FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended June 30, 2015

FDIC Insurance Cert. Number: 35095

TOWNEBANK
(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

The number of shares of the Company's common stock outstanding as of July 31, 2015 was 51,550,832 shares.

TOWNEBANK

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(In thousands, except share data)	June 30, 2015	June 30, 2014	December 31, 2014
	(unaudited)	(unaudited)	(1)
ASSETS			
Cash and due from banks	$ 184,099	$ 268,012	$ 212,994
Interest-bearing deposits in financial institutions	1,011	1,011	1,011
Total Cash and Cash Equivalents	185,110	269,023	214,005
Securities available for sale, at fair value	759,425	549,177	603,908
Securities held to maturity, at amortized cost	80,195	88,148	85,247
Federal Home Loan Bank stock, at amortized cost	24,058	21,987	22,157
Total Securities	863,678	659,312	711,312
Mortgage loans held for sale	165,994	91,763	71,390
Loans, net of unearned income and deferred costs:			
Real estate - residential 1-4 family	948,138	828,832	837,370
Real estate - commercial	1,748,567	1,387,048	1,447,078
Real estate - construction and land development	554,053	487,613	452,481
Real estate - multifamily	137,378	55,620	51,472
Commercial and industrial business	732,936	658,839	700,623
Consumer and other loans	107,055	51,246	75,365
Loans, net of unearned income and deferred costs	4,228,127	3,469,198	3,564,389
Less: Allowance for loan losses	(37,290)	(35,786)	(35,917)
Net Loans	4,190,837	3,433,412	3,528,472
Premises and equipment, net	172,492	152,646	155,774
Goodwill	153,191	111,761	113,159
Other intangible assets, net	22,016	18,373	22,509
Bank-owned life insurance policies	146,729	57,779	58,716
Other assets	155,134	115,774	107,148
TOTAL ASSETS	$ 6,055,181	$ 4,909,843	$ 4,982,485
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 1,363,551	$ 1,203,040	$ 1,224,466
Interest-bearing:			
Demand and money market accounts	1,680,038	1,306,595	1,365,183
Savings	300,203	192,932	301,033
Certificates of deposit	1,342,860	1,093,262	955,920
Total Deposits	4,686,652	3,795,829	3,846,602
Advances from the Federal Home Loan Bank	437,584	394,620	398,181
Repurchase agreements and other borrowings	35,737	27,525	31,893
Total Borrowings	473,321	422,145	430,074
Other liabilities	92,317	87,057	87,533
TOTAL LIABILITIES	5,252,290	4,305,031	4,364,209
Shareholders' Equity			
Preferred stock: 2,000,000 shares authorized 0 shares issued at June 30, 2015 and 76,458 shares issued at June 30, 2014 and December 31, 2014	—	76,458	76,458
Common stock, $1.667 par: 90,000,000 shares authorized 51,551,312; 35,516,140; and 35,785,679 shares issued at June 30, 2015 and 2014 and December 31, 2014, respectively	85,936	59,205	59,655
Capital surplus	532,646	315,946	317,718
Retained earnings	175,145	143,519	154,655
Common stock issued to deferred compensation trust, at cost 651,738; 617,886; and 627,730 shares at June 30, 2015 and 2014 and December 31, 2014, respectively	(10,110)	(9,508)	(9,674)
Deferred compensation trust	10,110	9,508	9,674
Accumulated other comprehensive income	291	867	458
TOTAL SHAREHOLDERS' EQUITY	794,018	595,995	608,944
Noncontrolling interests	8,873	8,817	9,332
TOTAL EQUITY	802,891	604,812	618,276
TOTAL LIABILITIES AND EQUITY	$ 6,055,181	$ 4,909,843	$ 4,982,485

(1) As derived from the audited consolidated financial statements for December 31, 2014.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(Dollars in thousands, except per share data)	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
INTEREST INCOME:				
Loans, including fees	$ 48,170	$ 39,939	$ 95,511	$ 79,150
Investment securities	3,321	2,396	6,658	4,385
Interest-bearing deposits in financial institutions and federal funds sold	56	111	181	319
Mortgage loans held for sale	1,161	719	1,726	1,147
Total Interest Income	52,708	43,165	104,076	85,001
INTEREST EXPENSE:				
Deposits	4,442	3,295	8,866	6,638
Advances from the Federal Home Loan Bank	3,365	3,320	6,739	6,606
Repurchase agreements and other borrowings	17	12	31	27
Total Interest Expense	7,824	6,627	15,636	13,271
Net Interest Income	44,884	36,538	88,440	71,730
PROVISION FOR LOAN LOSSES	1,723	(833)	2,045	(503)
Net Interest Income after Provision for Loan Losses	43,161	37,371	86,395	72,233
NONINTEREST INCOME:				
Residential mortgage banking income, net	10,251	7,735	18,694	12,798
Real estate brokerage and property management income, net	4,584	3,248	8,539	6,539
Insurance commissions and other title fees and income, net	9,885	8,893	20,934	17,954
Service charges on deposit accounts	2,326	2,366	4,523	4,498
Credit card merchant fees, net	566	965	998	1,738
Other income	5,354	2,139	8,044	4,546
Net gain (loss) on investment securities	119	(62)	169	(60)
Total Noninterest Income	33,085	25,284	61,901	48,013
NONINTEREST EXPENSE:				
Salaries and employee benefits	26,544	25,325	54,223	48,721
Occupancy expense	4,856	4,393	9,786	8,569
Furniture and equipment	2,369	2,040	4,738	4,040
Other expenses	15,298	12,910	30,760	24,419
Total Noninterest Expense	49,067	44,668	99,507	85,749
Income before income tax expense and noncontrolling interest	27,179	17,987	48,789	34,497
Provision for income tax expense	8,201	5,432	14,586	10,337
Net income	18,978	12,555	34,203	24,160
Net income attributable to noncontrolling interest	(1,166)	(878)	(1,853)	(1,352)
Net income attributable to TowneBank	$ 17,812	$ 11,677	$ 32,350	$ 22,808
Preferred stock dividends	—	191	13	382
Net income available to common shareholders	$ 17,812	$ 11,486	$ 32,337	$ 22,426
Per common share information				
Basic earnings	$ 0.35	$ 0.33	$ 0.64	$ 0.64
Diluted earnings	$ 0.35	$ 0.33	$ 0.63	$ 0.64
Cash dividends declared	$ 0.12	$ 0.11	$ 0.23	$ 0.21

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

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

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$ 18,978	$ 12,555	$ 34,203	$ 24,160
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	(3,200)	1,445	(286)	1,804
Deferred tax expense	1,120	(506)	100	(632)
Realized gains reclassified into earnings	—	62	(49)	60
Deferred tax expense benefit	—	(22)	17	(21)
Net unrealized gains (losses)	(2,080)	979	(218)	1,211
Defined benefit retirement plan				
Amortization	18	—	78	—
Deferred tax expense	(6)	—	(27)	—
Change in defined benefit retirement plan, net of tax	12	—	51	—
Other comprehensive income (loss), net of tax	(2,068)	979	(167)	1,211
Comprehensive income	$ 16,910	$ 13,534	$ 34,036	$ 25,371

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

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

(Dollars in thousands)	Six Months Ended June 30,	
OPERATING ACTIVITIES:	**2015**	**2014**
Net income	$ 34,203	$ 24,160
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Net amortization of securities	1,596	1,599
Investment securities (gains) losses	(169)	60
Depreciation, amortization, and other intangible amortization	7,937	6,690
Provision for loan losses	2,045	(503)
Bank-owned life insurance income	(2,468)	(920)
Deferred income tax (benefit) expense	(1,678)	321
Share-based compensation expense	1,189	924
Originations of mortgage loans held for sale	(731,806)	(495,802)
Proceeds from sales of mortgage loans held for sale	662,890	478,899
Gain on sales of mortgage loans held for sale	(25,688)	(16,218)
Loss on sale and write-down of foreclosed assets	643	1,485
Changes in:		
Interest receivable	(2,750)	(306)
Other assets	(42,146)	(12,563)
Interest payable	129	(227)
Other liabilities	(6,106)	6,903
Net cash used for operating activities	(102,179)	(5,498)
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(165,847)	(252,321)
Purchase of held-to-maturity securities	—	(31,792)
Sale of available-for-sale securities	133,313	258
Sale of held-to-maturity securities	2,272	—
Sale of FHLB stock	8,113	1,082
Proceeds from maturities, calls, and prepayments of available-for-sale securities	96,110	246,714
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	2,770	2,685
Net increase in loans	(172,045)	(90,096)
Purchase of premises and equipment	(11,876)	(4,519)
Proceeds from sales of premises and equipment	122	99
Proceeds from sales of foreclosed assets	11,978	5,682
Cash acquired in acquisitions of business, net of cash consideration paid	248,766	(6,098)
Net cash from (used for) investing activities	153,676	(128,306)
FINANCING ACTIVITIES:		
Net change in deposit accounts	157,104	228,725
Net change in borrowings	(148,232)	(21,028)
Redemption of preferred stock	(76,458)	—
Distribution of interest in joint ventures	(2,311)	(1,545)
Proceeds from (payments for) issuance of common stock	1,365	(302)
Cash dividends paid	(11,860)	(7,816)
Net cash from (used for) financing activities	(80,392)	198,034
Change in cash and cash equivalents	(28,895)	64,230
Cash and cash equivalents at beginning of year	214,005	204,793
Cash and cash equivalents at end of period	$ 185,110	$ 269,023
Supplemental cash flow information:		
Cash paid for interest	$ 15,507	$ 13,497
Cash paid for income taxes	$ 9,386	$ 6,930
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	$ 4,863	$ 9,741
Sales of foreclosed assets financed by the Company	$ 1,413	$ 1,209
Net unrealized gains (losses) on available-for-sale securities, net of tax	$ (218)	$ 1,211
Shares issued for business acquisitions	$ 238,656	$ 2,771
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ —	$ 90

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENT OF EQUITY

(Dollars in thousands)	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total
Balance, January 1, 2015	**35,785,679**	**$ 76,458**	**$ 59,655**	**$ 317,718**	**$ 154,655**	**$ 9,674**	**$ (9,674)**	**$ 458**	**$ 9,332**	**$ 618,276**
Net income	—	—	—	—	32,350	—	—	—	1,853	34,203
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(167)	—	(167)
Cash dividends declared on common stock	—	—	—	—	(11,847)	—	—	—	—	(11,847)
Cash dividends declared on preferred stock	—	—	—	—	(13)	—	—	—	—	(13)
Director's deferred compensation	—	—	—	—	—	436	(436)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	—	(2,312)	(2,312)
Redemption of preferred stock	—	(76,458)	—	—	—	—	—	—	—	(76,458)
Issuance of common stock - contingent consideration earned on acquisitions	102,851	—	171	1,468	—	—	—	—	—	1,639
Issuance of common stock - acquisitions	15,547,462	—	25,916	212,740	—	—	—	—	—	238,656
Issuance of common stock - stock compensation plans	115,320	—	194	720	—	—	—	—	—	914
Balance, June 30, 2015	**51,551,312**	**$ —**	**$ 85,936**	**$ 532,646**	**$ 175,145**	**$ 10,110**	**$ (10,110)**	**$ 291**	**$ 8,873**	**$ 802,891**

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

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

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of TowneBank (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes necessary for a complete presentation of financial position, results of operations and cash flow activity required in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments, which are of a normal, recurring nature, that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01 of the Securities and Exchange Commission (the "SEC"). These statements should be read in conjunction with the Company's 2014 audited Consolidated Financial Statements and the 2014 Annual Report on Form 10-K. Results of operations for the period ended June 30, 2015 are not necessarily indicative of the results of operations for the full year or any other interim periods.

Reclassifications and corrections

To maintain consistency and comparability, certain amounts from prior periods have been reclassified to conform to current period presentation. In order to better reflect the Company's view of the business and credit characteristics of the instruments, a reclassification of industrial revenue bonds ("IRB") from investment securities to loans held for investment was made during second quarter 2015. Because there was no allowance for loan loss previously associated with the IRBs, the Company recorded a provision for loan loss of $0.80 million in second quarter 2015. Additionally, all prior period amounts presented were reclassified as shown in the following schedule:

	June 30, 2015			December 31,2014		
(in thousands)	Prior to Revision	Revision	As Presented	As Previously Presented	Revision	Subsequent to Revision
Securities held to maturity, at amortized cost	$ 254,702	$ (174,507)	$ 80,195	$ 252,370	$ (167,123)	$ 85,247
Loans, net of unearned income and deferred costs:	$ 4,053,620	$ 174,507	$ 4,228,127	$ 3,397,266	$ 167,123	$ 3,564,389
Allowance for loan losses	(36,486)	(804)	(37,290)	(35,917)	—	(35,917)
Net loans	$ 4,017,134	$ 173,703	$ 4,190,837	$ 3,361,349	$ 167,123	$ 3,528,472

	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
	Prior to Revision	Revision	As Presented	Prior to Revision	Revision	Subsequent to Revision
INTEREST INCOME:						
Loans, including fees	$ 46,941	$ 1,229	$ 48,170	$ 93,087	$ 2,424	$ 95,511
Investment securities	$ 4,550	$ (1,229)	$ 3,321	$ 9,082	$ (2,424)	$ 6,658
Provision for loan losses	$ 919	$ 804	$ 1,723	$ 1,241	$ 804	$ 2,045

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

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Prior to Revision	Revision	As Presented	As Previously Presented	Revision	Subsequent to Revision
INTEREST INCOME:						
Loans, including fees	$ 38,941	$ 998	$ 39,939	$ 77,149	$ 2,001	$ 79,150
Investment securities	$ 3,394	$ (998)	$ 2,396	$ 6,386	$ (2,001)	$ 4,385
Provision for loan losses	$ (833)	$ —	$ (833)	$ (503)	$ —	$ (503)

Recent accounting pronouncements

In January 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("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. The ASU was adopted prospectively, as the retrospective adjustments were not material.

In January 2014, the FASB issued 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 did not 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 U.S. 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, 2017, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. The Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures.

In February 2015, the FASB issued ASU No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis.* The ASU changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments include: (1) modifying the evaluation of limited partnerships and similar legal entities, (2) amending when fees paid to a decision maker should be included in the variable interest entity analysis, (3) amending the related party relationship guidance, and (4) providing a scope exception from the consolidation guidance for reporting entities with interests in certain investment funds. The ASU is effective for interim and annual reporting periods beginning after December 15, 2015, although early adoption is permitted. The Company is currently assessing the impact of adoption of ASU 2015-02.

Note 2. Earnings per Share and Shareholders' Equity

Earnings per share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share are determined by dividing net income available to common shareholders by the weighted average number of common shares outstanding, assuming all securities that could be converted to common stock have been converted or exercised.

The following table summarizes basic and diluted earnings per share calculations for the periods indicated (dollars in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	**2014**	**2015**	**2014**
Basic				
Net income, as reported	$ 17,812	$ 11,677	$ 32,350	$ 22,808
Preferred stock dividends	—	191	13	382
Net income available to common shareholders	$ 17,812	$ 11,486	$ 32,337	$ 22,426
Weighted-average common shares outstanding	51,089,051	35,207,989	50,876,552	35,108,273
Basic earnings per share amount	$ 0.35	$ 0.33	$ 0.64	$ 0.64
Diluted				
Net income available to common shareholders, for diluted EPS	$ 17,812	$ 11,486	$ 32,337	$ 22,426
Weighted-average common shares outstanding	51,089,051	35,207,989	50,876,552	35,108,273
Add shares if converted:				
Stock compensation plans, net of tax benefit (1)	62,461	29,883	59,857	51,255
Weighted-average diluted shares outstanding	51,151,512	35,237,872	50,936,409	35,159,528
Diluted earnings per share amount	$ 0.35	$ 0.33	$ 0.63	$ 0.64

(1) Stock options and restricted stock shares totaling 24,305 and 2,574 were excluded from the computation of diluted earnings per share during the second quarter of 2015 and 2014, respectively, 43,356 and 2,955 were excluded from the computation of diluted earnings per share during the six months ended June 30, 2015 and 2014, respectively, because their inclusion would be anti-dilutive.

