

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 September 30, 2015

FDIC Insurance Cert. Number: 35095

TOWNE BANK

(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 ☒ 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 ☒

The number of shares of the Company's common stock outstanding as of October 31, 2015 was 51,667,040 shares.

TOWNE BANK

TABLE OF CONTENTS

Part I. Financial Information

Item 1.	Financial Statements	
	Consolidated Balance Sheets	3
	September 30, 2015 (unaudited)	
	September 30, 2014 (unaudited)	
	December 31, 2014 (audited)	
	Consolidated Statements of Income	4
	Three and Nine Months Ended September 30, 2015 (unaudited)	
	Three and Nine Months Ended September 30, 2014 (unaudited)	
	Consolidated Statements of Comprehensive Income	5
	Three and Nine Months Ended September 30, 2015 (unaudited)	
	Three and Nine Months Ended September 30, 2014 (unaudited)	
	Consolidated Statements of Cash Flow	6
	Nine Months Ended September 30, 2015 (unaudited)	
	Nine Months Ended September 30, 2014 (unaudited)	
	Consolidated Statement of Equity	7
	Nine Months Ended September 30, 2015 (unaudited)	
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	43
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	78
Item 4.	Controls and Procedures	79

Part II. Other Information

Item 1.	Legal Proceedings	80
Item 1A.	Risk Factors	80
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	80
Item 3.	Defaults Upon Senior Securities	80
Item 4.	Mine Safety Disclosures	80
Item 5.	Other Information	80
Item 6.	Exhibits	80

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS (unaudited)

(In thousands, except share data)

(In thousands, except share data)	September 30,		December 31,
	2015	2014	2014
	(unaudited)		(1)
ASSETS			
Cash and due from banks	\$ 284,625	\$ 230,889	\$ 212,994
Interest-bearing deposits in financial institutions	1,000	1,000	1,011
Total Cash and Cash Equivalents	285,625	231,889	214,005
Securities available for sale, at fair value	542,634	607,931	603,908
Securities held to maturity, at amortized cost	75,154	86,794	85,247
Federal Home Loan Bank stock, at amortized cost	24,058	22,150	22,157
Total Securities	641,846	716,875	711,312
Mortgage loans held for sale	99,330	86,034	71,390
Loans, net of unearned income and deferred costs:			
Real estate - residential 1-4 family	965,559	833,208	837,370
Real estate - commercial	1,796,150	1,451,271	1,447,078
Real estate - construction and land development	554,753	476,379	452,481
Real estate - multifamily	138,954	53,368	51,472
Commercial and industrial business	790,614	644,528	700,623
Consumer and other loans	121,009	62,321	75,365
Loans, net of unearned income and deferred costs	4,367,039	3,521,075	3,564,389
Less: Allowance for loan losses	(37,351)	(36,180)	(35,917)
Net Loans	4,329,688	3,484,895	3,528,472
Premises and equipment, net	172,940	154,343	155,774
Goodwill	152,438	111,761	113,159
Other intangible assets, net	23,080	17,721	22,509
Bank-owned life insurance policies	147,949	58,217	58,716
Other assets	320,995	110,713	107,148
TOTAL ASSETS	\$ 6,173,891	\$ 4,972,448	\$ 4,982,485
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	\$ 1,445,978	\$ 1,245,925	\$ 1,224,466
Interest-bearing:			
Demand and money market accounts	1,676,623	1,309,085	1,365,183
Savings	295,952	306,811	301,033
Certificates of deposit	1,369,325	988,111	955,920
Total Deposits	4,787,878	3,849,932	3,846,602
Advances from the Federal Home Loan Bank	437,282	398,477	398,181
Repurchase agreements and other borrowings	33,784	24,594	31,893
Total Borrowings	471,066	423,071	430,074
Other liabilities	98,878	86,037	87,533
TOTAL LIABILITIES	5,357,822	4,359,040	4,364,209
Shareholders' Equity			
Preferred stock: 2,000,000 shares authorized			
0 shares issued at September 30, 2015 and 76,458 shares issued at September 30, 2014 and December 31, 2014	—	76,458	76,458
Common stock, \$1.667 par: 90,000,000 shares authorized			
51,580,762; 35,538,144; and 35,785,679 shares issued at September 30, 2015 and 2014 and December 31, 2014, respectively	85,985	59,242	59,655
Capital surplus	533,609	316,240	317,718
Retained earnings	186,522	151,547	154,655
Common stock issued to deferred compensation trust, at cost			
651,362; 617,886; and 627,730 shares at September 30, 2015 and 2014 and December 31, 2014, respectively	(10,151)	(9,508)	(9,674)
Deferred compensation trust	10,151	9,508	9,674
Accumulated other comprehensive income	1,036	698	458
TOTAL SHAREHOLDERS' EQUITY	807,152	604,185	608,944
Noncontrolling interests	8,917	9,223	9,332
TOTAL EQUITY	816,069	613,408	618,276
TOTAL LIABILITIES AND EQUITY	\$ 6,173,891	\$ 4,972,448	\$ 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		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
INTEREST INCOME:				
Loans, including fees	\$ 48,906	\$ 40,404	\$ 144,418	\$ 119,554
Investment securities	3,728	2,303	10,386	6,688
Interest-bearing deposits in financial institutions and federal funds sold	107	174	287	493
Mortgage loans held for sale	1,246	787	2,971	1,934
Total Interest Income	53,987	43,668	158,062	128,669
INTEREST EXPENSE:				
Deposits	4,881	3,405	13,747	10,043
Advances from the Federal Home Loan Bank	3,422	3,385	10,160	9,990
Repurchase agreements and other borrowings	14	11	44	38
Total Interest Expense	8,317	6,801	23,951	20,071
Net Interest Income	45,670	36,867	134,111	108,598
PROVISION FOR LOAN LOSSES	130	996	2,176	493
Net Interest Income after Provision for Loan Losses	45,540	35,871	131,935	108,105
NONINTEREST INCOME:				
Residential mortgage banking income, net	8,262	7,858	26,956	20,655
Real estate brokerage and property management income, net	5,349	3,645	13,888	10,184
Insurance commissions and other title fees and income, net	9,710	8,861	30,644	26,815
Service charges on deposit accounts	2,388	2,406	6,911	6,904
Credit card merchant fees, net	823	927	1,821	2,665
Other income	3,036	2,572	11,081	7,119
Net gain (loss) on investment securities	736	44	904	(15)
Total Noninterest Income	30,304	26,313	92,205	74,327
NONINTEREST EXPENSE:				
Salaries and employee benefits	28,910	25,080	83,133	73,801
Occupancy expense	4,703	4,618	14,489	13,188
Furniture and equipment	2,211	2,040	6,949	6,080
Other expenses	14,082	12,416	44,843	36,836
Total Noninterest Expense	49,906	44,154	149,414	129,905
Income before income tax expense and noncontrolling interest	25,938	18,030	74,726	52,527
Provision for income tax expense	7,444	5,044	22,030	15,381
Net income	18,494	12,986	52,696	37,146
Net income attributable to noncontrolling interest	(928)	(860)	(2,780)	(2,212)
Net income attributable to TowneBank	\$ 17,566	\$ 12,126	\$ 49,916	\$ 34,934
Preferred stock dividends	—	191	13	573
Net income available to common shareholders	\$ 17,566	\$ 11,935	\$ 49,903	\$ 34,361
Per common share information				
Basic earnings	\$ 0.34	\$ 0.34	\$ 0.98	\$ 0.98
Diluted earnings	\$ 0.34	\$ 0.34	\$ 0.98	\$ 0.98
Cash dividends declared	\$ 0.12	\$ 0.11	\$ 0.35	\$ 0.32

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		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$ 18,494	\$ 12,986	\$ 52,696	\$ 37,146
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	1,822	(229)	1,536	1,575
Deferred tax (expense) benefit	(638)	80	(538)	(552)
Realized (gains) losses reclassified into earnings	(736)	(44)	(785)	15
Deferred tax expense (benefit)	258	15	275	(6)
Net unrealized gains (losses)	706	(178)	488	1,032
Defined benefit retirement plan				
Amortization	60	15	138	15
Deferred tax expense	(21)	(5)	(48)	(5)
Change in defined benefit retirement plan, net of tax	39	10	90	10
Other comprehensive income (loss), net of tax	745	(168)	578	1,042
Comprehensive income	<u>\$ 19,239</u>	<u>\$ 12,818</u>	<u>\$ 53,274</u>	<u>\$ 38,188</u>

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)

	Nine Months Ended September 30,	
	2015	2014
OPERATING ACTIVITIES:		
Net income	\$ 52,696	\$ 37,146
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Net amortization of securities	2,479	2,407
Investment securities (gains) losses	(904)	15
Depreciation, amortization, and other intangible amortization	11,981	10,197
Provision for loan losses	2,176	493
Bank-owned life insurance income	(3,688)	(1,359)
Deferred income tax (benefit) expense	(2,056)	1,158
Share-based compensation expense	1,658	1,276
Originations of mortgage loans held for sale	(1,126,580)	(836,381)
Proceeds from sales of mortgage loans held for sale	1,138,103	837,009
Gain on sales of mortgage loans held for sale	(39,463)	(28,020)
Loss on sale and write-down of foreclosed assets	844	1,369
Changes in:		
Interest receivable	(1,774)	100
Other assets	(38,651)	(14,045)
Interest payable	586	(80)
Other liabilities	(300)	5,750
Net cash from operating activities	(2,893)	17,035
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(278,400)	(322,820)
Purchase of held-to-maturity securities	—	(31,793)
Sale of available-for-sale securities	234,909	1,861
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	149,120	255,722
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	7,767	3,973
Net increase in loans	(311,026)	(142,575)
Purchase of premises and equipment	(19,327)	(9,109)
Proceeds from sales of premises and equipment	3,641	138
Proceeds from sales of foreclosed assets	17,614	11,190
Cash acquired in acquisitions of business, net of cash consideration paid	247,881	(6,098)
Net cash from (used for) investing activities	62,564	(238,429)
FINANCING ACTIVITIES:		
Net change in deposit accounts	258,330	282,828
Net change in borrowings	(150,480)	(20,098)
Redemption of preferred stock	(76,458)	—
Distribution of interest in joint ventures	(3,195)	(1,999)
Proceeds from (payments for) issuance of common stock	1,801	(327)
Cash dividends paid	(18,049)	(11,914)
Net cash from financing activities	11,949	248,490
Change in cash and cash equivalents	71,620	27,096
Cash and cash equivalents at beginning of year	214,005	204,793
Cash and cash equivalents at end of period	\$ 285,625	\$ 231,889
Supplemental cash flow information:		
Cash paid for interest	\$ 23,365	\$ 20,151
Cash paid for income taxes	\$ 10,720	\$ 12,047
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 6,316	\$ 10,500
Sales of foreclosed assets financed by the Company	\$ 9,791	\$ 2,328
Net unrealized gains on available-for-sale securities, net of tax	\$ 488	\$ 1,033
Shares issued for business acquisitions	\$ 238,755	\$ 2,771
Common stock issued in connection with conversion of convertible subordinated capital debentures	\$ 7	\$ 94

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	—	—	—	—	49,916	—	—	—	2,780	52,696
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	578	—	578
Cash dividends declared on common stock	—	—	—	—	(18,036)	—	—	—	—	(18,036)
Cash dividends declared on preferred stock	—	—	—	—	(13)	—	—	—	—	(13)
Director's deferred compensation	—	—	—	—	—	477	(477)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	—	(3,195)	(3,195)
Redemption of preferred stock	—	(76,458)	—	—	—	—	—	—	—	(76,458)
Conversion of convertible debt into common stock	484	—	1	6	—	—	—	—	—	7
Issuance of common stock - contingent consideration earned on acquisitions	113,388	—	189	1,645	—	—	—	—	—	1,834
Issuance of common stock - acquisitions	15,552,981	—	25,925	212,830	—	—	—	—	—	238,755
Issuance of common stock - stock compensation plans	128,230	—	215	1,410	—	—	—	—	—	1,625
Balance, September 30, 2015	<u>51,580,762</u>	<u>\$ —</u>	<u>\$ 85,985</u>	<u>\$ 533,609</u>	<u>\$ 186,522</u>	<u>\$ 10,151</u>	<u>\$ (10,151)</u>	<u>\$ 1,036</u>	<u>\$ 8,917</u>	<u>\$ 816,069</u>

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 three- and nine-month periods ended September 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		
	Prior to Revision	Revision	As Presented	As Previously Presented	Revision	Subsequent to Revision
<i>(in thousands)</i>						
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 September 30, 2014			Nine Months Ended September 30, 2014		
	Prior to Revision	Revision	As Presented	As Previously Presented	Revision	Subsequent to Revision
INTEREST INCOME:						
Loans, including fees	\$ 39,271	\$ 1,133	\$ 40,404	\$ 116,420	\$ 3,134	\$ 119,554
Investment securities	\$ 3,436	\$ (1,133)	\$ 2,303	\$ 9,822	\$ (3,134)	\$ 6,688
Provision for loan losses	\$ 996	\$ —	\$ 996	\$ 493	\$ —	\$ 493

At September 30, 2015, the Company had \$237.78 million in IRBs classified as loans held for investment. The Company reclassified \$162.54 million in IRBs previously included in investment securities to loans held for investment at September 30, 2014. Additionally, the Company recorded \$1.58 million and \$4.01 million

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

in interest income from loans related to IRBs for the three and nine months ended September 30, 2015, respectively.

