

FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended March 31, 2016

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 April 28, 2016 was 51,678,667 shares.

TOWNE BANK

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TOWNE BANK

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(In thousands, except share data)	March 31,		December 31,
	2016	2015	2015
	(unaudited)		(audited)
ASSETS			
Cash and due from banks	\$ 195,161	\$ 144,215	\$ 250,836
Interest-bearing deposits in financial institutions	1,006	1,000	1,001
Total Cash and Cash Equivalents	196,167	145,215	251,837
Securities available for sale, at fair value	821,551	771,208	723,489
Securities held to maturity, at amortized cost	66,921	83,752	69,045
Federal Home Loan Bank stock, at amortized cost	23,903	22,366	23,691
Total Securities	912,375	877,326	816,225
Mortgage loans held for sale	97,491	102,850	102,346
Loans, net of unearned income and deferred costs:			
Real estate - residential 1-4 family	988,432	915,205	973,331
Real estate - commercial	1,762,312	1,725,706	1,784,393
Real estate - construction and land development	635,992	519,390	598,875
Real estate - multifamily	160,246	146,395	167,371
Commercial and industrial business	852,005	700,252	857,036
Consumer and other loans	153,273	88,747	138,387
Loans, net of unearned income and deferred costs	4,552,260	4,095,695	4,519,393
Less: Allowance for loan losses	(37,760)	(35,907)	(38,359)
Net Loans	4,514,500	4,059,788	4,481,034
Premises and equipment, net	178,154	166,164	173,695
Goodwill	157,659	156,516	154,842
Other intangible assets, net	29,286	23,090	26,153
Bank-owned life insurance policies	150,623	145,401	149,452
Other assets	128,914	152,353	140,990
TOTAL ASSETS	\$ 6,365,169	\$ 5,828,703	\$ 6,296,574
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	\$ 1,449,660	\$ 1,261,482	\$ 1,393,264
Interest-bearing:			
Demand and money market accounts	1,769,414	1,643,534	1,824,226
Savings	302,373	303,936	300,408
Certificates of deposit	1,433,679	1,296,666	1,396,129
Total Deposits	4,955,126	4,505,618	4,914,027
Advances from the Federal Home Loan Bank	428,940	397,884	429,080
Repurchase agreements and other borrowings	39,442	37,202	37,434
Total Borrowings	468,382	435,086	466,514
Other liabilities	105,658	96,419	95,839
TOTAL LIABILITIES	5,529,166	5,037,123	5,476,380
Shareholders' Equity			
Preferred stock:			
Authorized and unissued shares - 2,000,000	—	—	—
Common stock, \$1.667 par: 90,000,000 shares authorized			
51,680,059; 51,466,606; and 51,605,521 shares issued at			
March 31, 2016 and 2015 and December 31, 2015, respectively	86,151	85,795	86,026
Capital surplus	536,294	531,483	535,094
Retained earnings	204,413	163,519	192,795
Common stock issued to deferred compensation trust, at cost			
651,379; 637,935; and 648,350 shares at			
March 31, 2016 and 2015 and December 31, 2015, respectively	(10,288)	(9,816)	(10,172)
Deferred compensation trust	10,288	9,816	10,172
Accumulated other comprehensive income (loss)	17	2,359	(2,994)
TOTAL SHAREHOLDERS' EQUITY	826,875	783,156	810,921
Noncontrolling interests	9,128	8,424	9,273
TOTAL EQUITY	836,003	791,580	820,194
TOTAL LIABILITIES AND EQUITY	\$ 6,365,169	\$ 5,828,703	\$ 6,296,574

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended	
	March 31,	
	2016	2015
INTEREST INCOME:		
Loans, including fees	\$ 50,247	\$ 47,341
Investment securities	3,464	3,337
Interest-bearing deposits in financial institutions and federal funds sold	330	125
Mortgage loans held for sale	693	565
Total Interest Income	54,734	51,368
INTEREST EXPENSE:		
Deposits	5,213	4,424
Advances from the Federal Home Loan Bank	3,163	3,374
Repurchase agreements and other borrowings	22	14
Total Interest Expense	8,398	7,812
Net Interest Income	46,336	43,556
PROVISION FOR LOAN LOSSES	(259)	323
Net Interest Income after Provision for Loan Losses	46,595	43,233
NONINTEREST INCOME:		
Residential mortgage banking income, net	7,118	8,443
Real estate brokerage and property management income, net	4,827	3,955
Insurance commissions and other title fees and income, net	14,033	11,049
Service charges on deposit accounts	2,176	2,197
Credit card merchant fees, net	895	432
Other income	3,366	2,691
Net gain on investment securities	—	49
Total Noninterest Income	32,415	28,816
NONINTEREST EXPENSE:		
Salaries and employee benefits	30,187	27,679
Occupancy expense	5,017	4,930
Furniture and equipment	2,357	2,369
Other expenses	14,600	15,462
Total Noninterest Expense	52,161	50,440
Income before income tax expense and noncontrolling interest	26,849	21,609
Provision for income tax expense	8,188	6,385
Net income	18,661	15,224
Net income attributable to noncontrolling interest	(842)	(686)
Net income attributable to TowneBank	\$ 17,819	\$ 14,538
Preferred stock dividends	—	13
Net income available to common shareholders	\$ 17,819	\$ 14,525
Per common share information		
Basic earnings	\$ 0.35	\$ 0.29
Diluted earnings	\$ 0.35	\$ 0.29
Cash dividends declared	\$ 0.12	\$ 0.11

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

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Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(Dollars in thousands)

	Three Months Ended	
	March 31,	
	2016	2015
Net income	\$ 18,661	\$ 15,224
Other comprehensive income		
Unrealized gains on securities		
Unrealized holding gains arising during the period	4,480	2,914
Deferred tax expense	(1,568)	(1,020)
Realized gains reclassified into earnings	—	(49)
Deferred tax benefit	—	17
Net unrealized gains	2,912	1,862
Pension and postretirement benefit plans		
Actuarial gains	109	—
Deferred tax expense	(38)	—
Amortization of prior service costs	38	—
Deferred tax expense	(13)	—
Amortization of net actuarial loss	4	60
Deferred tax expense	(1)	(21)
Change in defined benefit retirement plan, net of tax	99	39
Other comprehensive income, net of tax	3,011	1,901
Comprehensive income	\$ 21,672	\$ 17,125

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

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Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOW (unaudited)

(Dollars in thousands)

	Three Months Ended March 31,	
	2016	2015
OPERATING ACTIVITIES:		
Net income	\$ 18,661	\$ 15,224
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Net amortization of securities	677	780
Investment securities gains	—	(49)
Depreciation, amortization, and other intangible amortization	4,253	4,002
Provision for loan losses	(259)	323
Bank-owned life insurance income	(1,172)	(1,140)
Deferred income tax benefit	(129)	(482)
Share-based compensation expense	443	724
Originations of mortgage loans held for sale	(270,877)	(294,470)
Proceeds from sales of mortgage loans held for sale	285,187	273,886
Gain on sales of mortgage loans held for sale	(9,455)	(10,876)
(Gain) loss on sale and write-down of foreclosed assets	(355)	672
Changes in:		
Interest receivable	(4,132)	(1,757)
Other assets	9,947	(35,946)
Interest payable	782	117
Other liabilities	9,195	(2,010)
Net cash from (used for) operating activities	<u>42,766</u>	<u>(51,002)</u>
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(203,254)	(118,892)
Purchase of held-to-maturity securities	—	(3,060)
Sale of available-for-sale securities	—	133,313
Sale of FHLB stock	—	8,113
Proceeds from maturities, calls, and prepayments of available-for-sale securities	108,836	43,018
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	2,074	3,190
Net increase in loans	(33,206)	(37,975)
Purchase of premises and equipment	(7,439)	(2,416)
Proceeds from sales of premises and equipment	163	122
Proceeds from sales of foreclosed assets	4,010	1,630
Cash acquired in acquisitions of business, net of cash consideration paid	<u>(5,554)</u>	<u>248,766</u>
Net cash from (used for) investing activities	<u>(134,370)</u>	<u>275,809</u>
FINANCING ACTIVITIES:		
Net change in deposit accounts	41,100	(23,931)
Net change in borrowings	1,868	(186,467)
Redemption of preferred stock	—	(76,458)
Distribution of interest in joint ventures	(987)	(1,594)
Proceeds from issuance of common stock	161	527
Cash dividends paid	<u>(6,208)</u>	<u>(5,674)</u>
Net cash from (used for) financing activities	<u>35,934</u>	<u>(293,597)</u>
Change in cash and cash equivalents	(55,670)	(68,790)
Cash and cash equivalents at beginning of year	<u>251,837</u>	<u>214,005</u>
Cash and cash equivalents at end of period	<u>\$ 196,167</u>	<u>\$ 145,215</u>
Supplemental cash flow information:		
Cash paid for interest	\$ 2,298	\$ 7,695
Cash paid for income taxes	\$ 14	\$ 1
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 1,406	\$ 4,020
Sales of foreclosed assets financed by the Company	\$ 2,918	\$ 567
Net unrealized gains on available-for-sale securities, net of tax	\$ 2,912	\$ 1,862
Shares issued for business acquisitions	\$ 720	\$ 238,656
Common stock issued in connection with conversion of convertible subordinated capital debentures	\$ 1	\$ —