On January 7, 2015, the Company redeemed in full its $76.46 million of outstanding Non-Cumulative Convertible Preferred Stock, Series C 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.

Note 3. Investment Securities

Available-for-sale securities

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

June 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 514,696	$ 876	$ (308)	$ 515,264
Municipal securities	19,257	478	(32)	19,703
Trust preferred and other corporate securities	7,740	629	(1)	8,368
Mortgage-backed securities issued by GSE	216,030	1,038	(978)	216,090
Total available-for-sale securities	$ 757,723	$ 3,021	$ (1,319)	$ 759,425

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

Held-to-maturity securities

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

June 30, 2015	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Trust preferred corporate securities	$ 500	$ 202	$ —	$ 702
Municipal securities	52,768	2,744	—	55,512
Mortgage-backed securities issued by GSE	26,927	152	(118)	26,961
Total held-to-maturity securities	$ 80,195	$ 3,098	$ (118)	$ 83,175

December 31, 2014	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Trust preferred corporate securities	$ 500	$ 222	$ —	$ 722
Municipal securities	56,924	3,965	—	60,889
Mortgage-backed securities issued by GSE	27,823	134	(15)	27,942
Total held-to-maturity securities	$ 85,247	$ 4,321	$ (15)	$ 89,553

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) as of June 30, 2015 and December 31, 2014 in the following table (in thousands):

June 30, 2015	**Available for Sale**		**Held to Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 98,999	$ 99,146	$ —	$ —
Due after one year through five years	399,764	400,316	2,087	2,246
Due after five years through 10 years	73,749	73,969	46,844	47,405
Due after 10 years	183,763	184,546	31,264	33,524
	756,275	757,977	80,195	83,175
Other equity securities	1,448	1,448	—	—
	$ 757,723	$ 759,425	$ 80,195	$ 83,175

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	2,100	2,273
Due after five years through 10 years	38,121	38,570	48,415	49,465
Due after 10 years	36,763	38,641	34,732	37,815
	600,477	602,515	85,247	89,553
Other equity securities	1,393	1,393	—	—
	$ 601,870	$ 603,908	$ 85,247	$ 89,553

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Unrealized losses

The following table shows the Company's gross unrealized losses and fair values of available-for-sale and held-to-maturity securities, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	**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	$ 98,195	$ (301)	$ 9,885	$ (7)	$ 108,080	$ (308)
Municipal securities	4,999	(20)	1,305	(12)	6,304	(32)
Mortgage-backed securities issued by GSE	101,669	(1,096)	—	—	101,669	(1,096)
Corporate Obligations	1,994	(1)	—	—	1,994	(1)
Total temporarily impaired securities	$ 206,857	$ (1,418)	$ 11,190	$ (19)	$ 218,047	$ (1,437)

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)
Mortgage-backed securities issued by GSE	7,330	(17)	—	—	7,330	(17)
Total temporarily impaired securities	$ 188,750	$ (302)	$ 74,100	$ (450)	$ 262,850	$ (752)

U.S. government agency securities

The Company's unrealized losses on obligations of U.S. government agencies were caused by interest rate fluctuations. At June 30, 2015, eight securities had unrealized losses of $0.31 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At June 30, 2015, five securities had unrealized losses of $0.03 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At June 30, 2015, 21 securities had unrealized losses of $1.10 million. The severity and duration of the unrealized loss will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider this investment other than temporarily impaired.

Trust preferred and other corporate securities

The Company's unrealized losses on corporate securities were caused by interest rate fluctuations. At June 30, 2015, two corporate securities had unrealized losses of $1,000. 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.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at June 30, 2015.

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 $24.06 million and $22.16 million of FHLB stock at June 30, 2015, and December 31, 2014, 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.

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Note 4. Loans and Allowance for Loan Losses

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

Allowance for loan losses

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company considers the allowance for loan losses of $37.29 million adequate to cover estimated loan losses inherent in the loan portfolio at June 30, 2015.

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three- and six-month periods ended June 30, 2015 and 2014 (in thousands):

Three Months Ended June 30, 2015	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 5,547	$ 14,927	$ 700	$ 8,543	$ 4,658	$ 1,532	$ 35,907
Provision for loan losses	25	(240)	52	622	821	443	1,723
Losses charged off	(115)	(104)	—	(342)	(112)	(23)	(696)
Recoveries	52	56	—	139	87	22	356
Balance, end of period	$ 5,509	$ 14,639	$ 752	$ 8,962	$ 5,454	$ 1,974	$ 37,290
Six Months Ended June 30, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
Provision for loan losses	(40)	622	85	262	436	680	2,045
Losses charged off	(166)	(278)	—	(689)	(117)	(36)	(1,286)
Recoveries	54	69	—	268	172	51	614
Balance, end of period	$ 5,509	$ 14,639	$ 752	$ 8,962	$ 5,454	$ 1,974	$ 37,290

Three Months Ended June 30, 2014	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 7,768	$ 13,922	$ 524	$ 10,168	$ 4,411	$ 750	$ 37,543
Provision charged to expense	(1,033)	514	47	(658)	219	78	(833)
Losses charged off	(59)	(558)	—	(404)	(95)	(30)	(1,146)
Recoveries	10	7	—	162	25	18	222
Balance, end of period	$ 6,686	$ 13,885	$ 571	$ 9,268	$ 4,560	$ 816	$ 35,786
Six Months Ended June 30, 2014							
Allowance for loan losses:							
Balance, beginning of year	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380
Provision charged to expense	(986)	897	(128)	(573)	16	271	(503)
Losses charged off	(285)	(944)	(1)	(1,111)	(237)	(194)	(2,772)
Recoveries	32	311	1	222	70	45	681
Balance, end of period	$ 6,686	$ 13,885	$ 571	$ 9,268	$ 4,560	$ 816	$ 35,786

The following table presents, by portfolio segment, the allocation of the allowance for loan losses at June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	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	$ 463	$ 873	$ 20	$ 980	$ 87	$ 1	$ 2,424
Loans collectively evaluated for impairment	5,046	13,766	732	7,982	5,367	1,973	34,866
Balance, end of period	$ 5,509	$ 14,639	$ 752	$ 8,962	$ 5,454	$ 1,974	$ 37,290
December 31, 2014							
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

The following table presents, by portfolio segment, the Company's investment in loans at June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	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	$ 10,280	$ 14,487	$ 751	$ 13,095	$ 524	$ 33	$ 39,170
Ending balance: collectively evaluated for impairment	534,810	1,691,203	120,438	902,720	732,412	107,022	4,088,605
Ending balance: loans acquired with deteriorated credit quality	8,963	42,877	16,189	32,323	—	—	100,352
Ending Balance	$ 554,053	$1,748,567	$ 137,378	$ 948,138	$ 732,936	$ 107,055	$4,228,127

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	699,110	75,324	3,512,099
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	$ 700,623	$ 75,365	$3,564,389

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.

The following table presents the changes in the accretable yield for purchased impaired loans for the six months ended June 30, 2015 and 2014 (in thousands):

	June 30,	
	2015	2014
Balance at beginning of period	$ 2,107	$ 2,800
Additions	42,648	—
Accretion	(3,659)	(350)
Reclassifications from nonaccretable balance, net	3,182	—
Other changes, net	292	—
Balance at end of period	$ 44,570	$ 2,450

At June 30, 2015, 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.

Portfolio quality indicators

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

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 table represents credit exposures by internally assigned grades as of June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	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	$ 527,215	$ 1,707,987	$ 132,980	$ 927,061	$ 724,281	$ 106,902	$ 4,126,426
Special Mention	822	18,419	3,647	3,261	5,035	54	31,238
Substandard	26,016	22,161	751	17,717	3,620	99	70,364
Doubtful	—	—	—	99	—	—	99
Total	$ 554,053	$ 1,748,567	$ 137,378	$ 948,138	$ 732,936	$ 107,055	$ 4,228,127

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	$ 695,733	$ 75,313	$ 3,478,599
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	$ 700,623	$ 75,365	$ 3,564,389

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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 June 30, 2015 and 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):

June 30, 2015	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 215	$ 516	$ 5,872	$ 1,263	$ 7,866	$ 546,187	$ 554,053	$ —
Commercial real estate	1,034	778	—	1,450	3,262	1,745,305	1,748,567	—
Multifamily real estate	—	—	—	751	751	136,627	137,378	—
1-4 family residential real estate	1,521	933	2,224	3,703	8,381	939,757	948,138	277
Commercial and industrial business loans	142	—	—	288	430	732,506	732,936	—
Consumer loans and other	141	3	—	—	144	106,911	107,055	—
Total	$ 3,053	$ 2,230	$ 8,096	$ 7,455	$ 20,834	$4,207,293	$ 4,228,127	$ 277

December 31, 2014	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 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	700,006	700,623	—
Consumer loans and other	61	—	—	—	61	75,304	75,365	—
Total	$ 9,144	$ 4,292	$ 12	$ 6,741	$ 20,189	$3,544,200	$ 3,564,389	$ 12

The following table includes an aging analysis of the recorded investment of purchased impaired loans as of June 30, 2015, included in the table above (in thousands):

	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
June 30, 2015						
Construction and land development	$ —	$ 517	$ 5,872	$ 6,389	$ 2,574	$ 8,963
Commercial real estate	—	46	—	46	42,831	42,877
Multifamily real estate	—	—	—	—	16,189	16,189
1-4 family residential real estate	—	735	1,947	2,682	29,641	32,323
Commercial and industrial business loans	—	—	—	—	—	—
Consumer loans and other	—	—	—	—	—	—
Total	$ —	$ 1,298	$ 7,819	$ 9,117	$ 91,235	$ 100,352

Impaired loans

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

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

Unearned loan income was $2.68 million in excess of deferred loan costs at June 30, 2015, $2.52 million at June 30, 2014, and $2.57 million at December 31, 2014. There were $7.46 million, $7.50 million, and $6.74 million in nonaccrual loans at June 30, 2015, June 30, 2014, and December 31, 2014, respectively. The Company would have earned $0.03 million in the second quarter of 2015 if interest on the loans had been accrued.

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The following tables include the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable, as of June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	QTD Interest Income Recognized	YTD Interest Income Recognized
Loans without a specific valuation allowance						
Construction and land development	$ 8,643	$ 8,627	$ —	$ 8,737	$ 106	$ 211
Commercial real estate	7,854	7,838	—	7,879	98	177
Multi-family real estate	755	751	—	757	4	12
1-4 family residential real estate	4,585	4,308	—	4,615	48	97
Commercial and industrial business loans	274	161	—	260	9	9
Consumer loans and other	27	27	—	30	—	1
Total	$ 22,138	$ 21,712	$ —	$ 22,278	$ 265	$ 507
Loans with a specific valuation allowance						
Construction and land development	$ 2,087	$ 1,653	$ 463	$ 2,422	$ 22	$ 28
Commercial real estate	7,133	6,649	871	7,152	89	154
Multi-family real estate	—	—	—	—	—	—
1-4 family residential real estate	8,972	8,787	980	9,027	112	199
Commercial and industrial business loans	426	363	109	439	5	10
Consumer loans and other	6	6	1	7	—	—
Total	$ 18,624	$ 17,458	$ 2,424	$ 19,047	$ 228	$ 391
Total impaired loans						
Construction and land development	$ 10,730	$ 10,280	$ 463	$ 11,159	$ 128	$ 239
Commercial real estate	14,987	14,487	871	15,031	187	331
Multi-family real estate	755	751	—	757	4	12
1-4 family residential real estate	13,557	13,095	980	13,642	160	296
Commercial and industrial business loans	700	524	109	699	14	19
Consumer loans and other	33	33	1	37	—	1
Total	$ 40,762	$ 39,170	$ 2,424	$ 41,325	$ 493	$ 898

Note: Included in the table above are accruing TDRs of $31.71 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $1.40 million.

December 31, 2014	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 9,288	$ 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
Multifamily real estate	—	—	—	—	—
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
Multifamily real estate	—	—	—	—	—
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

Note: 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.

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. All restructured loans are considered impaired in the calendar year of restructuring. Effective January 1, 2015, the Company adopted a policy stating that in subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months. The adoption of this policy resulted in a reduction of $4.74 million in loans designated as TDR and impaired.

The following table shows the loans modified in TDRs for the three and six months ended June 30, 2015 and 2014 (in thousands, except number of loans):

	Three Months Ended June 30, 2015			Six Months Ended June 30, 2015		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
1-4 family residential real estate	1	$ 82	$ 82	2	$ 183	$ 183
Consumer loans and other	1	3	3	1	3	3
Total	2	$ 85	$ 85	3	$ 186	$ 186

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial and industrial	1	$ 106	$ 106	1	$ 106	$ 106
Consumer loans and other	—	—	—	1	32	32
Total	1	$ 106	$ 106	2	$ 138	$ 138

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 loan that was restructured within the last 12 months that subsequently defaulted; a personal loan in the amount 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 June 30, 2015, all significant impaired loans have been determined to be collateral-dependent.

Nonaccrual loans

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

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

The table below presents a summary of the activity related to OREO for the three and six months ended June 30, 2015 and 2014 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Beginning balance	$ 51,698	$ 41,510	$ 35,115	$ 39,534
Additions	5,621	5,677	10,118	11,246
Additions from Franklin Merger	—	—	14,955	—
Sales	(11,194)	(3,342)	(13,391)	(6,891)
Valuation allowance	—	(1,226)	(186)	(1,526)
Gain (loss) on sale and write-downs, net	29	(215)	(457)	41
Ending balance	$ 46,154	$ 42,404	$ 46,154	$ 42,404

As of June 30, 2015, the Company's recorded investment in OREO collateralized by residential real estate was $12.58 million. As of June 30, 2015, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $0.48 million.

Note 6. Segment Reporting

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina and includes the operations of TowneBank Commercial Mortgage, LLC and Towne Investment Group. The Realty segment combines the operations of Berkshire Hathaway HomeServices Towne Realty with TowneBank Mortgage: Virginia Home Title and Settlements, LLC; SimonTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; NewTowne Mortgage, LLC; Homesale Mortgage, LLC; and Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head, 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, 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.