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. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. The pronouncement is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying the pronouncement recognized at the date of initial application. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Basic				
Net income, as reported	\$ 17,566	\$ 12,126	\$ 49,916	\$ 34,934
Preferred stock dividends	—	191	13	573
Net income available to common shareholders	\$ 17,566	\$ 11,935	\$ 49,903	\$ 34,361
Weighted-average common shares outstanding	51,153,205	35,271,506	50,976,963	35,142,937
Basic earnings per share amount	\$ 0.34	\$ 0.34	\$ 0.98	\$ 0.98
Diluted				
Net income available to common shareholders, for diluted EPS	\$ 17,566	\$ 11,935	\$ 49,903	\$ 34,361
Weighted-average common shares outstanding	51,153,205	35,271,506	50,976,963	35,142,937
Add shares if converted:				
Stock compensation plans, net of tax benefit (1)	110,177	39,826	69,936	48,827
Weighted-average diluted shares outstanding	51,263,382	35,311,332	51,046,899	35,191,764
Diluted earnings per share amount	\$ 0.34	\$ 0.34	\$ 0.98	\$ 0.98

(1) There were no shares with respect to stock options or restricted stock excluded from the computation of diluted earnings per share during the third quarter of 2015 and there were 573 shares with respect to stock options and restricted stock excluded from the computation of diluted earnings per share during the third quarter of 2014; 22,234 and 19,846 shares with respect to stock options and restricted stock were excluded from the computation of diluted earnings per share during the nine months ended September 30, 2015 and 2014, respectively, because their inclusion would be anti-dilutive.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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):

September 30, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	\$ 347,517	\$ 699	\$ —	\$ 348,216
Municipal securities	18,887	478	(11)	19,354
Trust preferred and other corporate securities	7,709	684	(2)	8,391
Mortgage-backed securities issued by GSE	165,732	1,190	(249)	166,673
Total available-for-sale securities	<u>\$ 539,845</u>	<u>\$ 3,051</u>	<u>\$ (262)</u>	<u>\$ 542,634</u>

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	<u>\$ 601,870</u>	<u>\$ 2,775</u>	<u>\$ (737)</u>	<u>\$ 603,908</u>

TOWNE BANK

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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):

September 30, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	\$ 500	\$ 216	\$ —	\$ 716
Municipal securities	49,160	2,954	—	52,114
Mortgage-backed securities issued by GSE	25,494	251	—	25,745
Total held-to-maturity securities	<u>\$ 75,154</u>	<u>\$ 3,421</u>	<u>\$ —</u>	<u>\$ 78,575</u>

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	<u>\$ 85,247</u>	<u>\$ 4,321</u>	<u>\$ (15)</u>	<u>\$ 89,553</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 in the following table (in thousands):

September 30, 2015

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 90,911	\$ 91,040	\$ —	\$ —
Due after one year through five years	237,657	238,262	2,080	2,224
Due after five years through 10 years	73,366	73,879	44,932	45,954
Due after 10 years	136,477	138,019	28,142	30,397
	538,411	541,200	75,154	78,575
Other equity securities	1,434	1,434	—	—
	<u>\$ 539,845</u>	<u>\$ 542,634</u>	<u>\$ 75,154</u>	<u>\$ 78,575</u>

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	—	—
	<u>\$ 601,870</u>	<u>\$ 603,908</u>	<u>\$ 85,247</u>	<u>\$ 89,553</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 (in thousands):

September 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
Municipal securities	\$ 2,463	\$ (11)	\$ —	\$ —	\$ 2,463	\$ (11)
Mortgage-backed securities issued by GSE	29,528	(249)	—	—	29,528	(249)
Corporate Obligations	1,994	(2)	—	—	1,994	(2)
Total temporarily impaired securities	<u>\$ 33,985</u>	<u>\$ (262)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 33,985</u>	<u>\$ (262)</u>

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	<u>\$ 188,750</u>	<u>\$ (302)</u>	<u>\$ 74,100</u>	<u>\$ (450)</u>	<u>\$ 262,850</u>	<u>\$ (752)</u>

U.S. government agency securities

The Company had no unrealized losses on obligations of U.S. government agency securities at September 30, 2015.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At September 30, 2015, two securities had unrealized losses of \$0.01 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015, twelve securities had unrealized losses of \$0.25 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 September 30, 2015, two corporate securities had unrealized losses of \$2,000. 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 September 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 September 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 \$37.35 million adequate to cover estimated loan losses inherent in the loan portfolio at September 30, 2015.

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

Three Months Ended	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
September 30, 2015							
Allowance for loan losses:							
Balance, beginning of period	\$ 5,509	\$ 14,639	\$ 752	\$ 8,962	\$ 5,454	\$ 1,974	\$ 37,290
Provision for loan losses	(827)	216	(94)	399	(201)	637	130
Losses charged off	(32)	—	—	(401)	—	(55)	(488)
Recoveries	21	14	—	100	243	41	419
Balance, end of period	<u>\$ 4,671</u>	<u>\$ 14,869</u>	<u>\$ 658</u>	<u>\$ 9,060</u>	<u>\$ 5,496</u>	<u>\$ 2,597</u>	<u>\$ 37,351</u>
Nine Months Ended							
September 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	(867)	838	(9)	661	236	1,317	2,176
Losses charged off	(198)	(278)	—	(1,090)	(118)	(91)	(1,775)
Recoveries	75	83	—	368	415	92	1,033
Balance, end of period	<u>\$ 4,671</u>	<u>\$ 14,869</u>	<u>\$ 658</u>	<u>\$ 9,060</u>	<u>\$ 5,496</u>	<u>\$ 2,597</u>	<u>\$ 37,351</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended	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
September 30, 2014							
Allowance for loan losses:							
Balance, beginning of period	\$ 6,686	\$ 13,885	\$ 571	\$ 9,268	\$ 4,560	\$ 816	\$ 35,786
Provision charged to expense	(219)	628	641	(280)	(117)	343	996
Losses charged off	(128)	—	(492)	(214)	(14)	(211)	(1,059)
Recoveries	17	119	—	271	26	24	457
Balance, end of period	<u>\$ 6,356</u>	<u>\$ 14,632</u>	<u>\$ 720</u>	<u>\$ 9,045</u>	<u>\$ 4,455</u>	<u>\$ 972</u>	<u>\$ 36,180</u>
Nine Months Ended							
September 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	(1,204)	1,526	513	(855)	(101)	614	493
Losses charged off	(414)	(944)	(493)	(1,324)	(251)	(405)	(3,831)
Recoveries	49	429	1	494	96	69	1,138
Balance, end of period	<u>\$ 6,356</u>	<u>\$ 14,632</u>	<u>\$ 720</u>	<u>\$ 9,045</u>	<u>\$ 4,455</u>	<u>\$ 972</u>	<u>\$ 36,180</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	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
September 30, 2015							
Period-end balance allocated to:							
Loans individually evaluated for impairment	\$ 459	\$ 982	\$ —	\$ 972	\$ 27	\$ 13	\$ 2,453
Loans collectively evaluated for impairment	4,212	13,887	658	8,088	5,469	2,584	34,898
Loans acquired with deteriorated credit quality	—	—	—	27	—	—	27
Balance, end of period	<u>\$ 4,671</u>	<u>\$ 14,869</u>	<u>\$ 658</u>	<u>\$ 9,060</u>	<u>\$ 5,496</u>	<u>\$ 2,597</u>	<u>\$ 37,351</u>
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	<u>\$ 5,661</u>	<u>\$ 14,226</u>	<u>\$ 667</u>	<u>\$ 9,121</u>	<u>\$ 4,963</u>	<u>\$ 1,279</u>	<u>\$ 35,917</u>

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

	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
September 30, 2015							
Ending balance: individually evaluated for impairment	\$ 10,288	\$ 14,107	\$ 742	\$ 12,664	\$ 510	\$ 85	\$ 38,396
Ending balance: collectively evaluated for impairment	534,793	1,743,454	122,164	921,477	790,104	120,924	4,232,916
Ending balance: loans acquired with deteriorated credit quality	9,672	38,589	16,048	31,418	—	—	95,727
Ending Balance	<u>\$ 554,753</u>	<u>\$1,796,150</u>	<u>\$ 138,954</u>	<u>\$ 965,559</u>	<u>\$ 790,614</u>	<u>\$ 121,009</u>	<u>\$4,367,039</u>
December 31, 2014							
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	<u>\$ 452,481</u>	<u>\$1,447,078</u>	<u>\$ 51,472</u>	<u>\$ 837,370</u>	<u>\$ 700,623</u>	<u>\$ 75,365</u>	<u>\$3,564,389</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 nine months ended September 30, 2015 and 2014 (in thousands):

	September 30,	
	2015	2014
Balance at beginning of period	\$ 2,107	\$ 2,800
Additions	42,648	—
Accretion	(5,481)	(523)
Reclassifications from nonaccretable balance, net	3,182	—
Other changes, net	292	—
Balance at end of period	<u>\$ 42,748</u>	<u>\$ 2,277</u>

At September 30, 2015, none of the purchased impaired 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 impaired 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 (in thousands):

	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
September 30, 2015							
Pass	\$ 528,587	\$ 1,751,355	\$ 134,488	\$ 944,488	\$ 781,684	\$ 120,850	\$ 4,261,452
Special Mention	740	22,846	3,443	4,203	5,346	50	36,628
Substandard	25,426	21,949	1,023	16,868	3,584	109	68,959
Doubtful	—	—	—	—	—	—	—
Total	<u>\$ 554,753</u>	<u>\$ 1,796,150</u>	<u>\$ 138,954</u>	<u>\$ 965,559</u>	<u>\$ 790,614</u>	<u>\$ 121,009</u>	<u>\$ 4,367,039</u>

	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
December 31, 2014							
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	<u>\$ 452,481</u>	<u>\$ 1,447,078</u>	<u>\$ 51,472</u>	<u>\$ 837,370</u>	<u>\$ 700,623</u>	<u>\$ 75,365</u>	<u>\$ 3,564,389</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 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):

	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
September 30, 2015								
Construction and land development	\$ 160	\$ —	\$ 5,956	\$ 1,323	\$ 7,439	\$ 547,314	\$ 554,753	\$ 31
Commercial real estate	2,215	533	—	2,456	5,204	1,790,946	1,796,150	—
Multifamily real estate	—	—	—	742	742	138,212	138,954	—
1-4 family residential real estate	1,979	678	1,991	3,614	8,262	957,297	965,559	—
Commercial and industrial business loans	172	—	—	285	457	790,157	790,614	—
Consumer loans and other	127	—	—	57	184	120,825	121,009	—
Total	\$ 4,653	\$ 1,211	\$ 7,947	\$ 8,477	\$ 22,288	\$4,344,751	\$ 4,367,039	\$ 31
	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
December 31, 2014								
Construction and land development	\$ 1,735	\$ 19	\$ —	\$ 1,680	\$ 3,434	\$ 449,047	\$ 452,481	\$ —
Commercial real estate	1,552	721	—	2,132	4,405	1,442,673	1,447,078	—
Multifamily real estate	762	—	—	—	762	50,710	51,472	—
1-4 family residential real estate	4,800	3,552	12	2,546	10,910	826,460	837,370	12
Commercial and industrial business loans	234	—	—	383	617	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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table includes an aging analysis of the recorded investment of purchased impaired loans as of September 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
September 30, 2015									
Construction and land development	\$	—	\$	—	\$	5,925	\$ 5,925	\$ 3,747	\$ 9,672
Commercial real estate		—		62		—	62	38,527	38,589
Multifamily real estate		—		—		—	—	16,048	16,048
1-4 family residential real estate		81		—		1,991	2,072	29,346	31,418
Commercial and industrial business loans		—		—		—	—	—	—
Consumer loans and other		—		—		—	—	—	—
Total	<u>\$</u>	<u>81</u>	<u>\$</u>	<u>62</u>	<u>\$</u>	<u>7,916</u>	<u>\$ 8,059</u>	<u>\$ 87,668</u>	<u>\$ 95,727</u>

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 \$2.97 million in excess of deferred loan costs at September 30, 2015, \$2.59 million at September 30, 2014, and \$2.57 million at December 31, 2014. There were \$8.48 million, \$5.85 million, and \$6.74 million in nonaccrual loans at September 30, 2015, September 30, 2014, and December 31, 2014, respectively. The Company would have earned \$0.07 million in the third quarter of 2015 if interest on the loans had been accrued.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 (in thousands):

	Unpaid			Average	QTD	YTD
	Principal	Recorded	Specific	Recorded	Interest	Interest
	Balance	Balance	Allowance	Investment	Income	Income
September 30, 2015					Recognized	Recognized
Loans without a specific valuation allowance						
Construction and land development	\$ 8,367	\$ 8,347	\$ —	\$ 8,463	\$ 100	\$ 302
Commercial real estate	4,648	4,648	—	4,667	52	155
Multi-family real estate	755	742	—	756	8	21
1-4 family residential real estate	2,106	1,951	—	2,132	20	60
Commercial and industrial business loans	277	161	—	264	3	12
Consumer loans and other	1	1	—	3	—	—
Total	\$ 16,154	\$ 15,850	\$ —	\$ 16,285	\$ 183	\$ 550
Loans with a specific valuation allowance						
Construction and land development	\$ 2,331	\$ 1,941	\$ 459	\$ 2,559	\$ 17	\$ 52
Commercial real estate	9,749	9,459	982	9,804	139	353
Multi-family real estate	—	—	—	—	—	—
1-4 family residential real estate	11,186	10,713	972	11,276	133	372
Commercial and industrial business loans	406	349	27	425	5	15
Consumer loans and other	85	84	13	92	3	3
Total	\$ 23,757	\$ 22,546	\$ 2,453	\$ 24,156	\$ 297	\$ 795
Total impaired loans						
Construction and land development	\$ 10,698	\$ 10,288	\$ 459	\$ 11,022	\$ 117	\$ 354
Commercial real estate	14,397	14,107	982	14,471	191	508
Multi-family real estate	755	742	—	756	8	21
1-4 family residential real estate	13,292	12,664	972	13,408	153	432
Commercial and industrial business loans	683	510	27	689	8	27
Consumer loans and other	86	85	13	95	3	3
Total	\$ 39,911	\$ 38,396	\$ 2,453	\$ 40,441	\$ 480	\$ 1,345

Note: Included in the table above are accruing TDRs of \$29.92 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled \$4.97 million.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
December 31, 2014					
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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 nine months ended September 30, 2015 and 2014 (in thousands, except number of loans):

	Three Months Ended September 30, 2015			Nine Months Ended September 30, 2015		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial real estate	1	\$ 468	\$ 468	1	\$ 468	\$ 468
Multi-family real estate	1	755	742	1	755	742
1-4 family residential real estate	13	1,169	1,151	15	1,352	1,334
Commercial and industrial	1	21	20	1	21	20
Consumer loans and other	—	—	—	1	3	3
Total	16	\$ 2,413	\$ 2,381	19	\$ 2,599	\$ 2,567

	Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	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	\$ 549	\$ 379	1	\$ 549	\$ 379
Commercial and industrial	—	—	—	1	106	106
Consumer loans and other	1	33	33	2	65	65
Total	2	\$ 582	\$ 412	4	\$ 720	\$ 550