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, 2016	51,605,521	\$ —	\$ 86,026	\$ 535,094	\$ 192,795	\$ 10,172	\$ (10,172)	\$ (2,994)	\$ 9,273	\$ 820,194
Net income	—	—	—	—	17,819	—	—	—	842	18,661
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	3,011	—	3,011
Cash dividends declared on common stock	—	—	—	—	(6,201)	—	—	—	—	(6,201)
Director's deferred compensation	—	—	—	—	—	116	(116)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	—	(987)	(987)
Conversion of convertible debt into common stock	139	—	—	1	—	—	—	—	—	1
Issuance of common stock - contingent consideration earned on acquisitions	24,292	—	41	408	—	—	—	—	—	449
Issuance of common stock - acquisitions	36,655	—	61	659	—	—	—	—	—	720
Issuance of common stock - stock compensation plans	13,452	—	23	132	—	—	—	—	—	155
Balance, March 31, 2016	<u>51,680,059</u>	<u>\$ —</u>	<u>\$ 86,151</u>	<u>\$ 536,294</u>	<u>\$ 204,413</u>	<u>\$ 10,288</u>	<u>\$ (10,288)</u>	<u>\$ 17</u>	<u>\$ 9,128</u>	<u>\$ 836,003</u>

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

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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 2015 audited Consolidated Financial Statements and the 2015 Annual Report on Form 10-K. Results of operations for the three-month period ended March 31, 2016 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. At March 31, 2016, the Company had \$238.70 million in IRBs classified as loans held for investment. Additionally, the Company recorded \$1.72 million in interest income from loans related to IRBs for the three months ended March 31, 2016. Prior period amounts presented were reclassified as shown in the following schedule:

		March 31, 2015		
		As Previously Presented	Revision	Subsequent to Revision
<i>(in thousands)</i>				
Securities held to maturity, at amortized cost		\$ 252,173	\$ (168,421)	\$ 83,752
Loans, net of unearned income and deferred costs:		\$ 3,927,274	\$ 168,421	\$ 4,095,695
Allowance for loan losses		(35,907)	—	(35,907)
Net loans		\$ 3,891,367	\$ 168,421	\$ 4,059,788
		Three Months Ended March 31, 2015		
		As Previously Presented	Revision	Subsequent to Revision
INTEREST INCOME:				
Loans, including fees		\$ 46,145	\$ 1,196	\$ 47,341
Investment securities		\$ 4,533	\$ (1,196)	\$ 3,337
Provision for loan losses		\$ 323	\$ —	\$ 323

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Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Recent accounting pronouncements

In February 2015, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“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. The adoption of this guidance did not have a material impact on the Company’s Consolidated Financial Statements.

In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*. The ASU amended the Business Combinations topic of the Accounting Standards Codification (“ASC”) to simplify the accounting for adjustments made to provisional amounts recognized in a business combination by eliminating the requirement to retrospectively account for those adjustments. The amendments are effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted for financial statements that have not been issued. All entities are required to apply the amendments prospectively to adjustments to provisional amounts that occur after the effective date. The adoption of this guidance did not have a material impact on the Company’s Consolidated Financial Statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU amends the Financial Instruments topic of the ASC to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for interim and annual reporting periods beginning after December 15, 2017. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements, but does not expect the adoption of this guidance to have a material impact.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The ASU was issued in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. The ASU is effective for interim and annual periods beginning after December 15, 2018, using a modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The ASU amends ASC Topic 718, *Compensation – Stock Compensation*. The ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2016 and early adoption is permitted. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements, but does not expect the adoption of this guidance to have a material impact.

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 March 31,	
	2016	2015
Basic		
Net income, as reported	\$ 17,819	\$ 14,538
Preferred stock dividends	—	13
Net income available to common shareholders	\$ 17,819	\$ 14,525
Weighted-average common shares outstanding	51,290,010	50,652,963
Basic earnings per common share	\$ 0.35	\$ 0.29
Diluted		
Net income available to common shareholders, for diluted EPS	\$ 17,819	\$ 14,525
Weighted-average common shares outstanding	51,290,010	50,652,963
Effect of dilutive securities:		
Stock compensation plans, net of tax benefit (1)	102,847	71,625
Weighted-average diluted shares outstanding	51,392,857	50,724,588
Diluted earnings per common share	\$ 0.35	\$ 0.29

(1) Stock options and restricted stock shares totaling 13,154 and 40,231 were excluded from the computation of diluted earnings per share during the first quarter of 2016 and 2015, respectively, because their inclusion would be anti-dilutive.

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

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Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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):

March 31, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	\$ 440,465	\$ 438	\$ (626)	\$ 440,277
U.S. Treasury notes	202,003	—	(3)	202,000
Municipal securities	20,937	466	(7)	21,396
Trust preferred and other corporate securities	5,419	521	—	5,940
Mortgage-backed securities issued by GSE	151,024	1,182	(268)	151,938
Total available-for-sale securities	<u>\$ 819,848</u>	<u>\$ 2,607</u>	<u>\$ (904)</u>	<u>\$ 821,551</u>

December 31, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	\$ 540,984	\$ 91	\$ (3,263)	\$ 537,812
U.S. Treasury notes	1,004	—	(7)	997
Municipal securities	21,445	449	(45)	21,849
Trust preferred and other corporate securities	5,409	620	(1)	6,028
Mortgage-backed securities issued by GSE	157,425	585	(1,207)	156,803
Total available-for-sale securities	<u>\$ 726,267</u>	<u>\$ 1,745</u>	<u>\$ (4,523)</u>	<u>\$ 723,489</u>

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):

March 31, 2016

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	\$ 500	\$ 218	\$ —	\$ 718
Municipal securities	43,518	3,237	—	46,755
Mortgage-backed securities issued by GSE	22,903	185	—	23,088
Total held-to-maturity securities	<u>\$ 66,921</u>	<u>\$ 3,640</u>	<u>\$ —</u>	<u>\$ 70,561</u>

December 31, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	\$ 500	\$ 214	\$ —	\$ 714
Municipal securities	44,377	3,111	—	47,488
Mortgage-backed securities issued by GSE	24,168	94	(97)	24,165
Total held-to-maturity securities	<u>\$ 69,045</u>	<u>\$ 3,419</u>	<u>\$ (97)</u>	<u>\$ 72,367</u>

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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 March 31, 2016 and December 31, 2015 in the following table (in thousands):

March 31, 2016

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 292,189	\$ 292,245	\$ —	\$ —
Due after one year through five years	337,836	337,680	2,067	2,201
Due after five years through 10 years	62,305	62,565	38,839	39,965
Due after 10 years	126,074	127,617	26,015	28,395
	818,404	820,107	66,921	70,561
Other equity securities	1,444	1,444	—	—
	<u>\$ 819,848</u>	<u>\$ 821,551</u>	<u>\$ 66,921</u>	<u>\$ 70,561</u>

