.38 million, and $40.43 million, respectively. The allowance was equal to 1.06% of total loans outstanding at December 31, 2014, compared with 1.19% at December 31, 2013, and 1.29% at December 31, 2012. 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 metrics, classified loans, defined as loans in the substandard and doubtful categories, remained low at 1.93% of total loans at December 31, 2014, up slightly from 1.90% at December 31, 2013. Additionally, while loans 60 to 89 days past due increased to $4.29 million at December 31, 2014, from $0.56 million at December 31, 2013, total past due and nonaccruing loans decreased to $20.19 million at December 31, 2014, from $26.66 million at December 31, 2013. 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 533% of nonperforming loans at December 31, 2014, compared with 301% at December 31, 2013. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at December 31, 2014.

The following table provides a summary of the activity in the allowance for loan losses for the periods indicated (dollars in thousands):

Year Ended December 31,	2014	2013	2012	2011	2010
Balance beginning of period	$ 38,380	$ 40,427	$ 39,740	$ 38,660	$ 33,793
Loans charged off:					
1-4 family residential real estate	(1,473)	(4,402)	(4,640)	(4,837)	(5,932)
Multifamily	(493)	(14)	(345)	—	(95)
Commercial real estate	(1,165)	(396)	(3,295)	(1,093)	(1,933)
Construction and land development	(561)	(1,734)	(5,989)	(7,562)	(7,294)
Commercial and industrial	(432)	(1,040)	(1,791)	(374)	(1,274)
Consumer and other	(415)	(397)	(504)	(318)	(1,867)
Total	(4,539)	(7,983)	(16,564)	(14,184)	(18,395)
Loans recovered:					
Residential 1-4 family	661	465	860	346	123
Multifamily	47	—	—	15	64
Commercial real estate	452	335	60	3	—
Construction and land development	134	367	54	851	332
Commercial and industrial	130	466	66	120	157
Consumer and other	160	55	56	327	21
Total	1,584	1,688	1,096	1,662	697
Net loans charged off	(2,955)	(6,295)	(15,468)	(12,522)	(17,698)
Provision for loan losses	492	4,248	16,155	13,602	22,565
Balance end of period	$ 35,917	$ 38,380	$ 40,427	$ 39,740	$ 38,660
Nonperforming assets:					
Nonperforming loans	$ 6,741	$ 12,753	$ 40,691	$ 55,801	$ 57,167
Foreclosed property	35,116	39,534	30,297	29,819	20,452
Total nonperforming assets	$ 41,857	$ 52,287	$ 70,988	$ 85,620	$ 77,619
Loans past due 90 days accruing interest	$ 12	$ —	$ 222	$ 1	$ 1,229
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	533%	301%	99%	71%	68%
Allowance to nonperforming assets	.86x	.73x	.57x	.46x	.50x
Allowance for loan losses to period end loans	1.06%	1.19%	1.29%	1.42%	1.42%
Nonperforming loans to period end loans	0.20%	0.39%	1.30%	2.00%	2.09%
Nonperforming assets to period end assets	0.84%	1.12%	1.61%	2.10%	2.01%
Net charge-offs to average loans	0.09%	0.20%	0.52%	0.46%	0.67%

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 December 31, 2014, we had $41.86 million in nonperforming assets, which amounted to 0.84% of total assets. Nonperforming assets consist of $6.74 million in nonperforming loans, as well as $35.12 million in foreclosed property. Nonperforming loans decreased by $6.01 million, or 47.14%, from December 31, 2013, as additions to nonaccrual loans during 2014 were more than offset by transfers to OREO, charge-offs, and payments received. The majority of the decrease was in construction and land development, which decreased by $4.01 million, as paydowns of $1.92 million, charge-offs of $0.56 million, and transfers to OREO of $1.97 million outpaced new nonperforming loans. Additionally, nonperforming 1-4 family residential real estate loans decreased by $1.65 million as paydowns of $2.10 million, charge-offs of $1.47 million, and transfers to OREO of $2.52 million outpaced new nonperforming loans. At December 31, 2014, foreclosed property totaled $35.12 million, a decrease from $39.53 million at December 31, 2013. The five largest foreclosed property developments represented 67.17% of total foreclosed property at December 31, 2014. Foreclosed property consists of 26 residential properties, 27 construction and development properties, and six commercial properties.

At December 31, 2014, loans 60 to 89 days delinquent, excluding nonperforming loans, totaled $4.29 million. Additionally, there are other performing loans, totaling $55.76 million, that are current but have certain documentation deficiencies or other potential weaknesses that management considers 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 December 31, 2014, nonaccruing TDRs, which are included in nonperforming loans, totaled $2.50 million, and accruing TDRs totaled $38.42 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):

	December 31, 2014	December 31, 2013
Construction and land development	$ 1,680	$ 5,687
Commercial real estate	2,132	1,422
Multifamily real estate	—	606
1-4 family residential real estate	2,546	4,194
Commercial and industrial loans	383	687
Consumer loans and other	—	157
Total nonperforming loans	$ 6,741	$ 12,753

Allocation of the Allowance for Loan Losses: At December 31, 2014, all of the allowance for loan losses was allocated to specific loan categories. Management monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Company experiences over time. This allocation of the allowance for loan losses is calculated on an approximate basis and is not intended as an indication of the specific amounts, by loan classification, to be charged to the allowance. The entire amount of the allowance is available to absorb losses occurring in any category of loans. The following table provides a breakdown of the allowance for loan losses among the various loan types for the periods indicated (in thousands):

Year Ended December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Real estate loans:					
1-4 family residential	$ 9,121	$ 10,730	$ 10,722	$ 10,837	$ 9,543
Commercial	14,226	13,621	12,521	10,578	12,827
Construction	5,661	7,925	11,691	13,623	10,984
Multifamily	667	699	589	395	557
Total real estate loans	29,675	32,975	35,523	35,433	33,911
Commercial and industrial loans	4,963	4,711	4,378	3,842	4,008
Consumer loans and other	1,279	694	526	465	741
Total	$ 35,917	$ 38,380	$ 40,427	$ 39,740	$ 38,660

In the opinion of management, the allowance was adequate at December 31, 2014, based on known conditions. However, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, changes in the value of collateral, and changes in general economic conditions and other risk factors.

Allowance for Loan Losses Policy and Methodology: Our allowance for loan loss methodology is based on guidance provided by various regulatory agencies and includes allowance allocations calculated in accordance with ASC 310, *Receivables*, and allowance allocations calculated in accordance with ASC 450, *Contingencies*. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools, and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for possible loan losses is designed to account for credit deterioration as it occurs. Our objective is to maintain a loan portfolio that is diverse in terms of loan type, industry concentration, and borrower concentration in order to reduce overall credit risk by minimizing the adverse impact of any single event or combination of related events.

Commercial lending may involve a higher degree of risk as compared to other types of lending because repayment usually depends on the cash flows generated by a borrower's business, and the debt service capacity of a business can deteriorate because of downturns in national and local economic conditions. Additionally, construction and development lending involves an elevated degree of risk because loans are generally made to builders for specific construction projects, and successful repayment of these types of loans is generally dependent upon the sale of the constructed property. To control risk, initial and continuing financial analysis of a borrower's financial information is required. While management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance methodology may be necessary if economic conditions differ substantially from the assumptions used in making the valuations, or if required by regulators based upon information at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Deposits: Customer deposits are attractive sources of liquidity because of their stability, low average cost, and the ability to generate fee income through the cross-sale of other services to depositors. Deposits are attracted principally from customers within our market area through the offering of a broad selection of deposit instruments, including demand deposits, negotiable order of withdrawal accounts, savings accounts, money rate savings, certificates of deposit, and individual retirement accounts. Deposit account terms vary with respect to the minimum balance required, the time period the funds must remain on deposit, and service charge schedules.

Interest rates paid on specific deposit types are set by considering the (i) interest rates offered by competitors, (ii) anticipated amount and timing of funding needs, (iii) availability of and cost of alternative sources of funding, and (iv) anticipated future economic conditions and interest rates.

Deposit accounts held as of December 31, 2014, totaled $3.85 billion. This represented an increase of $279.50 million, or 7.84%, over 2013, which was $187.05 million, or 5.53%, over 2012. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in the Greater Hampton Roads area and northeastern North Carolina. The deposits consist of demand deposits, interest-bearing checking accounts, money market deposit accounts, and time deposits. Some of our interest-bearing deposits were obtained through brokered transactions and our participation in CDARS. We had brokered time deposits of $163.49 million and CDARS deposits of $50.21 million at December 31, 2014.

The following tables provide the average balance and cost rate of interest-bearing deposits in addition to maturities of certificates of deposit of $100,000 and greater for the periods indicated (dollars in thousands). The aggregate amount of time deposits of $250,000 or more was $194.47 million and $198.22 million at December 31, 2014 and 2013, respectively. See Note 9 in the Notes to Consolidated Financial Statements for additional information on deposits.

	Average Balance			Average Cost Rate		
For the Year Ended December 31,	**2014**	**2013**	**2012**	**2014**	**2013**	**2012**
Noninterest-bearing demand deposits	$ 1,158,888	$ 1,022,168	$ 904,513	—	—	—
Demand and money markets	1,306,738	1,166,510	1,064,840	0.23%	0.27%	0.40%
Savings	310,722	323,011	300,235	0.92%	0.96%	1.07%
Certificates of deposit:						
Less than $100,000	280,522	351,135	326,076	1.33%	0.90%	1.30%
$100,000 or more	692,180	574,522	678,852	0.54%	0.69%	0.75%
Total interest-bearing deposits	2,590,162	2,415,178	2,370,003	0.52%	0.55%	0.71%
Total deposits	$ 3,749,050	$ 3,437,346	$ 3,274,516	0.36%	0.39%	0.51%

Average noninterest-bearing demand deposits were 30.91% of average total deposits during the year ended December 31, 2014, and 29.74% and 27.62% during 2013 and 2012, respectively. This change is attributable to historically low rates and is consistent with the decrease in the Company's cost of funds. The average cost of interest-bearing deposits was 0.52% for the year ended December 31, 2014, compared with 0.55% for 2013, and 0.71% for 2012.

Advances from the Federal Home Loan Bank: Our ability to borrow funds through nondeposit sources provides additional flexibility in meeting the liquidity needs of customers while enhancing our cost of funds structure. Average funds borrowed were $396.67 million and $386.09 million for the years ended December 31, 2014 and 2013, respectively. The balance at December 31, 2014, of $398.18 million, increased $3.09 million from the balance at December 31, 2013, of $395.09 million. Refer to Note 10 in the Notes to Consolidated Financial Statements for additional disclosures related to borrowing arrangements.

Convertible Subordinated Capital Notes: The Company had no convertible subordinated capital debentures at December 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. Average total convertible subordinated capital debentures for the years ended December 31, 2014 and 2013, were $0, compared with $2.95 million for 2012. Refer to Note 10 of the Notes to Consolidated Financial Statements for information on convertible subordinated capital debentures.

Liquidity: Liquidity represents our ability to provide funds to meet customer demand 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.

We maintained an average of $253.42 million outstanding in overnight interest-bearing deposits during 2014, compared with $300.98 million for 2013. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2014, we primarily funded our growth in total assets with deposit growth.

Capital Resources: Federal banking laws set forth certain regulatory capital requirements that apply to us. Within the framework established by the law, we qualify for the classification "well-capitalized," which is the highest regulatory classification.

On September 22, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the U.S. Department of the Treasury (the "U.S. Treasury"), pursuant to which the Company sold and issued 76,458 shares of the Company's Series C Preferred Stock, liquidation value of $1,000 per share (the "Series C Preferred Stock"), for a total purchase price of $76.46 million. The issuance was pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The holder of the Series C Preferred Stock was entitled to receive non-cumulative dividends, payable quarterly, on January 1, April 1, July 1, and October 1 of each year. The dividend rate could fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" ("QSBL") by the Company as compared to the Company's baseline QSBL level, which was established at the closing of the securities issuance. The dividend rate for the initial dividend period was at 5%. For the second through 10th calendar quarters, the dividend rate could be adjusted to between 1% and 5% per annum based upon the increase in QSBL as compared to the initial baseline. For the 11th calendar quarter through four and one-half years after issuance, the dividend rate was fixed at between 1% and 7% based upon the level of QSBL compared to the baseline. Due to the Company's loan growth, the blended rate for the period from closing through December 31, 2011 was 4.63%, with the rate reduced to 3.92% for the first quarter of 2012, and 2.28% for the second quarter of 2012. Beginning with the third quarter of 2012, the rate decreased to 1.0% and remained fixed at that rate through the date of repayment (January 7, 2015). The Series C Preferred Stock was redeemable at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of the Federal Deposit Insurance Corporation ("FDIC").

On September 22, 2011, the Company used the proceeds from the sale and issuance of the Series C Preferred Stock to repurchase all 76,458 outstanding shares of its preferred stock issued to the U.S. Treasury in connection with the Capital Purchase Program (the "CPP"), under the Troubled Asset Relief Program, for a redemption price of $76.46 million, plus accrued but unpaid dividends.

On January 7, 2015, the Company used internally available funds to repurchase all 76,458 outstanding shares of its Series C Preferred Stock for a redemption price of $76.46 million, plus accrued but unpaid dividends.

In connection with the issuance to the U.S. Treasury under the CPP of its Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B, liquidation amount $1,000 per share, which the Company redeemed in 2011, the Company issued a 10-year warrant to purchase 554,330 common shares at an exercise price of $20.69 per share. On May 15, 2013, the Company repurchased the warrant from the U.S. Treasury 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.

In August 2008, the Company issued 598,542 shares of Series A Preferred Stock, at a purchase price of $100 per share. The Series A Preferred Stock paid a non-cumulative dividend of 8% per year. Each share of the Series A Preferred Stock could be converted at any time, at the option of the holder, into shares of common stock equal to the purchase price divided by $18.02.

On September 1, 2013, all outstanding shares of the 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.

Additional information concerning our capital resources is contained in Note 16 of the Notes to Consolidated Financial Statements.

Contractual Obligations, Contingent Liabilities, and Commitments: The following table summarizes our significant contractual obligations, contingent liabilities, and certain other commitments outstanding as of December 31, 2014 (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1 - 3 years**	**3 - 5 years**	**More Than 5 Years**
Operating lease obligations	$ 35,725	$ 7,578	$ 11,942	$ 7,592	$ 8,613
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	398,181	—	327,000	53,000	18,181
Other commitments					
Standby letters of credit	28,755	28,755	—	—	—
Commitments to extend credit	1,189,546	1,189,546	—	—	—
Total contractual obligations	$ 1,652,207	$ 1,225,879	$ 338,942	$ 60,592	$ 26,794

Impact of Inflation and Changing Prices: The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles. These principles dictate that financial position and operating results be measured in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. A financial institution's assets and liabilities are primarily monetary in nature. As a result, general levels of inflation typically have a less significant effect on financial performance than do changes in interest rates; however, noninterest expenses tend to rise in periods of general inflation.