The restructured loans generally include terms to reduce the interest rate and extend payment terms. We have not forgiven any principal on the above loans. There were two loans that were restructured within the last 12 months that subsequently defaulted; a personal loan in the amount of \$6,000 and a commercial loan in the amount \$0.10 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 September 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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Beginning balance	\$ 46,154	\$ 42,404	\$ 35,115	\$ 39,534
Additions	6,460	2,057	16,578	13,304
Additions from Franklin Merger	1,110	—	16,065	—
Sales	(14,015)	(6,626)	(27,405)	(13,518)
Valuation allowance	—	300	(152)	(1,226)
Gain (loss) on sale and write-downs, net	(200)	(184)	(692)	(143)
Ending balance	<u>\$ 39,509</u>	<u>\$ 37,951</u>	<u>\$ 39,509</u>	<u>\$ 37,951</u>

As of September 30, 2015, the Company’s recorded investment in OREO collateralized by residential real estate was \$12.13 million. As of September 30, 2015, the Company’s recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was \$1.31 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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 44,747	\$ 923	\$ —	\$ 45,670
Provision for loan losses	130	—	—	130
Net interest income after provision for loan losses	44,617	923	—	45,540
Residential mortgage banking income, net	(273)	8,535	—	8,262
Real estate brokerage and property management income, net	—	5,349	—	5,349
Insurance commissions and other title fees and income, net	—	451	9,259	9,710
Other noninterest income	6,428	357	198	6,983
Noninterest expense	31,749	10,858	7,299	49,906
Income before income tax, corporate allocation and noncontrolling interest	19,023	4,757	2,158	25,938
Corporate allocation	293	(135)	(158)	—
Income before income tax provision and noncontrolling interest	19,316	4,622	2,000	25,938
Provision for income tax expense	5,168	1,518	758	7,444
Net income	14,148	3,104	1,242	18,494
Noncontrolling interest	—	(759)	(169)	(928)
Net income attributable to TowneBank	\$ 14,148	\$ 2,345	\$ 1,073	\$ 17,566
Net income as percentage of total	80.54%	13.35%	6.11%	100.00%
Total assets	\$ 5,883,863	\$ 173,498	\$ 116,530	\$ 6,173,891

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended September 30, 2014

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 36,343	\$ 524	\$ —	\$ 36,867
Provision for loan losses	996	—	—	996
Net interest income after provision for loan losses	35,347	524	—	35,871
Residential mortgage banking income, net	(66)	7,924	—	7,858
Real estate brokerage and property management income, net	—	3,645	—	3,645
Insurance commissions and other title fees and income, net	—	444	8,417	8,861
Other noninterest income	5,353	406	190	5,949
Noninterest expense	27,901	9,579	6,674	44,154
Income before income tax, corporate allocation and noncontrolling interest	12,733	3,364	1,933	18,030
Corporate allocation	253	(143)	(110)	—
Income before income tax provision and noncontrolling interest	12,986	3,221	1,823	18,030
Provision for income tax expense	3,417	951	676	5,044
Net income	9,569	2,270	1,147	12,986
Noncontrolling interest	—	(738)	(122)	(860)
Net income attributable to TowneBank	<u>\$ 9,569</u>	<u>\$ 1,532</u>	<u>\$ 1,025</u>	<u>\$ 12,126</u>
Net income as percentage of total	78.91%	12.64%	8.45%	100.00%
Total assets	\$ 4,724,639	\$ 145,446	\$ 102,363	\$ 4,972,448

Nine Months Ended September 30, 2015

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 132,006	\$ 2,105	\$ —	\$ 134,111
Provision for loan losses	2,176	—	—	2,176
Net interest income after provision for loan losses	129,830	2,105	—	131,935
Residential mortgage banking income, net	(550)	27,506	—	26,956
Real estate brokerage and property management income, net	—	13,888	—	13,888
Insurance commissions and other title fees and income, net	—	1,211	29,433	30,644
Other noninterest income	17,736	2,420	561	20,717
Noninterest expense	95,169	32,283	21,962	149,414
Income before income tax, corporate allocation and noncontrolling interest	51,847	14,847	8,032	74,726
Corporate allocation	901	(400)	(501)	—
Income before income tax provision and noncontrolling interest	52,748	14,447	7,531	74,726
Provision for income tax expense	14,425	4,856	2,749	22,030
Net income	38,323	9,591	4,782	52,696
Noncontrolling interest	—	(1,870)	(910)	(2,780)
Net income attributable to TowneBank	<u>\$ 38,323</u>	<u>\$ 7,721</u>	<u>\$ 3,872</u>	<u>\$ 49,916</u>
Net income as percentage of total	76.77%	15.47%	7.76%	100%
Total assets	\$ 5,883,863	\$ 173,498	\$ 116,530	\$ 6,173,891

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine Months Ended September 30, 2014

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 107,300	\$ 1,298	\$ —	\$ 108,598
Provision for loan losses	436	57	—	493
Net interest income after provision for loan losses	106,864	1,241	—	108,105
Residential mortgage banking income, net	(205)	20,860	—	20,655
Real estate brokerage and property management income, net	—	10,184	—	10,184
Insurance commissions and other title fees and income, net	—	1,203	25,612	26,815
Other noninterest income	14,959	1,020	694	16,673
Noninterest expense	84,051	27,635	18,219	129,905
Income before income tax, corporate allocation and noncontrolling interest	37,567	6,873	8,087	52,527
Corporate allocation	757	(435)	(322)	—
Income before income tax provision and noncontrolling interest	38,324	6,438	7,765	52,527
Provision for income tax expense	10,800	1,867	2,714	15,381
Net income	27,524	4,571	5,051	37,146
Noncontrolling interest	—	(1,629)	(583)	(2,212)
Net income attributable to TowneBank	\$ 27,524	\$ 2,942	\$ 4,468	\$ 34,934
Net income as percentage of total	78.79%	8.42%	12.79%	100.00%
Total assets	\$ 4,724,639	\$ 145,446	\$ 102,363	\$ 4,972,448

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 September 30, 2015, the amounts of off-balance sheet commitments to extend credit were \$1.41 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 September 30, 2015, standby letters of credit and financial guarantees were \$36.18 million.

Additionally, the Company had \$21.92 million in mortgage loans sold to investors with various recourse and warranty provisions as of September 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 \$109.55 million at

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015. The income statement impact associated with these instruments is recorded as a decrease in net residential mortgage banking income in the amount of \$0.46 million and an increase of \$0.79 million for the three- and nine-month periods ended September 30, 2015, respectively. In 2014, the income statement impact associated with these instruments was recorded as a decrease in net residential mortgage banking income in the amount of \$0.06 million and an increase of \$0.68 million for the three- and nine-month periods ended September 30, 2014, respectively.

Note 8. Mergers and Acquisitions

Total Insurance Planning, LLC: Effective September 1, 2015, the Company acquired Total Insurance Planning, LLC, which is affiliated with Towne Insurance Agency (“Towne Insurance”), a wholly-owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting, 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 September 1, 2015. The total purchase price for the transaction was \$1.45 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of \$0.06 million, goodwill of \$1.0 million, and other intangible assets including customer lists of \$0.39 million.

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 \$39.86 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	10,890
OREO, net of valuation allowance	16,065
Core deposit intangible	1,501
Other assets	88,889
Total assets	<u>\$ 1,092,809</u>
Fair value of liabilities assumed:	
Deposits	\$ 682,947
Long-term borrowings	191,478
Other liabilities	9,687
Total liabilities	<u>\$ 884,112</u>
Net identifiable assets acquired	\$ 208,697
Goodwill	39,859
Net assets acquired	<u>\$ 248,556</u>
Purchase Price:	
Company common shares issued	15,547,627
Purchase price per share of Company's common stock	<u>\$ 15.35</u>
Common stock issued and cash exchanged for fractional shares	<u>\$ 238,656</u>
Cash consideration for stock options paid	9,900
Fair value of total consideration transferred	<u>\$ 248,556</u>

The Company assumed long-term borrowings of \$191.48 million in the form of FHLB advances. On January 7, 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 preliminary estimated fair value of the Franklin purchased performing loans acquired was \$390.78 million, the related gross contractual amount was \$557.82 million, and the preliminary estimated contractual cash flows not expected to be collected were \$15.27 million.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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)
Preliminary estimated fair value of loans acquired with a deterioration of credit quality	<u>\$ 101,528</u>

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.

(in thousands)	Pro Forma for the Three Months Ended September 30,		Pro Forma for the Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues (net interest income plus noninterest income)	\$ 76,326	\$ 83,328	\$ 226,788	\$ 224,523
Net income	\$ 17,653	\$ 18,179	\$ 49,731	\$ 49,312

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. 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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):

	September 30,				December 31, 2014	
	2015		2014			
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 1,918	\$ 376	\$ 417	\$ 198	\$ 417	\$ 211
Non-compete agreements	1,481	1,164	1,456	1,345	1,706	1,374
Customer lists	30,162	12,267	25,020	10,997	30,386	11,773
Trade name	211	116	211	74	211	84
Total intangible assets subject to amortization	33,772	13,923	27,104	12,614	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	\$ 37,003	\$ 13,923	\$ 30,335	\$ 12,614	\$ 35,951	\$ 13,442

Amortization expense for intangible assets was \$918,000 and \$652,000 for the three-month periods and \$2.57 million and \$1.79 million for the nine-month periods ended September 30, 2015 and 2014, respectively.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	39,859	—	2,998	42,857
Other adjustments	(237)	(3,341)	—	(3,578)
Balance, September 30, 2015	\$ 98,506	\$ 13,999	\$ 39,933	\$ 152,438

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of September 30, 2015, was \$147.95 million. The Company had \$58.22 million and \$58.72 million of BOLI at September 30, 2014 and December 31, 2014, respectively. The Company recognized BOLI income, included in other noninterest income, of \$1.22 million and \$0.44 million for the three-month periods and \$3.69 million and \$1.36 million for the nine-month periods ended September 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 September 30, 2015	Three Months Ended September 30, 2014
Service cost	\$ 366	\$ 381
Interest cost	211	197
Amortization of actuarial loss	60	15
Net periodic postretirement benefit cost	\$ 637	\$ 593

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Service cost	\$ 1,140	\$ 1,173
Interest cost	633	591
Amortization of actuarial loss	138	15
Net periodic postretirement benefit cost	<u>\$ 1,911</u>	<u>\$ 1,779</u>

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2015 and 2014 (in thousands), and changes in the nine 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	998	—	998
Amounts reclassified from AOCI	(510)	90	(420)
Net change	488	90	578
Balance, September 30, 2015	<u>\$ 1,813</u>	<u>\$ (777)</u>	<u>\$ 1,036</u>

	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	1,023	—	1,023
Amounts reclassified from AOCI	9	10	19
Net change	1,032	10	1,042
Balance, September 30, 2014	<u>\$ 788</u>	<u>\$ (90)</u>	<u>\$ 698</u>

(1) For additional information about securities, refer to Note 3.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13. Other Expenses

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Advertising and marketing	\$ 1,704	\$ 1,456	\$ 5,550	\$ 3,694
Acquisition-related expenses	243	1,090	1,027	1,177
Other	1,264	1,326	4,493	4,747
Charitable contributions	1,121	748	4,109	2,381
Outside processing	1,182	921	3,745	2,690
Professional fees	1,314	1,025	4,263	3,213
Stationery and supplies	601	500	1,794	1,506
FDIC and other insurance	1,242	988	3,679	2,857
Foreclosed property expenses	573	350	1,972	3,112
Software expense	1,537	1,222	4,324	3,311
Telephone and postage	1,142	1,009	3,524	3,104
Amortization-intangibles	918	652	2,565	1,794
Bank franchise tax/SCC fees	596	572	1,895	1,619
Directors fees and expenses	294	298	918	798
Travel/meals/entertainment	351	259	985	833
Total other expenses	<u>\$ 14,082</u>	<u>\$ 12,416</u>	<u>\$ 44,843</u>	<u>\$ 36,836</u>

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 \$61.87 million, \$59.68 million, and \$59.62 million in these partnerships were not included in the Consolidated Balance Sheets at September 30, 2015, September 30, 2014, and December 31, 2014, respectively. These limited partner interests had carrying values of \$16.12 million, \$15.91 million, and \$15.17 million at September 30, 2015, September 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 \$16.12 million, \$15.91 million, and \$15.17 million at September 30, 2015, September 30, 2014, and December 31, 2014, respectively. As of September 30, 2015, the Company had \$16.59 million in funding commitments that are dependent on certain contractual milestones. For the three- and nine-month periods ended September 30, 2015, a tax benefit totaling \$0.32 million and \$0.97 million, net of amortization expense of \$0.60 million and \$1.79 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 nine-month periods ended September 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 \$1.73 million at September 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 September 30, 2015 and December 31, 2014 (in thousands):

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 348,216	\$ —	\$ 348,216
Municipal securities	—	19,354	—	19,354
Mortgage-backed securities issued by GSEs	—	166,673	—	166,673
Trust preferred and other corporate securities	—	8,391	—	8,391
Interest rate lock commitments	—	—	1,732	1,732

	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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 (in thousands):

September 30, 2015	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ —	\$ —	\$ 16,741	\$ 16,741
Other real estate owned	\$ —	\$ 34,322	\$ 13,664	\$ 47,986
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 63%, with a weighted average of 13.84%.

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 7% to 17%, with a weighted average of 12.12%.

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

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

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

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.