December 31, 2015

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 138,796	\$ 138,749	\$ —	\$ —
Due after one year through five years	391,267	388,376	2,074	2,191
Due after five years through 10 years	63,766	63,681	40,803	41,662
Due after 10 years	131,003	131,248	26,168	28,514
	724,832	722,054	69,045	72,367
Other equity securities	1,435	1,435	—	—
	<u>\$ 726,267</u>	<u>\$ 723,489</u>	<u>\$ 69,045</u>	<u>\$ 72,367</u>

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Unrealized losses

The following table shows the Company's gross unrealized losses and fair values of available-for-sale and held-to-maturity securities, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of March 31, 2016 and December 31, 2015 (in thousands):

March 31, 2016	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	\$ 265,305	\$ (629)	\$ —	\$ —	\$ 265,305	\$ (629)
Municipal securities	1,571	(3)	1,333	(4)	2,904	(7)
Mortgage-backed securities issued by GSE	19,500	(64)	8,951	(204)	28,451	(268)
Total temporarily impaired securities	<u>\$ 286,376</u>	<u>\$ (696)</u>	<u>\$ 10,284</u>	<u>\$ (208)</u>	<u>\$ 296,660</u>	<u>\$ (904)</u>

December 31, 2015	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	\$ 467,708	\$ (3,270)	\$ —	\$ —	\$ 467,708	\$ (3,270)
Municipal securities	4,464	(28)	2,439	(17)	6,903	(45)
Mortgage-backed securities issued by GSE	144,475	(1,144)	3,794	(160)	148,269	(1,304)
Trust preferred and other corporate obligations	—	—	1,995	(1)	1,995	(1)
Total temporarily impaired securities	<u>\$ 616,647</u>	<u>\$ (4,442)</u>	<u>\$ 8,228</u>	<u>\$ (178)</u>	<u>\$ 624,875</u>	<u>\$ (4,620)</u>

U.S. Treasury obligations and direct obligations of U.S. government agencies

The Company's unrealized losses on obligations of U.S. government agencies were caused by interest rate fluctuations. At March 31, 2016, sixteen securities had unrealized losses of \$0.63 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on credit quality of the issuers, it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At March 31, 2016, three 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.

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Government-Sponsored Enterprises (“GSE”) mortgage-backed securities

The Company’s unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At March 31, 2016, thirteen securities had unrealized losses of \$0.27 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 had no unrealized losses on corporate securities at March 31, 2016.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at March 31, 2016.

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, since this is a restricted security without a readily determinable fair value. The Company had \$23.90 million and \$23.69 million of FHLB stock at March 31, 2016, and December 31, 2015, respectively. Based on the Company’s review of the credit quality of the institution, the institution’s ability to repurchase shares, and the Company’s carrying value in the shares, the Company does not consider this investment other than temporarily impaired.

Note 4. Loans and Allowance for Loan Losses

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

Allowance for loan losses

The total allowance reflects management’s estimate of loan losses inherent in the loan portfolio at the balance sheet date. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company considers the allowance for loan losses of \$37.76 million adequate to cover estimated loan losses inherent in the loan portfolio at March 31, 2016.

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The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three-month periods ended March 31, 2016 and 2015 (in thousands):

Three Months Ended March 31, 2016	Construction and Land Development	Commercial Real Estate	Multi- Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	\$ 4,984	\$ 14,687	\$ 945	\$ 8,990	\$ 5,774	\$ 2,979	\$ 38,359
Provision for loan losses	88	196	(23)	(571)	(342)	393	(259)
Losses charged off	(62)	(66)	—	(321)	(72)	(12)	(533)
Recoveries	5	16	—	114	30	28	193
Balance, end of period	<u>\$ 5,015</u>	<u>\$ 14,833</u>	<u>\$ 922</u>	<u>\$ 8,212</u>	<u>\$ 5,390</u>	<u>\$ 3,388</u>	<u>\$ 37,760</u>

Three Months Ended March 31, 2015	Construction and Land Development	Commercial Real Estate	Multi- Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	\$ 5,661	\$ 14,226	\$ 667	\$ 9,121	\$ 4,963	\$ 1,279	\$ 35,917
Provision charged to expense	(64)	862	33	(360)	(385)	237	323
Losses charged off	(51)	(174)	—	(347)	(5)	(13)	(590)
Recoveries	1	13	—	129	85	29	257
Balance, end of period	<u>\$ 5,547</u>	<u>\$ 14,927</u>	<u>\$ 700</u>	<u>\$ 8,543</u>	<u>\$ 4,658</u>	<u>\$ 1,532</u>	<u>\$ 35,907</u>

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The following table presents, by portfolio segment, the allocation of the allowance for loan losses at March 31, 2016 and December 31, 2015 (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
March 31, 2016							
Period-end balance allocated to:							
Loans individually evaluated for impairment	\$ 316	\$ 783	\$ —	\$ 759	\$ 47	\$ 5	\$ 1,910
Loans collectively evaluated for impairment	4,699	14,050	922	7,453	5,343	3,383	35,850
Loans acquired with deteriorated credit quality	—	—	—	—	—	—	—
Balance, end of period	<u>\$ 5,015</u>	<u>\$ 14,833</u>	<u>\$ 922</u>	<u>\$ 8,212</u>	<u>\$ 5,390</u>	<u>\$ 3,388</u>	<u>\$ 37,760</u>
December 31, 2015							
Period-end balance allocated to:							
Loans individually evaluated for impairment	\$ 411	\$ 819	\$ —	\$ 1,255	\$ 26	\$ 13	\$ 2,524
Loans collectively evaluated for impairment	4,573	13,868	945	7,708	5,748	2,966	35,808
Loans acquired with deteriorated credit quality	—	—	—	27	—	—	27
Balance, end of year	<u>\$ 4,984</u>	<u>\$ 14,687</u>	<u>\$ 945</u>	<u>\$ 8,990</u>	<u>\$ 5,774</u>	<u>\$ 2,979</u>	<u>\$ 38,359</u>

The following table presents, by portfolio segment, the Company's investment in loans at March 31, 2016 and December 31, 2015 (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
March 31, 2016							
Ending balance: individually evaluated for impairment	\$ 6,613	\$ 12,168	\$ 715	\$ 12,675	\$ 581	\$ 145	\$ 32,897
Ending balance: collectively evaluated for impairment	622,801	1,720,057	143,322	946,808	851,424	153,128	4,437,540
Ending balance: loans acquired with deteriorated credit quality	6,578	30,087	16,209	28,949	—	—	81,823
Ending Balance	<u>\$ 635,992</u>	<u>\$1,762,312</u>	<u>\$ 160,246</u>	<u>\$ 988,432</u>	<u>\$ 852,005</u>	<u>\$ 153,273</u>	<u>\$4,552,260</u>
December 31, 2015							
Ending balance: individually evaluated for impairment	\$ 9,566	\$ 13,627	\$ 731	\$ 13,286	\$ 496	\$ 78	\$ 37,784
Ending balance: collectively evaluated for impairment	582,901	1,740,467	150,282	930,185	856,540	138,309	4,398,684
Ending balance: loans acquired with deteriorated credit quality	6,408	30,299	16,358	29,860	—	—	82,925
Ending Balance	<u>\$ 598,875</u>	<u>\$1,784,393</u>	<u>\$ 167,371</u>	<u>\$ 973,331</u>	<u>\$ 857,036</u>	<u>\$ 138,387</u>	<u>\$4,519,393</u>

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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. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses.