Return on Equity and Assets: The annualized ratio of operating income to average total assets and average shareholders' equity and average equity to average assets for the periods indicated are as follows:

Year Ended December 31,	**2014**	**2013**	**2012**
Return on average assets	0.87%	0.93%	0.90%
Return on average equity	6.95%	7.27%	6.95%
Average equity to average assets	12.75%	12.75%	12.99%

Interest Sensitivity: 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.

We 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 protect ourselves from unanticipated rate movements, by understanding the dynamic nature of our balance sheet components.

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. At December 31, 2014, we had $371.94 million more liabilities than assets subject to repricing within one year and, therefore, were in a liability-sensitive position.

Market Risk Management: 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 the management of interest rate risk 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. Our 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 and liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities, and/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. In addition, funding and balance sheet management strategies are adopted with the intent to ensure that the potential impact on earnings and liquidity due to fluctuations in interest rates are within acceptable standards. We currently do not use off-balance-sheet financial instruments to manage interest rate sensitivity and net interest income.

Earnings Simulation Analysis: Management uses simulation analysis to measure the sensitivity of net interest income to changes in interest rates. The model calculates an earnings estimate based on current and projected balances and rates. This method is subject to the accuracy of the assumptions that underlie the process, but it provides an additional analysis of the sensitivity of earnings to changes in interest rates to static gap analysis. Assumptions used in the model rates are derived from historical trends, peer analysis, and management's outlook, and include loans and deposit growth rates and projected yields and rates. All maturities, calls, and prepayments in the securities portfolio are assumed to be reinvested in like instruments. Mortgage loans and mortgage-backed securities prepayment assumptions are based on industry estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Different interest rate scenarios and yield curves are used to measure the sensitivity of earnings to changing interest rates. Interest rates on different asset and liability accounts move differently when the prime rate changes and is reflected in the different rate scenarios.

The following table represents interest rate sensitivity on our net interest income using different rate scenarios:

Change in Prime Rate	% Change in Net Interest Income
+ 300 basis points	4.59%
+ 200 basis points	2.46%
+ 100 basis points	1.05%
- 100 basis points	(4.94)%

Market Value Simulation: Market value simulation is used to calculate the estimated fair value of assets and liabilities over different interest rate environments. Market values are calculated based on discounted cash flow analysis. The net market value is the market value of all assets minus the market value of all liabilities. The change in net market value over different rate environments is an indication of the longer term repricing risk in the balance sheet. The same assumptions are used in the market value simulation as in the earnings simulation. The following table reflects the change in net market value over different rate environments:

Change in Prime Rate	Change in Net Market Value (dollars in thousands)
+ 300 basis points	$(265.38)
+ 200 basis points	$(183.36)
+ 100 basis points	$(80.74)
- 100 basis points	$(29.92)

Credit Risk Elements: We place a loan in nonaccrual status when management believes, after considering economic and business conditions and collections efforts, that the borrower's financial condition is such that full collection of principal and interest is doubtful or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection.

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to our plans, objectives, future performance, and business, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "expects," "anticipates," "believes," "estimates," and other similar expressions or future or conditional verbs such as "will," "should," "would," and "could" are intended to identify such forward-looking statements. These forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties and are based on the beliefs and assumptions of our management.

Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following:

- competitive pressures in the banking industry may increase significantly;
- changes in the interest rate environment may reduce margins and/or the volumes and values of loans made or held, as well as the value of other financial assets held;
- changes in the creditworthiness of customers and the possible impairment of the collectability of loans;
- general economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit or other services;
- changes in the legislative or regulatory environment, including changes in accounting standards, may adversely affect our businesses;
- costs or difficulties related to the integration of the business and the businesses we have acquired may be greater than expected;
- expected cost savings associated with pending or recently completed acquisitions may not be fully realized or realized within the expected time frame;
- our competitors may have greater financial resources and develop products that enable them to compete more successfully;
- changes in business conditions;

- changes in the securities market; and
- changes in our local economy with regard to our market area and its heavy concentration of U.S. military bases and related personnel.

We do not undertake and specifically disclaim any obligation to publicly update or revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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 our calculation of return on average tangible assets and return on average tangible equity. This adjustment allows management to review the Company's core operating results and core capital position and facilitates comparisons with other banks.

Year Ended December 31,	**2014**	**2013**
Return on average assets (GAAP basis)	0.87%	0.93%
Impact of excluding average goodwill and other intangibles	0.06%	0.02%
Return on average tangible assets	0.93%	0.95%
Return on average equity (GAAP basis)	6.95%	7.27%
Impact of excluding average goodwill and other intangibles	2.21%	1.91%
Return on average tangible equity	9.16%	9.18%

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, the Company excludes goodwill and other intangible assets, allowing management to review its core capital position.

	Per share	
Year Ended December 31,	**2014**	**2013**
Book value (GAAP basis)	$ 14.88	$ 14.16
Impact of excluding average goodwill and other intangibles	3.79	3.40
Tangible book value	$ 11.09	$ 10.76

When computing the efficiency ratio (noninterest expense divided by the sum of net interest income and noninterest income, excluding securities gains or losses), management excludes gains and losses on securities because of the uncertainty of the amount of gain or loss recognized.

Year Ended December 31,	**2014**	**2013**
Efficiency ratio (GAAP basis)	73.77 %	72.00%
Impact of excluding securities gains/(losses)	(0.01)%	0.19%
Efficiency ratio, as reported	73.76 %	72.19%

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
TowneBank
Suffolk, Virginia

We have audited the accompanying consolidated balance sheets of *TowneBank* and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the years in the three-year period ended December 31, 2014. We also have audited *TowneBank's* internal control over financial reporting as of December 31, 2014, including controls over the preparation of regulatory financial statements in accordance with the instructions for Consolidated Reports of Condition and Income (Call Report) of the Federal Financial Institutions Examination Council, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). *TowneBank's* management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of consolidated financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income (call report). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles and call report instructions, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the consolidated financial statements.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of *TowneBank* and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, *TowneBank* maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We do not express an opinion or any other form of assurance on management's statements in the accompanying Management's Report on Internal Control in the section Compliance with Designated Laws and Regulations.

/s/ Dixon Hughes Goodman LLP

Norfolk, Virginia
March 13, 2015

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of TowneBank is responsible for the preparation and fair presentation of the financial statements and other financial information contained in this report. The accompanying consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include, as necessary, best estimates and judgments by management. Management also prepared other information in the Annual Report and is responsible for its accuracy and consistency with the consolidated financial statements. Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for our compliance with laws and regulations relating to safety and soundness designated by the Federal Deposit Insurance Corporation ("FDIC"). Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We maintain systems of controls that we believe are reasonably designed to provide our management with timely and accurate information about our operations. The system of internal controls includes, but is not limited to, maintaining internal audit and compliance functions; establishing formal written policies, procedures, and codes of conduct; training personnel; and segregating key duties and functions, where appropriate.

The Audit and Risk Management Committee of the Board of Directors participates in the adequacy of the system of internal controls and financial reporting. The Audit and Risk Management Committee consists of independent directors who meet regularly with management, the internal auditor, the Chief Risk Officer, and the independent auditors to review the scope of their work and findings.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014, including controls over regulatory financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income ("Call Report"). In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013). Based on our assessment we believe that, as of December 31, 2014, our internal control over financial reporting is effective based on those criteria.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2014, and for the year then ended. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts, some of which are based on management's judgments and estimates.

Compliance with Designated Laws and Regulations

Our management is also responsible for compliance with federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations. Management assessed our compliance with the designated laws and regulations. Based on this assessment, our management believes that we complied, in all significant respects, with the designated laws and regulations relating to safety and soundness for the year ended December 31, 2014.

Dixon Hughes Goodman LLP, the independent registered public accounting firm that performed our consolidated financial statement audit, has issued an attestation report on our assessment of our internal controls over financial reporting. A copy of this report, which is combined with the report expressing an opinion on the consolidated financial statements, precedes.

March 13, 2015

/s/ G. Robert Aston, Jr.

G. Robert Aston, Jr.
Chairman and Chief Executive Officer

/s/ Clyde E. McFarland, Jr.

Clyde E. McFarland, Jr.
Senior Executive Vice President and Chief Financial Officer

TOWNEBANK

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data)
December 31, 2014 and 2013

ASSETS	2014	2013
Cash and due from banks	$ 212,994	$ 203,782
Interest-bearing deposits in financial institutions	1,011	1,011
Total Cash and Cash Equivalents	214,005	204,793
Securities available for sale, at fair value	603,908	543,521
Securities held to maturity, at amortized cost	252,370	204,348
Federal Home Loan Bank stock, at amortized cost	22,157	23,069
Total Securities	878,435	770,938
Mortgage loans held for sale	71,390	58,642
Loans, net of unearned income and deferred costs:	3,397,266	3,235,989
Less: allowance for loan losses	(35,917)	(38,380)
Net Loans	3,361,349	3,197,609
Premises and equipment, net	155,774	153,436
Goodwill	113,159	104,446
Other intangible assets, net	22,509	15,615
Bank-owned life insurance policies	58,716	57,372
Other assets	107,148	110,146
TOTAL ASSETS	$ 4,982,485	$ 4,672,997
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 1,224,466	$ 1,037,028
Interest-bearing:		
Demand and money market accounts	1,365,183	1,240,949
Savings	301,033	321,103
Certificates of deposit	955,920	968,024
Total Deposits	3,846,602	3,567,104
Advances from the Federal Home Loan Bank	398,181	395,087
Repurchase agreements and other borrowings	31,893	47,659
Total Borrowings	430,074	442,746
Other liabilities	87,533	77,829
TOTAL LIABILITIES	4,364,209	4,087,679
Preferred stock		
Authorized shares - 2,000,000		
Issued and outstanding shares 76,458 in 2014 and 2013	76,458	76,458
Common stock, $1.667 par value		
Authorized shares - 90,000,000		
Issued and outstanding shares 35,785,679 in 2014 and 35,306,281 in 2013	59,655	58,856
Capital surplus	317,718	312,811
Retained earnings	154,655	128,527
Common stock issued to deferred compensation trust, at cost 627,730 shares in 2014 and 558,638 shares in 2013	(9,674)	(8,595)
Deferred compensation trust	9,674	8,595
Accumulated other comprehensive income (loss)	458	(344)
TOTAL SHAREHOLDERS' EQUITY	608,944	576,308
Noncontrolling interest	9,332	9,010
TOTAL EQUITY	618,276	585,318
TOTAL LIABILITIES AND EQUITY	$ 4,982,485	$ 4,672,997

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share data)
For the Years Ended December 31, 2014, 2013, and 2012

	2014	2013	2012
INTEREST INCOME:			
Loans, including fees	$ 155,894	$ 156,592	$ 156,979
Investment securities	13,395	9,470	11,571
Interest-bearing deposits in financial institutions and federal funds sold	637	759	783
Mortgage loans held for sale	2,586	3,469	4,173
Total interest income	172,512	170,290	173,506
INTEREST EXPENSE:			
Deposits	13,352	13,353	16,749
Advances from the Federal Home Loan Bank	13,373	13,057	12,233
Convertible subordinated capital debentures	—	—	237
Repurchase agreements and other borrowings, net of capitalized interest	51	(15)	3
Total interest expense	26,776	26,395	29,222
Net interest income	145,736	143,895	144,284
PROVISION FOR LOAN LOSSES	492	4,248	16,155
Net interest income after provision for loan losses	145,244	139,647	128,129
NONINTEREST INCOME:			
Residential mortgage banking income, net	27,179	28,977	26,998
Real estate brokerage and property management income, net	12,634	12,316	11,515
Insurance commissions and other title fees and income, net	34,558	28,322	23,458
Service charges on deposit accounts	9,192	8,682	7,798
Credit card merchant fees, net	3,576	3,471	3,578
Other income	9,605	8,149	7,837
Gain (loss) on investment securities	(15)	611	3,005
Total noninterest income	96,729	90,528	84,189
NONINTEREST EXPENSE:			
Salaries and employee benefits	99,007	97,108	89,669
Occupancy	17,863	16,298	14,384
Furniture and equipment	8,183	7,458	6,467
Other expenses	53,811	47,928	48,229
Total noninterest expense	178,864	168,792	158,749
Income before income tax expense & noncontrolling interest	63,109	61,383	53,569
Provision for income tax expense	18,179	17,135	13,964
Net income	$ 44,930	$ 44,248	$ 39,605
Net income attributable to noncontrolling interest	(2,761)	(2,486)	(1,674)
Net income attributable to TowneBank	$ 42,169	$ 41,762	$ 37,931
Preferred stock dividends and accretion	765	4,227	6,226
Net income available to common shareholders	$ 41,404	$ 37,535	$ 31,705
Per common share information			
Basic earnings	$ 1.18	$ 1.14	$ 1.03
Diluted earnings	$ 1.18	$ 1.14	$ 1.03
Cash dividends declared	$ 0.43	$ 0.38	$ 0.33

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

For the Years Ended December 31, 2014, 2013, and 2012

	2014	2013	2012
Net income	$ 44,930	$ 44,248	$ 39,605
Other comprehensive income (loss)			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during the period	2,404	(2,905)	259
Deferred tax benefit (expense)	(844)	1,017	(91)
Realized (gains) losses reclassified into earnings	15	(84)	(1,881)
Deferred tax benefit (expense)	(6)	29	658
Net unrealized gains (losses)	1,569	(1,943)	(1,055)
Defined benefit retirement plan			
Actuarial gain (loss)	(1,196)	962	(1,359)
Deferred tax benefit (expense)	418	(336)	476
Amortization	17	242	—
Deferred tax expense	(6)	(85)	—
Change in defined benefit retirement plan, net of tax	(767)	783	(883)
Other comprehensive income (loss), net of tax	802	(1,160)	(1,938)
Comprehensive income	$ 45,732	$ 43,088	$ 37,667

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF EQUITY

(dollars in thousands, except share data)