TOWNE BANK

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 September 30, 2015 and December 31, 2014 are as follows (in thousands):

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
September 30, 2015					
Cash and due from banks	\$ 284,625	\$ 284,625	\$ 284,625		
Interest-bearing deposits in financial institutions	1,000	1,000	1,000		
Securities available for sale	542,634	542,634		542,634	
Securities held to maturity	75,154	78,575		78,575	
Mortgage loans held for sale	99,330	99,444		99,444	
Net loans	4,367,039	4,418,385			4,418,385
Interest receivable	14,049	14,049		14,049	
Deposits	4,787,878	4,409,675		4,409,675	
Advances from the Federal Home Loan Bank of Atlanta	437,282	453,479		453,479	
Repurchase agreements and other borrowings	33,784	33,786		33,786	
Interest payable	2,996	2,996		2,996	

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
December 31, 2014					
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 Federal Deposit Insurance Corporation. 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 \$51.56 million at September 30, 2015 and \$46.96 million at December 31, 2014 were pledged as collateral for these secured transactions. The pledged securities are held in

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

PART I. FINANCIAL INFORMATION

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

Selected Quarterly Information (unaudited) TOWNEBANK

(Dollars in thousands, except per share data)

	Third Quarter 2015	Second Quarter 2015	First Quarter 2015	Fourth Quarter 2014	Third Quarter 2014
Results of Operations:					
Interest income	\$ 53,987	\$ 52,708	\$ 51,368	\$ 43,843	\$ 43,668
Interest expense	8,317	7,824	7,812	6,704	6,801
Net interest income	45,670	44,884	43,556	37,139	36,867
Provision for loan losses	130	1,723	323	(1)	996
Net interest income after provision for loan losses	45,540	43,161	43,233	37,140	35,871
Noninterest income:					
Residential mortgage banking income, net	8,262	10,251	8,443	6,523	7,858
Real estate brokerage and property management income, net	5,349	4,584	3,955	2,450	3,645
Insurance commissions and other title fees and income, net	9,710	9,885	11,049	7,743	8,861
Service charges on deposit accounts	2,388	2,326	2,197	2,288	2,406
Credit card merchant fees, net	823	566	432	911	927
Other income	3,036	5,354	2,691	2,486	2,572
Gain on investment securities	736	119	49	—	44
Total noninterest income	30,304	33,085	28,816	22,401	26,313
Noninterest expense:					
Salaries and benefits	28,910	26,544	27,679	25,205	25,080
Occupancy expense	4,703	4,856	4,930	4,676	4,618
Furniture and equipment	2,211	2,369	2,369	2,103	2,040
Other expenses	14,082	15,298	15,462	16,975	12,416
Total noninterest expense	49,906	49,067	50,440	48,959	44,154
Income before noncontrolling interest and income tax	25,938	27,179	21,609	10,582	18,030
Provision for income tax expense	7,444	8,201	6,385	2,798	5,044
Net income	18,494	18,978	15,224	7,784	12,986
Net income from noncontrolling interest	(928)	(1,166)	(686)	(549)	(860)
Net income attributable to TowneBank	\$ 17,566	\$ 17,812	\$ 14,538	\$ 7,235	\$ 12,126
Net income available to common shareholders	\$ 17,566	\$ 17,812	\$ 14,525	\$ 7,044	\$ 11,935

PART I. FINANCIAL INFORMATION

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

Selected Quarterly Information (unaudited) TOWNEBANK

(Dollars in thousands, except per share data)

	Third Quarter 2015	Second Quarter 2015	First Quarter 2015	Fourth Quarter 2014	Third Quarter 2014
Per Share Data:					
Net income:					
Basic	\$ 0.34	\$ 0.35	\$ 0.29	\$ 0.20	\$ 0.34
Diluted	0.34	0.35	0.29	0.20	0.34
Book value at period end	15.65	15.40	15.22	14.88	14.85
Tangible book value at period end	12.25	12.00	11.73	11.09	11.21
Cash dividends declared	0.12	0.12	0.11	0.11	0.11
Common Stock Closing Price:					
High	19.23	17.00	16.38	15.83	16.46
Low	16.05	15.66	14.28	13.51	13.58
Close	18.85	16.29	16.08	15.12	13.58
Selected Financial Ratios (annualized):					
Return on average assets	1.14%	1.21%	1.01%	0.57%	0.97%
Return on average tangible assets	1.21%	1.28%	1.08%	0.63%	1.03%
Return on average equity	8.58%	8.93%	7.54%	4.62%	7.86%
Return on average tangible equity	11.25%	11.77%	10.27%	6.35%	10.32%
Net interest margin (tax-equivalent basis) (1)	3.40%	3.52%	3.52%	3.35%	3.32%
Daily Averages:					
Total assets	\$ 6,115,681	\$ 5,900,816	\$ 5,829,533	\$ 5,005,112	\$ 4,961,204
Total tangible assets	5,940,258	5,724,957	5,642,883	4,868,868	4,831,294
Loans, net of unearned income, excluding nonaccrual loans	4,300,751	4,161,304	4,066,484	3,526,859	3,471,206
Total earning assets (1)	5,604,472	5,407,516	5,290,562	4,610,309	4,558,857
Total deposits	4,734,876	4,548,351	4,504,857	3,864,688	3,838,834
FHLB advances	437,431	418,388	408,288	398,326	398,620
Total equity	812,602	800,369	781,833	621,579	612,250
Tangible equity	637,179	624,511	595,183	485,335	482,341
Basic weighted average shares outstanding	51,153,205	51,089,051	50,652,963	35,400,548	35,271,506
Diluted weighted average shares outstanding	51,263,382	51,151,512	50,724,588	35,458,804	35,311,332

(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 September 30, 2015:

- Net income for the three months ended September 30, 2015 was \$17.57 million, or \$0.34 per common diluted share, compared with \$12.13 million, or \$0.34 per common diluted share in the same period in 2014. Net income for the nine months ended September 30, 2015 was \$49.92 million, or \$0.98 per

PART I. FINANCIAL INFORMATION

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

common diluted share, compared to \$34.93 million, or \$0.98 per common diluted share, in the nine months ended September 30, 2014. Net income available to common shareholders for the third quarter of 2015 was \$17.57 million compared with \$11.93 million in the same period of 2014.

- Net interest income increased \$8.80 million, or 23.88%, in the third 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 \$0.13 million, a decrease from the provision of \$1.00 million in the comparative three-month period of 2014, and \$2.18 million, an increase from the provision of \$0.49 million in the comparative nine-month period of 2014. The loan loss reserve was 0.86% of total loans at September 30, 2015, down slightly from 0.88% at June 30, 2015, and down from 1.03% at September 30, 2014. The decrease in the provision for loan losses in the current quarter from comparative prior year was primarily a result of a reduction in historical loss ratios combined with continued improvements in credit quality, which offset the effects of loan growth. In the nine-month comparison to the prior year, a reclassification of industrial revenue bonds from investment securities to loans during second quarter 2015 was responsible for \$0.80 million of the increase, while loan growth drove the remainder of the increase. 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 nine-month periods ended September 30, 2015 increased by \$3.30 million, or 12.56%, and increased by \$16.96 million, or 22.81%, respectively, from the comparative periods in 2014. The increase from the comparable prior year periods was primarily related to an increase in our Real Estate segment related increased residential mortgage banking income and property management fees combined with increases in our Insurance segment related to insurance agency acquisitions.
- For the three- and nine-month periods ended September 30, 2015, noninterest expense increased \$5.75 million, or 13.03%, and \$19.51 million, or 15.02%, 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 29.76% for the third quarter of 2015, a slight increase from 28.69% in the comparative period of 2014. For the first nine months of 2015, the effective tax rate increased slightly to 30.62% compared to 30.57% for the same period in 2014. The variance from the comparative periods of the prior year was primarily a result of an increase in taxable income subject to the federal statutory rate of 35%, which was partially offset by the increase in non-taxable income arising from bank-owned life insurance.

PART I. FINANCIAL INFORMATION

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

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 1.14% for the third quarter of 2015 compared to 0.97% for the third quarter of 2014, and 1.21% for the second quarter of 2015. The annualized return on average tangible assets was 1.21%, 1.03%, and 1.28% for the same respective periods. ROA for the nine months ended September 30, 2015 was 1.12% compared to 0.97% for the nine months ended September 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 8.58% for the third quarter of 2015, 7.86% for the third quarter of 2014, and 8.93% for the second quarter of 2015, while the annualized return on average tangible equity was 11.25%, 10.32%, and 11.77% for the same respective periods. ROE for the nine months ended September 30, 2015 was 8.36%, compared to 7.76% for the nine months ended September 30, 2014.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was \$75.24 million for the quarter ended September 30, 2015, which increased \$12.10 million, or 19.17%, compared to the quarter ended September 30, 2014. Operating income was \$77.85 million for the quarter ended June 30, 2015. For the nine months ended September 30, 2015, operating income was \$225.41 million, an increase of \$42.47 million, or 23.22% over comparative 2014.

Basic earnings per share were \$0.34 for the three months ended September 30, 2015 compared to \$0.34 in comparative 2014, while basic earnings per share for the nine months ended September 30, 2015 was \$0.98, remaining the same as comparative 2014. Diluted earnings per share were \$0.34 for the three months ended September 30, 2015 unchanged from \$0.34 in comparative 2014, while diluted earnings per share for the nine months ended September 30, 2015 was \$0.98 from \$0.98 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

PART I. FINANCIAL INFORMATION

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

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 \$48.04 million for the quarter ended September 30, 2015, which was \$9.94 million, or 26.10%, higher than the year-ago amount of \$38.10 million. On a linked quarter basis, tax-equivalent net interest income increased by \$0.55 million, or 1.16%, from the \$47.49 million reported for the second 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 \$0.68 million, or six basis points, to margin in the current quarter.

Interest income, on a tax-equivalent basis, was \$56.36 million for the quarter ended September 30, 2015, which was \$11.46 million, or 25.52%, higher than the \$44.90 million reported for the period ended September 30, 2014. On a linked quarter basis, tax-equivalent interest income increased \$1.04 million, or 1.89%, from \$55.31 million in the second quarter of 2015. Average earning assets grew to \$5.60 billion in the quarter ended September 30, 2015, from \$4.56 billion in the comparative prior year quarter, an increase of \$1.05 billion, or 22.94%. In the linked quarter comparison, average earning assets increased by \$0.20 billion, or 3.64%, from \$5.41 billion in the second quarter of 2015. The yield on earning assets was 3.99% in the quarter ended September 30, 2015, which compared to 3.91% in the comparative prior year and 4.10% in the linked period. Average loan balances, excluding nonaccrual loans, of \$4.30 billion were \$829.55 million, or 23.90%, higher in the third quarter of 2015 than in the same period a year ago, while loan yields declined by 12 basis points. In the linked quarter, loans grew \$139.45 million, or 3.35%, and loan yields were 14 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 September 30, 2015, was \$8.32 million, which was \$1.52 million, or 22.28%, higher than the \$6.80 million amount in the year-ago quarter. The average balance of interest-bearing liabilities increased to \$3.82 billion in the third quarter of 2015 from \$3.03 billion in the comparative prior year quarter, an increase of 25.84%. On a linked quarter basis, interest expense increased slightly by 6.29% to \$8.32 million from \$7.82 million in the second quarter of 2015. In the linked quarter, average interest-bearing liabilities increased by \$116.73 million, or 3.15%, from \$3.70 billion in the quarter ended June 30, 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 3.40% in the quarter ended September 30, 2015, which was eight basis points higher than the 3.32% margin of the September 30, 2014 quarter and twelve basis points lower than the 3.52% margin from the June 30, 2015 quarter. The margin improvement in comparison to the prior year periods was driven by accretion of purchase accounting marks and 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.

PART I. FINANCIAL INFORMATION

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

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

	Three Months Ended September 30, 2015			Three Months Ended June 30, 2015			Three Months Ended September 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	\$ 4,300,751	\$ 49,398	4.56%	\$ 4,161,304	\$ 48,730	4.70%	\$ 3,471,206	\$ 40,961	4.68%
Taxable investment securities	796,062	3,235	1.63%	818,000	2,825	1.38%	604,908	1,734	1.15%
Tax-exempt investment securities	61,048	493	3.23%	63,255	496	3.14%	70,854	568	3.21%
Interest-bearing deposits	167,247	107	0.25%	87,709	56	0.25%	275,634	174	0.25%
Loans held for sale	132,214	1,246	3.77%	131,305	1,161	3.54%	78,325	787	4.02%
Bank-owned life insurance	147,150	1,877	5.06%	145,943	2,044	5.62%	57,930	674	4.62%
Total earning assets	5,604,472	56,356	3.99%	5,407,516	55,312	4.10%	4,558,857	44,898	3.91%
Less: allowance for loan losses	(37,926)			(36,854)			(36,355)		
Total nonearning assets	549,135			530,154			438,702		
Total assets	<u>\$ 6,115,681</u>			<u>\$ 5,900,816</u>			<u>\$ 4,961,204</u>		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 1,693,424	\$ 1,201	0.28%	\$ 1,646,075	\$ 1,144	0.28%	\$ 1,317,611	\$ 717	0.22%
Savings	297,041	695	0.93%	301,020	692	0.92%	308,466	707	0.91%
Certificates of deposit	1,356,409	2,985	0.87%	1,294,181	2,606	0.81%	983,950	1,981	0.80%
Total interest-bearing deposits	3,346,874	4,881	0.58%	3,241,276	4,442	0.55%	2,610,027	3,405	0.52%
Borrowings	472,120	3,435	2.85%	460,993	3,382	2.90%	424,746	3,396	3.13%
Total interest-bearing liabilities	3,818,994	8,316	0.86%	3,702,269	7,824	0.85%	3,034,773	6,801	0.89%
Demand deposits	1,388,002			1,307,075			1,228,807		
Other noninterest-bearing liabilities	96,083			91,103			85,374		
Total liabilities	5,303,079			5,100,447			4,348,954		
Shareholders' equity	812,602			800,369			612,250		
Total liabilities and equity	<u>\$ 6,115,681</u>			<u>\$ 5,900,816</u>			<u>\$ 4,961,204</u>		
Net interest income (tax-equivalent basis)		\$ 48,040			\$ 47,488			\$ 38,097	
Reconciliation of Non-GAAP Financial Measures									
Bank-owned life insurance		(1,877)			(2,044)			(674)	
Tax-equivalent basis adjustment		(493)			(560)			(556)	
Net interest income (GAAP)		<u>\$ 45,670</u>			<u>\$ 44,884</u>			<u>\$ 36,867</u>	
Interest rate spread (1)			3.13%			3.26%			3.02%
Interest expense as a percent of average earning assets			0.59%			0.58%			0.59%
Net interest margin (tax equivalent basis) (2)			3.40%			3.52%			3.32%
Total cost of deposits			0.41%			0.39%			0.35%

- (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.