The following table presents the changes in the accretable yield for purchased impaired loans for the three months ended March 31, 2016 and 2015 (in thousands):

	March 31,	
	2016	2015
Balance at beginning of period	\$ 43,959	\$ 2,107
Additions	—	42,648
Accretion	(1,543)	(1,819)
Reclassifications from nonaccretable balance, net	2,039	3,182
Other changes, net	(2,261)	292
Balance at end of period	<u>\$ 42,194</u>	<u>\$ 46,410</u>

Portfolio quality indicators

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

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The Company's internally assigned grades are as follows:

- **Pass** – Several pass credit grades comprise loans in this category, which are assigned based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to management attention credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring.
- **Special Mention** – Loans in this category are considered to have potential weaknesses that deserve management's attention. The borrower's ability to repay from the primary (intended) sources is currently adequate, but threatened by potential weaknesses which may, if not corrected, result in the deterioration of 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 March 31, 2016 and December 31, 2015 (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
March 31, 2016							
Pass	\$ 614,021	\$ 1,702,933	\$ 155,330	\$ 971,086	\$ 846,369	\$ 153,049	\$ 4,442,788
Special Mention	3,881	28,947	—	1,449	2,076	52	36,405
Substandard	18,087	30,432	4,916	15,897	3,560	172	73,064
Doubtful	3	—	—	—	—	—	3
Total	<u>\$ 635,992</u>	<u>\$ 1,762,312</u>	<u>\$ 160,246</u>	<u>\$ 988,432</u>	<u>\$ 852,005</u>	<u>\$ 153,273</u>	<u>\$ 4,552,260</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, 2015							
Pass	\$ 578,737	\$ 1,740,028	\$ 162,934	\$ 953,790	\$ 851,775	\$ 138,219	\$ 4,425,483
Special Mention	956	18,886	3,429	2,275	1,851	59	27,456
Substandard	19,182	25,479	1,008	17,266	3,410	109	66,454
Doubtful	—	—	—	—	—	—	—
Total	<u>\$ 598,875</u>	<u>\$ 1,784,393</u>	<u>\$ 167,371</u>	<u>\$ 973,331</u>	<u>\$ 857,036</u>	<u>\$ 138,387</u>	<u>\$ 4,519,393</u>

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Age analysis of past-due financing receivables by class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of March 31, 2016 and December 31, 2015. 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 because 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
March 31, 2016								
Construction and land development	\$ 473	\$ —	\$ 387	\$ 839	\$ 1,699	\$ 634,293	\$ 635,992	\$ —
Commercial real estate	2,835	1,105	—	2,048	5,988	1,756,324	1,762,312	—
Multifamily real estate	—	—	—	715	715	159,531	160,246	—
1-4 family residential real estate	6,764	295	759	3,850	11,668	976,764	988,432	—
Commercial and industrial business loans	470	—	—	369	839	851,166	852,005	—
Consumer loans and other	113	—	—	123	236	153,037	153,273	—
Total	\$ 10,655	\$ 1,400	\$ 1,146	\$ 7,944	\$ 21,145	\$4,531,115	\$ 4,552,260	\$ —
	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, 2015								
Construction and land development	\$ 239	\$ —	\$ 810	\$ 1,243	\$ 2,292	\$ 596,583	\$ 598,875	\$ 424
Commercial real estate	1,689	1,220	—	2,093	5,002	1,779,391	1,784,393	—
Multifamily real estate	—	—	—	731	731	166,640	167,371	—
1-4 family residential real estate	2,586	834	895	4,267	8,582	964,749	973,331	—
Commercial and industrial business loans	633	—	—	282	915	856,121	857,036	—
Consumer loans and other	276	—	—	54	330	138,057	138,387	—
Total	\$ 5,423	\$ 2,054	\$ 1,705	\$ 8,670	\$ 17,852	\$4,501,541	\$ 4,519,393	\$ 424

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The following table includes an aging analysis of the recorded investment of purchased impaired loans as of March 31, 2016, 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
March 31, 2016						
Construction and land development	\$ —	\$ —	\$ 387	\$ 387	\$ 6,191	\$ 6,578
Commercial real estate	59	—	—	59	30,028	30,087
Multifamily real estate	—	—	—	—	16,209	16,209
1-4 family residential real estate	892	60	759	1,711	27,238	28,949
Commercial and industrial business loans	—	—	—	—	—	—
Consumer loans and other	—	—	—	—	—	—
Total	<u>\$ 951</u>	<u>\$ 60</u>	<u>\$ 1,146</u>	<u>\$ 2,157</u>	<u>\$ 79,666</u>	<u>\$ 81,823</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. Smaller balance loans (under \$500,000) are generally not individually assessed for impairment, but are evaluated collectively.

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 \$3.10 million in excess of deferred loan costs at March 31, 2016, \$2.54 million at March 31, 2015, and \$2.86 million at December 31, 2015. There were \$7.94 million, \$7.05 million, and \$8.67 million in nonaccrual loans at March 31, 2016, March 31, 2015, and December 31, 2015, respectively. The Company would have earned \$0.35 million in the first quarter of 2016 if interest on the loans had been accrued.

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The following tables include the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable, as of March 31, 2016 and December 31, 2015 (in thousands):

	Unpaid			Average	YTD
	Principal	Recorded	Specific	Recorded	Interest
March 31, 2016	Balance	Balance	Allowance	Investment	Income
					Recognized
Loans without a specific valuation allowance					
Construction and land development	\$ 5,156	\$ 5,132	\$ —	\$ 5,157	\$ 39
Commercial real estate	4,686	4,686	—	4,694	53
Multifamily real estate	746	715	—	748	10
1-4 family residential real estate	1,918	1,828	—	1,922	17
Commercial and industrial business loans	310	179	—	294	4
Consumer loans and other	24	13	—	24	—
Total	\$ 12,840	\$ 12,553	\$ —	\$ 12,839	\$ 123
Loans with a specific valuation allowance					
Construction and land development	\$ 1,863	\$ 1,481	\$ 316	\$ 2,785	\$ 18
Commercial real estate	7,573	7,482	783	7,586	101
Multifamily real estate	—	—	—	—	—
1-4 family residential real estate	11,319	10,847	759	11,342	116
Commercial and industrial business loans	476	402	47	482	5
Consumer loans and other	134	132	5	136	1
Total	\$ 21,365	\$ 20,344	\$ 1,910	\$ 22,331	\$ 241
Total impaired loans					
Construction and land development	\$ 7,019	\$ 6,613	\$ 316	\$ 7,942	\$ 57
Commercial real estate	12,259	12,168	783	12,280	154
Multifamily real estate	746	715	—	748	10
1-4 family residential real estate	13,237	12,675	759	13,264	133
Commercial and industrial business loans	786	581	47	776	9
Consumer loans and other	158	145	5	160	1
Total	\$ 34,205	\$ 32,897	\$ 1,910	\$ 35,170	\$ 364

Note: Included in the table above are accruing TDRs of \$24.96 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled \$4.87 million.

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	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
December 31, 2015					
Loans without a specific valuation allowance					
Construction and land development	\$ 7,822	\$ 7,802	\$ —	\$ 8,385	\$ 400
Commercial real estate	4,701	4,701	—	4,731	209
Multifamily real estate	751	731	—	755	28
1-4 family residential real estate	2,086	2,070	—	2,107	75
Commercial and industrial business loans	281	161	—	268	16
Consumer loans and other	—	—	—	—	—
Total	\$ 15,641	\$ 15,465	\$ —	\$ 16,246	\$ 728
Loans with a specific valuation allowance					
Construction and land development	\$ 2,154	\$ 1,764	\$ 411	\$ 2,450	\$ 52
Commercial real estate	8,982	8,926	819	9,103	448
Multifamily real estate	—	—	—	—	—
1-4 family residential real estate	11,738	11,216	1,255	12,214	541
Commercial and industrial business loans	393	335	26	419	20
Consumer loans and other	80	78	13	90	5
Total	\$ 23,347	\$ 22,319	\$ 2,524	\$ 24,276	\$ 1,066
Total impaired loans					
Construction and land development	\$ 9,976	\$ 9,566	\$ 411	\$ 10,835	\$ 452
Commercial real estate	13,683	13,627	819	13,834	657
Multifamily real estate	751	731	—	755	28
1-4 family residential real estate	13,824	13,286	1,255	14,321	616
Commercial and industrial business loans	674	496	26	687	36
Consumer loans and other	80	78	13	90	5
Total	\$ 38,988	\$ 37,784	\$ 2,524	\$ 40,522	\$ 1,794

Note: Included in the table above are accruing TDRs of \$29.11 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled \$4.80 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

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will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. Effective January 1, 2015, the Company adopted a policy stating that in subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

The following table shows the loans modified in TDRs for the three months ended March 31, 2016 and 2015 (in thousands, except number of loans):

Three Months Ended March 31, 2016			
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	1	\$ 150	\$ 148
Total	1	\$ 150	\$ 148

Three Months Ended March 31, 2015			
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
1-4 family residential real estate	1	\$ 101	\$ 101
Total	1	\$ 101	\$ 101

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 \$82,000 and a commercial loan in the amount \$22,000.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At March 31, 2016, all significant impaired loans have been determined to be collateral-dependent.