For the Years Ended December 31, 2014, 2013, and 2012

	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, December 31, 2011	**29,564,991**	**$ 134,507**	**$ 49,287**	**$ 233,193**	**$ 94,453**	**$ 6,835**	**$ (6,835)**	**$ 2,754**	**$ 6,295**	**$ 520,489**
Net income	—	—	—	—	37,931	—	—	—	1,674	$ 39,605
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(1,938)	—	$ (1,938)
Cash dividends declared on common stock	—	—	—	—	(10,419)	—	—	—	—	(10,419)
Cash dividends declared on preferred stock	—	—	—	—	(6,226)	—	—	—	—	(6,226)
Stock dividend on common stock	919,923	—	1,536	10,351	(11,905)	—	—	—	—	(18)
Directors' deferred compensation	—	—	—	—	—	1,009	(1,009)	—	—	—
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	—	(1,000)	(1,000)
Issuance of common stock - acquisitions	100,000	—	167	1,382	—	—	—	—	—	1,549
Conversion of preferred stock into common stock	11,037	(203)	27	185	—	—	—	—	—	9
Conversion of convertible debt into common stock	1,028,058	—	1,718	12,042	—	—	—	—	—	13,760
Issuance of common stock - stock compensation plans	341,962	—	554	3,514	—	—	—	—	—	4,068
Balance, December 31, 2012	**31,965,971**	**$ 134,304**	**$ 53,289**	**$ 260,667**	**$ 103,834**	**$ 7,844**	**$ (7,844)**	**$ 816**	**$ 6,969**	**$ 559,879**
Net income	—	—	—	—	41,762	—	—	—	2,486	44,248
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(1,160)	—	(1,160)
Cash dividends declared on common stock	—	—	—	—	(12,842)	—	—	—	—	(12,842)
Cash dividends declared on preferred stock	—	—	—	—	(4,227)	—	—	—	—	(4,227)
Stock dividend on common stock	—	—	—	—	—	—	—	—	—	—
Directors' deferred compensation	—	—	—	—	—	751	(751)	—	—	—
Stock Warrant Repurchase	—	—	—	(1,500)	—	—	—	—	—	(1,500)
Distribution of interests in joint ventures, net	—	—	—		—	—	—	—	(445)	(445)
Issuance of common stock - acquisitions	10,180	—	17	135	—	—	—	—	—	152
Conversion of preferred stock into common stock	3,226,744	(57,846)	5,378	52,469	—	—	—	—	—	1
Conversion of convertible debt into common stock	1,530	—	3	11	—	—	—	—	—	14
Issuance of common stock - stock compensation plans	117,934	—	196	1,274	—	—	—	—	—	1,470
Common stock - cancellation of shares issued as contingent consideration	(16,078)	—	(27)	(245)	—	—	—	—	—	(272)
Balance, December 31, 2013	**35,306,281**	**$ 76,458**	**$ 58,856**	**$ 312,811**	**$ 128,527**	**$ 8,595**	**$ (8,595)**	**$ (344)**	**$ 9,010**	**$ 585,318**
Net income	—	—	—	—	42,169	—	—	—	2,761	44,930
Other comprehensive income, net of taxes	—	—	—	—	—	—	—	802	—	802
Cash dividends declared on common stock	—	—	—	—	(15,276)	—	—	—	—	(15,276)
Cash dividends declared on preferred stock	—	—	—	—	(765)	—	—	—	—	(765)
Directors' deferred compensation	—	—	—	—	—	1,079	(1,079)	—	—	—
Distribution of interests in joint ventures, net	—	—	—		—	—	—	—	(2,439)	(2,439)
Issuance of common stock - acquisitions	312,891	—	521	4,042	—	—	—	—	—	4,563
Conversion of convertible debt into common stock	6,526	—	12	82	—	—	—	—	—	94
Issuance of common stock - stock compensation plans	159,981	—	266	783	—	—	—	—	—	1,049
Balance, December 31, 2014	**35,785,679**	**$ 76,458**	**$ 59,655**	**$ 317,718**	**$ 154,655**	**$ 9,674**	**$ (9,674)**	**$ 458**	**$ 9,332**	**$ 618,276**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

For the Years Ended December 31, 2014, 2013, and 2012

OPERATING ACTIVITIES:	2014	2013	2012
Net income	$ 44,930	$ 44,248	$ 39,605
Adjustments to reconcile net income to net cash from operating activities:			
Net amortization of securities	3,173	3,959	2,448
Investment securities loss (gains)	15	(611)	(3,005)
Depreciation, amortization, and other intangible amortization	13,900	12,502	11,576
Provision for loan losses	492	4,248	16,155
Bank-owned life insurance income	(2,139)	(1,993)	(2,064)
Deferred income tax expense (benefit)	(1,146)	(2,641)	1,404
Share-based compensation expense	1,391	1,695	1,542
Purchases of trading account securities	—	(483)	(560)
Loss on sale and write-down of foreclosed assets	1,784	693	2,308
Originations of mortgage loans held for sale	(1,130,200)	(1,362,746)	(1,226,287)
Proceeds from sales of mortgage loans held for sale	1,155,261	1,481,347	1,242,103
Gain on sales of mortgage loans held for sale	(37,809)	(42,871)	(38,914)
Changes in:			
Interest receivable	(1,089)	106	193
Other assets	(10,013)	(21,648)	(14,895)
Interest payable	(238)	(71)	(753)
Other liabilities	6,209	(193)	9,480
Net cash from operating activities	44,521	115,541	40,336
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(325,395)	(839,055)	(688,988)
Purchase of held-to-maturity securities	(60,443)	(62,342)	(21,879)
Sale of available-for-sale securities	1,861	—	44,939
Sale of Federal Home Loan Bank Stock	1,082	—	—
Proceeds from maturities, calls, and prepayments of available-for-sale securities	262,438	739,107	518,527
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	12,185	13,337	20,758
Net increase in loans	(164,231)	(108,777)	(355,782)
Purchases of premises and equipment	(11,926)	(19,170)	(20,609)
Proceeds from sales of premises and equipment	152	317	416
Proceeds from sales of foreclosed assets	14,185	15,591	9,401
Acquisition of business, net of cash acquired	(12,798)	(1,351)	(3,239)
Net cash used for investing activities	(282,890)	(262,343)	(496,456)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	279,497	187,052	189,265
Net change in borrowings	(13,094)	51,228	100,279
Proceeds (payments) from share-based compensation activity	(342)	(224)	2,526
Payments from issuance of common stock	—	(273)	(9)
Repurchase of warrants	—	(1,500)	—
Distribution of interest in joint ventures, net	(2,439)	(445)	(1,000)
Cash dividends paid	(16,041)	(13,536)	(19,792)
Net cash from financing activities	247,581	222,302	271,269
Change in cash and cash equivalents	9,212	75,500	(184,851)
Cash and cash equivalents at beginning of year	204,793	129,293	314,144
Cash and cash equivalents at end of year	$ 214,005	$ 204,793	$ 129,293
Supplemental cash flow information:			
Cash paid for interest	$ 27,014	$ 26,467	$ 29,974
Cash paid for income taxes	$ 18,271	$ 20,373	$ 11,399
Noncash financing and investing activities:			
Transfer from loans to foreclosed property	$ 10,684	$ 18,703	$ 30,652
Sales of foreclosed assets financed by the Company	$ 3,138	$ 8,237	$ 9,554
Transfers from foreclosed property to premises and equipment	$ (549)	$ 511	$ —
Net unrealized gain (loss) on available-for-sale securities	$ 1,569	$ (1,943)	$ (1,055)
Common stock issued in connection with business acquisitions	$ 4,563	$ 152	$ 1,549
Common stock issued in conversion of convertible subordinated capital debentures	$ 94	$ 14	$ 13,760

See accompanying Notes to Consolidated Financial Statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business: TowneBank (the "Company") was organized and incorporated under the laws of the Commonwealth of Virginia on September 1, 1998, and commenced operations on April 8, 1999. The Company, through its banking and non-banking subsidiaries, provides a diverse range of financial services and products throughout the greater Hampton Roads region and northeastern North Carolina.

Basis of presentation: The consolidated financial statements include the accounts of the Company and all other entities in which the Company has a controlling financial interest. The accompanying consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices of the banking industry. All significant intercompany balances and transactions have been eliminated in consolidation. The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

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. In the periods ended on December 31, 2013 and prior, 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.

Use of estimates: The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of other real estate owned ("OREO"), deferred income taxes, fair value estimates, and goodwill and other intangibles.

Cash and cash equivalents: For purposes of reporting cash flows, the Company considers cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold as cash and cash equivalents. Generally, federal funds and securities purchased under agreements to resell are purchased and sold for one-day periods. The Company is required to maintain average reserve balances in cash with the Federal Reserve Bank of Richmond; required reserves were $14.98 million and $9.82 million at December 31, 2014 and 2013, respectively.

Investment securities: Investment securities are classified in three categories and accounted for as follows:

a) Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.

b) Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings.

c) Debt and equity securities not classified as either held-to-maturity or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized holding gains and losses excluded from earnings and reported as other comprehensive income, a separate component of shareholders' equity, until realized.

Gains and losses on sales of securities are determined on a trade date basis using specific identification of the adjusted cost of each security and included in noninterest income. Amortization of premiums and accretion of discounts are computed by the effective yield method and included in interest income. Other-than-temporary declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost, if any, are included in earnings as realized losses.

The Company evaluates its investment securities portfolio on a quarterly basis for indicators of other-than-temporary impairment ("OTTI"). Management assesses whether OTTI has occurred when the fair value of a debt security is less than the amortized cost basis at the balance sheet date. Management reviews the amount of unrealized loss, the length of time the security has been in an unrealized loss position, the credit rating history, market trends of similar security classes, time remaining to maturity, and the source of both interest and principal payments to identify securities which could potentially be impaired. OTTI is considered to have occurred (1) if management intends to sell the security; (2) if it is more likely than not management will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover all contractually required principal and interest payments. For securities that management does not expect to sell, or it is not more likely than not to be required to sell, the OTTI is separated into credit and noncredit components. A discounted cash flow analysis, which includes evaluating the timing of expected cash flows, is completed for all debt securities subject to credit impairment. The measurement of the credit loss component is equal to the difference between the debt security's cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The credit-related OTTI, represented by the expected loss in principal, is recognized in noninterest income. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit-related and, therefore, are recognized in other comprehensive income ("OCI"). Management believes that it will fully collect the carrying value of securities on which noncredit-related impairment has been recognized in OCI. Noncredit-related OTTI results from other factors, including increased liquidity spreads, and extension of the security. For securities that management does expect to sell, or if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, any OTTI is recognized in earnings. Once an OTTI is recorded, when future cash flows can be reasonably estimated, future cash flows are re-allocated between interest and principal cash flows to provide for a level-yield on the security.

Loans: Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are stated at the amount of outstanding principal less unamortized fees and costs on originated loans, unearned income, and participation interests sold to other lending institutions. Interest on loans is accrued and credited to income based upon the principal amount outstanding. Fees collected and costs incurred in connection with loans originated are deferred and recognized as interest income over the term of the loan as an adjustment of yield.

Allowance for loan losses: 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 and anticipated 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 Topic ("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 assign 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. An 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.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. 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. Management considers the current level of allowance for loan losses adequate to absorb losses inherent in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses, which is based on the factors and risk identification procedures previously discussed, requires the use of judgments and estimations that may change in the future. Changes in the factors used by management to determine the adequacy of the allowance or the availability of new information could cause the allowance for loan losses to be adjusted in future periods.

Loans acquired: Loans acquired through the completion of a transfer, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable, are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance. Loans are evaluated individually to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans, if the loans being aggregated have common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "nonaccretable difference," are not recognized as a yield adjustment or as a loss accrual or a valuation allowance. Significant increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized immediately as impairment. If the Company does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

For purchased loans that are not deemed impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value. Loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Subsequent to the purchase date, the methods utilized to estimate the required allowance for credit losses for these loans is similar to originated loans; however, the Company records a provision for loan losses only when the required allowance exceeds any remaining credit discounts. The difference between the initial fair value at acquisition and the undiscounted expected cash flows is recorded in interest income over the life of the loans using a method that approximates the effective interest method.

Mortgage loans held for sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Premises and equipment: Premises and equipment are stated at cost, less accumulated depreciation. Leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less.

For financial reporting purposes, depreciation is computed by the straight-line method over the estimated useful lives of the assets. For income tax purposes, the modified accelerated cost recovery system is used. Costs of maintenance and repairs are charged to expense as incurred. Costs of replacing structural parts of major units are considered individually and are expensed or capitalized as the facts dictate.

Fixed assets may be retired and disposed of by sale, trade, abandonment, or through a casualty loss such as a fire or storm. At retirement, the cost of the asset and its related accumulated depreciation are removed from the accounts. The type of disposal will determine the specific treatment of the asset.

Goodwill and other intangibles: Goodwill is not subject to amortization, but is subject to an annual assessment for impairment by applying a fair-value-based test as required by the Financial Accounting Standards Board (the "FASB") ASC 350, *Goodwill and Other Intangible Assets*. Additionally, under ASC 350, acquired intangible assets are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful life.

Goodwill is tested for impairment at the reporting unit level on an annual basis as of August 31, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step (step 1) compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. For our annual impairment testing conducted during 2014, we identified five reporting units with goodwill: Berkshire Hathaway HomeServices Towne Realty; property and casualty insurance division; benefits insurance division; Corolla Classic Vacations, LLC; and Banking. For purposes of performing step 1 of the goodwill impairment test, the Company primarily uses the income approach to value its reporting units. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the respective reporting units. The significant inputs to the income approach include expected future cash flows, the long-term target tangible equity to tangible assets ratio, and the discount rate. Discount rates are unique to each reporting unit and are based upon the cost of capital specific to the industry in which the reporting unit operates. Management evaluated the sensitivity of the significant assumptions in its impairment analysis, including consideration of the effect of changes in estimated future cash flows or the discount rate for each reporting unit. Based on our analysis, we determined there is no goodwill impairment, since the fair value for all reporting units was in excess of the respective reporting unit's carrying value as of August 31, 2014. The fair value of each of the Company's reporting units exceeded its respective carrying value by at least the 6.3% margin as calculated for our property and casualty insurance division.

The second step (step 2) of impairment testing is necessary only if the reporting unit does not pass step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination. Significant judgment and estimates are involved in estimating the fair value of the assets and liabilities of the reporting unit. Since none of the reporting units failed step 1, step 2 was not applicable during 2014 testing. The Company monitored events and circumstances during the fourth quarter of 2014, and it determined that there were no triggering events requiring an updated impairment test as of December 31, 2014.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. Selection and weighting of the various fair value techniques may result in a higher or lower fair value. Judgment is applied in determining the weightings most representative of fair value.

Intangible assets are amortized or tested for impairment based on whether they have finite or indefinite lives. Intangibles that have finite lives are amortized on a straight-line basis over their useful life and tested for impairment whenever events or circumstances indicate the carrying amount of the assets may not be recoverable. Intangibles with indefinite lives are tested annually for impairment. Note 7 provides additional information related to goodwill and other intangibles.

Other Real Estate Owned: Other Real Estate Owned ("OREO"), which is included in other assets on the balance sheet, consists primarily of commercial and residential real estate that has been obtained in partial or full satisfaction of loan obligations. OREO is carried at the fair value of the property, less estimated selling costs, with any difference between the fair value of the property, less estimated selling costs, and the carrying value of the loan recorded through a charge to the allowance for loan losses. Subsequent write-downs required for declines in value are recorded through a valuation allowance, or taken directly to the asset, charged to other noninterest expense.