PART I. FINANCIAL INFORMATION

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

(Dollars in thousands)

	Increase/(Decrease) Three Months Ended September 30, 2015 Compared to Three Months Ended June 30, 2015			Increase/(Decrease) Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	\$ 1,909	\$ (1,240)	\$ 669	\$ 9,553	\$ (1,116)	\$ 8,437
Taxable investment securities	(78)	488	410	647	854	1,501
Tax-exempt investment securities	(17)	14	(3)	(79)	4	(75)
Interest-bearing deposits	51	—	51	(68)	1	(67)
Loans held for sale	8	77	85	511	(52)	459
Bank-owned life insurance	19	(186)	(167)	1,132	71	1,203
Total earning assets	1,892	(847)	1,045	11,696	(238)	11,458
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	43	14	57	235	249	484
Savings	(5)	8	3	(27)	15	(12)
Certificates of deposit	141	238	379	806	198	1,004
Total interest-bearing deposits	179	260	439	1,014	462	1,476
Borrowings	102	(48)	54	359	(320)	39
Total interest-bearing liabilities	281	212	493	1,373	142	1,515
Net interest income	\$ 1,611	\$ (1,059)	\$ 552	\$ 10,323	\$ (380)	\$ 9,943

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

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended September 30, 2015			Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2015 Compared with September 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	\$ 4,177,038	\$ 146,020	4.67%	\$ 3,425,074	\$ 121,129	4.73%	\$ 24,891	\$ (1,411)	\$ 26,302
Taxable investment securities	787,996	8,862	1.50%	545,226	5,067	1.24%	3,795	1,216	2,578
Tax-exempt investment securities	63,684	1,524	3.19%	71,035	1,621	3.04%	(97)	77	(173)
Interest-bearing deposits	152,472	287	0.25%	262,057	493	0.25%	(206)	—	(206)
Loans held for sale	109,592	2,971	3.62%	64,483	1,934	4.00%	1,037	(201)	1,239
Bank-owned life insurance	144,551	5,674	5.25%	57,672	2,090	4.85%	3,584	187	3,396
Total earning assets	5,435,333	165,338	4.07%	4,425,547	132,334	4.00%	33,004	(132)	33,136
Less: allowance for loan losses	(36,950)			(37,461)					
Total nonearning assets	\$ 551,342			\$ 431,815					
Total assets	<u>\$ 5,949,725</u>			<u>\$ 4,819,901</u>					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 1,658,531	\$ 3,456	0.28%	\$ 1,294,093	\$ 2,264	0.23%	\$ 1,192	\$ 482	\$ 710
Savings	300,996	2,071	0.92%	313,114	2,155	0.92%	(84)	(1)	(83)
Certificates of deposit	1,319,827	8,220	0.83%	973,919	5,624	0.77%	2,596	471	2,126
Total interest-bearing deposits	3,279,354	13,747	0.56%	2,581,126	10,043	0.52%	3,704	952	2,753
Borrowings	460,195	10,205	2.92%	428,870	10,028	3.12%	177	(600)	776
Total interest-bearing liabilities	3,739,549	23,952	0.86%	3,009,996	20,071	0.89%	3,881	352	3,529
Demand deposits	1,317,517			1,128,954					
Other noninterest-bearing liabilities	94,278			79,161					
Total liabilities	5,151,344			4,218,111					
Shareholders' equity	798,381			601,790					
Total liabilities and equity	<u>\$ 5,949,725</u>			<u>\$ 4,819,901</u>					
Net interest income (tax-equivalent basis)		\$ 141,386			\$ 112,263		\$ 29,123	\$ (484)	\$ 29,607
Reconciliation of Non-GAAP Financial Measures									
Bank-owned life insurance		(5,674)			(2,090)		(3,584)		
Tax-equivalent basis adjustment		(1,601)			(1,575)		\$ (26)		
Net interest income (GAAP)		<u>\$ 134,111</u>			<u>\$ 108,598</u>		<u>\$ 25,513</u>		
Interest rate spread (1)			3.21%			3.11%			
Interest expense as a percent of average earning assets			0.59%			0.61%			
Net interest margin (tax equivalent basis) (2)			3.48%			3.39%			
Total cost of deposits			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.

PART I. FINANCIAL INFORMATION

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

Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended September 30, 2015 was \$29.57 million, an increase of \$3.30 million, or 12.56%, compared to the same period in 2014 and a decrease of \$3.40 million, or 10.31%, compared to the second quarter of 2015. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for the third quarter of 2015 was 39.30%, compared with 41.61% for comparative 2014 and 42.35% for the second 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		Increase/(Decrease)	
	September 30, 2015	2014	2015 over 2014 Amount	Percent
Residential mortgage banking income, net	\$ 8,262	\$ 7,858	\$ 404	5.14 %
Real estate brokerage and property management, net	5,349	3,645	1,704	46.75 %
Insurance commissions and other title fees and income, net	9,710	8,861	849	9.58 %
Service charges on deposit accounts	2,388	2,406	(18)	(0.75)%
Credit card merchant fees, net	823	927	(104)	(11.22)%
Other income	3,036	2,572	464	18.04 %
Subtotal before gain on investment securities	29,568	26,269	3,299	12.56 %
Net gain on investment securities	736	44	692	N/M
Total noninterest income	\$ 30,304	\$ 26,313	\$ 3,991	15.17 %

	Three Months Ended		Increase/(Decrease)	
	September 30, 2015	June 30, 2015	Third Quarter 2015 over Second Quarter 2015 Amount	Percent
Residential mortgage banking income, net	\$ 8,262	\$ 10,251	\$ (1,989)	(19.40)%
Real estate brokerage and property management, net	5,349	4,584	765	16.69 %
Insurance commissions and other title fees and income, net	9,710	9,885	(175)	(1.77)%
Service charges on deposit accounts	2,388	2,326	62	2.67 %
Credit card merchant fees, net	823	566	257	45.41 %
Other income	3,036	5,354	(2,318)	(43.29)%
Subtotal before gain on investment securities	29,568	32,966	(3,398)	(10.31)%
Net gain on investment securities	736	119	617	518.49 %
Total noninterest income	\$ 30,304	\$ 33,085	\$ (2,781)	(8.41)%

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended September 30,		Increase/(Decrease) 2015 over 2014	
	2015	2014	Amount	Percent
Residential mortgage banking income, net	\$ 26,956	\$ 20,655	\$ 6,301	30.51 %
Real estate brokerage and property management, net	13,888	10,184	3,704	36.37 %
Insurance commissions and other title fees and income, net	30,644	26,815	3,829	14.28 %
Service charges on deposit accounts	6,911	6,904	7	0.10 %
Credit card merchant fees, net	1,821	2,665	(844)	(31.67)%
Other income	11,081	7,119	3,962	55.65 %
Subtotal before gain on sale of investment securities	91,301	74,342	16,959	22.81 %
Net gain (loss) on investment securities	904	(15)	919	N/M
Total noninterest income	<u>\$ 92,205</u>	<u>\$ 74,327</u>	<u>\$ 17,878</u>	<u>24.05 %</u>

For the third quarter of 2015, residential mortgage banking income, net of commission expense, was \$8.26 million, reflecting an increase of \$0.40 million, or 5.14%, compared to the third quarter of 2014 and a decrease of \$1.99 million, or 19.40%, compared to the second quarter of 2015. For the nine-month period ended September 30, 2015, residential mortgage banking income, net of commission expense, was \$26.96 million, reflecting an increase of \$6.30 million, or 30.51%, compared to the same period in 2014. The increase from the prior year periods was primarily due to higher production volumes and improved pricing and margins, while the decrease from the linked quarter was due to a seasonally-driven decrease in production volumes. Also factoring in the variance from the prior periods was a seasonal decrease in mortgage banking income of \$0.46 million associated with a decrease in the value of rate lock commitments recorded as of September 30, 2015, as compared to an increase of \$0.22 million and an decrease of \$0.06 million recognized for the quarters ended June 30, 2015 and September 30, 2014, respectively.

Real estate brokerage and property management income, net of commission expense, for third quarter 2015 was \$5.35 million, which was \$1.70 million, or 46.75%, higher than comparative 2014, and \$0.77 million, or 16.69%, higher than second quarter 2015. The increase for the 2015 nine-month period was \$3.70 million, or 36.37% from the comparative period in 2014. The increase from the comparative 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 \$1.26 million in third quarter 2014, \$1.80 million in first quarter 2015, and \$3.94 million in the first nine months of 2014. The Company recognized a gain of \$1.36 million on the sale, which was recorded in other noninterest income in the second quarter of 2015.

For the third quarter of 2015, insurance commissions and other title income, net of commission expense, was \$9.71 million, which was \$0.85 million, or 9.58%, higher than comparative 2014, and \$0.18 million, or 1.77%, lower than the second quarter of 2015. For the nine-month period, insurance commissions and other title income, net of commission expense, was \$3.83 million, or 14.28%, higher than comparative 2014. The increase from the comparative prior year three-month period was largely due to the acquisition of an insurance agency in September 2015 and two insurance agencies in February 2015, which contributed additional commission and fee income of \$0.40 million. The increase from the comparative prior year nine-

PART I. FINANCIAL INFORMATION

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

month period was due to the afore mentioned acquisitions combined with the acquisition of Southern Insurance Agency, Inc. in May 2014, which contributed additional commission and fee income of \$2.98 million. The decrease in the linked quarter comparison was primarily due to seasonal decreases in policy renewals.

Service charges on deposit accounts were \$2.39 million for the third quarter of 2015, compared with \$2.41 million for the comparative 2014 period, and \$2.33 million for the second quarter of 2015. For the nine months ended September 30, 2015, service charges on deposit accounts were \$6.91 million, which was \$0.01 million, or 0.10%, higher than comparative 2014. Decreases in overdraft checking fees from prior year periods mostly offset the increase in average deposits.

For the third quarter of 2015, credit card merchant fees totaled \$0.82 million, which was \$0.10 million, or 11.22%, lower than comparative 2014, and \$0.26 million, or 45.41%, higher than the second quarter of 2015. For the nine months ended September 30, 2015, credit card merchant fees totaled \$1.82 million, which was \$0.84 million, or 31.67%, 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 nine months ended September 30, 2015 was \$3.04 million and \$11.08 million, respectively, and included income generated by Towne Investment Group, net of commission expense. For the three months ended September 30, 2015, net commission income for Towne Investment Group totaled \$0.68 million as compared to \$0.65 million for the third quarter of 2014 and \$0.74 million for the second quarter of 2015. The increase from prior year periods was due to an increase in income from bank-owned life insurance policies of \$0.78 million and \$2.33 million from the three- and nine-month periods ended September 30, 2014, while the increase in the comparative nine-month period was also affected by the nonrecurring 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 during the second quarter of 2015.

Noninterest Expense. For the quarter ended September 30, 2015, total noninterest expense was \$49.91 million, which was \$5.75 million, or 13.03%, higher than comparative 2014, and \$0.84 million, or 1.71%, higher than the quarter ended June 30, 2015. For the nine months ended September 30, 2015, total noninterest expense increased \$19.51 million, or 15.02% from comparative 2014 to \$149.41 million.

As a percentage of operating income, noninterest expense was 66.33% for the third quarter of 2015, 69.94% for comparative 2014, and 63.03% for the quarter ended June 30, 2015. The primary components of noninterest expense in the third quarter of 2015 were salaries and employee benefits of \$28.91 million, occupancy expenses of \$4.70 million, furniture and equipment expenses of \$2.21 million, advertising and marketing expenses of \$1.70 million, software expenses of \$1.54 million, and professional fees of \$1.31 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 \$2.75 million. Additionally, insurance agency acquisitions in 2015 contributed additional operational expenses of \$0.40 million, and the Beach Properties acquisition in October 2014 contributed \$1.27 million of additional expenses. Merger activities related to the acquisitions of Franklin and the insurance agencies resulted in \$0.24 million of acquisition-related expenses in third quarter 2015 as compared to \$1.09 million in third quarter 2014 and \$0.37 million in second quarter 2015. Also contributing

PART I. FINANCIAL INFORMATION

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

to the increase from third 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 \$0.15 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)			
	September 30,		June 30,	September 30, 2015 over September 30, 2014		September 30, 2015 over June 30, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Salaries and benefits	\$ 28,910	\$ 25,080	\$ 26,544	\$ 3,830	15.27 %	\$ 2,366	8.91 %
Occupancy expense	4,703	4,618	4,856	85	1.84 %	(153)	(3.15)%
Furniture and equipment	2,211	2,040	2,369	171	8.38 %	(158)	(6.67)%
Other							
Advertising and marketing	1,704	1,456	2,065	248	17.03 %	(361)	(17.48)%
Acquisition-related expenses	243	1,090	370	(847)	(77.71)%	(127)	(34.32)%
Other	1,264	1,326	1,504	(62)	(4.68)%	(240)	(15.96)%
Charitable contributions	1,121	748	1,575	373	49.87 %	(454)	(28.83)%
Outside processing	1,182	921	1,141	261	28.34 %	41	3.59 %
Professional fees	1,314	1,025	1,485	289	28.20 %	(171)	(11.52)%
Stationery and supplies	601	500	526	101	20.20 %	75	14.26 %
FDIC and other insurance	1,242	988	1,339	254	25.71 %	(97)	(7.24)%
Foreclosed property expenses	573	350	526	223	63.71 %	47	8.94 %
Software expense	1,537	1,222	1,493	315	25.78 %	44	2.95 %
Telephone and postage	1,142	1,009	1,155	133	13.18 %	(13)	(1.13)%
Amortization - intangibles	918	652	802	266	40.80 %	116	14.46 %
Bank franchise tax/SCC fees	596	572	670	24	4.20 %	(74)	(11.04)%
Directors fees and expenses	294	298	292	(4)	(1.34)%	2	0.68 %
Travel/meals/entertainment	351	259	355	92	35.52 %	(4)	(1.13)%
Total other expenses	14,082	12,416	15,298	1,666	13.42 %	(1,216)	(7.95)%
Total noninterest expense	\$ 49,906	\$ 44,154	\$ 49,067	\$ 5,752	13.03 %	\$ 839	1.71 %

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended		Increase/(Decrease)	
	September 30,		2015 over 2014	
	2015	2014	Amount	Percent
Salaries and benefits	\$ 83,133	\$ 73,801	\$ 9,332	12.64 %
Occupancy expense	14,489	13,188	1,301	9.87 %
Furniture and equipment	6,949	6,080	869	14.29 %
Other				
Advertising and marketing	5,550	3,694	1,856	50.24 %
Acquisition-related expenses	1,027	1,177	(150)	(12.74)%
Other	4,493	4,747	(254)	(5.35)%
Charitable contributions	4,109	2,381	1,728	72.57 %
Outside processing	3,745	2,690	1,055	39.22 %
Professional fees	4,263	3,213	1,050	32.68 %
Stationery and supplies	1,794	1,506	288	19.12 %
FDIC and other insurance	3,679	2,857	822	28.77 %
Foreclosed property expenses	1,972	3,112	(1,140)	(36.63)%
Software expense	4,324	3,311	1,013	30.59 %
Telephone and postage	3,524	3,104	420	13.53 %
Amortization - intangibles	2,565	1,794	771	42.98 %
Bank franchise tax/SCC fees	1,895	1,619	276	17.05 %
Directors fees and expenses	918	798	120	15.04 %
Travel/meals/entertainment	985	833	152	18.25 %
Total other expenses	44,843	36,836	8,007	21.74 %
Total noninterest expense	<u>\$ 149,414</u>	<u>\$ 129,905</u>	<u>\$ 19,509</u>	<u>15.02 %</u>

Salary and benefits expense, the largest portion of noninterest expense, was \$28.91 million, representing 57.93% of total noninterest expense for the quarter ended September 30, 2015, and \$83.13 million or 55.64% for the nine months ended September 30, 2015. Salary and benefits expense increased \$3.83 million, or 15.27%, and increased \$9.33 million, or 12.64% over the comparative three- and nine-month periods in 2014 and increased \$2.37 million, or 8.91%, from second quarter 2015. The increase from third quarter 2014 is primarily due to company-wide annual salary adjustments effective July 1, 2015, combined with the addition of staff resulting from the Franklin acquisition, which resulted in an increase of \$1.31 million and expansion of our Insurance and Realty segment businesses, which resulted in an increase of \$0.88 million. The increase from the linked quarter is primarily due to an increase in employee profit sharing expense and the aforementioned salary adjustments, which were partially offset by lower payroll tax expenses. The increase from the comparative nine-month period of the prior year is primarily due to the aforementioned salary increases and business acquisitions combined with increased 401(k) matching expense.