Nonaccrual loans

The Company generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach a certain number of days past due. Commercial loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 90 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. Residential mortgage loans and other consumer loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of

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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 months ended March 31, 2016 and 2015 (in thousands):

	Three Months Ended March 31,	
	2016	2015
Beginning balance	\$ 34,420	\$ 35,115
Additions	2,127	4,497
Franklin Merger	(234)	14,955
Sales	(6,928)	(2,197)
Valuation allowance	91	(186)
Gain (loss) on sale and write-downs, net	264	(486)
Ending balance	<u>\$ 29,740</u>	<u>\$ 51,698</u>

As of March 31, 2016, the Company’s recorded investment in OREO collateralized by residential real estate was \$9.52 million. As of March 31, 2016, the Company’s recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was \$1.00 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: Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements, SimonTowne Mortgage, LLC, Towne Mortgage of the Carolinas, LLC, NewTowne Mortgage, LLC, Homesale Mortgage, LLC, Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head, and Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations, to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance and TFA Benefits.

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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 March 31, 2016

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 45,823	\$ 513	\$ —	\$ 46,336
Provision for loan losses	(259)	—	—	(259)
Net interest income after provision for loan losses	46,082	513	—	46,595
Residential mortgage banking income, net	(192)	7,310	—	7,118
Real estate brokerage and property management income, net	—	4,827	—	4,827
Insurance commissions and other title fees and income, net	—	350	13,683	14,033
Other noninterest income	5,793	414	230	6,437
Noninterest expense	32,181	11,184	8,796	52,161
Income before income tax, corporate allocation and noncontrolling interest	19,502	2,230	5,117	26,849
Corporate allocation	360	(170)	(190)	—
Income before income tax provision and noncontrolling interest	19,862	2,060	4,927	26,849
Provision for income tax expense	5,729	659	1,800	8,188
Net income	14,133	1,401	3,127	18,661
Noncontrolling interest	—	(368)	(474)	(842)
Net income attributable to TowneBank	\$ 14,133	\$ 1,033	\$ 2,653	\$ 17,819
Net income as percentage of total	79.31%	5.80%	14.89%	100.00%
Total assets	\$ 6,046,199	\$ 178,289	\$ 140,681	\$ 6,365,169

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Three Months Ended March 31, 2015

	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 43,185	\$ 371	\$ —	\$ 43,556
Provision for loan losses	323	—	—	323
Net interest income after provision for loan losses	42,862	371	—	43,233
Residential mortgage banking income, net	(71)	8,514	—	8,443
Real estate brokerage and property management income, net	—	3,955	—	3,955
Insurance commissions and other title fees and income, net	—	301	10,748	11,049
Other noninterest income	4,898	290	181	5,369
Noninterest expense	32,744	10,436	7,260	50,440
Income before income tax, corporate allocation and noncontrolling interest	14,945	2,995	3,669	21,609
Corporate allocation	292	(132)	(160)	—
Income before income tax provision and noncontrolling interest	15,237	2,863	3,509	21,609
Provision for income tax expense	4,129	960	1,296	6,385
Net income	11,108	1,903	2,213	15,224
Noncontrolling interest	—	(256)	(430)	(686)
Net income attributable to TowneBank	\$ 11,108	\$ 1,647	\$ 1,783	\$ 14,538
Net income as percentage of total	76.41%	11.33%	12.26%	100.00%
Total assets	\$ 5,540,554	\$ 178,956	\$ 109,193	\$ 5,828,703

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 March 31, 2016, the amounts of off-balance sheet commitments to extend credit were \$1.45 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 March 31, 2016, standby letters of credit and financial guarantees were \$36.09 million.

Additionally, the Company had \$14.70 million in mortgage loans sold to investors with various recourse and warranty provisions as of March 31, 2016.

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 \$119.29 million at March 31, 2016. The income statement impact associated with these instruments is recorded as an increase in net residential mortgage banking income in the amount of \$0.38 million and \$1.03 million for the three-month periods ended March 31, 2016, and 2015, respectively.

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Note 8. Mergers and Acquisitions

Oak Island Accommodations, Inc.: Effective January 14, 2016, the Company acquired Oak Island Accommodations, Inc., an independent resort property management company that was merged with the operations of Towne Vacations Oak Island, LLC, a division of TowneBank's Realty segment. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing January 14, 2016. The purchase price for the transaction was \$6.28 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of \$0.36 million, goodwill of \$2.34 million, and other intangible assets of \$3.58 million.

Monarch Financial Holdings: On December 17, 2015, the Company announced the signing of a definitive agreement and plan of reorganization, dated December 16, 2015 (the "Monarch merger agreement"), to acquire Monarch Financial Corporation ("Monarch"), and its wholly owned bank subsidiary, Monarch Bank, a Chesapeake, Virginia-based bank with 12 banking offices servicing the Hampton Roads region of southeastern Virginia and the Outer Banks region of northeastern North Carolina. The proposed acquisition of Monarch and Monarch Bank has been approved by the Boards of Directors of TowneBank and Monarch and is expected to close in the second quarter of 2016, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of each company's shareholders. At December 31, 2015, Monarch had total assets of \$1.16 billion, gross loans of \$829.27 million, and total deposits of \$999.09 million.

Under terms of the Monarch merger agreement, Monarch shareholders will receive 0.883 shares of the Company's common stock for each share of Monarch common stock held immediately prior to the effective date of the merger. As a result of the merger, restricted stock awards will be converted into replacement stock awards of TowneBank, adjusted based on the 0.883 exchange ratio, unless vested at the time of the merger in accordance with the related award agreement and converted into shares of TowneBank common stock.

Insurance Agencies: Effective October 1, 2015, the Company acquired two insurance agencies, SIFA Corporation d/b/a B.H. Baird Insurance Agency and Invincia Corporation, which were merged with the operations of Towne Insurance Agency, LLC ("Towne Insurance"), a wholly owned subsidiary of TowneBank. The acquisitions were accounted for as business combinations under the acquisition method of accounting, and, as such, the assets acquired and liabilities assumed in the transactions 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 October 1, 2015. The total purchase price for the transactions was \$10.69 million in cash, common stock, and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of \$0.49 million, goodwill of \$6.60 million, other intangible assets of \$3.88 million, and assumed liabilities of \$0.29 million.

Total Insurance Planning, LLC: Effective September 1, 2015, the Company acquired Total Insurance Planning, LLC, 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 business are included in the Company's Consolidated Statements of Income

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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.

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 transactions 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 common stock consideration. The allocation of the purchase price resulted in tangible assets of \$0.30 million, goodwill of \$1.98 million, other intangible assets, including customer lists of \$0.78 million, and assumed liabilities of \$0.17 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 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 Franklin merger has been accounted for under the acquisition method of accounting in accordance with 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.