Transfers of financial assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the asset has been isolated from the Company, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred asset, and (iii) an agreement to repurchase the transferred asset before its maturity does not exist.

Credit-related financial instruments: In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded. They are considered in calculating the provision for loan losses.

Rate lock commitments: The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). The commitments are generally for periods of 60 days and are at market rates. In order to mitigate risk from interest rate fluctuations, the Company enters into forward loan sale commitments on a "best efforts" basis while the loan is in the pipeline.

Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Loans in the pipeline that have an interest rate lock with the customer are termed rate lock commitments, whereby, the interest rate on the loan is determined prior to funding. Under these interest rate lock commitments, expected income less direct origination costs is recorded upon the locking of the interest rate with the borrower. The commitments are generally for periods of 60 days and are at market rates. Changes in the rate lock commitments subjected to recurring fair value adjustments are affected by the changes in the balances of locked mortgage loan commitments, changes in the fall out rates and changes in the prevailing secondary market prices for like-kind mortgage loans. The fall out rate measures the likelihood that an interest rate lock commitment will ultimately not become a closed loan held for sale. The income statement impact associated with these instruments is recorded in net residential mortgage banking income and amounted to an increase in income of $0.36 million, a reduction in income of $0.66 million, and an increase in income of $1.24 million for the years ended December 31, 2014, 2013, and 2012, respectively.

Loans are sold service-released on a non-recourse basis, except for normal representations and warranties, which is consistent with industry practices.

Revenue recognition: Revenue earned on interest-earning assets is recognized based on the effective yield of the financial instrument.

Service charges on deposit accounts are recognized as charged. Credit-related fees, including letter of credit fees, are recognized in noninterest income when earned.

Insurance commission income is recorded as of the effective date of insurance coverage or the billing date, whichever is later. Contingent commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known.

Real estate commissions are earned by the Company's real estate brokerage business upon the closing of a real estate transaction (i.e., purchase or sale of a home). The real estate commissions are recorded net of commissions paid to real estate agents, which are recognized concurrently with the associated revenues.

The Company provides title and closing services, which include title search procedures for title insurance policies, home sale escrow, and other closing services. Title revenues, which are recorded net of amounts remitted to third-party insurance underwriters, and title and closing service fees are recorded at the time a home sale transaction or refinancing closes.

Investment fund servicing fees are primarily based on a percentage of the fair value of the fund assets serviced.

Income recognition on impaired and nonaccrual loans: Commercial loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. Residential mortgage loans and other consumer loans are classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 120 days, unless the debt is both well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is generally classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual, if repayment in full of principal and/or interest is unlikely.

While a loan is classified as nonaccrual and the probability of collecting the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the probability of collecting the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower in accordance with the contractual terms of interest and principal.

Advertising costs: Advertising costs are expensed as incurred.

Segment information: Operating segments as defined by ASC 280, *Segment Reporting*, are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The accounting policies of operating segments are the same as those described elsewhere in this footnote. Revenue for all segments is derived from external sources. See Note 24 for further discussion of the Company's operating segments.

Mergers and acquisitions: Mergers and acquisitions are accounted for using the purchase method, as required by ASC 805, *Business Combinations*. Under this method, the cost of the acquired entity will be allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The excess of the cost over the fair value of the acquired net assets is recognized as goodwill. See Note 2 for further discussion on the Company's mergers and acquisitions.

Income taxes: Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities that result in future taxable or deductible amounts. The effect on deferred taxes of a change in tax rates is recognized in the year of enactment and is measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized in the near term. Note 19 provides additional information on the Company's income taxes.

Comprehensive income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income or loss. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with the operating net income or loss, are components of comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on available-for-sale securities and actuarial gains and losses on our Supplemental Executive Retirement Plan ("SERP").

Share-based compensation: The Company has a share-based employee compensation plan, which is described in more detail in Note 13. The Company accounts for the plan using the fair value method, which requires that compensation cost relating to stock-based payment transactions be recognized in the financial statements over the vesting period. The compensation cost is measured based on the fair value of the instruments issued.

Earnings per share: Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the year, less the average number of nonvested restricted stock awards. Diluted earnings per share reflect the potential dilution from the issuance of additional shares of common stock caused by the exercise of stock options and restricted stock awards. Also considered in the calculation is the impact of the convertible subordinated capital debentures on earnings available to shareholders and weighted-average common shares outstanding. See Note 25 for further discussion on the Company's earnings per share.

Recent accounting pronouncements

In February 2013, 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 No. 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 No. 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.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The ASU will supersede most of the existing revenue recognition requirements in GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The pronouncement is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. We are currently evaluating the impact the pronouncement will have on our consolidated financial statements and related disclosures.

NOTE 2: MERGERS AND ACQUISITIONS

Beach Properties of Hilton Head: Effective October 1, 2014, the Company acquired Beach Properties of Hilton Head, Inc., an independent resort property management company that was merged with the operations of Towne Vacations, a division of TowneBank's Realty segment. 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 October 1, 2014. The purchase price for the transaction was $8.60 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $3.53 million, goodwill of $1.52 million, other intangible assets including customer lists of $5.47 million, and assumed liabilities of $1.88 million.

Southern Insurance Agency: Effective May 1, 2014, the Company acquired Southern Insurance Agency, Inc., which is affiliated with Towne Insurance Agency ("Towne Insurance"), a wholly-owned subsidiary of TowneBank. 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 May 1, 2014. The purchase price for the transaction was $11.81 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $1.22 million, goodwill of $7.14 million, other intangible assets including customer lists of $3.90 million, and assumed liabilities of $0.45 million.

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 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 $0.19 million, goodwill of $1.53 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 $0.62 million, goodwill of $4.76 million, other intangible assets, including customer lists of $1.53 million, and assumed liabilities of $0.61 million.

These acquisitions, when considered individually or in aggregate under relevant disclosure guidance, do not require the presentation of separate pro forma financial information.

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):

December 31, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 512,762	$ 371	$ (692)	$ 512,441
Municipal securities	24,148	614	(43)	24,719
Trust preferred and other corporate securities	7,720	736	—	8,456
Mortgage-backed securities issued by GSE	57,240	1,054	(2)	58,292
Total available-for-sale securities	$ 601,870	$ 2,775	$ (737)	$ 603,908

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

For the year ended December 31, 2014, proceeds from securities available for sale amounted to $1.86 million and resulted in gross realized gains of $45,000 and gross realized losses of $60,000. For the year ended December 31, 2013, the Company had no proceeds from sales of securities available for sale or related gross realized gains or losses. For the year ended December 31, 2012, proceeds from securities available for sale amounted to $44.94 million, excluding prepayments related to mortgage-backed securities, and resulted in gross realized gains of $1.88 million. The Company had no gross realized losses in 2012.

Held-to-maturity securities

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

December 31, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 222	$ —	$ 722
Municipal securities	56,923	3,965	—	60,888
Industrial revenue bonds	167,124	11,885	(297)	178,712
Mortgage-backed securities issued by GSE	27,823	134	(15)	27,942
Total held-to-maturity securities	$ 252,370	$ 16,206	$ (312)	$ 268,264

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

Trading securities

Prior to 2013, the Company had mutual fund investments in a self-directed employee deferred compensation plan, structured as a rabbi trust and classified as trading securities. 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 no gains or losses in 2014 and gains of $0.53 million and $1.08 million in 2013 and 2012, respectively. See Note 12 for additional discussion of the deferred compensation plan.

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):

December 31, 2014	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 34,629	$ 34,676	$ —	$ —
Due after one year through five years	490,964	490,628	3,333	3,605
Due after five years through 10 years	38,121	38,570	64,666	66,318
Due after 10 years	36,763	38,641	184,371	198,341
	600,477	602,515	252,370	268,264
Other equity securities	1,393	1,393	—	—
	$ 601,870	$ 603,908	$ 252,370	$ 268,264

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	28,491
Due after 10 years	65,994	67,199	172,445	176,171
	543,825	543,450	204,348	208,286
Other equity securities	71	71	—	—
	$ 543,896	$ 543,521	$ 204,348	$ 208,286

Pledged securities

At December 31, 2014 and 2013, the Company had investment securities with market values of $192.53 million and $148.96 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the Federal Reserve Bank of Richmond ("FRB") at December 31, 2014 or 2013. The Company also had $44.72 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2014, compared to $59.21 million at December 31, 2013.

Unrealized losses

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

December 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	$ 176,379	$ (255)	$ 70,335	$ (437)	$ 246,714	$ (692)
Municipal securities	5,041	(30)	3,765	(13)	8,806	(43)
Industrial revenue bonds	5,270	(292)	946	(5)	6,216	(297)
Mortgage-backed securities issued by GSE	7,330	(17)	—	—	7,330	(17)
Total temporarily impaired securities	$ 194,020	$ (594)	$ 75,046	$ (455)	$ 269,066	$ (1,049)

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
Trust preferred and other corporate securities	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

At December 31, 2014, 12 securities had unrealized losses of $0.69 million. The Company's unrealized losses on U.S. government agency securities were caused by interest rate fluctuations. 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

At December 31, 2014, eight securities had unrealized losses of $0.04 million. The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. 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

At December 31, 2014, two securities experienced a total unrealized loss of $0.02 million. The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses 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 securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Trust preferred and other corporate securities

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

Industrial revenue bonds

At December 31, 2014, three bond issuances had total unrealized losses of $0.30 million. The Company's unrealized losses on industrial revenue bonds were caused by interest rate fluctuations. 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 December 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 $22.16 million and $23.07 million of FHLB stock at December 31, 2014 and 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.

A summary of loan balances by major classification (in thousands):

December 31,	2014	2013
Real estate loans		
1-4 family residential	$ 837,370	$ 797,723
Commercial	1,447,078	1,365,572
Construction and land development	452,481	469,679
Multifamily	51,472	53,562
Total real estate loans	2,788,401	2,686,536
Commercial and industrial business	533,500	500,755
Consumer loans and other	75,365	48,698
Loans, net of unearned income and deferred costs	$ 3,397,266	$ 3,235,989

Unearned loan income was $2.57 million in excess of deferred loan costs at December 31, 2014, $2.39 million at December 31, 2013, and $2.47 million at December 31, 2012. There were $6.74 million, $12.75 million, and $40.69 million in nonaccrual loans at December 31, 2014, 2013, and 2012, respectively. The Company would have earned $0.17 million in 2014, $0.22 million in 2013, and $1.07 million in 2012 if interest on the loans had been accrued. Of total loans, $748.86 million was pledged as collateral to secure overnight borrowings with the FHLB, and $58.02 million was pledged to secure borrowings from the discount window at the FRB at December 31, 2014.

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 $35.92 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2014.

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the years ended December 31, 2014, 2013, and 2012 (in thousands):

December 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 year	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380
Provision charged to expense	(1,837)	1,318	414	(797)	554	840	492
Losses charged off	(561)	(1,165)	(493)	(1,473)	(432)	(415)	(4,539)
Recoveries	134	452	47	661	130	160	1,584
Balance, end of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
December 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	(2,399)	1,161	124	3,945	907	510	4,248
Losses charged off	(1,734)	(396)	(14)	(4,402)	(1,040)	(397)	(7,983)
Recoveries	367	335	—	465	466	55	1,688
Balance, end of year	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380
December 31, 2012							
Allowance for loan losses:							
Balance, beginning of year	$ 13,623	$ 10,578	$ 395	$ 10,837	$ 3,842	$ 465	$ 39,740
Provision charged to expense	4,003	5,178	539	3,665	2,261	509	16,155
Losses charged off	(5,989)	(3,295)	(345)	(4,640)	(1,791)	(504)	(16,564)
Recoveries	54	60	—	860	66	56	1,096
Balance, end of year	$ 11,691	$ 12,521	$ 589	$ 10,722	$ 4,378	$ 526	$ 40,427

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

December 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	$ 464	$ 1,177	$ —	$ 1,195	$ 231	$ —	$ 3,067
Loans collectively evaluated for impairment	5,197	13,049	667	7,926	4,732	1,279	32,850
Balance, end of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
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):

December 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	$ 10,924	$ 19,141	$ —	$ 14,379	$ 674	$ 41	$ 45,159
Ending balance: collectively evaluated for impairment	440,663	1,425,888	51,472	819,642	531,987	75,324	3,344,976
Ending balance: loans acquired with deteriorated credit quality	894	2,049	—	3,349	839	—	7,131
Ending Balance	$ 452,481	$ 1,447,078	$ 51,472	$ 837,370	$ 533,500	$ 75,365	$ 3,397,266
December 31, 2013							
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 years ended December 31, 2014 and 2013 (in thousands):

	December 31, 2014				December 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	(693)	693	(1,673)	1,673	(737)	737	(2,210)	2,210
Reclassifications from nonaccretable balance, net	—	—	—	—	2,545	—	2,402	—
Payments received, net	—	(1,492)	—	(4,866)	—	(2,420)	—	(7,802)
Balance at end of period	$ 2,107	$ 7,131	$ 2,760	$ 24,972	$ 2,800	$ 7,930	$ 4,433	$ 28,165

At December 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 December 31, 2014, was $9.77 million and $26.04 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 on impaired credits 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.

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 consumer credit exposures by internally assigned grades for the years ended December 31, 2014 and 2013 (in thousands):

December 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	$ 431,101	$ 1,411,831	$ 47,962	$ 816,659	$ 528,610	$ 75,313	$ 3,311,476
Special Mention	295	14,222	288	3,658	1,506	4	19,973
Substandard	21,085	21,025	3,222	17,053	3,384	48	65,817
Doubtful	—	—	—	—	—	—	—
Total	$ 452,481	$ 1,447,078	$ 51,472	$ 837,370	$ 533,500	$ 75,365	$ 3,397,266

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 December 31, 2014. 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).

	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
December 31, 2014								
Construction and land development	$ 1,735	$ 19	$ —	$ 1,680	$ 3,434	$ 449,047	$ 452,481	$ —
Commercial real estate	1,552	721	—	2,132	4,405	1,442,673	1,447,078	—
Multifamily real estate	762	—	—	—	762	50,710	51,472	—
1-4 family residential real estate	4,800	3,552	12	2,546	10,910	826,460	837,370	12
Commercial and industrial business loans	234	—	—	383	617	532,883	533,500	—
Consumer loans and other	61	—	—	—	61	75,304	75,365	—
Total	$ 9,144	$ 4,292	$ 12	$ 6,741	$ 20,189	$ 3,377,077	$ 3,397,266	$ 12

	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
December 31, 2013								
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.