In our Banking segment we had a total of 703 full-time equivalent employees ("FTE") at September 30, 2015, which was up from 624 at September 30, 2014, and down from 729 at June 30, 2015. In our non-Banking segments at September 30, 2015, we had a total of 748 FTEs, excluding real estate sales agents, which was down from 749 at September 30, 2014, and up from 741 at June 30, 2015. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE was \$52,000 for the quarter ended September 30, 2015, increased from \$46,000 for the three-month period ended September 30, 2014, and down slightly from \$53,000 for the three-month period ended June 30, 2015.

PART I. FINANCIAL INFORMATION

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

Occupancy expense for the third quarter of 2015 experienced a \$0.09 million, or 1.84%, increase from the comparative quarter of 2014, and a \$0.15 million, or 3.15%, decrease from the second quarter of 2015. Occupancy expense for the first nine months of 2015 increased \$1.30 million, or 9.87%, 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 linked quarter was primarily a result of lower rent expense due to the June 2015 purchase of a previously leased banking office.

For the three- and nine-month periods ended September 30, 2015, furniture and equipment expense increased by \$0.17 million and \$0.87 million, respectively, over comparative 2014, and decreased \$0.16 million compared to the second quarter of 2015. Increases from comparative prior year periods were primarily related to facilities acquired in the Franklin acquisition.

Other noninterest expenses for the third quarter of 2015 were \$14.08 million, an increase of \$1.67 million, or 13.42%, compared to the same period in 2014, and for the first nine months of 2015 increased \$8.01 million, or 21.74%, compared to the same period in 2014, while there was a slight decrease of \$1.22 million, or 7.95%, compared to second 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. In the linked quarter comparison, the reduction in advertising and marketing was partially offset by the increase in foreclosed property expenses of \$0.05 million and stationary and supplies of \$0.08 million.

Provision for Income Taxes. We reported a provision for income tax expense of \$7.44 million, representing an effective tax rate of 29.76%, in the third quarter of 2015. The provision for income tax expense was \$5.04 million for the third quarter of 2014, with an effective rate of 28.69%, and \$8.20 million, with an effective rate of 31.53%, in the second quarter of 2015. For the first nine months of 2015, the effective tax rate increased to 30.62% compared to 30.57% in the same period in 2014. The variance from the comparative periods of the prior year was primarily a result of an increase in taxable income subject to the federal statutory rate of 35%, which was partially offset by the increase in non-taxable income arising from bank-owned life insurance. The decrease from the sequential quarter was primarily due to less taxable income subject to the federal statutory rate of 35% combined with an increase in federal tax credits.

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 September 30, 2015, the Banking segment represented 80.54%, or \$14.15 million, of our total consolidated net income compared to 78.91%, or \$9.57 million, for comparative 2014. For the nine months ended September 30, 2015, the Banking segment represented 76.77%, or \$38.32 million, of our total consolidated income compared to 78.79%, or \$27.52 million, for comparative 2014.

Pre-tax earnings for the three months ended September 30, 2015 for the Banking segment were \$19.32 million, increasing \$6.33 million, or 48.74%, from comparative 2014. The increase in earnings from the comparative 2014 quarter was primarily driven by an increase in net interest income of \$8.40 million, an increase in other income of \$0.30 million, and a decrease in the provision for loan losses to \$0.13 million from \$1.00 million, which was partially offset by an increase in noninterest expenses of \$3.85 million. The

PART I. FINANCIAL INFORMATION

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

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 \$829.55 million to \$4.30 billion and average investments increased to \$857.11 million from \$675.76 million. The increase was partially offset by an increase in interest expense as average interest-bearing deposits were higher by \$736.85 million, primarily due to the Franklin merger. The increase in noninterest income was due to an increase in income from bank-owned life insurance policies of \$0.78 million and an increase in gains on securities sale of \$0.69 million.

The increase in noninterest expense was due to increases in salaries and employee benefits of \$2.82 million, furniture and equipment expense of \$0.21 million and other expense of \$0.76 million. The increases were largely due to operational expenses related to the Franklin acquisition, combined with increases in profit sharing accruals, salaries due to annual salary adjustments, charitable contributions, professional fees, software expense and foreclosed property expenses. The increases were partially offset by a decrease in acquisition-related expenses.

Pre-tax earnings were up \$1.12 million compared to the linked quarter ended June 30, 2015. The increase in earnings was a result of an overall increase in revenue of \$0.62 million and a decrease in the provision for loan losses of \$1.59 million. An increase in noninterest expenses of \$1.07 million partially offset the increase in earnings. The increase in net interest income of \$0.67 million was primarily due to loan growth in the third quarter, while a reduction in historical loss ratios combined with continued improvements in credit quality led to the decrease in the provision for loan losses. The increase in noninterest expense to the linked quarter ended June 30, 2015 was driven by an increase in salaries and employee benefits of \$2.23 million primarily due to higher profit-sharing accruals and salary expenses, combined with a decrease in other expenses of \$0.91 million, as charitable contributions and marketing costs decreased.

Pre-tax earnings were up \$14.42 million, or 37.64%, for the nine months ended September 30, 2015, compared to the comparative period in 2014. The leading factor in the increase was an increase in net interest income of \$24.71 million related to earning assets acquired in the Franklin merger. The increase was partially offset by increases in the provision for loan losses of \$1.74 million and noninterest expenses of \$11.12 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)			
	September 30,		June 30, 2015	2015 over 2014		September over June	
	2015	2014		Amount	Percent	Amount	Percent
Net interest income	\$ 44,747	\$ 36,343	\$ 44,074	\$ 8,404	23.12 %	\$ 673	1.53 %
Service charges on deposit accounts	2,388	2,406	2,326	(18)	(0.75)%	62	2.67 %
Credit card merchant fees	823	927	566	(104)	(11.22)%	257	45.41 %
Other income	2,208	1,910	3,194	298	15.60 %	(986)	(30.87)%
Net gain on investment securities	736	44	119	692	N/M	617	518.49 %
Total noninterest income	6,155	5,287	6,205	868	16.42 %	(50)	(0.81)%
Total revenue	50,902	41,630	50,279	9,272	22.27 %	623	1.24 %
Provision for loan losses	130	996	1,723	(866)	(86.95)%	(1,593)	(92.46)%
Salaries and employee benefits	17,992	15,173	15,760	2,819	18.58 %	2,232	14.16 %
Occupancy expense	3,282	3,220	3,411	62	1.93 %	(129)	(3.78)%
Furniture and equipment	1,777	1,571	1,897	206	13.11 %	(120)	(6.33)%
Other expenses	8,698	7,937	9,608	761	9.59 %	(910)	(9.47)%
Total noninterest expenses	31,749	27,901	30,676	3,848	13.79 %	1,073	3.50 %
Income before income tax and corporate allocation	19,023	12,733	17,880	6,290	49.40 %	1,143	6.39 %
Corporate allocation	293	253	315	40	15.81 %	(22)	(6.98)%
Income before income tax provision	19,316	12,986	18,195	6,330	48.74 %	1,121	6.16 %
Provision for income tax expense	5,168	3,417	5,128	1,751	51.24 %	40	0.78 %
Net income	\$ 14,148	\$ 9,569	\$ 13,067	\$ 4,579	47.85 %	\$ 1,081	8.27 %
Efficiency ratio (1)	63.29%	67.09%	61.16%	(3.80)%	(5.66)%	2.13%	3.48 %

(1) Excludes gain on investment securities.

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended		Increase/(Decrease)	
	September 30,		2015 over 2014	
	2015	2014	Amount	Percent
Net interest income	\$ 132,006	\$ 107,300	\$ 24,706	23.03 %
Service charges on deposit accounts	6,911	6,904	7	0.10 %
Credit card merchant fees	1,821	2,665	(844)	(31.67)%
Other income	7,550	5,200	2,350	45.19 %
Net gain (loss) on investment securities	904	(15)	919	N/M
Total noninterest income	17,186	14,754	2,432	16.48 %
Total revenue	149,192	122,054	27,138	22.23 %
Provision for loan losses	2,176	436	1,740	399.08 %
Salaries and employee benefits	50,607	45,763	4,844	10.58 %
Occupancy expense	10,117	9,138	979	10.71 %
Furniture and equipment	5,517	4,696	821	17.48 %
Other expenses	28,928	24,454	4,474	18.30 %
Total noninterest expenses	95,169	84,051	11,118	13.23 %
Income before income tax and corporate allocation	51,847	37,567	14,280	38.01 %
Corporate allocation	901	757	144	19.02 %
Income before income tax provision	52,748	38,324	14,424	37.64 %
Provision for income tax expense	14,425	10,800	3,625	33.56 %
Net income	\$ 38,323	\$ 27,524	\$ 10,799	39.23 %
Efficiency ratio (1)	64.18%	68.85%	(4.67)%	(6.78)%

(1) Excludes gain on investment securities.

Realty Segment. For the three months ended September 30, 2015, the Realty segment had income before income tax provision and noncontrolling interest of \$4.62 million, as compared to \$3.22 million for the comparative 2014 period, and \$6.96 million for the linked quarter ended June 30, 2015. Total revenue increased to \$15.62 million in the third quarter of 2015 from \$12.94 million in the third quarter of 2014. The \$0.61 million, or 7.71%, increase in residential mortgage banking income was a result of increased production volume and improved pricing. Residential mortgage banking income included a seasonal decrease in the value of rate lock commitments of \$0.46 million for the quarter ended September 30, 2015, compared to a decrease of \$0.06 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 \$0.40 million on a prior year quarter comparison and \$0.11 million on a linked quarter comparison. Additionally, net interest and other income in second quarter 2015 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 13.35%, or \$1.28 million, when compared to the same period in 2014, and decreased by 1.18%, or \$0.13 million, when compared to the quarter ended June 30, 2015. The increase from third 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 decrease in expenses over the linked quarter ended June 30, 2015 was mainly driven by seasonal decreases.

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 Realty segment for the periods presented (dollars in thousands):

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2015		September 30, 2015	
	September 30,		June 30,	September 30, 2014		June 30, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	\$ 8,535	\$ 7,924	\$ 10,457	\$ 611	7.71 %	\$ (1,922)	(18.38)%
Real estate brokerage income, net	1,989	1,941	1,965	48	2.47 %	24	1.22 %
Title insurance and settlement fees	451	444	459	7	1.58 %	(8)	(1.74)%
Property management fees, net	3,360	1,704	2,619	1,656	97.18 %	741	28.29 %
Income from unconsolidated subsidiary	132	210	190	(78)	(37.14)%	(58)	(30.53)%
Net interest and other income	1,148	720	2,392	428	59.44 %	(1,244)	(52.01)%
Total revenue	15,615	12,943	18,082	2,672	20.64 %	(2,467)	(13.64)%
Salaries and employee benefits	6,335	5,633	6,049	702	12.46 %	286	4.73 %
Occupancy expense	940	945	966	(5)	(0.53)%	(26)	(2.69)%
Furniture and equipment	231	269	248	(38)	(14.13)%	(17)	(6.85)%
Amortization of intangible assets	236	127	246	109	85.83 %	(10)	(4.07)%
Other expenses	3,116	2,605	3,479	511	19.62 %	(363)	(10.43)%
Total expenses	10,858	9,579	10,988	1,279	13.35 %	(130)	(1.18)%
Income before income tax, corporate allocation and noncontrolling interest	4,757	3,364	7,094	1,393	41.41 %	(2,337)	(32.94)%
Corporate allocation	(135)	(143)	(133)	8	5.59 %	(2)	(1.50)%
Income before income tax provision and noncontrolling interest	4,622	3,221	6,961	1,401	(43.50)%	(2,339)	33.60 %
Provision for income tax	1,518	951	2,378	567	(59.62)%	(860)	36.16 %
Net income	3,104	2,270	4,583	834	36.74 %	(1,479)	32.27 %
Noncontrolling interest	(759)	(738)	(856)	(21)	(2.85)%	97	11.33 %
Net income attributable to TowneBank	\$ 2,345	\$ 1,532	\$ 3,727	\$ 813	(53.07)%	\$ (1,382)	37.08 %
Key data:							
Efficiency ratio	69.54%	74.01%	60.77%	(4.47)%	(6.04)%	8.77%	14.43 %
Number of units sold	1,122	1,044	1,095	78	7.47 %	27	2.47 %
Volume of units sold	\$ 318,171	\$ 298,415	\$ 295,127	\$ 19,756	6.62 %	\$ 23,044	7.81 %
Number of real estate agents	405	383	393	22	5.74 %	12	3.05 %
Loans originated, mortgage	\$ 221,772	\$ 159,401	\$ 233,545	\$ 62,371	39.13 %	\$ (11,773)	(5.04)%
Loans originated, joint venture	213,049	203,140	232,686	9,909	4.88 %	(19,637)	(8.44)%
Total loans originated	\$ 434,821	\$ 362,541	\$ 466,231	\$ 72,280	19.94 %	\$ (31,410)	(6.74)%
Number of loans, mortgage	993	720	1,002	273	37.92 %	(9)	(0.90)%
Number of loans, joint venture	936	976	1,085	(40)	(4.10)%	(149)	(13.73)%
Total number of loans	1,929	1,696	2,087	233	13.74 %	(158)	(7.57)%
Average loan amount, mortgage	\$ 223	\$ 221	\$ 233	\$ 2	0.90 %	\$ (10)	(4.29)%
Average loan amount, joint venture	228	208	214	20	9.62 %	14	6.54 %
Average loan amount	\$ 225	\$ 214	\$ 223	\$ 11	5.14 %	\$ 2	0.90 %
Average number of originators, mortgage	72	70	70	2	2.86 %	2	2.86 %
Average number of originators, joint venture	52	62	51	(10)	(16.13)%	1	1.96 %
Average number of originators	124	132	121	(8)	(6.06)%	3	2.48 %