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The following table presents the 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	496,297
Bank premise and equipment	10,890
OREO, net of valuation allowance	15,693
Core deposit intangible	1,501
Other assets	89,290
Total assets	<u>\$ 1,096,769</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	\$ 212,657
Goodwill	35,899
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>

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 2015 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):

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	March 31,				December 31, 2015	
	2016		2015			
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 1,918	\$ 486	\$ 434	\$ 224	\$ 1,918	\$ 431
Non-compete agreements	1,531	1,216	1,431	1,121	1,531	1,190
Customer lists	38,380	14,146	31,795	12,572	34,158	13,148
Trade name	211	137	211	95	211	127
Total intangible assets subject to amortization	42,040	15,985	33,871	14,012	37,818	14,896
Contractual agreements	3,231	—	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—	3,231	—
Total intangible assets	\$ 45,271	\$ 15,985	\$ 37,102	\$ 14,012	\$ 41,049	\$ 14,896

Amortization expense for intangible assets was \$1.09 million and \$0.85 million for the three-month periods ended March 31, 2016 and 2015, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2015, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2015	\$ 94,319	\$ 13,999	\$ 46,524	\$ 154,842
Additions to goodwill	—	2,344	—	2,344
Other adjustments	464	—	9	473
Balance, March 31, 2016	\$ 94,783	\$ 16,343	\$ 46,533	\$ 157,659

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of March 31, 2016, was \$150.62 million. The Company had \$145.40 million and \$149.45 million of BOLI at March 31, 2015 and December 31, 2015, respectively. The Company recognized BOLI income, included in other noninterest income, of \$1.17 million and \$1.14 million for the three-month periods ended March 31, 2016 and 2015, respectively. The Company has a related retirement plan, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits.

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Note 11. Postretirement Benefits

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

	SERP		Other Postretirement Benefits	
	Three Months Ended		Three Months Ended	
	2016	2015	2016	2015
March 31,				
Service cost	\$ 409	\$ 366	\$ 15	\$ 21
Interest cost	255	211	8	8
Amortization of prior service costs	38	—	—	—
Amortization of actuarial (gain) loss	19	60	(15)	—
Net periodic postretirement benefit cost	<u>\$ 721</u>	<u>\$ 637</u>	<u>\$ 8</u>	<u>\$ 29</u>

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at March 31, 2016 and 2015 (in thousands), and changes in the three months then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the pension and postretirement plans are a component of salaries and employee benefits expense on the consolidated statements of income.

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2015	\$ (1,805)	\$ (1,189)	\$ (2,994)
Other comprehensive income before reclassifications	2,912	71	2,983
Amounts reclassified from AOCI	—	28	28
Net change	2,912	99	3,011
Balance, March 31, 2016	<u>\$ 1,107</u>	<u>\$ (1,090)</u>	<u>\$ 17</u>
	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2014	\$ 1,325	\$ (867)	\$ 458
Other comprehensive income before reclassifications	1,894	—	1,894
Amounts reclassified from AOCI	(32)	39	7
Net change	1,862	39	1,901
Balance, March 31, 2015	<u>\$ 3,187</u>	<u>\$ (828)</u>	<u>\$ 2,359</u>

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

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

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Note 13. Other Expenses

The following table shows a summary of other expenses for the three months ended March 31, 2016 and 2015 (in thousands):

	Three Months Ended	
	March 31,	
	2016	2015
Advertising and marketing	\$ 1,902	\$ 1,780
Acquisition-related expenses	414	415
Other	1,174	1,725
Charitable contributions	1,048	1,413
Outside processing	1,397	1,422
Professional fees	1,451	1,464
Stationery and supplies	594	666
FDIC and other insurance	991	1,099
Foreclosed property expenses	113	873
Software expense	1,622	1,293
Telephone and postage	1,210	1,227
Amortization-intangibles	1,092	845
Bank franchise tax/SCC fees	941	629
Directors fees and expenses	271	332
Travel/meals/entertainment	380	279
Total other expenses	<u>\$ 14,600</u>	<u>\$ 15,462</u>

Note 14. Variable Interest Entities

A Variable Interest Entity (“VIE”) is an entity that either (i) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (ii) has a group of equity owners that are unable to make significant decisions about its activities, or (iii) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns as generated by its operations. If any of these characteristics are present, the entity is subject to a variable interest consolidation model, and consolidation is based on variable interests, not on ownership of the entity's outstanding voting stock. Variable interests are defined as contractual, ownership, or other monetary interests in an entity that change with fluctuations in the entity's net asset value. The primary beneficiary consolidates the VIE. 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.

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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 meet the definition of a VIE and are evaluated for the purpose 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 the general partner of each limited partnership has both the power to direct the activities which most significantly affect the performance of each partnership and the obligation to absorb losses or the right to receive benefits that could be significant to the entities. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of \$77.92 million, \$61.33 million, and \$61.71 million in these partnerships were not included in the Consolidated Balance Sheets at March 31, 2016, March 31, 2015, and December 31, 2015, respectively. These limited partner interests had carrying values of \$15.57 million, \$14.86 million, and \$16.16 million at March 31, 2016, March 31, 2015, and December 31, 2015, 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 \$21.49 million, \$14.86 million, and \$16.16 million at March 31, 2016, March 31, 2015, and December 31, 2015, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments along with \$5.92 million of loans to the entities at March 31, 2016. As of March 31, 2016, the Company had \$20.44 million in funding commitments that are dependent on certain contractual milestones and \$12.0 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the quarter ended March 31, 2016, a tax benefit totaling \$0.32 million, net of amortization expense of \$0.60 million, 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.

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

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

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

Interest Rate Lock Commitments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three-month periods ended March 31, 2016 and 2015, and the year ended December 31, 2015, the Company used weighted average fall-out rates of 17.16%, 20.0%, and 16.80%, respectively. The carrying value of the interest rate lock commitments was \$1.62 million at March 31, 2016 and \$1.24 million at December 31, 2015.

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 440,277	\$ —	\$ 440,277
U.S. Treasury notes	\$ —	\$ 202,000	\$ —	\$ 202,000
Municipal securities	\$ —	\$ 21,396	\$ —	\$ 21,396
Mortgage-backed securities issued by GSEs	\$ —	\$ 151,938	\$ —	\$ 151,938
Trust preferred and other corporate securities	\$ —	\$ 5,940	\$ —	\$ 5,940
Interest rate lock commitments	\$ —	\$ —	\$ 1,624	\$ 1,624

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	December 31, 2015			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 537,812	\$ —	\$ 537,812
U.S. Treasury notes	\$ —	\$ 997	\$ —	\$ 997
Municipal securities	\$ —	\$ 21,849	\$ —	\$ 21,849
Mortgage-backed securities issued by GSEs	\$ —	\$ 156,803	\$ —	\$ 156,803
Trust preferred and other corporate securities	\$ —	\$ 6,028	\$ —	\$ 6,028
Interest rate lock commitments	\$ —	\$ —	\$ 1,239	\$ 1,239

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at March 31, 2016 and December 31, 2015 (in thousands):

March 31, 2016	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ —	\$ —	\$ 13,910	\$ 13,910
Other real estate owned	\$ —	\$ 27,934	\$ 1,806	\$ 29,740

December 31, 2015	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ —	\$ —	\$ 13,858	\$ 13,858
Other real estate owned	\$ —	\$ 24,378	\$ 10,042	\$ 34,420

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 3% to 67%, with a weighted average of 12.01%.

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 12%, with a weighted average of 8.88%.

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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.

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.