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

December 31, 2014	**Unpaid Principal Balance**	**Recorded Investment**	**Specific Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
Loans without a specific valuation allowance					
Construction and land development	$ 9,288	$ 9,043	$ —	$ 9,602	$ 451
Commercial real estate	10,232	9,964	—	10,342	486
1-4 family residential real estate	6,686	6,459	—	6,730	288
Commercial and industrial business loans	572	443	—	578	23
Consumer loans and other	41	41	—	53	4
Total	$ 26,819	$ 25,950	$ —	$ 27,305	$ 1,252
Loans with a specific valuation allowance					
Construction and land development	$ 2,076	$ 1,881	$ 464	$ 2,452	$ 36
Commercial real estate	9,350	9,177	1,177	9,474	377
1-4 family residential real estate	8,077	7,920	1,195	8,141	391
Commercial and industrial business loans	255	231	231	282	13
Consumer loans and other	—	—	—	—	—
Total	$ 19,758	$ 19,209	$ 3,067	$ 20,349	$ 817
Total impaired loans					
Construction and land development	$ 11,364	$ 10,924	$ 464	$ 12,054	$ 487
Commercial real estate	19,582	19,141	1,177	19,816	863
1-4 family residential real estate	14,763	14,379	1,195	14,871	679
Commercial and industrial business loans	827	674	231	860	36
Consumer loans and other	41	41	—	53	4
Total	$ 46,577	$ 45,159	$ 3,067	$ 47,654	$ 2,069

(1) Included in the table above are accruing TDRs of $38.42 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $2.50 million.

December 31, 2013	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	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
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
Multifamily 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
Multifamily 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.

December 31, 2012	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 23,374	$ 20,315	$ —	$ 25,497	$ 667
Commercial real estate	18,290	17,923	—	18,246	1,031
1-4 family residential real estate	11,410	10,867	—	11,534	464
Commercial and industrial business loans	947	626	—	924	53
Consumer loans and other	107	102	—	118	8
Total	$ 54,128	$ 49,833	$ —	$ 56,319	$ 2,223
Loans with a specific valuation allowance					
Construction and land development	$ 22,216	$ 20,928	$ 1,544	$ 22,177	$ 67
Commercial real estate	6,516	6,278	978	6,571	274
1-4 family residential real estate	5,875	5,357	1,246	5,901	269
Commercial and industrial business loans	—	—	—	—	—
Consumer loans and other	393	348	185	398	9
Total	$ 35,000	$ 32,911	$ 3,953	$ 35,047	$ 619
Total impaired loans					
Construction and land development	$ 45,590	$ 41,243	$ 1,544	$ 47,674	$ 734
Commercial real estate	24,806	24,201	978	24,817	1,305
1-4 family residential real estate	17,285	16,224	1,246	17,435	733
Commercial and industrial business loans	947	626	—	924	53
Consumer loans and other	500	450	185	516	17
Total	$ 89,128	$ 82,744	$ 3,953	$ 91,366	$ 2,842

(1) Included in the table above are accruing TDRs of $38.91 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $25.30 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 years ended December 31, 2014 and 2013 (in thousands, except number of loans):

	Year Ended December 31, 2014		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	—	$ —	$ —
Commercial real estate	1	134	134
Multifamily real estate	—	—	—
1-4 family residential real estate	1	549	379
Commercial and industrial	3	293	269
Consumer loans and other	3	69	69
Total	8	$ 1,045	$ 851

	Year Ended December 31, 2013		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	2	$ 2,550	$ 2,530
Commercial real estate	5	4,819	4,819
Multifamily real estate	1	365	365
1-4 family residential real estate	8	5,914	5,629
Commercial and industrial	1	2,000	2,000
Consumer loans and other	1	4	4
Total	18	$ 15,652	$ 15,347

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 was one consumer loan that was restructured within the last 12 months that subsequently defaulted. The loan had a recorded balances of $0.03 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 December 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

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

	Year Ended December 31, 2014	Year Ended December 31, 2013
Beginning balance	$ 39,534	$ 30,297
Additions	14,688	34,269
Sales	(17,323)	(23,828)
Valuation allowance	(1,271)	(414)
Loss on sale and write-downs	(513)	(279)
Transfers to premises and equipment	—	(511)
Ending balance	$ 35,115	$ 39,534

NOTE 6: PREMISES, EQUIPMENT, AND LEASES

A summary of the cost and accumulated depreciation of premises and equipment is as follows (in thousands):

	Useful Life	December 31, 2014	December 31, 2013
Land and improvements	—	$ 27,898	$ 26,012
Buildings and improvements	10 to 45 years	95,221	91,656
Autos	3 to 5 years	3,937	3,947
Computer equipment	2 to 5 years	11,780	11,227
Equipment	5 to 10 years	14,371	13,390
Furniture and fixtures	5 to 20 years	39,387	38,340
Leasehold improvements	Lesser of lease term or 15 years	22,399	21,414
Construction in progress	—	2,883	1,516
		217,876	207,502
Less accumulated depreciation		(62,102)	(54,066)
Net premises and equipment		$ 155,774	$ 153,436

Depreciation and leasehold amortization expense for the years ended December 31, 2014, 2013, and 2012 was $10.46 million, $9.57 million, and $8.36 million, respectively.

Various facilities and equipment are leased under noncancellable operating leases with initial remaining terms in excess of one year and an option for renewal. In addition to minimum rentals, certain leases have escalation clauses and include provisions for additional payments to cover taxes, insurance, and maintenance. The effects of scheduled rent increases, which are included in the minimum lease payments, are recognized on a straight-line basis over the lease term. Rental expense was $7.64 million for 2014, compared to $6.98 million for 2013, and $6.31 million for 2012.

Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2014, are listed in the following chart (in thousands):

2015	$	7,578
2016		6,278
2017		5,664
2018		5,276
2019		2,316
Thereafter		8,613
	$	35,725

Rental income for the year ended December 31, 2014 was $0.33 million, compared to $0.37 million for 2013, and $0.43 million for 2012. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2014 (in thousands):

2015	$	386
2016		247
2017		192
2018		171
2019		57
Thereafter		52
	$	1,105

NOTE 7: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2014		2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 417	$ 211	$ 417	$ 159
Non-compete agreements	1,706	1,374	1,456	1,292
Customer lists	30,386	11,773	21,119	9,332
Trade names	211	84	211	42
Total intangible assets subject to amortization	32,720	13,442	23,203	10,825
Intangible assets not subject to amortization				
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—
Total intangible assets	$ 35,951	$ 13,442	$ 26,434	$ 10,825

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2014 was $2.62 million, compared to $2.14 million for 2013, and $2.25 million for 2012. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2014, is as follows: 2015, $2.95 million; 2016, $2.65 million; 2017, $2.48 million; 2018, $2.31 million; and 2019, $2.07 million.

During 2014, the Company recorded $8.65 million in net increases to goodwill and $9.52 million in intangible assets. This represents the acquisitions of an insurance agency, an insurance-related book of business, and a property resort management company. During 2013, the Company recorded $1.53 million in net increases to goodwill and $1.67 million in intangible assets. This represented the acquisition of two insurance agencies and several insurance-related books of business. The book-of-business purchases resulted in an increase to intangible assets of $0.51 million. The intangible assets acquired are finite-lived, consisting primarily of book-of-business purchases. These assets are included in the Company's Insurance segment.

No impairment charges were recorded in any year reported. Impairment testing indicated that goodwill was not impaired in 2014, 2013, or 2012. Changes in the carrying amount of goodwill related to each of the Company's segments are as follows (in thousands):

	Bank	Realty	Insurance	Consolidated Totals
Balance, December 31, 2012	$ 58,884	$ 15,825	$ 28,203	$ 102,912
Additions to goodwill	—	—	1,534	1,534
Balance, December 31, 2013	$ 58,884	$ 15,825	$ 29,737	$ 104,446
Additions to goodwill	—	1,515	7,139	8,654
Other adjustments	—	—	59	59
Balance, December 31, 2014	$ 58,884	$ 17,340	$ 36,935	$ 113,159

NOTE 8: BANK-OWNED LIFE INSURANCE POLICIES

The total carrying amount of bank-owned life insurance policies (“BOLI”) as of December 31, 2014 was $58.72 million. The Company had $57.37 million of BOLI at December 31, 2013, and $55.38 million at December 31, 2012. The Company recognized BOLI income, included in other noninterest income, of $2.14 million, $1.99 million, and $2.06 million for the years ended December 31, 2014, 2013, and 2012, respectively. The Company has a related retirement plan, 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. Refer to Note 12 for additional discussions regarding retirement plans.

NOTE 9: DEPOSITS

A summary of time deposits by maturity at December 31, 2014, is shown in the following chart (dollars in thousands):

Maturity	Total
2015	$ 585,030
2016	220,927
2017	20,725
2018	13,978
2019 and thereafter	115,260
	$ 955,920

At year-end 2014, TowneBank had a total of $380.22 million in no-penalty time deposits as compared to $364.48 million at December 31, 2013. The aggregate amount of time deposits of $250,000 or more was $194.47 million and $198.22 million at December 31, 2014 and 2013, respectively.

Some of the Company’s officers and directors, and the respective companies in which the officers and directors have a financial interest, have deposit relationships with the Company. Related party deposits amounted to approximately $52.52 million and $46.35 million at December 31, 2014 and 2013, respectively.

NOTE 10: BORROWINGS

TowneBank is a member of the FHLB and may borrow funds based on criteria established by the FHLB. The FHLB may call these borrowings if the adjusted collateral balance falls below the borrowing level. The borrowing arrangements available from the FHLB could be either short- or long-term, depending on our related cost and needs.

Advances from the FHLB for the years ended December 31 are summarized as follows (dollars in thousands):

	2014	2013
Balance outstanding at end of year	$ 398,181	$ 395,087
Average balance outstanding	$ 396,672	$ 386,089
Maximum outstanding at any month-end	$ 398,717	$ 395,140
Average interest rate during the year	3.37%	3.38%
Average interest rate at end of year	3.32%	3.33%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2014, are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Call Date	Outstanding Amount
03/06/2017	4.08%	03/06/2015	$ 100,000
05/18/2017	4.35%	02/18/2015	80,000
05/18/2017	4.48%	02/18/2015	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%	—	8,550
11/15/2028	3.43%	—	5,596
12/01/2028	2.83%	—	4,035
			$ 398,181

Information concerning securities sold under agreements to repurchase and federal funds purchased is summarized as follows (dollars in thousands):

	2014	2013
Balance outstanding at end of year	$ 31,893	$ 47,659
Average balance outstanding	$ 32,574	$ 39,126
Maximum outstanding at any month-end	$ 42,531	$ 51,473
Average interest rate during the year	0.16%	0.17%
Average interest rate at end of year	0.16%	0.14%

Repurchase agreements totaled $31.89 million at December 31, 2014. They are classified as secured borrowings and generally mature within one business day from the transaction date. They are reflected as the amount of cash received in connection with the transaction. In addition, federal funds lines with other financial institutions were available at December 31, 2014, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2014 and 2013, the Company had an unused line of credit with the FHLB totaling $996.56 million and $906.81 million, respectively. The FHLB advances are secured by a blanket floating lien on certain 1-4 family residential, multifamily, HELOCS, second mortgages, and commercial mortgages with carrying values of $748.86 million at December 31, 2014.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2014, which provide potential additional funding.

At January 1, 2012, the Company had outstanding convertible subordinated capital debentures of $13.74 million in the form of Series III Towne Investment Notes. During 2012, the debentures were called and there were no convertible subordinated capital debentures outstanding at December 31, 2014 or 2013. Interest expense on debentures was $0 for the years ended December 31, 2014 and 2013, and $0.24 million for 2012.

NOTE 11: COMMITMENTS

TowneBank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk, which have not been recognized in the balance sheet. The contract amount of these instruments reflects the extent of the Company's involvement or "credit risk."

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Unless noted otherwise, collateral or other security is required to support financial instruments with credit risk.

Our contractual amounts are as follows (in thousands):

December 31,	**2014**	**2013**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 1,189,546	$ 859,076
Standby letters of credit	28,755	27,889
	$ 1,218,301	$ 886,965

Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and real estate.

Standby letters of credit are conditional commitments issued to guarantee performance of a customer to a third party. The letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral supporting those commitments is generally held, if deemed necessary. The Company provides an allowance for estimated losses from such provisions that management considered adequate at December 31, 2014. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

NOTE 12: RETIREMENT PLANS

Defined Contribution Plans

The Company has a defined contribution 401(k) plan. All employees who are at least 18 years of age and have completed one quarter of a year of service are eligible to participate. Under the plan, employees may contribute a percentage of their annual salary, subject to statutory limitations, and the Company will make a discretionary match of the employees' contributions up to 6% of their salary. The Company did not match employee contributions in 2014 and matched employee contributions up to 3.0%, and 4.50% in the years ended December 31, 2013, and 2012, respectively. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2014, 2013, or 2012. The Company made matching contributions of $0, $2.20 million, and $2.66 million for the years ended December 31, 2014, 2013, and 2012, respectively.

The Company has a non-qualified deferred compensation plan that allows certain executives, senior officers, and other employees to defer payment of up 100% of their base salary and annual bonus. The Company has the option to match an employee's combined nonqualified deferred compensation and 401(k) deferrals up to a maximum of 6% of his or her salary. The Company does not match contributions made by employees who are participants in the SERP.

During the third quarter of 2013, the Company amended the deferred compensation plan, which is structured as a rabbi trust, from a self-directed, diversified plan to a plan that does not permit diversification. Due to the change in the plan's structure, the funds previously held in the plan were sold, with proceeds invested in certificates of deposit, which are included in other assets on the balance sheet. Changes in the obligation are now recorded in compensation expense, which resulted in an increase in expenses of $0.42 million for the year ended December 31, 2014. The Company did not make matching contributions to the plan for the years ended December 31, 2014, 2013, or 2012.

Supplemental Executive Retirement Plan

On December 1, 2008, the Company implemented a noncontributory, unfunded SERP for certain officers and key employees. The SERP is intended to provide retirement benefits and post-retirement health benefits to individuals covered under the plan. The SERP agreements with the officers provide that upon attainment of retirement age, generally at age 65, the participating officer will be entitled to receive a retirement benefit equal to either (i) a designated percentage, ranging from 30% to 50% of their base salary depending on their level of seniority, with an annual 4% increase until retirement, or (ii) a fixed targeted benefit amount. The retirement benefit is payable over a 15-year period, beginning at attainment of contractual retirement age. The SERP agreements provide for an annual vesting schedule until the participating officer reaches retirement age. In the case of a participating officer's voluntary termination of employment, disability, or termination for cause, the annual amount payable under the SERP is equal to the amount of the vested benefit earned as of the date of termination of employment. In the case of involuntary termination without cause or termination of employment for good reason by the participating officer, the participating officer becomes fully vested in the full retirement benefit. Upon termination of employment, payment of the retirement benefit does not begin until the participating officer reaches the designated retirement age set forth in the SERP agreement. In the event of death, the full amount of the retirement benefit is payable.