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

Three Months Ended June 30, 2015	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 44,074	$ 810	$ —	$ 44,884
Provision for loan losses	1,723	—	—	1,723
Net interest income after provision for loan losses	42,351	810	—	43,161
Residential mortgage banking income, net	(206)	10,457	—	10,251
Real estate brokerage and property management income, net	—	4,584	—	4,584
Insurance commissions and other title fees and income, net	—	459	9,426	9,885
Other noninterest income	6,411	1,772	182	8,365
Noninterest expense	30,676	10,988	7,403	49,067
Income before income tax, corporate allocation and noncontrolling interest	17,880	7,094	2,205	27,179
Corporate allocation	315	(133)	(182)	—
Income before income tax provision and noncontrolling interest	18,195	6,961	2,023	27,179
Provision for income tax expense	5,128	2,378	695	8,201
Net income	13,067	4,583	1,328	18,978
Noncontrolling interest	—	(856)	(310)	(1,166)
Net income attributable to TowneBank	$ 13,067	$ 3,727	$ 1,018	$ 17,812
Net income as percentage of total	73.36%	20.92%	5.72%	100.00%
Total assets	$ 5,693,865	$ 251,454	$ 109,862	$ 6,055,181

Three Months Ended June 30, 2014	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 36,050	$ 488	$ —	$ 36,538
Provision for loan losses	(866)	33	—	(833)
Net interest income after provision for loan losses	36,916	455	—	37,371
Residential mortgage banking income, net	(82)	7,817	—	7,735
Real estate brokerage and property management income, net	—	3,248	—	3,248
Insurance commissions and other title fees and income, net	—	414	8,479	8,893
Other noninterest income	4,864	333	211	5,408
Noninterest expense	29,303	9,134	6,231	44,668
Income before income tax, corporate allocation and noncontrolling interest	12,395	3,133	2,459	17,987
Corporate allocation	252	(145)	(107)	—
Income before income tax provision and noncontrolling interest	12,647	2,988	2,352	17,987
Provision for income tax expense	3,728	875	829	5,432
Net income	8,919	2,113	1,523	12,555
Noncontrolling interest	—	(679)	(199)	(878)
Net income attributable to TowneBank	$ 8,919	$ 1,434	$ 1,324	$ 11,677
Net income as percentage of total	76.38%	12.28%	11.34%	100.00%
Total assets	$ 4,655,744	$ 154,081	$ 100,018	$ 4,909,843

Six Months Ended June 30, 2015	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 87,258	$ 1,182	$ —	$ 88,440
Provision for loan losses	2,045	—	—	2,045
Net interest income after provision for loan losses	85,213	1,182	—	86,395
Residential mortgage banking income, net	(277)	18,971	—	18,694
Real estate brokerage and property management income, net	—	8,539	—	8,539
Insurance commissions and other title fees and income, net	—	760	20,174	20,934
Other noninterest income	11,308	2,063	363	13,734
Noninterest expense	63,419	21,425	14,663	99,507
Income before income tax, corporate allocation and noncontrolling interest	32,825	10,090	5,874	48,789
Corporate allocation	608	(265)	(343)	—
Income before income tax provision and noncontrolling interest	33,433	9,825	5,531	48,789
Provision for income tax expense	9,256	3,339	1,991	14,586
Net income	24,177	6,486	3,540	34,203
Noncontrolling interest	—	(1,112)	(741)	(1,853)
Net income attributable to TowneBank	$ 24,177	$ 5,374	$ 2,799	$ 32,350
Net income as percentage of total	74.74%	16.61%	8.65%	100%
Total assets	$ 5,693,865	$ 251,454	$ 109,862	$ 6,055,181

Six Months Ended June 30, 2014	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 70,955	$ 775	$ —	$ 71,730
Provision for loan losses	(560)	57	—	(503)
Net interest income after provision for loan losses	71,515	718	—	72,233
Residential mortgage banking income, net	(137)	12,935	—	12,798
Real estate brokerage and property management income, net	—	6,539	—	6,539
Insurance commissions and other title fees and income, net	—	759	17,195	17,954
Other noninterest income	9,604	614	504	10,722
Noninterest expense	56,149	18,056	11,544	85,749
Income before income tax, corporate allocation and noncontrolling interest	24,833	3,509	6,155	34,497
Corporate allocation	505	(293)	(212)	—
Income before income tax provision and noncontrolling interest	25,338	3,216	5,943	34,497
Provision for income tax expense	7,382	917	2,038	10,337
Net income	17,956	2,299	3,905	24,160
Noncontrolling interest	—	(891)	(461)	(1,352)
Net income attributable to TowneBank	$ 17,956	$ 1,408	$ 3,444	$ 22,808
Net income as percentage of total	78.73%	6.17%	15.10%	100.00%
Total assets	$ 4,655,744	$ 154,081	$ 100,018	$ 4,909,843

Note 7. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At June 30, 2015, the amounts of off-balance sheet commitments to extend credit were $1.50 billion.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At June 30, 2015, standby letters of credit and financial guarantees were $36.23 million.

Additionally, the Company had $18.58 million in mortgage loans sold to investors with various recourse and warranty provisions as of June 30, 2015.

Rate lock commitments, which are designed to mitigate the Company's exposure to fluctuations in interest rates associated with rate lock commitments and loans held for sale, are related to the origination of mortgage loans held for sale and the corresponding loan sale commitments and are considered derivative instruments. Outstanding loan balances under these rate lock commitments totaled $126.20 million at

June 30, 2015. The income statement impact associated with these instruments is recorded as an increase in net residential mortgage banking income in the amount of $0.22 million and $1.25 million for the three- and six-month periods ended June 30, 2015, respectively. In 2014, the income statement impact associated with these instruments was recorded as an increase in net residential mortgage banking income in the amount of $0.56 million and $0.74 million for the three- and six-month periods ended June 30, 2014, respectively.

Note 8. Mergers and Acquisitions

Franklin Financial Corporation: Effective 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 15.55 million shares of TowneBank common stock to Franklin stockholders and cash of $9.90 million to holders of equity awards. 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 $248.56 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 in accordance with Accounting Standards Codification Topic ("ASC") 805, *Business Combinations*. 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 $41.52 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

The following table presents the estimated fair values of the assets acquired and liabilities assumed for Franklin as of January 2, 2015 (dollars in thousands):

Fair value of assets acquired:		
Cash and cash equivalents	$	260,559
Securities available for sale		222,539
Net loans		492,366
Bank premise and equipment		11,254
OREO, net of valuation allowance		14,955
Core deposit intangible		17
Other assets		89,574
Total assets	$	1,091,264
Fair value of liabilities assumed:		
Deposits	$	682,947
Long-term borrowings		191,478
Other liabilities		9,800
Total liabilities	$	884,225
Net identifiable assets acquired	$	207,039
Goodwill		41,517
Net assets acquired	$	248,556
Purchase Price:		
Company common shares issued		15,547,627
Purchase price per share of Company's common stock	$	15.35
Common stock issued and cash exchanged for fractional shares	$	238,656
Cash consideration for stock options paid		9,900
Fair value of total consideration transferred	$	248,556

The Company assumed long-term borrowings of $191.48 million in the form of FHLB advances. On January 5, 2015, the Company repaid the advances in full.

The loans acquired in the Franklin merger were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 (purchased impaired), and loans that do not meet this criteria, which are accounted for under ASC 310-20 (purchased performing). As of January 2, 2015, the fair value of the Franklin purchased performing loans acquired was $390.78 million, the related gross contractual amount was $557.82 million, and the estimated contractual cash flows not expected to be collected were $15.27 million.

The following table presents the acquired impaired loans receivable at the acquisition date (dollars in thousands):

Contractual principal and interest at acquisition	$ 177,615
Nonaccretable difference	(33,439)
Expected cash flows at acquisition	144,176
Accretable yield	(42,648)
Fair value of loans acquired with a deterioration of credit quality	$ 101,528

The following table presents unaudited pro forma results of operations for the periods presented as if the Franklin acquisition had been completed on January 1, 2014. 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 2014. 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 Three Months Ended June 30,		Pro Forma for the Six Months Ended June 30,	
(in thousands)	2015	2014	2015	2014
Revenues (net interest income plus noninterest income)	$ 77,897	$ 71,533	$ 150,462	$ 141,192
Net income	$ 17,540	$ 15,023	$ 32,105	$ 31,186

Insurance Agencies: Effective February 1, 2015, the Company acquired two insurance agencies, Lackey-Saunders Co., Inc. and Gloucester-Southside Insurance Agency, Inc., which were merged with the operations of 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, 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 February 1, 2015. The total purchase price for the transactions was $2.89 million in cash and contingent consideration. The allocation of the purchase price resulted in tangible assets of $0.24 million, goodwill of $2.04 million, other intangible assets, including customer lists of $0.78 million, and assumed liabilities of $0.17 million.

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, 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. The acquisition was accounted for as a business combination under the acquisition method of accounting, 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 May 1, 2014. The total purchase price for the transactions 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.

Note 9. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 7 – Goodwill and Intangible Assets* of the 2014 Annual Report to the Stockholders for more information on the Company's goodwill and other intangibles. The following table presents the gross carrying amount and accumulated amortization for the Company's intangible assets as of the dates indicated (in thousands):

	June 30,					
	2015		2014		December 31, 2014	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	$ 417	$ 220	$ 417	$ 185	$ 417	$ 211
Non-compete agreements	1,431	1,141	1,456	1,327	1,706	1,374
Customer lists	29,713	11,520	25,019	10,386	30,386	11,773
Trade name	211	106	211	63	211	84
Total intangible assets subject to amortization	31,772	12,987	27,103	11,961	32,720	13,442
Contractual agreements	3,231	—	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—	3,231	—
Total intangible assets	$ 35,003	$ 12,987	$ 30,334	$ 11,961	$ 35,951	$ 13,442

Amortization expense for intangible assets was $802,000 and $612,000 for the three-month periods and $1.65 million and $1.14 million six-month periods ended June 30, 2015 and 2014, respectively.

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On April 1, 2015, the Company completed the sale of its North Carolina-based property management business resulting in a gain of $1.36 million, before selling expenses of $0.24 million. As part of the transaction, the Company recorded a reduction of net intangible assets of $0.19 million and a reduction of goodwill of $3.34 million.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2014, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2014	$ 58,884	$ 17,340	$ 36,935	$ 113,159
Additions to goodwill	41,517	—	2,033	43,550
Other adjustments	(177)	(3,341)	—	(3,518)
Balance, June 30, 2015	$ 100,224	$ 13,999	$ 38,968	$ 153,191

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of June 30, 2015, was $146.73 million. The Company had $57.78 million and $58.72 million of BOLI at June 30, 2014 and December 31, 2014, respectively. The Company recognized BOLI income, included in other noninterest income, of $1.33 million and $433,000 for the three-month periods and $2.47 million and $920,000 for the six-month periods ended June 30, 2015 and 2014, respectively. The Company has a related retirement plan, implemented in the fourth quarter of 2008, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits.

Note 11. Postretirement Benefits

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

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014
Service cost	$ 408	$ 396
Interest cost	211	197
Amortization of actuarial loss	18	—
Net periodic postretirement benefit cost	$ 637	$ 593

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Service cost	$ 774	$ 792
Interest cost	422	394
Amortization of actuarial loss	78	—
Net periodic postretirement benefit cost	$ 1,274	$ 1,186

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at June 30, 2015 and 2014 (in thousands), and changes in the six months then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the defined benefit retirement plan are a component of salaries and employee benefits expense on the consolidated statements of income.

	Unrealized Gains (Losses) on Securities (1)	Defined Benefit Retirement Plan (2)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2014	$ 1,325	$ (867)	$ 458
Other comprehensive income before reclassifications	(186)	—	(186)
Amounts reclassified from AOCI	(32)	51	19
Net change	(218)	51	(167)
Balance, June 30, 2015	$ 1,107	$ (816)	$ 291

	Unrealized Gains (Losses) on Securities (1)	Defined Benefit Retirement Plan (2)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2013	$ (244)	$ (100)	$ (344)
Other comprehensive income before reclassifications	1,172	—	1,172
Amounts reclassified from AOCI	39	—	39
Net change	1,211	—	1,211
Balance, June 30, 2014	$ 967	$ (100)	$ 867

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

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Note 13. Other Expenses

The following table shows a summary of other expenses for the three and six months ended June 30, 2015 and 2014 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Advertising and marketing	$ 2,065	$ 1,180	$ 3,846	$ 2,239
Acquisition-related expenses	370	35	784	87
Other	1,504	1,486	3,229	3,422
Charitable contributions	1,575	856	2,988	1,633
Outside processing	1,141	906	2,563	1,769
Professional fees	1,485	1,000	2,948	2,188
Stationery and supplies	526	565	1,192	1,006
FDIC and other insurance	1,339	969	2,438	1,868
Foreclosed property expenses	526	1,957	1,400	2,761
Software expense	1,493	1,108	2,786	2,089
Telephone and postage	1,155	1,100	2,382	2,095
Amortization-intangibles	802	612	1,647	1,142
Bank franchise tax/SCC fees	670	534	1,299	1,047
Directors fees and expenses	292	279	624	500
Travel/meals/entertainment	355	323	634	573
Total other expenses	$ 15,298	$ 12,910	$ 30,760	$ 24,419

Note 14. Variable Interest Entities

In the normal course of business, the Company is involved with various entities that are considered to be Variable Interest Entities ("VIE"). A VIE is an entity that has either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support, or whose equity investors lack the characteristics of a controlling financial interest. In accordance with existing accounting guidance, the Company is required to consolidate any VIE of which it is 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. The Company reviews all significant interests in the VIEs it is involved with, including the amounts and types of financial and other support, including equity investments, debt financing, and guarantees. The Company also considers the activities of the VIEs that most significantly impact the VIEs' economic performance and whether it has control over those activities. To provide the necessary disclosures, similar VIEs are aggregated 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 $62.07 million, $59.86 million, and $59.62 million in these partnerships were not included in the Consolidated Balance Sheets at June 30, 2015, June 30, 2014, and December 31, 2014, respectively. These limited partner interests had carrying values of $16.72 million, $16.35 million, and $15.17 million at June 30, 2015, June 30, 2014, and December 31, 2014, 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 $16.72 million, $16.35 million, and $15.17 million at June 30, 2015, June 30, 2014, and December 31, 2014, respectively. As of June 30, 2015, the Company had $16.59 million in funding commitments that are dependent on certain contractual milestones. For the three- and six-month periods ended June 30, 2015, a tax benefit totaling $0.32 million and $0.65 million, net of amortization expense of $0.60 million and $1.19 million, respectively, was recognized as a component of income tax expense.

Note 15. Fair Value Disclosures

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

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

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

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

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

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

Interest Rate Lock Commitments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three- and six-month periods ended June 30, 2015 and 2014, and the year ended December 31, 2014, the Company used a weighted average fall-out rate of 20%. The carrying value of the interest rate lock commitments was $2.20 million at June 30, 2015 and $0.95 million at December 31, 2014.

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014 (in thousands):

	June 30, 2015			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 515,264	$ —	$ 515,264
Municipal securities	—	19,703	—	19,703
Mortgage-backed securities issued by GSEs	—	216,090	—	216,090
Trust preferred and other corporate securities	—	8,368	—	8,368
Interest rate lock commitments	—	—	2,196	2,196

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

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ —	$ —	$ 12,712	$ 12,712
Other real estate owned	$ —	$ 32,067	$ 14,087	$ 46,154

December 31, 2014	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ —	$ —	$ 16,142	$ 16,142
Other real estate owned	$ —	$ 21,409	$ 13,706	$ 35,115

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

Loans: Impaired loans for which repayment of the loan is expected to be provided solely by the value of the underlying collateral are considered collateral-dependent and are valued based on the fair value of such collateral. Collateral values are estimated using inputs based on observable market data or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically, discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 2% to 90%, with a weighted average of 15.53%.

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 6% to 17%, with a weighted average of 11.40%.

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.

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

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 future cash flows using current rates at which similar deposits would be made.

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

Repurchase agreements: The carrying amount approximates fair value.

Federal funds purchased: The carrying amount approximates fair value.