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

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The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of March 31, 2016 and December 31, 2015 are as follows (in thousands):

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
March 31, 2016					
Cash and due from banks	\$ 195,161	\$ 195,161	\$ 195,161	\$ —	\$ —
Interest-bearing deposits in financial institutions	\$ 1,006	\$ 1,006	\$ 1,006	\$ —	\$ —
Securities available for sale	\$ 821,551	\$ 821,551	\$ —	\$ 821,551	\$ —
Securities held to maturity	\$ 66,921	\$ 70,561	\$ —	\$ 70,561	\$ —
Mortgage loans held for sale	\$ 97,491	\$ 97,778	\$ —	\$ 97,778	\$ —
Net loans	\$ 4,552,260	\$ 4,548,283	\$ —	\$ —	\$ 4,548,283
Interest receivable	\$ 16,407	\$ 16,407	\$ —	\$ 16,407	\$ —
Deposits	\$ 4,955,126	\$ 4,575,495	\$ —	\$ 4,575,495	\$ —
Advances from the Federal Home Loan Bank of Atlanta	\$ 428,940	\$ 439,754	\$ —	\$ 439,754	\$ —
Repurchase agreements and other borrowings	\$ 39,442	\$ 39,445	\$ —	\$ 39,445	\$ —
Interest payable	\$ 3,192	\$ 3,192	\$ —	\$ 3,192	\$ —

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
December 31, 2015					
Cash and due from banks	\$ 250,836	\$ 250,836	\$ 250,836	\$ —	\$ —
Interest-bearing deposits in financial institutions	\$ 1,001	\$ 1,001	\$ 1,001	\$ —	\$ —
Securities available for sale	\$ 723,489	\$ 723,489	\$ —	\$ 723,489	\$ —
Securities held to maturity	\$ 69,045	\$ 72,367	\$ —	\$ 72,367	\$ —
Mortgage loans held for sale	\$ 102,346	\$ 102,346	\$ —	\$ 102,346	\$ —
Net loans	\$ 4,481,034	\$ 4,523,282	\$ —	\$ —	\$ 4,523,282
Interest receivable	\$ 16,522	\$ 16,522	\$ —	\$ 16,522	\$ —
Deposits	\$ 4,914,027	\$ 4,454,157	\$ —	\$ 4,454,157	\$ —
Advances from the Federal Home Loan Bank of Atlanta	\$ 429,080	\$ 441,175	\$ —	\$ 441,175	\$ —
Repurchase agreements and other borrowings	\$ 37,434	\$ 37,437	\$ —	\$ 37,437	\$ —
Interest payable	\$ 2,908	\$ 2,908	\$ —	\$ 2,908	\$ —

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 \$49.53 million at March 31, 2016, and \$50.34 million at December 31, 2015, were pledged as collateral for these secured transactions. The pledged securities are held in safekeeping at

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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.

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Selected Quarterly Information (unaudited) TOWNEBANK

(Dollars in thousands, except per share data)

	First Quarter 2016	Fourth Quarter 2015	Third Quarter 2015	Second Quarter 2015	First Quarter 2015
Results of Operations:					
Interest income	\$ 54,734	\$ 54,811	\$ 53,987	\$ 52,708	\$ 51,368
Interest expense	8,398	8,480	8,317	7,824	7,812
Net interest income	46,336	46,331	45,670	44,884	43,556
Provision for loan losses	(259)	852	130	1,723	323
Net interest income after provision for loan losses	46,595	45,479	45,540	43,161	43,233
Noninterest income:					
Residential mortgage banking income, net	7,118	7,255	8,262	10,251	8,443
Real estate brokerage and property management income, net	4,827	2,438	5,349	4,584	3,955
Insurance commissions and other title fees and income, net	14,033	8,997	9,710	9,885	11,049
Service charges on deposit accounts	2,176	2,254	2,388	2,326	2,197
Credit card merchant fees, net	895	767	823	566	432
Other income	3,366	3,368	3,036	5,354	2,691
Gain on investment securities	—	—	736	119	49
Total noninterest income	32,415	25,079	30,304	33,085	28,816
Noninterest expense:					
Salaries and benefits	30,187	30,826	28,910	26,544	27,679
Occupancy expense	5,017	5,156	4,703	4,856	4,930
Furniture and equipment	2,357	2,390	2,211	2,369	2,369
Other expenses	14,600	14,371	14,082	15,298	15,462
Total noninterest expense	52,161	52,743	49,906	49,067	50,440
Income before noncontrolling interest and income tax	26,849	17,815	25,938	27,179	21,609
Provision for income tax expense	8,188	4,846	7,444	8,201	6,385
Net income	18,661	12,969	18,494	18,978	15,224
Net income attributable to noncontrolling interest	(842)	(503)	(928)	(1,166)	(686)
Net income attributable to TowneBank	\$ 17,819	\$ 12,466	\$ 17,566	\$ 17,812	\$ 14,538
Net income available to common shareholders	\$ 17,819	\$ 12,466	\$ 17,566	\$ 17,812	\$ 14,525

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Selected Quarterly Information (unaudited) TOWNEBANK

(Dollars in thousands, except per share data)

	First Quarter 2016	Fourth Quarter 2015	Third Quarter 2015	Second Quarter 2015	First Quarter 2015
Per Share Data:					
Net income:					
Basic	\$ 0.35	\$ 0.24	\$ 0.34	\$ 0.35	\$ 0.29
Diluted	0.35	0.24	0.34	0.35	0.29
Book value at period end	16.00	15.71	15.65	15.40	15.22
Tangible book value at period end	12.38	12.21	12.25	12.00	11.73
Cash dividends declared	0.12	0.12	0.12	0.12	0.11
Common Stock Closing Price:					
High	20.88	22.51	19.23	17.00	16.38
Low	16.65	18.57	16.05	15.66	14.28
Close	19.19	20.87	18.85	16.29	16.08
Selected Financial Ratios (annualized):					
Return on average assets	1.14%	0.78%	1.14%	1.21%	1.01%
Return on average tangible assets	1.21%	0.85%	1.21%	1.28%	1.08%
Return on average equity	8.63%	6.00%	8.58%	8.93%	7.54%
Return on average tangible equity	11.56%	8.11%	11.25%	11.77%	10.27%
Net interest margin (tax-equivalent basis) (1)	3.37%	3.36%	3.40%	3.52%	3.52%
Daily Averages:					
Total assets	\$ 6,313,238	\$ 6,305,571	\$ 6,115,681	\$ 5,900,816	\$ 5,829,533
Total tangible assets	6,126,524	6,120,799	5,940,258	5,724,957	5,642,883
Loans, net of unearned income, excluding nonaccrual loans	4,516,277	4,426,387	4,300,751	4,161,304	4,066,484
Total earning assets (1)	5,815,383	5,800,907	5,604,472	5,407,516	5,290,562
Total deposits	4,915,400	4,878,644	4,734,876	4,548,351	4,504,859
FHLB advances	429,020	431,421	437,431	418,388	408,288
Total equity	830,178	823,627	812,602	800,369	781,833
Tangible equity	643,464	638,855	637,179	624,511	595,183
Basic weighted average shares outstanding	51,290,010	51,267,447	51,153,205	51,089,051	50,652,963
Diluted weighted average shares outstanding	51,392,857	51,440,440	51,263,382	51,151,512	50,724,588

(1) Includes bank-owned life insurance.

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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 2015 audited Consolidated Financial Statements included in our 2015 Annual Report to Stockholders and our 2015 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 2015 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 March 31, 2016:

- Net income for the three months ended March 31, 2016 was \$17.82 million, or \$0.35 per common diluted share, compared with \$14.54 million, or \$0.29 per common diluted share, in the same period in 2015.

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- Net interest income increased \$2.78 million, or 6.38%, in the first quarter of 2016 from the comparable period in 2015. 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 decreased \$0.58 million from the provision of \$0.32 million in the comparative three-month period of 2015, and decreased \$1.11 million from December 31, 2015. The loan loss reserve was 0.83% of total loans at March 31, 2016, down from 0.85% at December 31, 2015, and 0.88% at March 31, 2015. 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 and a seasonally slower rate of loan growth. The decrease in the loan loss reserve from December 31, 2015, 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-month period ended March 31, 2016 increased by \$3.65 million, or 12.68%, over the first quarter of 2015, and increased by \$7.34 million, or 29.25%, respectively, from December 31, 2015. The increase from the comparable prior year period was primarily due to increases in our Insurance segment related to our acquisition of five insurance agencies in 2015. The increase from the sequential quarter was primarily due to increased contingency commission income combined with the increases related to insurance agency acquisitions in 2015. Also contributing was the acquisition of a North Carolina resort property management company in January 2016.
- For the first quarter of 2016, noninterest expense increased \$1.72 million, or 3.41%, compared to the first quarter of 2015, and decreased \$0.58 million, or 1.10% from December 31, 2015. The increase from the prior year comparative period was driven by increased operating expenses related to the previously mentioned insurance agency and resort property management company acquisitions. The decrease in operating expenses from the sequential quarter was primarily due to reductions in personnel expenses and occupancy costs.
- Our effective tax rate was 31.48% for the first quarter of 2016, an increase from 30.52% in the comparative period of 2015, and increased from 27.99% in the fourth quarter of 2015. The variance from both prior periods was primarily a result of an increase in taxable income subject to the federal statutory rate of 35%. Additionally, the fourth quarter 2015 rate was affected by the utilization of a capital loss carryforward and an increase in nontaxable income arising from bank-owned life insurance.