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended		Increase/(Decrease)	
	September 30,		2015 over 2014	
	2015	2014	Amount	Percent
Residential mortgage banking income, net	\$ 27,506	\$ 20,860	\$ 6,646	31.86 %
Real estate brokerage income, net	5,220	4,926	294	5.97 %
Title insurance and settlement fees	1,211	1,203	8	0.67 %
Property management fees, net	8,668	5,259	3,409	64.82 %
Income from unconsolidated subsidiary	447	403	44	10.92 %
Net interest and other income	4,078	1,857	2,221	119.60 %
Total revenue	47,130	34,508	12,622	36.58 %
Salaries and employee benefits	18,415	16,398	2,017	12.30 %
Occupancy expense	2,956	2,817	139	4.93 %
Furniture and equipment	763	821	(58)	(7.06)%
Amortization of intangible assets	786	382	404	105.76 %
Other expenses	9,363	7,217	2,146	29.74 %
Total expenses	32,283	27,635	4,648	16.82 %
Income before income tax, corporate allocation and noncontrolling interest	14,847	6,873	7,974	116.02 %
Corporate allocation	(400)	(435)	35	(8.05)%
Income before income tax provision and noncontrolling interest	14,447	6,438	8,009	124.40 %
Provision for income tax expense	4,856	1,867	2,989	160.10 %
Net income	9,591	4,571	5,020	109.82 %
Noncontrolling interest	(1,870)	(1,629)	(241)	14.79 %
Net income attributable to TowneBank	\$ 7,721	\$ 2,942	\$ 4,779	162.44 %
Key data:				
Efficiency ratio	68.50%	80.09%	(11.59)%	(14.47)%
Number of units sold	2,953	2,683	270	10.06 %
Volume of units sold	\$ 806,159	\$ 755,262	\$ 50,897	6.74 %
Number of real estate agents	405	391	14	3.58 %
Loans originated, mortgage	\$ 616,188	\$ 387,306	\$ 228,882	59.10 %
Loans originated, joint venture	603,288	513,882	89,406	17.40 %
Total loans originated	\$ 1,219,476	\$ 901,188	\$ 318,288	35.32 %
Number of loans, mortgage	2,651	1,774	877	49.44 %
Number of loans, joint venture	2,827	2,450	377	15.39 %
Total number of loans	5,478	4,224	1,254	29.69 %
Average loan amount, mortgage	\$ 232	\$ 218	\$ 14	6.42 %
Average loan amount, joint venture	213	210	3	1.43 %
Average loan amount	\$ 223	\$ 213	\$ 10	4.69 %

Mortgage. The loan volume for the combined mortgage operations increased in the quarter ended September 30, 2015 as compared to the same period in 2014. Total loans originated in the third quarter of 2015 were \$434.82 million, a 19.94% increase, or \$72.28 million, from \$362.54 million in the comparative period of 2014. This was a \$31.41 million, or 6.74%, decrease compared to the volume for the quarter ended June 30, 2015. Refinance activity comprised \$58.07 million of loan volume for the quarter ended September 30, 2015, while purchases accounted for the remaining \$376.75 million in loan volume for the quarter. For the quarters ended September 30, 2014 and June 30, 2015, refinance volume was \$45.17 million and \$75.84 million, respectively, while purchase volume was \$317.37 million and \$390.39 million, respectively.

PART I. FINANCIAL INFORMATION

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

Insurance Segment. The Insurance segment comprises property and casualty and group benefit divisions. The Insurance segment represented 6.11%, or \$1.07 million, of total consolidated net income at September 30, 2015, and 8.45%, or \$1.03 million, at September 30, 2014.

Earnings before income taxes and noncontrolling interests for the three months ended September 30, 2015 were \$2.00 million, increasing \$0.18 million, or 9.71%, from comparative 2014. Earnings before income taxes and noncontrolling interests for the first nine months of 2015 were \$7.53 million, decreasing \$0.23 million, or 3.01%, from the same period in 2014. The primary factors affecting earnings in the aforementioned periods were higher acquisition-related expenses due to the acquisition of an insurance agency in September 2015 and two insurance agencies in February 2015, and an increase in amortization of intangible assets related to the acquisitions.

PART I. FINANCIAL INFORMATION

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

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)			
	September 30,		June 30,	September 30, 2015		September 30, 2015	
	September 30,		June 30,	September 30, 2014		June 30, 2015	
	2015	2014	2015	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	\$ 8,156	\$ 7,335	\$ 8,012	\$ 821	11.19 %	\$ 144	1.80 %
Employee benefits	2,578	2,723	2,443	(145)	(5.33)%	135	5.53 %
Travel insurance	626	468	910	158	33.76 %	(284)	(31.21)%
Specialized benefit services	145	138	135	7	5.07 %	10	7.41 %
Total net commissions and fees	11,505	10,664	11,500	841	7.89 %	5	0.04 %
Contingency and bonus revenue	260	56	387	204	364.29 %	(127)	(32.82)%
Other income	53	52	47	1	1.92 %	6	12.77 %
Total revenues	11,818	10,772	11,934	1,046	9.71 %	(116)	(0.97)%
Employee commission expense	2,361	2,165	2,326	196	9.05 %	35	1.50 %
Revenue, net of commission expense	\$ 9,457	\$ 8,607	\$ 9,608	850	9.88 %	(151)	(1.57)%
Salaries and employee benefits	4,583	4,274	4,734	309	7.23 %	(151)	(3.19)%
Occupancy expense	480	454	480	26	5.73 %	—	— %
Furniture and equipment	202	200	225	2	1.00 %	(23)	(10.22)%
Amortization of intangible assets	543	510	540	33	6.47 %	3	0.56 %
Other expenses	1,491	1,236	1,424	255	20.63 %	67	4.71 %
Total operating expenses	7,299	6,674	7,403	625	9.36 %	(104)	(1.40)%
Income before income tax, corporate allocation and noncontrolling interest	2,158	1,933	2,205	225	11.64 %	(47)	(2.13)%
Corporate allocation	(158)	(110)	(182)	(48)	43.64 %	24	(13.19)%
Income before income tax provision and noncontrolling interest	2,000	1,823	2,023	177	9.71 %	(23)	(1.14)%
Provision for income tax	758	676	695	82	12.13 %	63	9.06 %
Net income	1,242	1,147	1,328	95	8.28 %	(86)	(6.48)%
Noncontrolling interest	(169)	(122)	(310)	(47)	38.52 %	141	(45.48)%
Net income attributable to TowneBank	\$ 1,073	\$ 1,025	\$ 1,018	\$ 48	4.68 %	\$ 55	5.40 %
Efficiency ratio	61.76%	61.96%	62.03%	(0.20)%	(0.32)%	(0.27)%	(0.44)%

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended		Increase/(Decrease)	
	September 30,		2015 over 2014	
	2015	2014	Amount	Percent
Net commission and fee income				
Property and casualty	\$ 22,627	\$ 18,805	\$ 3,822	20.32 %
Employee benefits	7,690	8,027	(337)	(4.20)%
Travel insurance	2,668	1,893	775	40.94 %
Specialized benefit services	413	407	6	1.47 %
Total net commissions and fees	33,398	29,132	4,266	14.64 %
Contingency and bonus revenue	3,171	3,165	6	0.19 %
Other income	148	287	(139)	(48.43)%
Total revenues	\$ 36,717	\$ 32,584	\$ 4,133	12.68 %
Employee commission expense	6,723	6,278	445	7.09 %
Revenue, net of commission expense	\$ 29,994	\$ 26,306	\$ 3,688	14.02 %
Salaries and employee benefits	\$ 14,111	\$ 11,640	\$ 2,471	21.23 %
Occupancy expense	1,416	1,232	184	14.94 %
Furniture and equipment	669	562	107	19.04 %
Amortization of intangible assets	1,609	1,368	241	17.62 %
Other expenses	4,157	3,417	740	21.66 %
Total operating expenses	21,962	18,219	3,743	20.54 %
Income before income tax, corporate allocation and noncontrolling interest	8,032	8,087	(55)	(0.68)%
Corporate allocation	(501)	(322)	(179)	55.59 %
Income before income tax provision and noncontrolling interest	7,531	7,765	(234)	(3.01)%
Provision for income tax expense	2,749	2,714	35	1.29 %
Net income	4,782	5,051	(269)	(5.33)%
Noncontrolling interest	(910)	(583)	(327)	56.09 %
Net income attributable to TowneBank	\$ 3,872	\$ 4,468	\$ (596)	(13.34)%
Efficiency ratio	59.81%	55.91%	3.9%	6.98 %

Total revenues for the third quarter of 2015 increased \$1.05 million, or 9.71%, when compared to the same period in 2014, and increased \$4.13 million, or 12.68%, for the nine months ended September 30, 2015 when compared to the same period in 2014. The increase from both comparative 2014 periods was impacted by the aforementioned insurance agency acquisitions and the nine-month comparison was also affected by a May 2014 insurance agency acquisition. The acquired insurance agencies resulted in additional net commission and fee income of \$0.40 million and \$2.98 million for the three- and nine-month periods, respectively. The decrease in revenues on a linked quarter basis was due to a drop in contingency and bonus revenue of \$0.13 million combined with a seasonal decrease in travel insurance commissions of \$0.28 million.

Total operating expenses for the third quarter of 2015 increased \$0.63 million, or 9.36%, when compared to the same period in 2014, and increased \$3.74 million, or 20.54%, for the nine months ended September 30, 2015 when compared to the same period in 2014. The largest factor in the increase was salaries and employee benefits expense, which increased \$0.31 million, or 7.23%, and \$2.47 million, or 21.23%, when

PART I. FINANCIAL INFORMATION

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

comparing the three- and nine-month periods ended September 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 \$0.27 million and \$1.88 million for the above mentioned three- and nine-month periods. The decrease in salaries and employee benefit expenses from the linked quarter of \$0.15 million was primarily due to lower incentive accruals in the current quarter.

Occupancy expense increased \$0.03 million, or 5.73%, and \$0.18 million, or 14.94%, when comparing the three- and nine-month periods ended September 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. The increase for the three- and nine-month periods ended September 30, 2015, was \$0.26 million and \$0.74 million, respectively, when compared to the same periods in 2014, while the increase from the linked quarter was \$0.07 million.

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2015, total assets were \$6.17 billion, which is \$1.20 billion, or 24.16%, higher than the period-end balance for comparative 2014, and \$118.71 million, or 1.96%, greater than the balance at June 30, 2015. Our loan portfolio, less unearned income and deferred costs, made up 70.73% of our period-end assets and totaled \$4.37 billion at September 30, 2015. Average assets for the quarter ended September 30, 2015 were \$6.12 billion, up \$1.15 billion, or 23.27%, from comparative September 30, 2014, and up \$214.87 million, or 3.64%, from the quarter ended June 30, 2015.

Average earning assets increased \$1.05 billion, or 22.94%, from \$4.56 billion for the third quarter of 2014 to \$5.60 billion for the third quarter of 2015. Compared to the second quarter of 2015, average earning assets increased \$196.96 million.

Our average total deposits were \$4.73 billion for third quarter 2015, reflecting growth of \$896.04 million, or 23.34%, compared to third quarter 2014. Growth continued in average noninterest-bearing deposits, which increased \$159.19 million, or 12.96%, from September 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 September 30, 2015 were \$245.49 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 third quarter of 2015 was \$167.25 million, or 2.98%, of average total earning assets compared with \$275.63 million, or 6.05%, of average total earning assets for comparative 2014. For the second quarter of 2015, the average balance of interest-bearing deposits in other banks was \$87.71 million, or 1.62%, 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 \$542.63 million at September 30, 2015, compared with \$607.93 million at September 30, 2014. The average balance during the third quarter of 2015 was \$739.28 million, compared to the 2014 period average of \$551.94 million, or 13.19% and 12.11% of average earning assets, respectively. During the nine months

PART I. FINANCIAL INFORMATION

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

ended September 30, 2015, we had sales, maturities, and calls totaling \$559.75 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 \$75.15 million at September 30, 2015, and \$86.79 million at September 30, 2014. The average balance during the third quarter of 2015 was \$78.85 million, compared with \$87.52 million in the 2014 period, representing 1.41% and 1.92% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At September 30, 2015, we held \$99.33 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$86.03 million at September 30, 2014, and \$165.99 million at June 30, 2015. Average loans held for sale were 2.36% and 1.72% of average earning assets for the quarters ended September 30, 2015 and 2014, respectively. Average loans held for sale were 2.43% of average earning assets for the quarter ended June 30, 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 \$4.37 billion at September 30, 2015, which was \$845.96 million, or 24.03%, above the \$3.52 billion reported at September 30, 2014, and \$138.91 million, or 3.29%, above the \$4.23 billion at June 30, 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 76.74% for the quarter ended September 30, 2015, compared with 76.14% for comparable 2014 and 76.95% for the quarter ended June 30, 2015.

PART I. FINANCIAL INFORMATION

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

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.