The following table sets forth changes in benefit obligations and financial data relative to the SERP. The accrued liability is recorded on the Consolidated Balance Sheets as a component of other liabilities (in thousands):

December 31,	**2014**	**2013**
Change in benefit obligation		
Benefit obligation, beginning of year	$ 16,610	$ 15,152
Service cost	3,026	1,937
Interest cost	755	666
Net amortization	17	242
Benefits paid	(408)	(183)
Net actuarial (gain) loss	1,179	(1,204)
Benefit obligation, end of year	$ 21,179	$ 16,610
Change in plan assets		
Fair value of plan assets, beginning of year	—	—
Employer contributions	408	183
Benefits paid	(408)	(183)
Fair value of plan assets, end of year	$ —	$ —
Funded status, end of year	$ (21,179)	$ (16,610)
Accumulated benefit obligation, end of year	$ 19,708	$ 15,374
Amounts recognized in other comprehensive income, pretax		
Net actuarial (gain) loss	$ 1,179	$ (1,204)

The components of the net periodic benefit cost for the SERP are as follows (in thousands):

	2014	**2013**	**2012**
Service cost	$ 3,026	$ 1,937	$ 2,515
Interest cost	755	666	476
Net amortization	17	242	—
Net periodic benefit cost	$ 3,798	$ 2,845	$ 2,991

Amounts recognized as a component of accumulated other comprehensive income that have not yet been recognized as a component of net periodic benefit cost consist of the following:

December 31,	**2014**	**2013**
Net actuarial loss	$ 1,333	$ 154
Deferred tax expense	(466)	(54)
Amounts included in accumulated other comprehensive income, net of tax	$ 867	$ 100

Pre-tax amounts recorded in accumulated other comprehensive income as of December 31, 2014 that are expected to be recognized as a component of our net periodic benefit cost in 2015 consist of the following:

December 31,	**Expected Amortization in 2015**
Net actuarial loss	$ 156

The Company used certain weighted average assumptions to determine benefit obligations and net benefit costs, including discount rate and rate of increase in future compensation levels. The discount rate used to determine net periodic benefit cost and benefit obligation was 4.08% in 2014, 4.92% in 2013, and 3.91% 2012. The rate of increase in future compensation levels used was 4.0% in 2014, 2013, and 2012. When estimating the discount rate, we review yields available on high-quality, fixed-income debt instruments and use a yield curve model from which the discount rate is derived by applying the projected benefit payments under the plan to points on a published yield curve.

The following table sets forth expected future benefit payments, which include expected future service, for the periods indicated (in thousands):

Year	**SERP**
2015	$ 533
2016	1,475
2017	1,475
2018	1,518
2019	1,877
2020-2023	10,433

NOTE 13: SHARE-BASED COMPENSATION

The Company maintains a share-based compensation plan (“Plan”) that provides for the granting of incentive and non-statutory stock options and restricted common stock. The Plan is administered by the Compensation Committee of the Board of Directors (the “Compensation Committee”). The maximum number of shares reserved under the Plan is equal to 20% of the fully diluted number of shares of the Company’s common stock outstanding, or such lesser number of shares as the Compensation Committee shall determine. The Company has a policy of using authorized and unissued common shares to satisfy share option exercises and vesting of restricted stock awards. At December 31, 2014, approximately 3.73 million common shares were available for issuance under the Plan.

Stock options: For stock options granted under the Plan, the stock option price cannot be less than the fair market value of the stock on the date granted. The Compensation Committee determines the exercise price for certain awards, and it can be based on future service. An option’s maximum contractual term is 10 years from the date of grant. Options and awards granted under the Plan are subject to vesting requirements ranging from two to 10 years.

The following tables summarize our stock option activity and related information:

For the Year Ended December 31,	2014		2013		2012	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Options outstanding, beginning balance	514,086	$ 18.43	574,465	$ 18.38	862,457	$ 16.22
Granted	—	—	—	—	—	—
Exercised	—	—	(3,090)	12.77	(254,462)	11.31
Expired	(96,270)	18.50	—	—	—	—
Forfeited	(3,811)	16.05	(57,289)	18.22	(33,530)	16.66
Options outstanding, ending balance	414,005	$ 18.44	514,086	$ 18.43	574,465	$ 18.38
Options exercisable at December 31,	338,781	$ 18.88	406,678	$ 18.85	421,228	$ 18.81

	Number of Shares	Weighted-Average Exercise Price
Unvested stock options, December 31, 2013	107,408	$ 16.87
Granted	—	—
Vested	(30,742)	17.89
Forfeited	(1,442)	16.72
Unvested stock options, December 31, 2014	75,224	$ 16.46

For the years ended December 31, 2014, 2013, and 2012, there were no stock options granted. There were no stock options exercised in 2014. For the years ended December 31, 2013 and 2012, the total intrinsic value of options exercised was $0.01 million and $0.59 million, respectively. Additional information pertaining to options outstanding at December 31, 2014, is as follows:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	414,005	$ 18.44	$ 57,526	2.29
Options vested or expected to vest	410,541	$ 18.47	$ 56,327	2.27
Options exercisable	338,781	$ 18.88	$ 33,608	1.94

The grant-date fair value of each option grant is estimated using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of the Company's stock over the most recent period of time equal to the expected term of the option. The average expected life was based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior based on historical patterns. The risk-free interest rate is based on the U.S. Department of the Treasury (the "U.S. Treasury") zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. Forfeitures are estimated based on historical voluntary termination behavior.

There were no exercises of stock options for the year ended December 31, 2014 for which cash was received and, therefore, no tax benefit realized. For the years ended December 31, 2013 and 2012, the tax benefit on cash paid for stock options exercised was $3,000 and $0.20 million. Compensation expense related to stock options for the years ended December 31, 2014, 2013, and 2012 was $0.16 million, $0.22 million, and $0.28 million, respectively. As of December 31, 2014, there was $0.30 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 3.52 years.

Restricted stock awards ("RSAs"): Under the Plan, grantees of restricted stock awards have full voting rights on the shares and are entitled to receive cash and stock dividends. RSAs granted under the Plan are generally subject to vesting requirements ranging from three to 10 years. The shares are subject to forfeiture if vesting and other contractual provision requirements are not met.

The following chart shows a summary of the restricted stock award activity and related information, assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2014:

	Number of Shares	Weighted-Average Price
Unvested RSAs, beginning balance	304,294	$ 14.52
Granted	174,561	14.81
Vested	(110,363)	14.25
Forfeited	(6,773)	14.80
Unvested RSAs, ending balance	361,719	$ 14.74

Compensation expense related to awards for the years ended December 31, 2014, 2013, and 2012 was $1.49 million, $1.47 million, and $1.26 million, respectively. The total fair value of awards vested during 2014, 2013, and 2012 was $1.57 million, $1.21 million, and $0.87 million, respectively. As of December 31, 2014, there was $4.46 million of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 4.0 years.

The Company has a directors' deferred compensation plan whereby the directors may elect to defer up to 100% of their directors' fees. 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 reflected in additional paid-in capital of $9.67 million and $8.59 million at December 31, 2014 and 2013, respectively.

NOTE 14: STOCK PURCHASE PLAN, DIVIDEND REINVESTMENT PLAN, AND DIVIDEND RESTRICTIONS

The Board of Directors approved and adopted the Member Stock Purchase and Dividend Reinvestment Plan to raise additional capital by providing a convenient and cost-effective way for shareholders, customers, and employees to purchase shares of TowneBank common stock. In connection with the member stock purchase component of the plan for the year ended December 31, 2014, the Company entered the open market and acquired 156,692 shares at an average price of $15.19 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2014, the Company entered the open market and acquired 279,077 shares at an average price of $15.28 per share.

In connection with the member stock purchase component of the plan for the year ended December 31, 2013, the Company entered the open market and acquired 157,626 shares at an average price of $15.06 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2013, the Company entered the open market and acquired 256,470 shares at an average price of $15.25 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In February 2014, the Company declared a quarterly cash dividend of $0.10 per common share. In May, August, and November of 2014, the Company declared quarterly cash dividends of $0.11 per common share. In February 2013 and May 2013, the Company declared quarterly cash dividends of $0.09 per common share. In August 2013 and November 2013, the Company declared quarterly cash dividends of $0.10 per common share. In February 2012, the Company declared a quarterly cash dividend of $0.078 per common share. In May 2012 and August 2012, the Company declared quarterly cash dividends of $0.08 per common share. In December 2012, the Company declared a quarterly cash dividend of $0.09 per common share. In 2011, the Company declared quarterly cash dividends of $0.078 per common share. The quarterly dividends were paid on January 12, 2012; April 12, 2012; July 12, 2012; October 12, 2012; December 28, 2012; April 12, 2013; July 12, 2013; October 11, 2013; January 12, 2014; April 11, 2014; July 11, 2014; October 10, 2014; and January 12, 2015.

Declaration of future cash dividends will depend on our earnings, our capital position, and other factors. 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.

Preferred Stock

On September 22, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the U.S. Treasury, pursuant to which the Company sold and issued 76,458 shares of the Company's Senior Non-Cumulative Perpetual Preferred Stock, Series C ("Series C Preferred Stock"), liquidation value of $1,000 per share, for a total purchase price of $76.46 million. The issuance was pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The holder of the Series C Preferred Stock is entitled to receive non-cumulative dividends, payable quarterly, on January 1, April 1, July 1, and October 1 of each year. The dividend rate can fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock is outstanding, based upon changes in the level of "Qualified Small Business Lending" ("QSBL") by the Company as compared to the Company's baseline QSBL level, which was established at the closing of the issuance. The dividend rate for the initial dividend period has been set at 5%. For the second through 10th calendar quarters, the dividend rate may be adjusted to between 1% and 5% per annum based upon the increase in QSBL as compared to the initial baseline. For the 11th calendar quarter through four and one-half years after issuance, the dividend rate will be fixed at between 1% and 7% based upon the level of QSBL compared to the baseline. After four and one-half years from issuance, the dividend rate will increase to 9%. Due to the Company's loan growth, the blended rate for the period from closing through December 31, 2011 was 4.63%, with the rate reduced to 3.92% for the first quarter of 2012, and 2.28% for the second quarter of 2012. Beginning with the third quarter of 2012, the rate decreased to 1.0% and will remain fixed at that rate through the end of 2015.

If the Company has not declared and paid an aggregate of six dividend payments on the Series C Preferred Stock, whether or not consecutive, the holder of the Series C Preferred Stock will have the right to elect two directors to the Company's Board of Directors. The Series C Preferred Stock may be redeemed at any time at the Company's option, at a redemption price of 100% of the liquidation amount plus accrued but unpaid dividends to the date of redemption for the current period, subject to the approval of the FDIC.

On September 22, 2011, the Company used the proceeds from the sale and issuance of the Series C Preferred Stock to repurchase all 76,458 outstanding shares of its Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B, liquidation amount $1,000 per share ("Series B Preferred Stock"), for a redemption price of $76.46 million, plus accrued but unpaid dividends. The Series B Preferred Stock was issued in the fourth quarter of 2008 to the U.S. Treasury under the Capital Purchase Program. With the repurchase of all shares of the Series B Preferred Stock, the remaining accretion of the discount of $1.86 million was accelerated into the third quarter of 2011 and reduced income available to common shareholders.

In connection with the issuance of the Series B Preferred Stock, the Company was required to issue to the U.S. Treasury immediately exercisable 10-year warrants to purchase 554,330 common shares at an exercise price of $20.69 per share. On May 15, 2013, the Company repurchased the warrants from the U.S. Treasury for $1.5 million. The transaction reduced additional paid-in capital within stockholders' equity by $1.5 million.

Non-cumulative dividends on the Series B Preferred Stock were payable at a rate of 5% while outstanding. The Company subsequently paid quarterly cash dividends of $12.50 per share of Series B Preferred Stock on November 15, 2010; February 15, 2011; May 16, 2011; and August 15, 2011.

In August 2008, the Company issued 598,542 shares of 8% Non-Cumulative Convertible Preferred Stock, Series A (the "Series A Preferred Stock"), liquidation value of $100 per share. The Series A Preferred Stock paid a non-cumulative dividend of 8% per year. Dividends were payable quarterly in cash, when, as, and if declared by the Board of Directors, on the first day of March, June, September, and December, commencing on December 1, 2008. Dividends on the Series A Preferred Stock began accruing August 15, 2008.

In 2012 and 2011, the Company declared quarterly cash dividends of $2.00 per share of Series A Preferred Stock. The Company also declared quarterly cash dividends of $2.00 per share of Series A Preferred Stock on January 23, 2013; April 24, 2013; and July 24, 2013. The quarterly dividends were paid on March 2, 2011; June 1, 2011; September 1, 2011; December 1, 2011; March 2, 2012; June 1, 2012; September 1, 2012; December 1, 2012; March 1, 2013; June 3, 2013; and September 3, 2013.

On September 1, 2013, all outstanding shares of the 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. During 2013, prior to the mandatory conversion, certain holders of Series A Preferred Stock voluntarily converted certain shares of Series A Preferred Stock into 37,839 shares of TowneBank common stock at a conversion price of $18.02 per share of common stock.

The following table presents the changes in the number of preferred shares for the years ended December 31, 2014 and 2013:

	Series A Preferred Shares	Series C Preferred Shares
Balance, December 31, 2012	581,453	76,458
Conversion of preferred stock into common stock	(581,453)	—
Balance, December 31, 2013	—	76,458
Conversion of preferred stock into common stock	—	—
Balance, December 31, 2014	**—**	**76,458**

NOTE 15: OTHER EXPENSES

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

Year Ended December 31,	2014	2013	2012
Advertising and marketing	$ 5,178	$ 5,374	$ 4,818
Acquisition-related expenses	4,280	(19)	768
Charitable contributions	3,430	4,209	3,574
Telephone and postage	4,184	3,937	3,527
Outside processing	3,631	3,425	3,019
Professional fees	5,178	4,325	4,606
Other	6,855	7,514	7,019
Stationery and office supplies	2,132	2,291	2,048
Amortization of intangible assets	2,623	2,145	2,251
Foreclosed property expenses	3,397	2,020	4,612
FDIC and other insurance	3,885	3,974	3,729
Software expense	4,615	4,217	4,227
Travel/Meals/Entertainment	1,133	1,424	981
Directors' expense	1,099	1,187	1,179
Bank franchise tax/SCC fees	2,191	1,905	1,871
	$ 53,811	$ 47,928	$ 48,229

NOTE 16: REGULATORY CAPITAL REQUIREMENTS

The Company is subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2014, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2014, the Company was categorized as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized," the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification which management believes have changed our category.