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

The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of June 30, 2015 and December 31, 2014 are as follows (in thousands):

June 30, 2015	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 184,099	$ 184,099	$ 184,099	$ —	$ —
Interest-bearing deposits in financial institutions	1,011	1,011	1,011	—	—
Securities available for sale	759,425	759,425	—	759,425	—
Securities held to maturity	80,195	83,175	—	83,175	—
Mortgage loans held for sale	165,994	166,163	—	166,163	—
Net loans	4,228,127	4,313,607	—	—	4,313,607
Interest receivable	15,025	15,025	—	15,025	—
Deposits	4,686,652	4,234,813	—	4,234,813	—
Advances from the Federal Home Loan Bank of Atlanta	437,584	414,151	—	414,151	—
Repurchase agreements and other borrowings	35,737	35,739	—	35,739	—
Interest payable	2,538	2,538	—	2,538	—

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	85,247	89,552	—	89,552	—
Mortgage loans held for sale	71,390	71,390	—	71,390	—
Net loans	3,528,472	3,621,431	—	—	3,621,431
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	—

Note 16. Borrowings

The Company has short-term borrowings for terms under one year consisting of retail repurchase agreements ("REPOs") and FHLB advances. FHLB advances are for various terms and are secured by a blanket lien on residential mortgages and other real estate secured loans. All REPOs are overnight short-term investments and are not insured by the FDIC. Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and are therefore accounted for as a secured borrowing. Mortgage backed securities and U.S. Government Agency Securities with a total carrying value of $52.24 million at June 30, 2015 and $46.96 million at December 31, 2014 were pledged as collateral for these secured transactions. The pledged securities are held in safekeeping at the FHLB. Due to the overnight short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily.

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Second Quarter 2015	First Quarter 2015	Fourth Quarter 2014	Third Quarter 2014	Second Quarter 2014
Results of Operations:					
Interest income	$ 52,708	$ 51,368	$ 43,843	$ 43,668	$ 43,165
Interest expense	7,824	7,812	6,704	6,801	6,627
Net interest income	44,884	43,556	37,139	36,867	36,538
Provision for loan losses	1,723	323	(1)	996	(833)
Net interest income after provision for loan losses	43,161	43,233	37,140	35,871	37,371
Noninterest income:					
Residential mortgage banking income, net	10,251	8,443	6,523	7,858	7,735
Real estate brokerage and property management income, net	4,584	3,955	2,450	3,645	3,248
Insurance commissions and other title fees and income, net	9,885	11,049	7,743	8,861	8,893
Service charges on deposit accounts	2,326	2,197	2,288	2,406	2,366
Credit card merchant fees, net	566	432	911	927	965
Other income	5,354	2,691	2,486	2,572	2,139
Gain (loss) on investment securities	119	49	—	44	(62)
Total noninterest income	33,085	28,816	22,401	26,313	25,284
Noninterest expense:					
Salaries and benefits	26,544	27,679	25,205	25,080	25,325
Occupancy expense	4,856	4,930	4,676	4,618	4,393
Furniture and equipment	2,369	2,369	2,103	2,040	2,040
Other expenses	15,298	15,462	16,975	12,416	12,910
Total noninterest expense	49,067	50,440	48,959	44,154	44,668
Income before noncontrolling interest and income tax	27,179	21,609	10,582	18,030	17,987
Provision for income tax expense	8,201	6,385	2,798	5,044	5,432
Net income	18,978	15,224	7,784	12,986	12,555
Net income from noncontrolling interest	(1,166)	(686)	(549)	(860)	(878)
Net income attributable to TowneBank	$ 17,812	$ 14,538	$ 7,235	$ 12,126	$ 11,677
Net income available to common shareholders	$ 17,812	$ 14,525	$ 7,044	$ 11,935	$ 11,486

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Second Quarter 2015	First Quarter 2015	Fourth Quarter 2014	Third Quarter 2014	Second Quarter 2014
Per Share Data:					
Net income:					
Basic	$ 0.35	$ 0.29	$ 0.20	$ 0.34	$ 0.33
Diluted	0.35	0.29	0.20	0.34	0.33
Book value at period end	15.40	15.22	14.88	14.85	14.63
Tangible book value at period end	12.00	11.73	11.09	11.21	10.96
Cash dividends declared	0.12	0.11	0.11	0.11	0.11
Common Stock Closing Price:					
High	17.00	16.38	15.83	16.46	16.47
Low	15.66	14.28	13.51	13.58	14.85
Close	16.29	16.08	15.12	13.58	15.71
Selected Financial Ratios (annualized):					
Return on average assets	1.21%	1.01%	0.57%	0.97%	0.97%
Return on average tangible assets	1.28%	1.08%	0.63%	1.03%	1.03%
Return on average equity	8.93%	7.54%	4.62%	7.86%	7.79%
Return on average tangible equity	11.77%	10.27%	6.35%	10.32%	10.20%
Net interest margin (tax-equivalent basis) (1)	3.52%	3.52%	3.35%	3.32%	3.43%
Daily Averages:					
Total assets	$ 5,900,816	$ 5,829,533	$ 5,005,112	$ 4,961,204	$ 4,810,582
Total tangible assets	5,724,957	5,642,883	4,868,868	4,831,294	4,683,697
Loans, net of unearned income, excluding nonaccrual loans	4,161,304	4,066,484	3,526,859	3,471,206	3,443,425
Total earning assets (1)	5,407,516	5,290,562	4,610,309	4,558,857	4,413,137
Total deposits	4,548,351	4,504,857	3,864,688	3,838,834	3,705,188
FHLB advances	408,288	408,288	398,326	398,620	394,723
Total equity	800,369	781,833	621,579	612,250	601,203
Tangible equity	624,511	595,183	485,335	482,341	474,319
Basic weighted average shares outstanding	51,089,051	50,652,963	35,400,548	35,271,506	35,207,989
Diluted weighted average shares outstanding	51,151,512	50,724,588	35,458,804	35,311,332	35,237,872

(1) Includes bank-owned life insurance.

PART I. FINANCIAL INFORMATION

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2014 audited Consolidated Financial Statements included in our 2014 Annual Report to Stockholders and our 2014 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by Dixon Hughes Goodman LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements with respect to our financial condition, results of operations, and business. These forward-looking statements involve certain risks and uncertainties and are based on the beliefs and assumptions of our management. When used in this quarterly report or future regulatory filings, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We wish to caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, mergers and acquisitions, competitive and legislative or regulatory factors, and other factors described in our 2014 Annual Report on Form 10-K could affect our financial performance and could cause actual results for future periods to differ materially from those anticipated or projected.*

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

Overview

TowneBank ("Company," "we," "us") is a retail and commercial banking business serving Richmond, Virginia, 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 financial performance in the quarter ended June 30, 2015:

- Net income for the three months ended June 30, 2015 was $17.81 million, or $0.35 per common diluted share, compared with $11.68 million, or $0.33 per common diluted share in the same period in 2014. Net income for the six months ended June 30, 2015 was $32.35 million, or $0.63 per common diluted share, compared to $22.81 million, or $0.64 per common diluted share, in the six months ended June 30,

2014. Net income available to common shareholders for the second quarter of 2015 was $17.81 million compared with $11.49 million in the same period of 2014.

- Net interest income increased $8.35 million, or 22.84%, in the second quarter of 2015 from the comparable period in 2014. The increase was primarily due to a significant increase in average earning assets as a result of the acquisition of Franklin Financial Corporation ("Franklin") in the first quarter of 2015.

- The provision for loan losses was $1.72 million, an increase from a negative provision of $0.83 million in the comparative three-month period of 2014, and $2.05 million, an increase from a negative provision of $0.50 million in the comparative six-month period of 2014. The loan loss reserve was 0.88% of total loans at June 30, 2015, unchanged from March 31, 2015, and down from 1.03% at June 30, 2014. A reclassification of industrial revenue bonds from investment securities to loans during second quarter 2015 was responsible for $0.80 million of the increase in the provision for loan losses, while loan growth drove the remainder of the increase in the current periods from the comparative prior periods. The decrease in the loan loss reserve as a percentage of total loans, excluding purchased loans, is consistent with continued improvements in credit quality.

- Excluding gains on investment securities, noninterest income for the three- and six-month periods ended June 30, 2015 increased by $7.62 million, or 30.06%, and increased by $13.66 million, or 28.41%, respectively, from the comparative periods in 2014. The increase from the comparable prior year periods was primarily related to an increase in residential mortgage banking income combined with increases in our Insurance segment related to our acquisition of an insurance agency in the second quarter of 2014 and two insurance agencies on February 1, 2015.

- For the three- and six-month periods ended June 30, 2015, noninterest expense increased $4.40 million, or 9.85%, and $13.76 million, or 16.04%, respectively, compared to the same periods in 2014. The increase from prior year comparative periods was primarily driven by increased operating expenses related to the acquisitions of Franklin, the aforementioned insurance agencies, and a resort property management company in the fourth quarter of 2014.

- Our effective tax rate was 31.53% for the second quarter of 2015, a slight decrease from 31.75% in the comparative period of 2014. For the first six months of 2015, the effective tax rate decreased to 31.08% compared to 31.19% for the same period in 2014. The variance from the comparative periods of the prior year was primarily a result of an increase in non-taxable income arising from bank-owned life insurance partially offset by a slight increase in nondeductible merger expenses. The increase from the sequential quarter was primarily due to higher taxable income subject to the federal statutory rate of 35%.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the consolidated financial statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, other real estate owned, deferred income taxes, estimates of fair value of financial instruments, and goodwill and other intangibles to be critical accounting policies. Refer to our 2014 Annual Report to Stockholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 1.21% for the second quarter of 2015 compared to 0.97% for the second quarter of 2014, and 1.01% for the first quarter of 2015. The annualized return on average tangible assets was 1.28%, 1.03%, and 1.08% for the same respective periods. ROA for the six months ended June 30, 2015 was 1.11% compared to 0.97% for the six months ended June 30, 2014. In comparison to both prior year comparative periods, ROA was positively affected by the increase in net income, which outpaced the growth in average assets.

The annualized return on average equity ("ROE") was 8.93% for the second quarter of 2015, 7.79% for the second quarter of 2014, and 7.54% for the first quarter of 2015, while the annualized return on average tangible equity was 11.77%, 10.20%, and 10.27% for the same respective periods. ROE for the six months ended June 30, 2015 was 8.25%, compared to 7.71% for the six months ended June 30, 2014.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $77.85 million for the quarter ended June 30, 2015, which increased $15.97 million, or 25.80%, compared to the quarter ended June 30, 2014. Operating income was $72.32 million for the quarter ended March 31, 2015. For the six months ended June 30, 2015, operating income was $150.17 million, an increase of $30.37 million, or 25.35% over comparative 2014.

Basic earnings per share were $0.35 for the three months ended June 30, 2015 compared to $0.33 in comparative 2014, while basic earnings per share for the six months ended June 30, 2015 was $0.64, remaining the same as comparative 2014. Diluted earnings per share increased to $0.35 for the three months ended June 30, 2015 from $0.33 in comparative 2014, while diluted earnings per share for the six months ended June 30, 2015 was $0.63 from $0.64 in comparative 2014. Earnings per share were affected, as compared to the comparative prior year periods, by the issuance 15.55 million shares of TowneBank common stock related to the acquisition of Franklin on January 2, 2015 and the reduction of preferred dividends related to the redemption in full of $76.46 million of outstanding Non-Cumulative Convertible Preferred Stock, Series C issued to the U.S. Treasury under the Small Business Lending Fund on January 7, 2015.

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 have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 35% federal marginal tax rate for all periods shown.

TowneBank reported net interest income, on a tax-equivalent basis, of $47.49 million for the quarter ended June 30, 2015, which was $9.77 million, or 25.91%, higher than the year-ago amount of $37.72 million. On a linked quarter basis, tax-equivalent net interest income increased by $1.63 million, or 3.55%, from the $45.86 million reported for the first quarter of 2015. In comparison to the prior year comparative period, net interest income rose primarily due to increased balances of earning assets related to the Franklin merger. Accretion of purchase accounting marks added $1.08 million, or 10 basis points, to margin in the current quarter.

Interest income, on a tax-equivalent basis, was $55.31 million for the quarter ended June 30, 2015, which was $10.97 million, or 24.74%, higher than the $44.34 million reported for the period ended June 30, 2014. On a linked quarter basis, tax-equivalent interest income increased $1.64 million, or 3.06%, from $53.67 million in the first quarter of 2015. Average earning assets grew to $5.41 billion in the quarter ended June 30, 2015, from $4.41 billion in the comparative prior year quarter, an increase of $994.38 million, or 22.53%. In the linked quarter comparison, average earning assets increased by $116.95 million, or 2.21%, from $5.29 billion in the first quarter of 2015. The yield on earning assets was 4.10% in the quarter ended June 30, 2015, which compared to 4.03% in the comparative prior year and 4.11% in the linked period. Average loan balances, excluding nonaccrual loans, of $4.16 billion were $727.88 million, or 21.20%, higher in the second quarter of 2015 than in the same period a year ago, while loan yields declined by three basis points. In the linked quarter, loans grew $94.82 million, or 2.33%, and loan yields were eight basis points lower. The increase in interest income from comparative prior year periods was driven by higher balances of earning assets largely due to the Franklin merger.

Interest expense for the quarter ended June 30, 2015, was $7.82 million, which was $1.20 million, or 18.06%, higher than the $6.63 million amount in the year-ago quarter. The average balance of interest-bearing liabilities increased to $3.70 billion in the second quarter of 2015 from $3.01 billion in the comparative prior year quarter, an increase of 22.85%. On a linked quarter basis, interest expense increased slightly by 0.15% to $7.82 million from $7.81 million in the first quarter of 2015. In the linked quarter, average interest-bearing liabilities increased by $6.24 million, or 0.17%, from $3.70 billion in the quarter ended March 31, 2015. The increase in interest expense as compared to the prior year periods was primarily driven by a significant increase in interest-bearing deposits as a result of the Franklin merger combined with slightly higher rates in certificates of deposits and money market funds.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.52% in the quarter ended June 30, 2015, which was nine basis points higher than the 3.43% margin of the June 30, 2014 quarter and unchanged from the March 31, 2015 quarter. The margin improvement in comparison to the prior year periods was driven by the rise in earning asset yields as loans and investment securities were a higher percentage of interest-earning assets as a result of the Franklin merger.