PART I. FINANCIAL INFORMATION

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

The allowance for loan losses at September 30, 2015, September 30, 2014, and June 30, 2015 was \$37.35 million, \$36.18 million, and \$37.29 million, respectively. The allowance was equal to 0.86% of total loans outstanding at September 30, 2015, compared with 1.03% and 0.88% at September 30, 2014 and June 30, 2015, respectively. Excluding purchased loans, the allowance was equal to 0.96% of loans outstanding at September 30, 2015, compared with 1.04% and 1.00% at September 30, 2014 and June 30, 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 1.58% of total loans at September 30, 2015, down from 1.85% at September 30, 2014 and 1.85% at December 31, 2014. Additionally, loans 30 to 89 days past due were \$5.86 million, including purchased impaired loans of \$0.14 million, at September 30, 2015, as compared to \$7.92 million and \$13.44 million at September 30, 2014 and December 31, 2014, respectively, and total past due and nonaccruing loans were \$22.29 million, including purchased impaired past-due loans of \$8.06 million, at September 30, 2015, from \$13.77 million and \$20.19 million at September 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 4.41x of nonperforming loans at September 30, 2015, compared with 6.18x and 5.00x at September 30, 2014 and June 30, 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 September 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			Nine Months Ended	
	September 30,		June 30,	September 30,	
	2015	2014	2015	2015	2014
Allowance for loan losses					
Balance beginning of period	\$ 37,290	\$ 35,786	\$ 35,907	\$ 35,917	\$ 38,380
Loans charged off:					
Residential 1-4 family	(401)	(214)	(342)	(1,090)	(1,324)
Multifamily	—	(492)	—	—	(493)
Commercial real estate	—	—	(104)	(278)	(944)
Construction	(32)	(128)	(115)	(198)	(414)
Commercial and industrial	—	(14)	(112)	(118)	(251)
Consumer and other	(55)	(211)	(23)	(91)	(405)
Total	(488)	(1,059)	(696)	(1,775)	(3,831)
Loans recovered:					
Residential 1-4 family	100	271	139	368	494
Multifamily	—	—	—	—	1
Commercial real estate	14	119	56	83	429
Construction	21	17	52	75	49
Commercial and industrial	243	26	87	415	96
Consumer and other	41	24	22	92	69
Total	419	457	356	1,033	1,138
Net loans charged off	(69)	(602)	(340)	(742)	(2,693)
Provision for loan losses	130	996	1,723	2,176	493
Balance end of period	<u>\$ 37,351</u>	<u>\$ 36,180</u>	<u>\$ 37,290</u>	<u>\$ 37,351</u>	<u>\$ 36,180</u>
Nonperforming assets					
Nonperforming loans	\$ 8,477	\$ 5,853	\$ 7,455	\$ 8,477	\$ 5,853
Foreclosed property	39,509	37,951	46,154	39,509	37,951
Total nonperforming assets	<u>\$ 47,986</u>	<u>\$ 43,804</u>	<u>\$ 53,609</u>	<u>\$ 47,986</u>	<u>\$ 43,804</u>
Loans past due 90 days and still accruing interest	<u>\$ 31</u>	<u>\$ —</u>	<u>\$ 277</u>	<u>\$ 31</u>	<u>\$ —</u>
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	4.41x	6.18x	5.00x	4.41x	6.18x
Allowance for loan losses to period end loans	0.86%	1.03%	0.88%	0.86%	1.03%
Allowance for loan losses to period end loans excluding purchased loans	0.96%	1.04%	1.00%	0.96%	1.04%
Nonperforming loans to period end loans	0.19%	0.17%	0.18%	0.19%	0.17%
Nonperforming assets to period end assets	0.78%	0.88%	0.89%	0.78%	0.88%
Net charge-offs to average loans (annualized)	0.01%	0.07%	0.03%	0.02%	0.10%

PART I. FINANCIAL INFORMATION

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

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 September 30, 2015, we had \$47.99 million in nonperforming assets, which amounted to 0.78% of total assets. Additionally, there were \$0.03 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consist of \$8.48 million in nonperforming loans as well as \$39.51 million in foreclosed property. Nonperforming loans increased by \$1.02 million from June 30, 2015, as additions to nonaccrual loans during the third quarter of 2015 outpaced transfers to other real estate owned ("OREO"), charge-offs, and payments received. Nonperforming residential loans decreased by \$0.09 million, with paydowns of \$0.18 million, transfers to OREO of \$0.67 million, and charge-offs of \$0.40 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 \$1.01 million, with paydowns of \$0.46 million, and transfers to OREO of \$0.51 million. At September 30, 2015, foreclosed property totaled \$39.51 million, a decrease from \$46.15 million at June 30, 2015, and an increase from \$37.95 million at September 30, 2014. Included in foreclosed property at September 30, 2015 was OREO of \$6.21 million acquired in the Franklin merger. The 10 largest foreclosed property developments represented approximately 83% of total foreclosed property at September 30, 2015, with the largest development representing approximately 42%. Foreclosed property consists of 29 residential properties, 29 construction and development properties, and four commercial properties.

At September 30, 2015, loans 60-89 days past due, excluding nonperforming loans, totaled \$1.21 million. Additionally, there are other performing loans, totaling \$26.32 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.

PART I. FINANCIAL INFORMATION

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

At September 30, 2015, nonaccruing TDRs, which are included in nonperforming loans, totaled \$4.97 million, and accruing TDRs totaled \$29.92 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):

	September 30, 2015	December 31, 2014
Construction and land development	\$ 1,323	\$ 1,680
Commercial real estate	2,456	2,132
Multi-family real estate	742	—
1-4 family residential real estate	3,614	2,546
Commercial and industrial business loans	285	383
Consumer loans and other	57	—
Total nonperforming loans	<u>\$ 8,477</u>	<u>\$ 6,741</u>

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):

	September 30, 2015	September 30, 2014	June 30, 2015
Real estate loans:			
Residential 1-4 family	\$ 9,060	\$ 9,045	\$ 8,962
Commercial	14,869	14,632	14,639
Construction	4,671	6,356	5,509
Multi-family	658	720	752
Total real estate loans	<u>29,258</u>	<u>30,753</u>	<u>29,862</u>
Commercial and industrial loans	<u>5,496</u>	<u>4,455</u>	<u>5,454</u>
Consumer loans and other	<u>2,597</u>	<u>972</u>	<u>1,974</u>
Total	<u>\$ 37,351</u>	<u>\$ 36,180</u>	<u>\$ 37,290</u>

PART I. FINANCIAL INFORMATION

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

Deposits. Total deposits at September 30, 2015 were \$4.79 billion, representing an increase of 24.36%, or \$937.95 million, over September 30, 2014, and an increase of \$101.23 million, or 2.16%, compared to June 30, 2015. Overall growth in deposits from the second 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 \$4.73 billion during the third quarter of 2015, compared to \$3.84 billion during the third quarter of 2014, and \$4.55 billion during the second quarter of 2015.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 29.31% during the third quarter of 2015 and 32.01% during the same period in 2014. Average noninterest-bearing demand deposits were 28.74% of average total deposits for the second quarter of 2015. The cost of interest-bearing deposits was 0.58% for the third quarter of 2015, compared with 0.52% for the third quarter of 2014, and 0.55% for the second 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					
		September 30,				June 30,	
		2015		2014		2015	
Interest-bearing demand and money market accounts	\$	1,693,424	0.28%	\$	1,317,611	0.22%	\$ 1,646,075 0.28%
Regular savings		297,041	0.93%		308,466	0.91%	301,020 0.92%
Certificates of deposit		1,356,409	0.87%		983,950	0.80%	1,294,181 0.81%
Total interest-bearing		3,346,874	0.58%		2,610,027	0.52%	3,241,276 0.55%
Noninterest-bearing		1,388,002			1,228,807		1,307,075
Total	\$	4,734,876	0.41%	\$	3,838,834	0.35%	\$ 4,548,351 0.39%

		Average Balance/Cost Rate			
		Nine Months Ended			
		September 30,		September 30,	
		2015		2014	
Interest bearing demand and money market accounts	\$	1,658,531	0.28%	\$	1,294,093 0.23%
Regular savings		300,996	0.92%		313,114 0.92%
Certificates of deposit		1,319,827	0.83%		973,919 0.77%
Total interest bearing		3,279,354	0.56%		2,581,126 0.52%
Noninterest bearing		1,317,517			1,128,954
Total	\$	4,596,871	0.40%	\$	3,710,080 0.36%

PART I. FINANCIAL INFORMATION

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

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					
	September 30,			June 30,		
	2015		2014		2015	
Interest-bearing demand and money market accounts	\$ 1,693,424	35.77%	\$ 1,317,611	34.32%	\$ 1,646,075	36.19%
Regular savings	297,041	6.27%	308,466	8.04%	301,020	6.62%
Certificates of deposit	1,356,409	28.65%	983,950	25.63%	1,294,181	28.45%
Total-interest bearing	3,346,874	70.69%	2,610,027	67.99%	3,241,276	71.26%
Noninterest-bearing	1,388,002	29.31%	1,228,807	32.01%	1,307,075	28.74%
Total	\$ 4,734,876	100.00%	\$ 3,838,834	100.00%	\$ 4,548,351	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the Federal Home Loan Bank of Atlanta ("FHLB") at September 30, 2015 were \$437.28 million, compared to \$398.48 million at September 30, 2014, and \$437.58 million at June 30, 2015. The average borrowing cost for the third quarter of 2015 was 3.06%, 3.32% in the fourth quarter of 2014, and 3.06% in the second quarter of 2015.

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

Maturity	Interest Rate	Call Date	Outstanding Amount
03/06/2017	4.08%	12/07/2015	\$ 100,000
05/18/2017	4.35%	11/18/2015	80,000
05/18/2017	4.48%	11/18/2015	80,000
01/29/2018	3.05%	—	13,000
01/29/2018	3.05%	—	7,000
09/28/2017	0.95%	—	34,000
09/30/2019	1.44%	—	33,000
06/08/2026	2.38%	—	8,063
11/15/2028	3.43%	—	5,361
12/01/2028	2.83%	—	3,858
05/16/2016	0.44%	—	40,000
09/28/2016	0.58%	—	33,000
Total FHLB Loans			<u>\$ 437,282</u>

At September 30, 2015, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of \$751.05 million collateralized the advances from the FHLB. At September 30, 2014, certain loans with carrying values of \$758.16 million collateralized the advances from the FHLB. 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.

PART I. FINANCIAL INFORMATION

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

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of September 30, 2015, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the third quarter of 2015 were \$472.12 million, compared with \$424.75 million for the third quarter of 2014, and \$460.99 million for the second quarter of 2015, while the average cost of these funds was 2.85%, 3.13%, and 2.90%, respectively.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* on page 44 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.

On August 26, 2015, we declared a quarterly shareholder cash dividend of \$0.12 per common share. The dividend was paid on October 9, 2015, to shareholders of record on September 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 12.52% for common equity tier I, 12.62% for tier I capital, and 13.35% 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 September 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 our risk-based capital position as of the date indicated (dollars in thousands):

	September 30,		June 30,
	2015	2014	2015
	Basel III	Basel I	Basel III
Tier I Capital:			
Shareholders' equity	\$ 816,069	\$ 613,408	\$ 802,891
Less: goodwill and intangible assets, net of deferred tax	160,677	127,448	161,046
AOCI-related adjustments	1,036	698	291
Noncontrolling interests	8,917	N/A	8,873
Total common equity tier I capital	645,439	N/A	632,681
Included noncontrolling interests	5,470	N/A	5,545
Total tier I capital	650,909	485,262	638,226
Tier II Capital:			
Qualifying allowance for loan losses (1)	37,351	36,180	37,290
Total tier II capital	37,351	36,180	37,290
Total Risk-Based Capital	\$ 688,260	\$ 521,442	\$ 675,516
Total assets	\$ 6,173,891	\$ 4,972,448	\$ 6,055,181
Total risk-weighted assets (2)	5,157,275	3,766,306	4,882,513
Average assets for leverage capital purposes	5,955,003	4,833,756	5,739,770
Risk-weighted assets to total assets	83.53%	75.74%	80.63%
Risk-based capital ratios:			
Common equity tier I (4.5% minimum requirement)	12.52%	N/A	12.96%
Tier I (6% minimum requirement in 2015, 4% in prior periods)	12.62%	12.88%	13.07%
Total (8% minimum requirement, all periods)	13.35%	13.84%	13.84%
Tier I leverage ratio (4% minimum requirement, all periods)	10.93%	10.04%	11.12%

(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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Return on average assets (GAAP basis)	1.14%	0.97%	1.12%	0.97%
Impact of excluding average goodwill and other intangibles and amortization	0.07%	0.06%	0.07%	0.06%
Return on average tangible assets	1.21%	1.03%	1.19%	1.03%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Return on average equity (GAAP basis)	8.58%	7.86%	8.36%	7.76%
Impact of excluding average goodwill and other intangibles and amortization	2.67%	2.46%	2.76%	2.37%
Return on average tangible equity	11.25%	10.32%	11.12%	10.13%

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 September 30,	
	2015	2014
Book value (GAAP basis)	\$ 15.65	\$ 14.85
Impact of excluding goodwill and other intangibles and amortization	(3.40)	(3.64)
Tangible book value	\$ 12.25	\$ 11.21

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 September 30, 2015, we had \$597.94 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

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 September 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 September 30, 2015. There were no changes that occurred during the period covered by this Form 10-Q that have materially affected, or are 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

<u>Exhibit No.</u>	<u>Description</u>
(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 November 6, 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

November 6, 2015

Date

By: /s/ G. Robert Aston, Jr.

G. Robert Aston, Jr.

Chairman of the Board/Chief Executive
Officer

November 6, 2015

Date

By: /s/ Clyde E. McFarland, Jr.

Clyde E. McFarland, Jr.

Senior Executive Vice President/Chief
Financial Officer

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 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.

November 6, 2015

Date

/s/ G. Robert Aston, Jr.

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.

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 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 (31.2)

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.

November 6, 2015

Date

/s/ Clyde E. McFarland, Jr.

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 September 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.

November 6, 2015

Date

/s/ G. Robert Aston, Jr.

G. Robert Aston, Jr.

Chairman of the Board/Chief Executive Officer

November 6, 2015

Date

/s/ Clyde E. McFarland, Jr.

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.



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 September 30, 2015 and 2014, the related consolidated statement of equity for the nine months ended September 30, 2015, the related consolidated statements of income, and comprehensive income for the three-month and nine-month periods ended September 30, 2015 and 2014, and the related consolidated statements of cash flows for the nine-month periods ended September 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
November 6, 2015