A summary of our required and actual capital components follow (dollars in thousands):

As of December 31, 2014	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Total risk-based capital						
(to risk-weighted assets)	$ 520,266	13.67%	$ 304,446	8.00%	$ 380,557	10.00%
Tier 1 capital						
(to risk-weighted assets)	$ 484,349	12.73%	$ 152,223	4.00%	$ 228,334	6.00%
Tier 1 leverage ratios						
(to average assets)	$ 484,349	9.94%	$ 194,866	4.00%	$ 243,582	5.00%

As of December 31, 2013	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Total risk-based capital						
(to risk-weighted assets)	$ 505,643	14.00%	$ 289,026	8.00%	$ 361,282	10.00%
Tier 1 capital						
(to risk-weighted assets)	$ 467,263	12.93%	$ 144,513	4.00%	$ 216,769	6.00%
Tier 1 leverage ratios						
(to average assets)	$ 467,263	10.29%	$ 181,701	4.00%	$ 227,127	5.00%

NOTE 17: 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.

The 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. The Company used a weighted average fall-out rate ratio of 20%. The carrying value of interest rate lock commitments was $0.95 million at December 31, 2014, and $0.58 million at December 31, 2013.

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

	December 31, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
U.S. agency securities	$ —	$ 512,441	$ —	$ 512,441
U.S. Treasury notes	—	—	—	—
Municipal securities	—	24,719	—	24,719
Mortgage-backed securities issued by GSE	—	58,292	—	58,292
Trust preferred and other corporate securities	—	8,456	—	8,456
Interest rate lock commitments	—	—	946	946

	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 GSE	—	64,855	—	64,855
Trust preferred and other corporate securities	—	8,257	—	8,257
Equity securities	—	—	—	—
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 (in thousands):

December 31, 2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 16,142	$ 16,142
Foreclosed property	$ —	$ 21,409	$ 13,706	$ 35,115

December 31, 2013	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 19,338	$ 19,338
Foreclosed property	$ —	$ 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, where available, 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 1.83% to 84.42%, with a weighted average of 28.40%.

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 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 5% to 12%.

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.

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.

The estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, and the level within the fair value hierarchy at which such assets and liabilities are measured on a recurring basis are as follows (in thousands):

December 31, 2014	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 212,994	$ 212,994	$ 212,994	$ —	$ —
Interest-bearing deposits in financial institutions	1,011	1,011	1,011	—	—
Securities available for sale	603,908	603,908	—	603,908	—
Securities held to maturity	252,370	268,264	—	89,552	178,712
Mortgage loans held for sale	71,390	71,390	—	71,390	—
Loans, net	3,361,349	3,442,719	—	—	3,442,719
Interest receivable	12,275	12,275	—	12,275	—
Deposits	3,846,602	3,460,829	—	3,460,829	—
Advances from the Federal Home Loan Bank of Atlanta	398,181	417,949	—	417,949	—
Repurchase agreements and other borrowings	31,893	31,895	—	31,895	—
Interest payable	2,410	2,410	—	2,410	—

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	56,821	56,821	—	56,821	—
Loans, net	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 18: 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 $59.62 million and $57.71 million in these partnerships were not included in the Consolidated Balance Sheets at December 31, 2014 and 2013, respectively. These limited partner interests had carrying values of $15.17 million and $16.45 million at December 31, 2014 and 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 $15.17 million and $16.45 million at December 31, 2014 and 2013, respectively. As of December 31, 2014, the Company has $4.67 million in funding commitments that are dependent on certain contractual milestones. For the 12-month period ended December 31, 2014, a tax benefit totaling $1.15 million, net of amortization of $2.08 million, was recognized as a component of income tax expense.

NOTE 19: INCOME TAXES

The provision for income taxes charged to operations is listed in the following chart (in thousands):

For the Year Ended December 31,	2014	2013	2012
Current income tax expense			
Federal	$ (18,778)	$ (19,332)	$ (12,094)
State	(547)	(444)	(466)
Total current tax expense	(19,325)	(19,776)	(12,560)
Deferred income tax (expense) benefit			
Federal	1,146	2,641	(1,404)
State	—	—	—
Total deferred income tax (expense) benefit	1,146	2,641	(1,404)
Income tax expense	$ (18,179)	$ (17,135)	$ (13,964)

Differences between income tax expense calculated at the statutory rate and shown on the Consolidated Statements of Income are summarized as follows (dollars in thousands):

	2014		2013		2012	
For the Year Ended December 31,	**$**	**Rate**	**$**	**Rate**	**$**	**Rate**
Federal income tax expense at statutory rate	$ (21,122)	(35.00)%	$ (20,614)	(35.00)%	$ (18,163)	(35.00)%
State income tax expense, net of federal benefit	(332)	(0.55)%	(289)	(0.49)%	(301)	(0.58)%
Tax advantaged income	2,760	4.57 %	2,443	4.15 %	2,768	5.33 %
Tax credits	222	0.37 %	2,140	3.63 %	2,229	4.30 %
LIHTC, net of amortization	1,152	1.91 %	—	—	—	—
Section 162(m) disallowance	(171)	(0.28)%	(349)	(0.59)%	(598)	(1.15)%
Merger and acquisition expense	(534)	(0.88)%	—	—	—	—
Other	(154)	(0.26)%	(466)	(0.79)%	101	0.19 %
Income tax expense	$ (18,179)	(30.12)%	$ (17,135)	(29.09)%	$ (13,964)	(26.91)%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management believes it is more likely than not that the Company will realize the benefits of the Company's deferred tax assets.

Significant components of deferred tax assets and deferred tax liabilities follow (in thousands):

Year Ended December 31,	**2014**	**2013**
Deferred tax assets:		
Allowance for loan losses	$ 12,571	$ 13,433
Stock-based compensation	1,147	1,386
Basis differences due to tax credits and partnerships	332	—
Other	3,706	3,818
Accrued expenses	1,248	1,769
Retirement plan	7,609	5,937
Unrealized loss on securities available for sale	—	131
Deferred compensation	5,765	5,567
Total deferred tax assets	32,378	32,041
Deferred tax liabilities:		
Depreciation	12,887	12,823
Noncompete and intangibles	1,895	1,321
Basis differences due to tax credits and partnerships	—	457
Unrealized gain on securities available for sale	713	—
Other	553	484
Total deferred tax liabilities	16,048	15,085
Net deferred tax assets	$ 16,330	$ 16,956

As of December 31, 2014 and December 31, 2013, the Company did not have any unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next 12 months. The Company recognizes interest and penalties related to unrecognized tax benefits as “Interest Expense” and “Other Expense,” respectively, and not as part of the tax provision. The Company did not recognize any interest expense or penalties for the years ended December 31, 2014, 2013, and 2012. Additionally, there were no interest or penalties accrued at December 31, 2014 or 2013. The Company is no longer subject to examination for federal and state purposes for tax years prior to 2011.

NOTE 20: ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the components of accumulated other comprehensive income (loss) at December 31, 2014, 2013, and 2012, and changes during the years 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 on Securities (a)	Defined Benefit Retirement Plan (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2011	$ 2,754	$ —	$ 2,754
Net change	(1,055)	(883)	(1,938)
Balance, December 31, 2012	1,699	(883)	816
Other comprehensive income (loss) before reclassifications, net of tax	(1,888)	626	(1,262)
Amounts reclassified from AOCI, net of tax	(55)	157	102
Net change	(1,943)	783	(1,160)
Balance, December 31, 2013	(244)	(100)	(344)
Other comprehensive income (loss) before reclassifications, net of tax	1,560	(778)	782
Amounts reclassified from AOCI, net of tax	9	11	20
Net change	1,569	(767)	802
Balance, December 31, 2014	$ 1,325	$ (867)	$ 458

(a) For additional information about securities, refer to Note 3.
(b) For additional information about retirement plans, refer to Note 12.

NOTE 21: LEGAL CONTINGENCIES

Various legal actions arise from time to time in the normal course of our business. There were no significant asserted claims or assessments at December 31, 2014. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2014.

NOTE 22: OTHER RELATED PARTY TRANSACTIONS

Loans are made to the Company’s executive officers and directors and their associates during the ordinary course of business. The aggregate amount of loans to such related parties totaled $218.21 million, $215.65 million, and $218.95 million as of December 31, 2014, 2013, and 2012, respectively. During 2014, new advances on all commitments to such parties totaled $138.97 million, adjustments to loans associated with related parties totaled $2.66 million, and repayments amounted to $138.41 million. Included in the loans to related parties, at December 31, 2014, we had $40.65 million in unfunded commitments to extend credit to such related parties.

The Company rents space for various financial centers from companies associated with its directors. Rent expense related to these leases was $2.38 million, $2.26 million, and $2.07 million for the years ended December 31, 2014, 2013, and 2012, respectively.

In the ordinary course of business, the Company acquired certain goods and services from companies associated with its directors, including purchases of automobiles, construction of Company-owned facilities, and maintenance and furnishing of Company facilities. Amounts paid to these companies during the years ended December 31, 2014, 2013, and 2012 approximated $0.77 million, $5.29 million, and $7.54 million, respectively.

NOTE 23: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2014 and 2013, is as follows (in thousands, except per share data):

2014	**Fourth**	**Third**	**Second**	**First**
Interest income	$ 43,843	$ 43,668	$ 43,165	$ 41,834
Interest expense	6,704	6,801	6,627	6,642
Provision for loan losses	(1)	996	(833)	330
Noninterest income	22,401	26,269	25,346	22,727
Net gain (loss) on investment securities	—	44	(62)	2
Noninterest expense	48,959	44,154	44,668	41,081
Income before income tax expense and noncontrolling interest	10,582	18,030	17,987	16,510
Income tax expense	2,798	5,044	5,432	4,905
Net income	7,784	12,986	12,555	11,605
Noncontrolling interest	(549)	(860)	(878)	(474)
Net income attributable to TowneBank	$ 7,235	$ 12,126	$ 11,677	$ 11,131
Net income per common share				
Basic	$ 0.20	$ 0.34	$ 0.33	$ 0.31
Diluted	$ 0.20	$ 0.34	$ 0.33	$ 0.31
Comprehensive income	$ 7,544	$ 12,818	$ 13,534	$ 11,837
Dividends	$ 0.11	$ 0.11	$ 0.11	$ 0.10

2013	**Fourth**	**Third**	**Second**	**First**
Interest income	$ 43,101	$ 42,695	$ 42,591	$ 41,903
Interest expense	6,645	6,543	6,514	6,693
Provision for loan losses	551	328	(202)	3,571
Noninterest income	18,711	22,988	24,463	23,755
Net gain (loss) on investment securities	66	150	(208)	604
Noninterest expense	41,000	43,379	43,817	40,596
Income before income tax expense and noncontrolling interest	13,682	15,583	16,717	15,402
Income tax expense	3,655	4,407	4,707	4,366
Net income	10,027	11,176	12,010	11,036
Noncontrolling interest	(353)	(758)	(811)	(564)
Net income attributable to TowneBank	$ 9,674	$ 10,418	$ 11,199	$ 10,472
Net income per common share				
Basic	$ 0.27	$ 0.28	$ 0.31	$ 0.29
Diluted	$ 0.27	$ 0.28	$ 0.31	$ 0.29
Comprehensive income	$ 10,267	$ 11,559	$ 10,180	$ 11,082
Dividends	$ 0.10	$ 0.10	$ 0.09	$ 0.09

NOTE 24: 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 Berkshire Hathaway HomeServices 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, 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.

Information about reportable segments and reconciliation of such information to the consolidated financial statements follows (dollars in thousands):

For the Year Ended December 31, 2014	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 143,999	$ 1,737	$ —	$ 145,736
Provision for loan losses	396	96	—	492
Net interest income after provision for loan losses	143,603	1,641	—	145,244
Residential mortgage banking income, net	(313)	27,492	—	27,179
Real estate brokerage and property management income, net	—	12,634	—	12,634
Insurance commissions and other title fees and income, net	—	1,516	33,042	34,558
Other noninterest income	20,059	1,413	886	22,358
Noninterest expense	107,162	35,546	22,255	164,963
Depreciation and amortization	9,386	1,937	2,578	13,901
Income before income tax, corporate allocation, and noncontrolling interest	46,801	7,213	9,095	63,109
Corporate allocation	(1,014)	575	439	—
Income before income tax provision and noncontrolling interest	47,815	6,638	8,656	63,109
Income tax provision	13,098	1,874	3,207	18,179
Net income	34,717	4,764	5,449	44,930
Noncontrolling interest	—	(2,056)	(705)	(2,761)
Net income attributable to TowneBank	$ 34,717	$ 2,708	$ 4,744	$ 42,169
Net income as percentage of total	82.33%	6.42%	11.25%	100.00%
Assets	$ 4,730,447	$ 145,274	$ 106,764	$ 4,982,485
Efficiency ratio	71.18%	83.68%	73.19%	73.77%

For the Year Ended December 31, 2013	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 141,543	$ 2,352	$ —	$ 143,895
Provision for loan losses	4,248	—	—	4,248
Net interest income after provision for loan losses	137,295	2,352	—	139,647
Residential mortgage banking income, net	(448)	29,425	—	28,977
Real estate brokerage and property management income, net	—	12,316	—	12,316
Insurance commissions and other title fees and income, net	—	1,921	26,401	28,322
Other noninterest income	18,463	1,416	1,034	20,913
Noninterest expense	100,411	36,651	19,228	156,290
Depreciation and amortization	8,727	1,665	2,110	12,502
Income before income tax, corporate allocation, and noncontrolling interest	46,172	9,114	6,097	61,383
Corporate allocation	(904)	568	336	—
Income before income tax provision and noncontrolling interest	47,076	8,546	5,761	61,383
Income tax provision	12,680	2,384	2,071	17,135
Net income	34,396	6,162	3,690	44,248
Noncontrolling interest	—	(2,099)	(387)	(2,486)
Net income attributable to TowneBank	$ 34,396	$ 4,063	$ 3,303	$ 41,762
Net income as percentage of total	82.36%	9.73%	7.91%	100.00%
Assets	$ 4,473,782	$ 118,150	$ 81,065	$ 4,672,997
Efficiency ratio	68.40%	80.78%	77.78%	72.00%

For the Year Ended December 31, 2012	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 141,517	$ 2,754	$ 13	$ 144,284
Provision for loan losses	16,155	—	—	16,155
Net interest income after provision for loan losses	125,362	2,754	13	128,129
Residential mortgage banking income, net	(548)	27,546	—	26,998
Real estate brokerage and property management income, net	—	11,515	—	11,515
Insurance commissions and other title fees and income, net	—	1,830	21,628	23,458
Other noninterest income	20,226	1,279	713	22,218
Noninterest expense	99,927	30,690	16,556	147,173
Depreciation and amortization	8,272	1,617	1,687	11,576
Income before income tax, corporate allocation, and noncontrolling interest	36,841	12,617	4,111	53,569
Corporate allocation	(565)	402	163	—
Income before income tax provision and noncontrolling interest	37,406	12,215	3,948	53,569
Income tax provision	8,468	3,995	1,501	13,964
Net income	28,938	8,220	2,447	39,605
Noncontrolling interest	—	(1,475)	(199)	(1,674)
Net income attributable to TowneBank	$ 28,938	$ 6,745	$ 2,248	$ 37,931
Net income as percentage of total	76.29%	17.78%	5.93%	100.00%
Assets	$ 4,140,727	$ 192,248	$ 72,948	$ 4,405,923
Efficiency ratio	67.12%	71.91%	81.61%	69.48%

The following table provides the change in net income and total assets for each segment, comparing the years ended December 31, 2014 and 2013 (dollars in thousands):

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 321	$ (1,355)	$ 1,441	$ 407
Net Income (%)	0.93%	(33.34)%	43.64%	0.98%
Total Assets ($)	$ 256,665	$ 27,124	$ 25,699	$ 309,488
Total Assets (%)	5.74%	22.96 %	31.70%	6.62%

NOTE 25: EARNINGS PER SHARE

The following chart summarizes information related to the computation of basic and diluted earnings per share (dollars in thousands, except per share data):

Year Ended December 31,	2014	2013	2012
Basic			
Net income, as reported	$ 42,169	$ 41,762	$ 37,931
Preferred stock dividends and accretion of discount	(765)	(4,227)	(6,226)
Net income available to common shareholders	$ 41,404	$ 37,535	$ 31,705
Average common shares outstanding	35,160,747	32,863,962	30,772,130
Basic earnings per common share	$ 1.18	$ 1.14	$ 1.03
Diluted			
Net income available to common shareholders	$ 41,404	$ 37,535	$ 31,705
Interest applicable to subordinated debt, net of tax (1)	—	—	154
Net income available to common shareholders, for diluted EPS	41,404	37,535	31,859
Average common shares outstanding	35,160,747	32,863,962	30,772,130
Effect of dilutive securities:			
Stock compensation plans, net of tax benefit (2)	48,333	56,326	52,025
Convertible subordinated debentures (3)	—	—	219,465
Average diluted shares outstanding	35,209,080	32,920,288	31,043,620
Diluted earnings per common share	$ 1.18	$ 1.14	$ 1.03

(1) Annualized interest on 8% convertible subordinated capital debentures (net of tax) is added to net income, since this interest would not be paid if the debentures were converted to common stock.
(2) Stock options and restricted stock shares totaling 140,172; 996; and 24,092 were excluded from the computation of diluted earnings per share during 2014, 2013, and 2012, respectively, because their inclusion would be antidilutive.
(3) Shares are assumed to have been converted since the beginning of the period.