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

	Three Months Ended June 30, 2015			Three Months Ended March 31, 2015			Three Months Ended June 30, 2014		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 4,161,304	$ 48,730	4.70%	$ 4,066,484	$ 47,890	4.78%	$ 3,433,425	$ 40,449	4.73%
Taxable investment securities	818,000	2,825	1.38%	749,414	2,801	1.49%	602,375	1,842	1.22%
Tax-exempt investment securities	63,255	496	3.14%	66,812	536	3.20%	70,842	554	3.13%
Interest-bearing deposits	87,709	56	0.25%	202,852	125	0.25%	177,045	111	0.25%
Loans held for sale	131,305	1,161	3.54%	64,512	565	3.50%	71,883	719	4.00%
Bank-owned life insurance	145,943	2,044	5.62%	140,488	1,753	5.06%	57,567	667	4.65%
Total earning assets	5,407,516	55,312	4.10%	5,290,562	53,670	4.11%	4,413,137	44,342	4.03%
Less: allowance for loan losses	(36,854)			(36,048)			(37,458)		
Total nonearning assets	530,154			575,019			434,903		
Total assets	$ 5,900,816			$ 5,829,533			$ 4,810,582		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 1,646,075	$ 1,144	0.28%	$ 1,635,454	$ 1,111	0.28%	$ 1,305,681	$ 807	0.25%
Savings	301,020	692	0.92%	305,016	683	0.91%	311,732	723	0.93%
Certificates of deposit	1,294,181	2,606	0.81%	1,308,364	2,630	0.82%	969,724	1,765	0.73%
Total interest-bearing deposits	3,241,276	4,442	0.55%	3,248,834	4,424	0.55%	2,587,137	3,295	0.51%
Borrowings	460,993	3,382	2.90%	447,198	3,388	3.03%	426,424	3,332	3.09%
Total interest-bearing liabilities	3,702,269	7,824	0.85%	3,696,032	7,812	0.86%	3,013,561	6,627	0.88%
Demand deposits	1,307,075			1,256,023			1,118,051		
Other noninterest-bearing liabilities	91,103			95,645			77,767		
Total liabilities	5,100,447			5,047,700			4,209,379		
Shareholders' equity	800,369			781,833			601,203		
Total liabilities and equity	$ 5,900,816			$ 5,829,533			$ 4,810,582		
Net interest income (tax-equivalent basis)		$ 47,488			$ 45,858			$ 37,715	
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(2,044)			(1,753)			(667)	
Tax-equivalent basis adjustment		(560)			(549)			(510)	
Net interest income (GAAP)		$ 44,884			$ 43,556			$ 36,538	
Interest rate spread (1)			3.26%			3.26%			3.15%
Interest expense as a percent of average earning assets			0.58%			0.60%			0.60%
Net interest margin (tax equivalent basis) (2)			3.52%			3.52%			3.43%
Total cost of deposits			0.39%			0.40%			0.36%

(1) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Fully tax equivalent.

(2) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.

(Dollars in thousands)	Increase/(Decrease) Three Months Ended June 30, 2015 Compared to Three Months Ended March 31, 2015			Increase/(Decrease) Three Months Ended June 30, 2015 Compared to Three Months Ended June 30, 2014		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 1,430	$ (591)	$ 839	$ 8,526	$ (245)	$ 8,281
Taxable investment securities	246	(221)	25	723	260	983
Tax-exempt investment securities	(28)	(11)	(39)	(60)	2	(58)
Interest-bearing deposits	(71)	2	(69)	(57)	2	(55)
Loans held for sale	590	5	595	534	(92)	442
Bank-owned life insurance	76	215	291	1,212	165	1,377
Total earning assets	2,243	(601)	1,642	10,878	92	10,970
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	12	21	33	228	109	337
Savings	(6)	15	9	(25)	(6)	(31)
Certificates of deposit	(13)	(11)	(24)	189	652	841
Total interest-bearing deposits	(7)	25	18	392	755	1,147
Borrowings	119	(126)	(7)	262	(212)	50
Total interest-bearing liabilities	112	(101)	11	654	543	1,197
Net interest income	$ 2,131	$ (500)	$ 1,631	$ 10,224	$ (451)	$ 9,773

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

	Six Months Ended June 30, 2015			Six Months Ended June 30, 2014			Six Months Ended June 30, 2015 Compared with June 30, 2014		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change due to Rate	Change due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 4,114,156	$ 96,619	4.74%	$ 3,401,627	$ 80,169	4.75%	$ 16,450	$ (284)	$ 16,734
Taxable investment securities	783,896	5,626	1.44%	514,888	3,332	1.29%	2,294	396	1,898
Tax-exempt investment securities	65,024	1,032	3.17%	71,126	1,053	2.96%	(21)	73	(94)
Interest-bearing deposits	144,962	181	0.25%	255,157	319	0.25%	(138)	—	(138)
Loans held for sale	98,093	1,726	3.52%	57,447	1,147	3.99%	579	(150)	729
Bank-owned life insurance	143,231	3,797	5.35%	57,541	1,416	4.96%	2,381	117	2,264
Total earning assets	5,349,362	108,981	4.11%	4,357,786	87,436	4.05%	21,545	152	21,393
Less: allowance for loan losses	(36,453)			(38,024)					
Total nonearning assets	$ 552,463			$ 428,317					
Total assets	$ 5,865,372			$ 4,748,079					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 1,640,794	$ 2,255	0.28%	$ 1,282,139	$ 1,547	0.24%	$ 708	$ 235	$ 473
Savings	303,007	1,375	0.92%	315,476	1,448	0.93%	(73)	(16)	(57)
Certificates of deposit	1,301,233	5,236	0.81%	968,821	3,643	0.76%	1,593	270	1,323
Total interest-bearing deposits	3,245,034	8,866	0.55%	2,566,436	6,638	0.52%	2,228	489	1,739
Borrowings	454,134	6,770	2.96%	430,966	6,633	3.06%	137	(213)	350
Total interest-bearing liabilities	3,699,168	15,636	0.85%	2,997,402	13,271	0.89%	2,365	276	2,089
Demand deposits	1,281,690			1,078,200					
Other noninterest-bearing liabilities	93,362			76,005					
Total liabilities	5,074,220			4,151,607					
Shareholders' equity	791,152			596,472					
Total liabilities and equity	$ 5,865,372			$ 4,748,079					
Net interest income (tax-equivalent basis)		$ 93,345			$ 74,165		$ 19,180	$ (124)	$ 19,304
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(3,797)			(1,416)		(2,381)		
Tax-equivalent basis adjustment		(1,108)			(1,019)		$ (89)		
Net interest income (GAAP)		$ 88,440			$ 71,730		$ 16,710		
Interest rate spread (1)			3.26%			3.15%			
Interest expense as a percent of average earning assets			0.59%			0.61%			
Net interest margin (tax equivalent basis) (2)			3.52%			3.43%			
Total cost of deposits			0.39%			0.37%			

(1) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Fully tax equivalent.

(2) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.

Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended June 30, 2015 was $32.97 million, an increase of $7.62 million, or 30.06%, compared to the same period in 2014 and an increase of $4.20 million, or 14.60%, compared to the first quarter of 2015. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for the second quarter of 2015 was 42.35%, compared with 40.96% for comparative 2014 and 39.78% for the first quarter of 2015. Our noninterest income primarily consists of fee income produced by our three reportable segments, less applicable commission expenses. The following table provides an analysis of noninterest income for the periods presented (dollars in thousands):

	Three Months Ended June 30,		Increase/(Decrease) 2015 over 2014	
	2015	2014	Amount	Percent
Residential mortgage banking income, net	$ 10,251	$ 7,735	$ 2,516	32.53 %
Real estate brokerage and property management, net	4,584	3,248	1,336	41.13 %
Insurance commissions and other title fees and income, net	9,885	8,893	992	11.15 %
Service charges on deposit accounts	2,326	2,366	(40)	(1.69)%
Credit card merchant fees, net	566	965	(399)	(41.35)%
Other income	5,354	2,139	3,215	150.30 %
Subtotal before gain on investment securities	32,966	25,346	7,620	30.06 %
Net gain (loss) on investment securities	119	(62)	181	N/M
Total noninterest income	$ 33,085	$ 25,284	$ 7,801	30.85 %

	Three Months Ended		Increase/(Decrease) Second Quarter 2015 over First Quarter 2015	
	June 30, 2015	March 31, 2015	Amount	Percent
Residential mortgage banking income, net	$ 10,251	$ 8,443	$ 1,808	21.41 %
Real estate brokerage and property management, net	4,584	3,955	629	15.90 %
Insurance commissions and other title fees and income, net	9,885	11,049	(1,164)	(10.53)%
Service charges on deposit accounts	2,326	2,197	129	5.87 %
Credit card merchant fees, net	566	432	134	31.02 %
Other income	5,354	2,691	2,663	98.96 %
Subtotal before gain on investment securities	32,966	28,767	4,199	14.60 %
Net gain on investment securities	119	49	70	142.86 %
Total noninterest income	$ 33,085	$ 28,816	$ 4,269	14.81 %

	Six Months Ended June 30,		Increase/(Decrease) 2015 over 2014	
	2015	2014	Amount	Percent
Residential mortgage banking income, net	$ 18,694	$ 12,798	$ 5,896	46.07 %
Real estate brokerage and property management, net	8,539	6,539	2,000	30.59 %
Insurance commissions and other title fees and income, net	20,934	17,954	2,980	16.60 %
Service charges on deposit accounts	4,523	4,498	25	0.56 %
Credit card merchant fees, net	998	1,738	(740)	(42.58)%
Other income	8,044	4,546	3,498	76.95 %
Subtotal before gain on sale of investment securities	61,732	48,073	13,659	28.41 %
Net gain (loss) on investment securities	169	(60)	229	(381.67)%
Total noninterest income	$ 61,901	$ 48,013	$ 13,888	28.93 %

For the second quarter of 2015, residential mortgage banking income, net of commission expense, was $10.25 million, reflecting an increase of $2.52 million, or 32.53%, compared to the second quarter of 2014 and an increase of $1.81 million, or 21.41%, compared to the first quarter of 2015. For the six-month period ended June 30, 2015, residential mortgage banking income, net of commission expense, was $18.69 million, reflecting an increase of $5.90 million, or 46.07%, compared to the same period in 2015. The increase from the prior periods was primarily due to higher production volumes and improved pricing and margins. Also factoring in the variance from the prior periods was a seasonal increase in mortgage banking income of $0.22 million associated with an increase in the value of rate lock commitments recorded as of June 30, 2015, as compared to an increase of $1.03 million and an increase of $0.56 million recognized for the quarters ended March 31, 2015 and June 30, 2014, respectively.

Real estate brokerage and property management income, net of commission expense, for second quarter 2015 was $4.58 million, which was $1.34 million, or 41.13%, higher than comparative 2014, and $0.63 million, or 15.90%, higher than first quarter 2015. The increase for the 2015 six-month period was $2.00 million, or 30.59% from the comparative period in 2014. The increase from the comparative 2014 periods was primarily a result of an increase in property management fees associated with our purchase of Beach Properties of Hilton Head, Inc. ("Beach Properties") on October 1, 2014, combined with a slight increase in real estate brokerage income. The increase was partially offset by the sale of our North Carolina-based property management business on April 1, 2015, which generated management fee revenue of $0.97 million in second quarter 2014, $1.80 million in first quarter 2015, and $2.68 million in the first six months of 2014. The Company recognized a gain of $1.36 million on the sale, which was recorded in other noninterest income. The increase from the linked quarter was primarily due to the seasonal increase in real estate brokerage income.

For the second quarter of 2015, insurance commissions and other title income, net of commission expense, was $9.88 million, which was $0.99 million, or 11.15%, higher than comparative 2014, and $1.16 million, or 10.53%, lower than first quarter of 2015. For the six-month period, insurance commissions and other title income, net of commission expense, was $2.98 million, or 16.60%, higher than comparative 2014. The increase from the comparative prior year periods was largely due to the acquisition of two insurance agencies in February 2015 and the acquisition of Southern Insurance Agency, Inc. in May 2014, which contributed additional commission and fee income of $0.98 million and $2.44 million in the three- and six-month periods ended June 30, 2015. The decrease in the linked quarter comparison was primarily due to an increase in contingency and bonus revenue income of $2.14 million from the first quarter of 2015 as contingent commissions are mostly received during the first quarter of each year.

Service charges on deposit accounts were $2.33 million for the second quarter of 2015, compared with $2.37 million for the comparative 2014 period, and $2.20 million for the first quarter of 2015. For the six months ended June 30, 2015, service charges on deposit accounts were $4.52 million, which was $0.03 million, or 0.56%, higher than comparative 2014. Decreases in overdraft checking fees from prior year periods mostly offset the increase in average deposits.

For the second quarter of 2015, credit card merchant fees totaled $0.57 million, which was $0.40 million, or 41.35%, lower than comparative 2014, and $0.13 million, or 31.02%, higher than the first quarter of 2015. For the six months ended June 30, 2015, credit card merchant fees totaled $1.00 million, which was $0.74 million, or 42.58%, lower than comparative 2014. The variances from the prior year periods were primarily related to decreased merchant fees related to structural changes in vendor contractual terms and non-recurring expenses related to a platform change and equipment purchases associated with EMV compliance. The Company believes the contractual changes will be beneficial in the long-term, which is reflected in the increase from the linked quarter.

Other noninterest income for the three and six months ended June 30, 2015 was $5.35 million and $8.04 million, respectively, and included income generated by Towne Investment Group, net of commission expense. For the three months ended June 30, 2015, net commission income for Towne Investment Group totaled $0.74 million as compared to $0.66 million for the second quarter of 2014 and $0.69 million for the first quarter of 2015. The increase from prior periods was due to an increase in income from bank-owned life insurance policies of $0.89 million and $1.55 million from the three- and six-month periods ended June 30, 2014, combined with the gain of $1.36 million on the sale of our North Carolina-based property management business and a gain of $0.57 million on the sale of land in Virginia Beach.

Noninterest Expense. For the quarter ended June 30, 2015, total noninterest expense was $49.07 million, which was $4.40 million, or 9.85%, higher than comparative 2014, and $1.37 million, or 2.72%, lower than the quarter ended March 31, 2015. For the six months ended June 30, 2015, total noninterest expense increased $13.76 million, or 16.04% from comparative 2014 to $99.51 million.

As a percentage of operating income, noninterest expense was 63.03% for the second quarter of 2015, 72.18% for comparative 2014, and 69.74% for the quarter ended March 31, 2015. The primary components of noninterest expense in the second quarter of 2015 were salaries and employee benefits of $26.54 million, occupancy expenses of $4.86 million, furniture and equipment expenses of $2.37 million, advertising and marketing expenses of $2.07 million, and professional fees of $1.48 million. In comparison to the prior year comparative quarter, a significant portion of the increase in total noninterest expense is due to operational expenses related to the Franklin acquisition, which resulted in additional expenses of $2.51 million. Additionally, insurance acquisitions in February 2015 and May 2014 contributed additional operational expenses of $0.94 million, and the Beach Properties acquisition in October 2014 contributed $1.20 million of additional expenses. Merger activities related to the acquisitions of Franklin and the insurance agencies resulted in $0.37 million of acquisition-related expenses in first quarter 2015 as compared to $0.03 million in second quarter 2014 and $0.42 million in first quarter 2015. Also contributing to the increase from second quarter 2014 was the opening of a new banking office in the Ghent area of Norfolk, Virginia, in May 2015, which resulted in additional noninterest expenses of $0.23 million.

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

	Three Months Ended			Increase/(Decrease)			
	June 30,		March 31,	June 30, 2015 over June 30, 2014		June 30, 2015 over March 31, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Salaries and benefits	$ 26,544	$ 25,325	$ 27,679	$ 1,219	4.81 %	$ (1,135)	(4.10)%
Occupancy expense	4,856	4,393	4,930	463	10.54 %	(74)	(1.50)%
Furniture and equipment	2,369	2,040	2,369	329	16.13 %	—	— %
Other							
Advertising and marketing	2,065	1,180	1,780	885	75.00 %	285	16.01 %
Acquisition-related expenses	370	35	415	335	957.14 %	(45)	(10.84)%
Other	1,504	1,486	1,725	18	1.21 %	(221)	(12.81)%
Charitable contributions	1,575	856	1,413	719	84.00 %	162	11.46 %
Outside processing	1,141	906	1,422	235	25.94 %	(281)	(19.76)%
Professional fees	1,485	1,000	1,464	485	48.50 %	21	1.43 %
Stationery and supplies	526	565	666	(39)	(6.90)%	(140)	(21.02)%
FDIC and other insurance	1,339	969	1,099	370	38.18 %	240	21.84 %
Foreclosed property expenses	526	1,957	873	(1,431)	(73.12)%	(347)	(39.75)%
Software expense	1,493	1,108	1,293	385	34.75 %	200	15.47 %
Telephone and postage	1,155	1,100	1,227	55	5.00 %	(72)	(5.87)%
Amortization - intangibles	802	612	845	190	31.05 %	(43)	(5.09)%
Bank franchise tax/SCC fees	670	534	629	136	25.47 %	41	6.52 %
Directors fees and expenses	292	279	332	13	4.66 %	(40)	(12.05)%
Travel/meals/entertainment	355	323	279	32	9.91 %	76	27.24 %
Total other expenses	15,298	12,910	15,462	2,388	18.50 %	(164)	(1.06)%
Total noninterest expense	$ 49,067	$ 44,668	$ 50,440	$ 4,399	9.85 %	$ (1,373)	(2.72)%

	Six Months Ended June 30,		Increase/(Decrease) 2015 over 2014	
	2015	2014	Amount	Percent
Salaries and benefits	$ 54,223	$ 48,721	$ 5,502	11.29 %
Occupancy expense	9,786	8,569	1,217	14.20 %
Furniture and equipment	4,738	4,040	698	17.28 %
Other				
Advertising and marketing	3,846	2,239	1,607	71.77 %
Acquisition-related expenses	784	87	697	801.15 %
Other	3,229	3,422	(193)	(5.64)%
Charitable contributions	2,988	1,633	1,355	82.98 %
Outside processing	2,563	1,769	794	44.88 %
Professional fees	2,948	2,188	760	34.74 %
Stationery and supplies	1,192	1,006	186	18.49 %
FDIC and other insurance	2,438	1,868	570	30.51 %
Foreclosed property expenses	1,400	2,761	(1,361)	(49.29)%
Software expense	2,786	2,089	697	33.37 %
Telephone and postage	2,382	2,095	287	13.70 %
Amortization - intangibles	1,647	1,142	505	44.22 %
Bank franchise tax/SCC fees	1,299	1,047	252	24.07 %
Directors fees and expenses	624	500	124	24.80 %
Travel/meals/entertainment	634	573	61	10.65 %
Total other expenses	30,760	24,419	6,341	25.97 %
Total noninterest expense	$ 99,507	$ 85,749	$ 13,758	16.04 %

Salary and benefits expense, the largest portion of noninterest expense, was $26.54 million, representing 54.10% of total noninterest expense for the quarter ended June 30, 2015, and 54.50% for the six months ended June 30, 2015. Salary and benefits expense increased $1.22 million, or 4.81%, and increased $5.50 million, or 11.29% over the comparative three- and six-month periods in 2014 and decreased $1.14 million, or 4.10%, from first quarter 2015. The increase from second quarter 2014 is primarily due to the addition of staff resulting from the Franklin acquisition, which resulted in an increase of $1.26 million and expansion of our Insurance and Realty segment businesses, which resulted in an increase of $1.01 million. The decrease from the linked quarter is primarily due to lower payroll tax expenses combined with a decrease in employee profit sharing expense. The increase from the comparative six-month period of the prior year is primarily due to the aforementioned Franklin and insurance agency acquisitions combined with increased 401(k) matching expense.

In our Banking segment we had a total of 729 full-time equivalent employees ("FTE") at June 30, 2015, which was up from 645 at June 30, 2014, and 704 at March 31, 2015. In our non-Banking segments at June 30, 2015, we had a total of 741 FTEs, excluding real estate sales agents, which was down from 771 at June 30, 2014, and 749 at March 31, 2015. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE was $53,000 for the quarter ended June 30, 2015, increased from $44,000 for the three-month period ended June 30, 2014, and increased from $50,000 for the three-month period ended March 31, 2015.

Occupancy expense for the second quarter of 2015 experienced a $0.46 million, or 10.54%, increase from the comparative quarter of 2014, and a $0.07 million, or 1.50%, decrease from the first quarter of 2015. Occupancy expense for the first six months of 2015 increased $1.22 million, or 14.20%, from comparative

2014. The increase from the comparative periods of the prior year was primarily driven by increases related to the acquisition of Franklin and Insurance segment acquisitions, combined with the opening of a new banking office in Norfolk in May 2015. The slight decrease from the sequential quarter was primarily a result of seasonally lower utility expenses.

For the three and six-month periods ended June 30, 2015, furniture and equipment expense increased by $0.33 million and $0.70 million, respectively, over comparative 2014, and was unchanged compared to the first quarter of 2015. Increases from comparative prior year periods were primarily related to facilities acquired in the Franklin acquisition.

Other noninterest expenses for the second quarter of 2015 were $15.30 million, an increase of $2.39 million, or 18.50%, compared to the same period in 2014, and for the first six months of 2015 increased $6.34 million, or 25.97%, compared to the same period in 2014, while there was a slight decrease of $0.16 million, or 1.06%, compared to first quarter of 2015. The Franklin merger was the primary driver of the increase from the comparative 2014 periods combined with increased charitable contributions and advertising and marketing expenses. The increases were partially offset by decreased foreclosed property expenses. In the linked quarter comparison, the increase in advertising and marketing was more than offset by the decrease in foreclosed property expenses of $0.35 million.

Provision for Income Taxes. We reported a provision for income tax expense of $8.20 million, representing an effective tax rate of 31.53%, in the second quarter of 2015. The provision for income tax expense was $5.43 million for the second quarter of 2014, with an effective rate of 31.75%, and $6.39 million, with an effective rate of 30.52%, in the first quarter of 2015. For the first six months of 2015, the effective tax rate decreased to 31.08% compared to 31.19% in the same period in 2014. The variance from the comparative periods of the prior year was primarily a result of an increase in non-taxable income arising from bank-owned life insurance partially offset by a slight increase in nondeductible merger expenses. The increase from the sequential quarter was primarily due to higher taxable income subject to the federal statutory rate of 35%.

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

Banking Segment. For the three months ended June 30, 2015, the Banking segment represented 73.36%, or $13.07 million, of our total consolidated net income compared to 76.38%, or $8.92 million, for comparative 2014. For the six months ended June 30, 2015, the Banking segment represented 74.74%, or $24.18 million, of our total consolidated income compared to 78.73%, or $17.96 million, for comparative 2014.

Pre-tax earnings for the three months ended June 30, 2015 for the Banking segment were $18.20 million, increasing $5.55 million, or 43.87%, from comparative 2014. The increase in earnings from the comparative 2014 quarter was primarily driven by an increase in net interest income of $8.02 million and an increase in other income of $1.68 million, which was partially offset by an increase in the provision for loan losses to $1.72 million from a negative provision of $0.87 million, and noninterest expenses of $1.37 million. The increase in net interest income was primarily a result of additional interest income from earning assets acquired in the Franklin merger, as average loan balances increased $727.88 million to $4.16 billion and average investments increased to $881.26 million from $673.22 million. This was partially offset by an increase in interest expense as average interest-bearing deposits were higher by $654.14 million, primarily due to the Franklin merger.

The increase in noninterest expense was due to increases in occupancy expense of $0.35 million, furniture and equipment expense of $0.34 million and other expense of $0.95 million. The increases were largely due to operational expenses related to the Franklin acquisition, combined with increases in charitable contributions, marketing expenses, and the opening of a new banking office in May 2015. The increases were partially offset by a decrease in salaries and employee benefits of $0.26 million and a decrease in foreclosed property expense of $1.43 million.

Pre-tax earnings were up $2.96 million compared to the linked quarter ended March 31, 2015. The increase in earnings was a result of an overall increase in revenue of $2.27 million and a decrease in noninterest expenses of $2.07 million. An increase in the provision for loan losses of $1.40 million partially offset the increase. The increase in net interest income of $0.89 million was primarily due to loan growth in the second quarter, while a gain of $0.57 million on the sale of land in Virginia Beach contributed to the increase in noninterest income. The decrease in noninterest expense to the linked quarter ended March 31, 2015 was driven by a decrease in salaries and employee benefits of $1.10 million primarily due to lower profit sharing accruals and payroll tax expenses, combined with a decrease in other expenses of $1.02 million, as foreclosed property expense and outside processing costs decreased.

Pre-tax earnings were up $8.10 million, or 31.95%, for the six months ended June 30, 2015, compared to the comparative period in 2014. The leading factor in the increase was an increase in net interest income of $16.30 million related to earning assets acquired in the Franklin merger. The increase was partially offset by increases in the provision for loan losses of $2.61 million and noninterest expenses of $7.27 million.

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

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

	Three Months Ended			Increase/(Decrease)			
	June 30,		March 31,	2015 over 2014		June over March	
	2015	2014	2015	Amount	Percent	Amount	Percent
Net interest income	$ 44,074	$ 36,050	$ 43,185	$ 8,024	22.26 %	$ 889	2.06 %
Service charges on deposit accounts	2,326	2,366	2,197	(40)	(1.69)%	129	5.87 %
Credit card merchant fees	566	965	433	(399)	(41.35)%	133	30.72 %
Other income	3,194	1,513	2,148	1,681	111.10 %	1,046	48.70 %
Net gain (loss) on investment securities	119	(62)	49	181	N/M	70	N/M
Total noninterest income	6,205	4,782	4,827	1,423	29.76 %	1,378	28.55 %
Total revenue	50,279	40,832	48,012	9,447	23.14 %	2,267	4.72 %
Provision for loan losses	1,723	(866)	323	2,589	(298.96)%	1,400	N/M
Salaries and employee benefits	15,760	16,017	16,855	(257)	(1.60)%	(1,095)	(6.50)%
Occupancy expense	3,411	3,062	3,424	349	11.40 %	(13)	(0.38)%
Furniture and equipment	1,897	1,562	1,842	335	21.45 %	55	2.99 %
Other expenses	9,608	8,662	10,623	946	10.92 %	(1,015)	(9.55)%
Total noninterest expenses	30,676	29,303	32,744	1,373	4.69 %	(2,068)	(6.32)%
Income before income tax and corporate allocation	17,880	12,395	14,945	5,485	44.25 %	2,935	19.64 %
Corporate allocation	315	252	292	63	25.00 %	23	7.88 %
Income before income tax provision	18,195	12,647	15,237	5,548	43.87 %	2,958	19.41 %
Provision for income tax expense	5,128	3,728	4,129	1,400	37.55 %	999	24.19 %
Net income	$ 13,067	$ 8,919	$ 11,108	$ 4,148	46.51 %	$ 1,959	17.64 %
Efficiency ratio (1)	61.16%	71.66%	68.27%	(10.50)%	(14.65)%	(7.11)%	(10.41)%

(1) Excludes gain on investment securities.

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014	Increase/(Decrease) 2015 over 2014 Amount	Increase/(Decrease) 2015 over 2014 Percent
Net interest income	$ 87,258	$ 70,955	$ 16,303	22.98 %
Service charges on deposit accounts	4,523	4,498	25	0.56 %
Credit card merchant fees	998	1,738	(740)	(42.58)%
Other income	5,341	3,291	2,050	62.29 %
Net gain (loss) on investment securities	169	(60)	229	(381.67)%
Total noninterest income	11,031	9,467	1,564	16.52 %
Total revenue	98,289	80,422	17,867	22.22 %
Provision for loan losses	2,045	(560)	2,605	(465.18)%
Salaries and employee benefits	32,615	30,589	2,026	6.62 %
Occupancy expense	6,835	5,918	917	15.50 %
Furniture and equipment	3,739	3,125	614	19.65 %
Other expenses	20,230	16,517	3,713	22.48 %
Total noninterest expenses	63,419	56,149	7,270	12.95 %
Income before income tax and corporate allocation	32,825	24,833	7,992	32.18 %
Corporate allocation	608	505	103	20.40 %
Income before income tax provision	33,433	25,338	8,095	31.95 %
Provision for income tax expense	9,256	7,382	1,874	25.39 %
Net income	$ 24,177	$ 17,956	$ 6,221	34.65 %
Efficiency ratio (1)	64.63%	69.77%	(5.14)	(7.37)%

(1) Excludes gain on investment securities.

Realty Segment. For the three months ended June 30, 2015, the Realty segment had income before income tax provision and noncontrolling interest of $6.96 million, as compared to $2.99 million for the comparative 2014 period, and $2.86 million for the linked quarter ended March 31, 2015. Total revenue increased to $18.08 million in the second quarter of 2015 from $12.27 million in the second quarter of 2014. The $2.64 million, or 33.77%, increase in residential mortgage banking income was a result of increased production volume and improved pricing. Residential mortgage banking income included a seasonal increase in the value of rate lock commitments of $0.22 million for the quarter ended June 30, 2015, compared to $0.56 million in the same period of 2014. The increase in property management fees from 2014 was primarily due to our purchase of Beach Properties on October 1, 2014 and was partially offset by fees lost due to the sale of our North Carolina-based property management business on April 1, 2015. The increase in net interest and other income was related to increased production volume leading to higher average mortgage loans held for sale resulting in additional net interest income of $0.32 million on a prior year quarter comparison and $0.41 million on a linked quarter comparison. Additionally, net interest and other income included a gain of $1.36 million on the sale of our North Carolina-based property management business, partially offset by expenses of $0.24 million recorded in noninterest expense.

Expenses for the Realty segment increased 20.30%, or $1.85 million, when compared to the same period in 2014, and increased by 5.29%, or $0.55 million, when compared to the quarter ended March 31, 2015. The increase from second quarter 2014 was primarily due to operating expenses related to Beach Properties operations combined with an expansion of our mortgage processing centers in 2014. The increase in expenses over the linked quarter ended March 31, 2015 was mainly driven by volume and seasonal increases.