On September 1, 2013, all outstanding shares of 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 Series A preferred stock were not included in the computation of diluted earnings per share because the effect was anti-dilutive for all periods presented in the table above.

In conjunction with the Company’s issuance of Series B Preferred Stock to the U.S. Treasury, the Company issued a 10-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 because the effect was anti-dilutive for the periods presented in the table above. On May 15, 2013, the Company repurchased the warrant from the U.S. Treasury 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.

On March 19, 2012, there was a mandatory conversion of TowneBank's $13.60 million of outstanding Series III notes into shares of TowneBank common stock.

NOTE 26: SUBSEQUENT EVENTS

Franklin Merger

On January 2, 2015, TowneBank completed its acquisition of Franklin Financial Corporation ("Franklin") in an all-stock transaction. As part of the merger, Franklin and Franklin Federal Savings Bank ("Franklin Bank"), a wholly-owned subsidiary of Franklin, merged with and into TowneBank.

In the merger with Franklin, each outstanding share of common stock of Franklin was converted into the right to receive 1.40 shares of TowneBank common stock. TowneBank issued an aggregate of 16.38 million shares of TowneBank common stock to Franklin stockholders. Based on the closing price of TowneBank's common stock on January 2, 2015 of $15.35 per share, the aggregate consideration paid to Franklin common stockholders and holders of equity awards to acquire Franklin common stock was approximately $261.32 million.

The integration of Franklin Bank's deposit system and the conversion of Franklin Bank's branches to TowneBank's operating platform were completed over the weekend of January 3-4, 2015. Franklin Bank had eight branches, which all re-opened on Monday January 5, 2015 as TowneBank branches.

The Franklin merger has been accounted for under the acquisition method of accounting. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the January 2, 2015 merger date. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The application of the acquisition method of accounting resulted in goodwill of approximately $64.18 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

The following table presents our pro forma results of operations for the periods presented as if the Franklin acquisition had been completed on January 1, 2013. The pro forma results of operations include the historical accounts of the Company and Franklin, and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The pro forma information is intended for informational purposes only and is not necessarily indicative of our future operating results or operating results that would have occurred had the Franklin acquisition been completed at the beginning of 2013. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions.

	Pro Forma for the Year Ended December 31,	
(in thousands)	2014	2013
Revenues (net interest income plus noninterest income)	$ 291,826	$ 270,672
Net income	$ 55,095	$ 53,852

Redemption of SBLF Preferred Stock

On January 7, 2015, the Company redeemed in full its $76.46 million of outstanding Series C Preferred Stock issued to the U.S. Treasury under the Small Business Lending Fund. The redemption price was $76.46 million plus accrued but unpaid dividends to the date of redemption.

TOWNEBANK
SHAREHOLDER INFORMATION

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 20, 2015, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

The Company's Common Stock is listed on the NASDAQ Global Select Market under the symbol TOWN. The following are the quarterly high and low closing sale prices of the Company's common stock for the periods indicated.

	2014		2013	
Quarter	**High**	**Low**	**High**	**Low**
First	$ 15.97	$ 14.41	$ 16.00	$ 14.40
Second	16.47	14.85	15.50	13.43
Third	16.46	13.58	17.13	14.05
Fourth	15.83	13.51	15.57	13.68

INVESTOR RELATIONS

Our Annual Report, Form 10-K, and other corporate publications are available to shareholders on request, without charge, by writing:

Mr. Clyde E. McFarland, Jr.
Senior Executive Vice President and Chief Financial Officer
TowneBank
6001 Harbour View Boulevard
Suffolk, Virginia 23435
757-638-6801
email: Clyde.McFarland@townebank.net

These reports are also available on our website at http://www.townebank.com/investor_relations.

INDEPENDENT AUDITORS

Dixon Hughes Goodman LLP
1400 Wells Fargo Center
440 Monticello Avenue
Norfolk, Virginia 23510

TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016-3572
800-866-1340

CORPORATE COUNSEL

LeClairRyan
999 Waterside Drive, Suite 2525
Norfolk, Virginia 23510

Troutman Sanders L.L.P.
222 Central Park Avenue, Suite 2000
Virginia Beach, Virginia 23462

Exhibit (14)

TOWNEBANK
CHIEF EXECUTIVE OFFICER, EXECUTIVE OFFICERS and SENIOR FINANCIAL OFFICERS
CODE OF ETHICAL CONDUCT

Preface

The honesty, integrity, and sound judgment of the Chief Executive Officer ("CEO"), executive and senior financial officers are fundamental to the reputation and success of TowneBank. While all employees, officers, and directors are required to adhere to the TowneBank ***Standards of Conduct***, the professional and ethical conduct of the CEO, executive and senior financial officers is essential to the proper function and success of TowneBank as a leading financial services provider.

The CEO, executive and senior financial officers hold an important and elevated role in corporate governance. These individuals are key members of the management team, who are uniquely capable and empowered to ensure that the interests of stakeholders (including shareholders, clients, employees, suppliers, and citizens of the communities in which TowneBank operates) are appropriately balanced, protected, and preserved. The CEO, executive and senior financial officers fulfill this responsibility by prescribing and enforcing the policies and procedures employed in TowneBank's financial operations.

Code of Ethical Conduct

General standards of ethical behavior

The CEO, executive and senior financial officers of TowneBank performing accounting, audit, financial management, or similar functions must:

- Act with honesty and integrity, avoiding actual or apparent conflicts of interest in personal and professional relationships.
- Provide colleagues with information that is accurate, complete, objective, relevant, timely, and understandable.
- Comply with applicable laws, rules, and regulations of federal, state, and local governments (both United States and foreign) and other appropriate private and public regulatory agencies.
- Act in good faith, with due care, competence, and diligence, without misrepresenting material facts or allowing independent judgment to be subordinated.
- Respect the confidentiality of information acquired in the course of employment.
- Share knowledge and maintain skills necessary and relevant to TowneBank's needs.

- Proactively promote ethical and honest behavior within the workplace.

- Assure responsible use of and control of all assets, resources, and information in possession of TowneBank.

- Keep management informed of financial information of importance, including departures from sound policy, practice and accounting norms.

Standards regarding financial records and reporting

The CEO, executive and senior financial officers of TowneBank performing accounting, audit, financial management, or similar functions must:

- Establish systems and procedures to ensure business transaction are recorded in accordance with Generally Accepted Accounting Principles, company policy and appropriate regulatory pronouncements and guidelines.

- Protect and maintain accounting records and information as required by applicable law, regulation, or regulatory guidelines.

- Inform the Board of Directors and the Audit Committee of any material information that affects the disclosures made by the Bank in its public filings.

- Report to the Board of Directors and the Audit Committee concerning (a) significant deficiencies in the design and operation of internal controls or (b) any fraud involving management or other employees with a significant role in the Bank's financial reporting, disclosures or internal controls.

The CEO, executive and senior financial officers are expected to adhere to both the TowneBank ***Standards of Conduct*** and the ***TowneBank Chief Executive Officer and Senior Financial Officers Code of Ethical Conduct*** at all times. The board of directors shall have the sole and absolute discretionary authority to approve any deviation or waiver from the ***Code of Ethical Conduct***. Any waiver and the grounds for such waiver for the CEO, executive or senior financial officer shall be promptly disclosed through a filing with the Federal Deposit Insurance Corporation on Form 8-K. Additionally, any change of this ***Code of Ethical Conduct*** shall be promptly disclosed to stockholders.

The policy is applicable to the Chief Executive Officer (CEO), Chief Financial Officer (CFO), Controller, Corporate Treasurer, Internal Audit members, any person Assistant Vice President and above in an Accounting/Financial position, Senior Financial Analyst, any Regulation O Executive Officers along with any person serving in an equivalent position regardless of whether or not they are designated as executive officers for Regulation O purposes, or any persons serving in equivalent positions within the Bank or any of its subsidiaries.

TOWNEBANK
CHIEF EXECUTIVE OFFICER, EXECUTIVE OFFICERS and SENIOR FINANCIAL OFFICERS
CODE OF ETHICAL CONDUCT

Please indicate that you have received, read and will abide by the ***TowneBank Chief Executive Officer, Executive Officer and Senior Financial Officers Code of Ethical Conduct*** by signing your name and dating the attached acknowledgment and returning it promptly to the Chairman and CEO of TowneBank.

ACKNOWLEDGMENT

I certify that I have received and read and that I will abide by the ***TowneBank Chief Executive Officer, Executive Officer and Senior Financial Officers Code of Ethical Conduct*** distributed to me on this ______________ day of ______________, 20___.

____
OFFICER

____
DATE

Exhibit (21)

Subsidiaries of TowneBank

Subsidiary	State of Incorporation
TowneBank Investment Corporation	Virginia
Towne Investments, LLC	Virginia
TowneBank Woodview Investment Co., LLC	Virginia
TowneBank Woodview Investment Co. II, LLC	Virginia
TowneBank Heritage Forest, LLC	Virginia
TowneBank Cromwell House Affordable Housing, LLC	Virginia
TowneBank Pavilion Place Affordable Housing, LLC	Virginia
TowneBank Westbury Cottages Affordable Housing, LLC	Virginia
Hamilton Place Towne I, LLC	Virginia
Hamilton Place Towne II, LLC	Virginia
TowneBank VCDC Fund 18, LLC	Virginia
Towne Financial Services Group, LLC	Virginia
GSH Residential Real Estate Corporation	Virginia
GSH NC Resort Management, LLC	Virginia
GSH NC Realty, LLC	Virginia
Towne Realty LLC, t/a Berkshire Hathaway HomeServices Towne Realty	Virginia
Lawyers Escrow & Title Agency, LLC	Virginia
Eastern Title Company, Inc.	Virginia
PTR Referral, LLC	Virginia
Berkshire Hathaway HomeServices Towne Realty at Stonehouse	Virginia
Towne Insurance Agency, LLC	Virginia
The Frieden Agency LLC, t/a TFA Benefits	Virginia
Benefit Design Group, LLC	Virginia
Beneflex Management, LLC	Virginia
Towne Insurance Agency of North Carolina, LLC	North Carolina
Out of Towne, LLC, t/a Red Sky Insurance	Virginia
Towne Vacations, LLC	Virginia
TowneBank Commercial Mortgage, LLC	Virginia
Towne Hall, LLC	Virginia
Towne 1031 Exchange, LLC	Virginia
Towne Security, LLC	Virginia
Towne Mortgage, LLC	Virginia
NewTowne Mortgage, LLC	Virginia
SimonTowne Mortgage, LLC	Virginia
Franklin Federal Mortgage Center, LLC	Virginia
Homesale Mortgage, LLC	Virginia
Southeastern Virginia Investment Properties, LLC	Virginia
Southeastern Virginia Properties Gateway I, LLC	Virginia
Southeastern Virginia Coastal Properties I, LLC	Virginia
Southeastern Virginia Properties, LLC	Virginia
Southeastern Virginia Properties at Uncles Neck, LLC	Virginia

Subsidiaries of TowneBank (continued)

Subsidiary	State of Incorporation
Towne Mortgage of the Carolinas, LLC	North Carolina
Northeastern North Carolina Properties, LLC	North Carolina
Northeastern North Carolina Properties at Bermuda Bay, LLC	North Carolina
Northeastern North Carolina Properties Bermuda Bay Development, LLC	North Carolina
Northeastern North Carolina Properties at Hamilton Cay, LLC	North Carolina
Northeastern North Carolina Properties at Heron's Ridge, LLC	North Carolina
Northeastern North Carolina Properties Corolla Soundside, LLC	North Carolina
Northeastern North Carolina Properties Oceanside Villas LLC	North Carolina
Virginia Hotel Properties, LLC	Virginia
Virginia Properties Apartment and Land, LLC	Virginia
CPF Partners, LLC	Virginia
Stonehouse Towne, LLC	Virginia
TBNCT, LLC	Virginia
TBVAT, LLC	Virginia
West Suffolk Properties, LLC	Virginia

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, G. Robert Aston, Jr., Chairman and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 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 its 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

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

5. The registrant's other certifying officer 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 (or person performing the equivalent functions):

   (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 controls over financial reporting.

March 13, 2015	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer

TowneBank

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Clyde E. McFarland, Jr., Senior Executive Vice President and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 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 its 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

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

5. The registrant's other certifying officer 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 (or person performing the equivalent functions):

   (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 controls over financial reporting.

March 13, 2015	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

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, each of the undersigned officers of TowneBank (the “Bank”), do hereby certify, to such officer’s knowledge, that:

1. Our Annual Report on Form 10-K for the year ended December 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 presents fairly, in all material respects, our financial condition and results of operations as of and for the period covered by the Report.

March 13, 2015	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive
March 13, 2015	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

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.