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

	Three Months Ended			Increase/(Decrease)			
	June 30,		March 31,	June 30, 2015 June 30, 2014		June 30, 2015 March 31, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	$ 10,457	$ 7,817	$ 8,514	$ 2,640	33.77 %	$ 1,943	22.82 %
Real estate brokerage income, net	1,965	1,845	1,266	120	6.50 %	699	55.21 %
Title insurance and settlement fees	459	414	301	45	10.87 %	158	52.49 %
Property management fees, net	2,619	1,403	2,689	1,216	86.67 %	(70)	(2.60)%
Income from unconsolidated subsidiary	190	106	125	84	79.25 %	65	52.00 %
Net interest and other income	2,392	682	536	1,710	250.73 %	1,856	346.27 %
Total revenue	18,082	12,267	13,431	5,815	47.40 %	4,651	34.63 %
Salaries and employee benefits	6,049	5,351	6,030	698	13.04 %	19	0.32 %
Occupancy expense	966	930	1,049	36	3.87 %	(83)	(7.91)%
Furniture and equipment	248	276	285	(28)	(10.14)%	(37)	(12.98)%
Amortization of intangible assets	246	127	304	119	93.70 %	(58)	(19.08)%
Other expenses	3,479	2,450	2,768	1,029	42.00 %	711	25.69 %
Total expenses	10,988	9,134	10,436	1,854	20.30 %	552	5.29 %
Income before income tax, corporate allocation and noncontrolling interest	7,094	3,133	2,995	3,961	126.43 %	4,099	136.86 %
Corporate allocation	(133)	(145)	(132)	12	8.28 %	(1)	(0.76)%
Income before income tax provision and noncontrolling interest	6,961	2,988	2,863	3,973	N/M	4,098	N/M
Provision for income tax	2,378	875	960	1,503	N/M	1,418	N/M
Net income	4,583	2,113	1,903	2,470	116.90 %	2,680	(140.83)%
Noncontrolling interest	(856)	(679)	(256)	(177)	(26.07)%	(600)	(234.38)%
Net income attributable to TowneBank	$ 3,727	$ 1,434	$ 1,647	$ 2,293	N/M	$ 2,080	(126.29)%
Key data:							
Efficiency ratio	60.77%	74.46%	77.70%	(13.69)%	(18.39)%	(16.93)%	(21.79)%
Number of units sold	1,095	1,028	736	67	6.52 %	359	48.78 %
Volume of units sold	$ 295,127	$ 290,971	$ 192,861	$ 4,156	1.43 %	$ 102,266	53.03 %
Number of real estate agents	393	397	381	(4)	(1.01)%	12	3.15 %
Loans originated, mortgage	$ 233,545	$ 145,207	$ 160,872	$ 88,338	60.84 %	$ 72,673	45.17 %
Loans originated, joint venture	232,686	189,673	157,553	43,013	22.68 %	75,133	47.69 %
Total loans originated	$ 466,231	$ 334,880	$ 318,425	$ 131,351	39.22 %	$ 147,806	46.42 %
Number of loans, mortgage	1,002	662	716	340	51.36 %	286	39.94 %
Number of loans, joint venture	1,085	899	746	186	20.69 %	339	45.44 %
Total number of loans	2,087	1,561	1,462	526	33.70 %	625	42.75 %
Average loan amount, mortgage	$ 233	$ 219	$ 225	$ 14	6.39 %	$ 8	3.56 %
Average loan amount, joint venture	214	211	211	3	1.42 %	3	1.42 %
Average loan amount	$ 223	$ 215	$ 218	$ 8	3.72 %	$ 5	2.29 %
Average number of originators, mortgage	70	67	68	3	4.48 %	2	2.94 %
Average number of originators, joint venture	51	61	52	(10)	(16.39)%	(1)	(1.92)%
Average number of originators	121	128	120	(7)	(5.47)%	1	0.83 %

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014	Increase/(Decrease) 2015 over 2014 Amount	Increase/(Decrease) 2015 over 2014 Percent
Residential mortgage banking income, net	$ 18,971	$ 12,935	$ 6,036	46.66 %
Real estate brokerage income, net	3,231	2,984	247	8.28 %
Title insurance and settlement fees	760	759	1	0.13 %
Property management fees, net	5,308	3,555	1,753	49.31 %
Income from unconsolidated subsidiary	316	193	123	63.73 %
Net interest and other income	2,929	1,139	1,790	157.16 %
Total revenue	31,515	21,565	9,950	46.14 %
Salaries and employee benefits	12,080	10,766	1,314	12.21 %
Occupancy expense	2,015	1,873	142	7.58 %
Furniture and equipment	532	552	(20)	(3.62)%
Amortization of intangible assets	550	255	295	115.69 %
Other expenses	6,248	4,610	1,638	35.53 %
Total expenses	21,425	18,056	3,369	18.66 %
Income before income tax, corporate allocation and noncontrolling interest	10,090	3,509	6,581	187.55 %
Corporate allocation	(265)	(293)	28	(9.56)%
Income before income tax provision and noncontrolling interest	9,825	3,216	6,609	205.50 %
Provision for income tax expense	3,339	917	2,422	264.12 %
Net income	6,486	2,299	4,187	182.12 %
Noncontrolling interest	(1,112)	(891)	(221)	24.80 %
Net income attributable to TowneBank	$ 5,374	$ 1,408	$ 3,966	281.68 %
Key data:				
Efficiency ratio	67.98%	83.73%	(15.75)	(18.81)%
Number of units sold	1,831	1,639	192	11.71 %
Volume of units sold	$ 487,989	$ 456,847	$ 31,142	6.82 %
Number of real estate agents	393	397	(4)	(1.01)%
Loans originated, mortgage	$ 394,416	$ 227,905	$ 166,511	73.06 %
Loans originated, joint venture	390,239	310,742	79,497	25.58 %
Total loans originated	$ 784,655	$ 538,647	$ 246,008	45.67 %
Number of loans, mortgage	1,718	1,054	664	63.00 %
Number of loans, joint venture	1,831	1,474	357	24.22 %
Total number of loans	3,549	2,528	1,021	40.39 %
Average loan amount, mortgage	$ 230	$ 216	$ 14	6.47 %
Average loan amount, joint venture	213	211	2	0.95 %
Average loan amount	$ 221	$ 213	$ 8	3.76 %

Mortgage. The loan volume for the combined mortgage operations increased in the quarter ended June 30, 2015 as compared to the same period in 2014. Total loans originated in the second quarter of 2015 were $466.23 million, a 39.22% increase, or $131.35 million, from $334.88 million in the comparative period of 2014. This was a $147.81 million, or 46.42%, increase compared to the volume for the quarter ended March 31, 2015. Refinance activity comprised $75.84 million of loan volume for the quarter ended June 30, 2015, while purchases accounted for the remaining $390.39 million in loan volume for the quarter. For the quarters ended June 30, 2014 and March 31, 2015, refinance volume was $34.61 million and $76.96 million, respectively, while purchase volume was $300.27 million and $241.47 million, respectively.

Insurance Segment. The Insurance segment comprises property and casualty and group benefit divisions. The Insurance segment represented 5.72%, or $1.02 million, of total consolidated net income at June 30, 2015, and 11.34%, or $1.32 million, at June 30, 2014.

Earnings before income taxes and noncontrolling interests for the three months ended June 30, 2015 were $2.02 million, decreasing $0.33 million, or 13.99%, from comparative 2014. Earnings before income taxes and noncontrolling interests for the first six months of 2015 were $5.53 million, decreasing $0.41 million, or 6.93%, from the same period in 2014. The primary factors affecting earnings in the aforementioned periods were higher acquisition-related expenses due to the acquisitions of two insurance agencies in first quarter 2015 and one agency in second quarter 2014 and a one-time reclassification of expenses between segments in the first quarter of the prior year.

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

	Three Months Ended			Increase/(Decrease)			
	June 30,		March 31,	June 30, 2015 June 30, 2014		June 30, 2015 March 31, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 7,433	$ 6,119	$ 6,372	$ 1,314	21.47 %	$ 1,061	16.65 %
Specialized benefit services	135	137	133	(2)	(1.46)%	2	1.50 %
Employee benefits	1,606	1,859	1,853	(253)	(13.61)%	(247)	N/M
Total net commissions and fees	9,174	8,115	8,358	1,059	13.05 %	816	9.76 %
Contingency and bonus revenue	387	500	2,523	(113)	(22.60)%	(2,136)	N/M
Other income	47	75	48	(28)	(37.33)%	(1)	(2.08)%
Total revenues	9,608	8,690	10,929	918	10.56 %	(1,321)	(12.09)%
Salaries and employee benefits	4,734	3,956	4,794	778	19.67 %	(60)	(1.25)%
Occupancy expense	480	400	456	80	20.00 %	24	5.26 %
Furniture and equipment	225	203	242	22	10.84 %	(17)	(7.02)%
Amortization of intangible assets	540	469	526	71	15.14 %	14	2.66 %
Other expenses	1,424	1,203	1,242	221	18.37 %	182	14.65 %
Total operating expenses	7,403	6,231	7,260	1,172	18.81 %	143	1.97 %
Income before income tax, corporate allocation and noncontrolling interest	2,205	2,459	3,669	(254)	(10.33)%	(1,464)	(39.90)%
Corporate allocation	(182)	(107)	(160)	(75)	70.09 %	(22)	13.75 %
Income before income tax provision and noncontrolling interest	2,023	2,352	3,509	(329)	(13.99)%	(1,486)	(42.35)%
Provision for income tax	695	829	1,296	(134)	(16.16)%	(601)	(46.37)%
Net income	1,328	1,523	2,213	(195)	(12.80)%	(885)	(39.99)%
Noncontrolling interest	(310)	(199)	(430)	(111)	55.78 %	120	(27.91)%
Net income attributable to TowneBank	$ 1,018	$ 1,324	$ 1,783	$ (306)	(23.11)%	$ (765)	(42.91)%
Efficiency ratio	77.05%	71.70%	66.43%	5.35%	7.46 %	10.62%	15.99 %

	Six Months Ended June 30,		Increase/(Decrease) 2015 over 2014	
	2015	2014	Amount	Percent
Net commission and fee income				
Property and casualty	$ 13,804	$ 10,398	$ 3,406	32.76 %
Specialized benefit services	268	270	(2)	(0.74)%
Employee benefits	3,459	3,687	(228)	(6.18)%
Total net commissions and fees	17,531	14,355	3,176	22.12 %
Contingency and bonus revenue	2,911	3,109	(198)	(6.37)%
Other income	95	235	(140)	(59.57)%
Total revenues	$ 20,537	$ 17,699	$ 2,838	16.03 %
Salaries and employee benefits	$ 9,528	$ 7,366	$ 2,162	29.35 %
Occupancy expense	936	779	157	20.15 %
Furniture and equipment	466	362	104	28.73 %
Amortization of intangible assets	1,066	858	208	24.24 %
Other expenses	2,667	2,179	488	22.40 %
Total operating expenses	14,663	11,544	3,119	27.02 %
Income before income tax, corporate allocation and noncontrolling interest	5,874	6,155	(281)	(4.57)%
Corporate allocation	(343)	(212)	(131)	61.79 %
Income before income tax provision and noncontrolling interest	5,531	5,943	(412)	(6.93)%
Provision for income tax expense	1,991	2,038	(47)	(2.31)%
Net income	3,540	3,905	(365)	(9.35)%
Noncontrolling interest	(741)	(461)	(280)	60.74 %
Net income attributable to TowneBank	$ 2,799	$ 3,444	$ (645)	(18.73)%
Efficiency ratio	71.40%	65.22%	6.18%	9.48 %

Total revenues for the second quarter of 2015 increased $0.92 million, or 10.56%, when compared to the same period in 2014, and increased $2.84 million, or 16.03%, for the six months ended June 30, 2015. The increase from the comparative 2014 periods was impacted by the aforementioned insurance agency acquisitions which contributed additional commission and fee income of $0.98 million and $2.44 million for the three and six-month periods, respectively. The decrease in revenues on a linked quarter basis was due to a drop in contingency and bonus revenue of $2.14 million, partially offset by a seasonal increase in property and casualty commissions of $1.06 million. 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. These commissions are seasonal in nature and are mostly received during the first quarter of each year.

Total operating expenses for the second quarter of 2015 increased $1.17 million, or 18.81%, when compared to the same period in 2014, and increased $3.12 million, or 27.02%, for the six months ended June 30, 2015. The largest factor in the increase was salaries and employee benefits expense, which increased $0.78 million, or 19.67%, and $2.16 million, or 29.35%, when comparing the three- and six-month periods ended June 30, 2015 to the same period for 2014. The increase was largely driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $0.57 million and $1.46 million for the above mentioned three- and six-month periods. The decrease in salaries and employee benefit expenses from the linked quarter of $0.06 million was primarily due to lower payroll taxes in the current quarter.

Occupancy expense increased $0.08 million, or 20.00%, and $0.16 million, or 20.15%, when comparing the three- and six-month periods ended June 30, 2015 to the same period for 2014, which was also a result of the acquisitions.

Other expenses also increased as a result of the insurance agency acquisitions, combined with an increase in legal expenses. The increase for the three- and six-month periods ended June 30, 2015, was $0.22 million and $0.49 million, respectively, when compared to the same period in 2014, while the increase over the linked quarter was $0.18 million.

ANALYSIS OF FINANCIAL CONDITION

Overview. At June 30, 2015, total assets were $6.06 billion, which is $1.15 billion, or 23.33%, higher than the period-end balance for comparative 2014, and $226.48 million, or 3.89%, greater than the balance at March 31, 2015. Our loan portfolio, less unearned income and deferred costs, made up 69.83% of our period-end assets and totaled $4.23 billion at June 30, 2015. Average assets for the quarter ended June 30, 2015 were $5.90 billion, up $1.09 billion, or 22.66%, from comparative June 30, 2014, and up $71.28 million, or 1.22%, from the quarter ended March 31, 2015.

Average earning assets increased $994.38 million, or 22.53%, from $4.41 billion for the second quarter of 2014 to $5.41 billion for the second quarter of 2015. Compared to the first quarter of 2015, average earning assets increased $116.95 million.

Our average total deposits were $4.55 billion for second quarter 2015, reflecting growth of $843.16 million, or 22.76%, compared to second quarter 2014. Growth continued in average noninterest-bearing deposits, which increased $189.02 million, or 16.91%, from June 30, 2014.

Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest-bearing deposit balances at June 30, 2015 were $164.53 million and consisted mainly of overnight deposits with the Federal Reserve Bank of Richmond.

The average balance of interest-bearing deposits in other banks and federal funds sold during the second quarter of 2015 was $87.71 million, or 1.62%, of average total earning assets compared with $177.05 million, or 4.01%, of average total earning assets for comparative 2014. For the first quarter of 2015, the average balance of interest-bearing deposits in other banks was $202.85 million, or 3.83%, of average total earning assets.

Securities Available for Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The available-for-sale securities portfolio was $759.42 million at June 30, 2015, compared with $549.18 million at June 30, 2014. The average balance during the second quarter of 2015 was $762.22 million, compared to the 2014 period average of $548.43 million, or 14.10% and 12.43% of average earning assets, respectively. During the six months ended June 30, 2015, we had sales, maturities, and calls totaling $229.42 million in investment securities that were classified as available for sale.

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

Securities Held to Maturity. Held-to-maturity securities are valued at amortized cost. Securities held to maturity were $80.19 million at June 30, 2015, and $88.15 million at June 30, 2014. The average balance during the second quarter of 2015 was $81.10 million, compared with $88.83 million in the 2014 period, representing 1.50% and 2.01% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At June 30, 2015, we held $165.99 million in mortgage loans originated and intended for sale in the secondary market, as compared with $91.76 million at June 30, 2014, and $102.85 million at March 31, 2015. Average loans held for sale were 2.43% and 1.63% of average earning assets for the quarters ended June 30, 2015 and 2014, respectively. Average loans held for sale were 1.22% of average earning assets for the quarter ended March 31, 2015. The majority of mortgage loans held for sale have been pre-committed to investors, which minimizes our interest rate risk.

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

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

Loan Portfolio. Loans, net of unearned income and deferred costs, were $4.23 billion at June 30, 2015, which was $758.93 million, or 21.88%, above the $3.47 billion reported at June 30, 2014, and $132.43 million, or 3.23%, above the $4.10 billion at March 31, 2015. The primary factor that contributed to the increase in loans from the prior year was the Franklin merger, which resulted in $492.37 million of acquired loans. Also contributing to the increase were the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers and directors. As a percentage of total average earning assets, average loans were 76.95% for the quarter ended June 30, 2015, compared with 77.80% for comparable 2014 and 76.86% for the quarter ended March 31, 2015.

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

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

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

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

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 June 30, 2015, June 30, 2014, and March 31, 2014 was $37.29 million, $35.79 million, and $35.91 million, respectively. The allowance was equal to 0.88% of total loans outstanding at June 30, 2015, compared with 1.03% and 0.88% at June 30, 2014 and March 31, 2015, respectively. Excluding purchased loans, the allowance was equal to 1.00% of loans outstanding at June 30, 2015, compared with 1.04% and 1.00% at June 30, 2014 and March 31, 2015, respectively. We believe the decline in the ratio, excluding purchased loans, is appropriate given continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Reflective of improving credit quality, classified loans, defined as loans in the substandard and doubtful categories, remained low at 1.67% of total loans at June 30, 2015, down from 1.89% at June 30, 2014 and 1.85% at December 31, 2014. Additionally, loans 30 to 89 days past due were $5.28 million, including purchased impaired loans of $1.30 million, at June 30, 2015, as compared to $9.66 million and $13.44 million at June 30, 2014 and December 31, 2014, respectively, and total past due and nonaccruing loans were $20.83 million, including purchased impaired past-due loans of $9.12 million, at June 30, 2015, from $17.32 million and $20.19 million at June 30, 2014 and December 31, 2014, respectively. Also reflecting improvement in our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 5.00x of nonperforming loans at June 30, 2015, compared with 4.77x and 5.10x at June 30, 2014 and March 31, 2015, respectively. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at June 30, 2015.

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

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

	Three Months Ended			Six Months Ended	
	June 30,		March 31,	June 30,	June 30,
	2015	2014	2015	2015	2014
Allowance for loan losses					
Balance beginning of period	$ 35,907	$ 37,543	$ 35,917	$ 35,917	$ 38,380
Loans charged off:					
Residential 1-4 family	(342)	(404)	(347)	(689)	(1,111)
Multifamily	—	—	—	—	(1)
Commercial real estate	(104)	(558)	(174)	(278)	(944)
Construction	(115)	(59)	(51)	(166)	(285)
Commercial and industrial	(112)	(95)	(5)	(117)	(237)
Consumer and other	(23)	(30)	(13)	(36)	(194)
Total	(696)	(1,146)	(590)	(1,286)	(2,772)
Loans recovered:					
Residential 1-4 family	139	162	129	268	222
Multifamily	—	—	—	—	1
Commercial real estate	56	7	13	69	311
Construction	52	10	1	54	32
Commercial and industrial	87	25	85	172	70
Consumer and other	22	18	29	51	45
Total	356	222	257	614	681
Net loans charged off	(340)	(924)	(333)	(672)	(2,091)
Provision for loan losses	1,723	(833)	323	2,045	(503)
Balance end of period	$ 37,290	$ 35,786	$ 35,907	$ 37,290	$ 35,786
Nonperforming assets					
Nonperforming loans	$ 7,455	$ 7,501	$ 7,045	$ 7,455	$ 7,501
Foreclosed property	46,154	42,404	51,698	46,154	42,404
Total nonperforming assets	$ 53,609	$ 49,905	$ 58,743	$ 53,609	$ 49,905
Loans past due 90 days and still accruing interest	$ 277	$ 28	$ 3	$ 277	$ 28
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	5.00x	4.77x	5.10x	5.00x	4.77x
Allowance for loan losses to period end loans	0.88%	1.03%	0.88%	0.88%	1.03%
Allowance for loan losses to period end loans excluding purchased loans	1.00%	1.04%	1.00%	1.00%	1.04%
Nonperforming loans to period end loans	0.18%	0.22%	0.17%	0.18%	0.22%
Nonperforming assets to period end assets	0.89%	1.02%	1.01%	0.89%	1.02%
Net charge-offs to average loans (annualized)	0.03%	0.11%	0.03%	0.03%	0.12%

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 June 30, 2015, we had $53.61 million in nonperforming assets, which amounted to 0.89% of total assets. Additionally, there were essentially no loans past due 90 days or more that were accruing interest. Nonperforming assets consist of $7.46 million in nonperforming loans as well as $46.15 million in foreclosed property. Nonperforming loans increased by $0.41 million, or 5.82%, from March 31, 2015, as additions to nonaccrual loans during the second quarter of 2015 outpaced transfers to other real estate owned ("OREO"), charge-offs, and payments received. Nonperforming residential loans increased by $0.10 million, with paydowns of $0.34 million, transfers to OREO of $0.20 million, and charge-offs of $0.28 million. Additionally, new construction and development nonperforming loans increased $0.06 million. These additions were outpaced by reductions in nonperforming commercial real estate loans, which decreased by $0.56 million, with paydowns of $0.65 million, charge-offs of $1.02 million, and transfers to OREO of $0.43 million. At June 30, 2015, foreclosed property totaled $46.15 million, a decrease from $51.70 million at March 31, 2015, and an increase from $42.40 million at June 30, 2014. Included in foreclosed property at June 30, 2015 was OREO of $10.33 million acquired in the Franklin merger. At June 30, 2015, four OREO properties with a total carrying value of $6.46 million were under contract to sell, but had not yet closed. The 10 largest foreclosed property developments represented approximately 82% of total foreclosed property at June 30, 2015, with the largest development representing approximately 34%. Foreclosed property consists of 32 residential properties, 32 construction and development properties, and four commercial properties.

At June 30, 2015, loans 60-89 days past due, excluding nonperforming loans, totaled $2.23 million. Additionally, there are other performing loans, totaling $27.13 million, that are current but have certain documentation deficiencies or other potential weaknesses that management has determined warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At June 30, 2015, nonaccruing TDRs, which are included in nonperforming loans, totaled $1.40 million, and accruing TDRs totaled $31.71 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. All restructured loans are considered impaired in the calendar year of restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

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

	June 30, 2015	December 31, 2014
Construction and land development	$ 1,263	$ 1,680
Commercial real estate	1,450	2,132
Multi-family real estate	751	—
1-4 family residential real estate	3,703	2,546
Commercial and industrial business loans	288	383
Consumer loans and other	—	—
Total nonperforming loans	$ 7,455	$ 6,741

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

	June 30,		March 31,
	2015	2014	2015
Real estate loans:			
Residential 1-4 family	$ 8,962	$ 9,268	$ 8,543
Commercial	14,639	13,885	14,927
Construction	5,509	6,686	5,547
Multi-family	752	571	700
Total real estate loans	29,862	30,410	29,717
Commercial and industrial loans	5,454	4,560	4,658
Consumer loans and other	1,974	816	1,532
Total	$ 37,290	$ 35,786	$ 35,907

Deposits. Total deposits at June 30, 2015 were $4.69 billion, representing an increase of 23.47%, or $890.82 million, over June 30, 2014, and an increase of $181.03 million, or 4.02%, compared to March 31, 2015. Overall growth in deposits from the first quarter of 2015 is primarily attributed to the Franklin merger, combined with an increase in the Banking segment customer base, and new branch strategies. Total average deposits were $4.55 billion during the second quarter of 2015, compared to $3.71 billion during the second quarter of 2014, and $4.50 billion during the first quarter of 2015.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 28.74% during the second quarter of 2015 and 30.18% during the same period in 2014. Average noninterest-bearing demand deposits were 27.88% of average total deposits for the first quarter of 2015. The cost of interest-bearing deposits was 0.55% for the second quarter of 2015, compared with 0.51% for the second quarter of 2014, and 0.55% for the first quarter of 2015.

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

	Average Balance/Cost Rate					
	Three Months Ended					
	June 30,				March 31,	
	2015		2014		2015	
Interest-bearing demand and money market accounts	$ 1,646,075	0.28%	$ 1,305,681	0.25%	$ 1,635,454	0.28%
Regular savings	301,020	0.92%	311,732	0.93%	305,016	0.91%
Certificates of deposit	1,294,181	0.81%	969,724	0.73%	1,308,364	0.82%
Total interest-bearing	3,241,276	0.55%	2,587,137	0.51%	3,248,834	0.55%
Noninterest-bearing	1,307,075		1,118,051		1,256,025	
Total	$ 4,548,351	0.39%	$ 3,705,188	0.36%	$ 4,504,859	0.40%

	Average Balance/Cost Rate			
	Six Months Ended			
	June 30, 2015		June 30, 2014	
Interest bearing demand and money market accounts	$ 1,640,794	0.28%	$ 1,282,139	0.24%
Regular savings	303,007	0.92%	315,476	0.93%
Certificates of deposit	1,301,233	0.81%	968,821	0.76%
Total interest bearing	3,245,034	0.55%	2,566,436	0.52%
Noninterest bearing	1,281,690		1,078,200	
Total	$ 4,526,724	0.39%	$ 3,644,636	0.37%

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

	Average Balance and Composition Three Months Ended								
	June 30,						March 31,		
	2015			2014			2015		
Interest-bearing demand and money market accounts	$	1,646,075	36.19%	$	1,305,681	35.24%	$	1,635,454	36.31%
Regular savings		301,020	6.62%		311,732	8.41%		305,016	6.77%
Certificates of deposit		1,294,181	28.45%		969,724	26.17%		1,308,364	29.04%
Total-interest bearing		3,241,276	71.26%		2,587,137	69.82%		3,248,834	72.12%
Noninterest-bearing		1,307,075	28.74%		1,118,051	30.18%		1,256,025	27.88%
Total	$	4,548,351	100.00%	$	3,705,188	100.00%	$	4,504,859	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the Federal Home Loan Bank of Atlanta ("FHLB") at June 30, 2015 were $437.58 million, compared to $394.62 million at June 30, 2014, and $397.88 million at March 31, 2015. The average borrowing cost for the second quarter of 2015 was 3.06%, and 3.32% in the fourth quarter of 2014 and the first quarter of 2015.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at June 30, 2015, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call Date		Outstanding Amount
03/06/2017	4.08%	09/08/2015	$	100,000
05/18/2017	4.35%	08/18/2015		80,000
05/18/2017	4.48%	08/18/2015		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%	—		8,226
11/15/2028	3.43%	—		5,440
12/01/2028	2.83%	—		3,918
05/16/2016	0.44%	—		40,000
		Total FHLB Loans	**$**	**437,584**

At June 30, 2015, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $735.81 million collateralized the advances from the FHLB. At June 30, 2014, certain loans with carrying values of $779.55 million collateralized the advances from the FHLB. At March 31, 2015, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $707.41 million collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of June 30, 2015, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the second quarter of 2015 were $460.99 million, compared with $426.42 million for the second quarter of 2014, and $447.20 million for the first quarter of 2015, while the average cost of these funds was 2.90%, 3.09%, and 3.03%, respectively.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* on page 43 in this report.

On February 27, 2015, we declared a quarterly shareholder cash dividend of $0.11 per common share. The dividend was paid on April 10, 2015, to shareholders of record on March 30, 2015.

On May 19, 2015, we declared a quarterly shareholder cash dividend of $0.12 per common share. The dividend was paid on July 10, 2015, to shareholders of record on June 30, 2015. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

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

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

In July 2013, the FDIC and the other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the FDIC final rule's revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. A transition period for the capital conservation buffer under Basel III for all banking organizations will begin on January 1, 2016 and end January 1, 2019.

An additional measure of capital adequacy is risk-based capital ratios. Risk-based capital ratios, which include common equity tier I, tier I capital, total capital and leverage capital, are calculated based on Basel III regulatory transitional guidance related to the measurement of capital, risk-weighted assets, and average assets. As indicated below, our risk-based capital ratios are 12.96% for common equity tier I, 13.07% for tier I, and 13.84% for total capital, which are well above the required minimums of 4.50%, 6.00%, and 8.00%, respectively. Under the FDIC rules, we are considered "well capitalized" as of June 30, 2015.

The following table provides information on our risk-based capital position as of the dated indicated (dollars in thousands):

	June 30, 2015	June 30, 2014	March 31, 2015
	Basel III	Basel I	Basel III
Tier I Capital:			
Shareholders' equity	$ 802,891	$ 604,812	$ 791,580
Less: goodwill and intangible assets, net of deferred tax	161,046	128,237	163,454
AOCI-related adjustments	291	867	2,359
Noncontrolling interests	8,873	N/A	8,424
Total common equity tier I capital	632,681	N/A	617,343
Included noncontrolling interests	5,545	N/A	5,244
Total tier I capital	638,226	475,708	622,587
Tier II Capital:			
Qualifying allowance for loan losses (1)	37,290	35,786	35,907
Total tier II capital	37,290	35,786	35,907
Total Risk-Based Capital	$ 675,516	$ 511,494	$ 658,494
Total assets	$ 6,055,181	$ 4,909,843	$ 5,828,703
Total risk-weighted assets (2)	4,882,513	3,708,318	4,716,018
Average assets for leverage capital purposes	5,739,770	4,682,345	5,666,078
Risk-weighted assets to total assets	80.63%	75.53%	80.91%
Risk-based capital ratios:			
Common equity tier I (4.5% minimum requirement)	12.96%	N/A	13.09%
Tier I (6% minimum requirement in 2015, 4% in prior periods)	13.07%	12.83%	13.20%
Total (8% minimum requirement, all periods)	13.84%	13.79%	13.96%
Tier I leverage ratio (4% minimum requirement, all periods)	11.12%	10.16%	10.99%

(1) Limited to 1.25% of risk-weighted assets.
(2) Risk-weighted assets are determined based on the regulatory capital requirements in effect for the periods presented.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Return on average assets (GAAP basis)	1.21%	0.97%	1.11%	0.97%
Impact of excluding average goodwill and other intangibles and amortization	0.07%	0.06%	0.08%	0.06%
Return on average tangible assets	1.28%	1.03%	1.19%	1.03%

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Return on average equity (GAAP basis)	8.93%	7.79%	8.25%	7.71%
Impact of excluding average goodwill and other intangibles and amortization	2.84%	2.41%	2.79%	2.32%
Return on average tangible equity	11.77%	10.20%	11.04%	10.03%

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

	Three Months Ended June 30,	
	2015	2014
Book value (GAAP basis)	$ 15.40	$ 14.63
Impact of excluding goodwill and other intangibles and amortization	(3.40)	(3.67)
Tangible book value	$ 12.00	$ 10.96

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

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

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

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

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

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

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

At June 30, 2015, we had $541.30 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

Item 4. Controls and Procedures

Controls and Procedures. As of June 30, 2015, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of June 30, 2015. There were no changes that occurred during the period covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
In the ordinary course of operations, we are a party to various legal proceedings. Based upon information currently available, management believes that such legal proceedings, in the aggregate, will not have a material adverse effect on our business, financial condition, or results of operations.

Item 1A. Risk Factors
For information regarding factors that could affect the Company's results of operations, financial condition, or liquidity, see the risk factors discussed in Part I, Item 1A, of TowneBank's 2014 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2, of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2014 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
None

Item 3. Defaults Upon Senior Securities
None

Item 4. Mine Safety Disclosures
Not applicable

Item 5. Other Information
None

Item 6. Exhibits

Exhibit No.	Description
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
(99)	Independent Accountants' Report by Dixon Hughes Goodman LLP, dated August 10, 2015

Signatures

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

TOWNEBANK

August 10, 2015	By: /s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
August 10, 2015	By: /s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

Exhibit (31.1)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2015 of TowneBank;

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

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

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act 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

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

   (a) All significant deficiencies and material weaknesses in the design or operation of 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

Exhibit (31.1)

continued

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

August 10, 2015	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr.
	Chairman of the Board/Chief Executive Officer

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

Exhibit (31.2)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2015 of TowneBank;

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

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

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act 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

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

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

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

August 10, 2015	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

Exhibit (32)

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

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

1. Our Quarterly Report on Form 10-Q for the quarter ended June 30, 2015 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

August 10, 2015	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
August 10, 2015	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

DIXON HUGHES GOODMAN LLP

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of *TowneBank*

We have reviewed the accompanying consolidated balance sheets of *TowneBank* and subsidiaries (the Company) as of June 30, 2015 and 2014, the related consolidated statement of equity for the six months ended June 30, 2015, and the related consolidated statements of income, comprehensive income and cash flows for the three-month and six-month periods ended June 30, 2015 and 2014. This condensed financial information is the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated balance sheet of *TowneBank* and subsidiaries as of December 31, 2014, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated March 13, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2014, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Dixon Hughes Goodman LLP

Norfolk, Virginia
August 10, 2015