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, mergers and acquisitions, and goodwill and other intangibles to be critical accounting policies. Refer to our 2015 Annual Report to Stockholders for further discussion of these policies.

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

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 1.14% for the first quarter of 2016 compared to 1.01% for the first quarter of 2015, and 0.78% for the fourth quarter of 2015. The annualized return on average tangible assets was 1.21%, 1.08%, and 0.85% for the same respective periods. 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 8.63% for first quarter 2016, 7.54% for first quarter 2015, and 6.00% for fourth quarter 2015, while the annualized return on average tangible equity was 11.56%, 10.27%, and 8.11% for the same respective periods.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was \$78.75 million for the quarter ended March 31, 2016, which increased \$6.43 million, or 8.89%, compared to the quarter ended March 31, 2015. Operating income was \$71.41 million for the quarter ended December 31, 2015.

Basic earnings per share were \$0.35 for the three months ended March 31, 2016, compared to \$0.29 in comparative 2015, and \$0.24 for the quarter ended December 31, 2015. Diluted earnings per share were \$0.35 for the three months ended March 31, 2016, \$0.29 for first quarter 2015, and \$0.24 for the linked quarter.

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 affected by market interest rates and the mix and volume of earning assets and interest-bearing liabilities. The yields and rates in this discussion and in the following tables have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 35% federal marginal tax rate for all periods shown.

TowneBank reported net interest income, on a tax-equivalent basis, of \$48.67 million for the quarter ended March 31, 2016, which was \$2.82 million, or 6.14%, higher than the year-ago amount of \$45.86 million. On a linked quarter basis, tax-equivalent net interest income decreased by \$0.50 million, or 1.02%, from the \$49.17 million reported for the fourth quarter of 2015. In comparison to the prior year comparative period, net interest income rose primarily due to increased balances of earning assets, while the decrease from the linked quarter was primarily due to a decrease in income from bank-owned life insurance. Accretion of purchase accounting marks added \$0.65 million, or six basis points, to margin in the current quarter, \$0.78 million, or eight basis points, in first quarter 2015, and \$1.22 million, or nine basis points, in the linked quarter.

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Interest income, on a tax-equivalent basis, was \$57.07 million for the quarter ended March 31, 2016, which was \$3.40 million, or 6.34%, higher than the \$53.67 million reported for the quarter ended March 31, 2015. On a linked quarter basis, tax-equivalent interest income decreased \$0.58 million, or 1.01%, from \$57.65 million in the fourth quarter of 2015. Average earning assets grew to \$5.82 billion in the quarter ended March 31, 2016, from \$5.29 billion in the comparative prior year quarter, an increase of \$524.82 million, or 9.92%. In the linked quarter comparison, average earning assets increased by \$14.48 million, or 0.25%, from \$5.80 billion in the fourth quarter of 2015. The yield on earning assets was 3.95% in the quarter ended March 31, 2016, which compared to 4.11% in the comparative prior year and 3.94% in the linked period. Average loan balances, excluding nonaccrual loans, of \$4.52 billion were \$449.79 million, or 11.06%, higher in the first quarter of 2016 than in the same period a year ago, while loan yields declined by 26 basis points. In the linked quarter, loans grew \$89.89 million, or 2.03%, and loan yields were 4 basis points lower. The increase in interest income from comparative prior year period was driven by loan growth, while a decrease in bank-owned life insurance income drove the decrease from the linked quarter.

Interest expense for the quarter ended March 31, 2016, was \$8.40 million, which was \$0.59 million, or 7.50%, higher than the \$7.81 million amount in the year-ago quarter. The average balance of interest-bearing liabilities increased to \$3.97 billion in the first quarter of 2016 from \$3.70 billion in the comparative prior year quarter, an increase of 7.37%. On a linked quarter basis, interest expense decreased slightly by 0.96% to \$8.40 million from \$8.48 million in the fourth quarter of 2015. In the linked quarter, average interest-bearing liabilities increased by \$37.88 million, or 0.96%, from \$3.93 billion in the quarter ended December 31, 2015. The increase in interest expense as compared to the comparative prior year period was primarily driven by an increase in interest-bearing deposits combined with slightly higher rates in time deposits and money market funds. The decrease in interest expense from the linked quarter was primarily due to lower borrowing costs.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.37% in the quarter ended March 31, 2016, which was 15 basis points lower than the 3.52% margin of the March 31, 2015 quarter and one basis point higher than the 3.36% margin from the December 31, 2015 quarter. The decrease in margin from the comparative prior year period was driven by a decrease in loan yields combined with a decrease in the accretion of purchase accounting marks. The slight margin improvement as compared to the linked quarter was partially offset by a decrease in the accretion of purchase accounting marks.

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

	Three Months Ended March 31, 2016			Three Months Ended December 31, 2015			Three Months Ended March 31, 2015		
	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	\$ 4,516,277	\$ 50,781	4.52%	\$ 4,426,387	\$ 50,850	4.56%	\$ 4,066,484	\$ 47,890	4.78%
Taxable investment securities	754,514	3,055	1.62%	782,998	2,987	1.53%	749,414	2,801	1.49%
Tax-exempt investment securities	52,979	410	3.09%	54,974	428	3.11%	66,812	536	3.20%
Interest-bearing deposits	265,256	330	0.50%	292,085	211	0.29%	202,852	125	0.25%
Loans held for sale	76,503	693	3.62%	95,932	865	3.61%	64,512	565	3.50%
Bank-owned life insurance	149,854	1,802	4.84%	148,531	2,311	6.17%	140,488	1,753	5.06%
Total earning assets	5,815,383	57,071	3.95%	5,800,907	57,652	3.94%	5,290,562	53,670	4.11%
Less: allowance for loan losses	(38,555)			(37,918)			(36,048)		
Total nonearning assets	536,410			542,582			575,019		
Total assets	<u>\$ 6,313,238</u>			<u>\$ 6,305,571</u>			<u>\$ 5,829,533</u>		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 1,782,908	\$ 1,328	0.30%	\$ 1,780,151	\$ 1,265	0.28%	\$ 1,635,454	\$ 1,111	0.28%
Savings	300,070	700	0.94%	299,503	684	0.91%	305,016	683	0.91%
Certificates of deposit	1,416,629	3,185	0.90%	1,378,943	3,170	0.91%	1,308,364	2,630	0.82%
Total interest-bearing deposits	3,499,607	5,213	0.60%	3,458,597	5,119	0.59%	3,248,834	4,424	0.55%
Borrowings	468,798	3,185	2.69%	471,929	3,360	2.79%	447,198	3,388	3.03%
Total interest-bearing liabilities	3,968,405	8,398	0.85%	3,930,526	8,479	0.86%	3,696,032	7,812	0.86%
Demand deposits	1,415,793			1,420,047			1,256,025		
Other noninterest-bearing liabilities	98,862			131,371			95,643		
Total liabilities	5,483,060			5,481,944			5,047,700		
Shareholders' equity	830,178			823,627			781,833		
Total liabilities and equity	<u>\$ 6,313,238</u>			<u>\$ 6,305,571</u>			<u>\$ 5,829,533</u>		
Net interest income (tax-equivalent basis)		\$ 48,673			\$ 49,173			\$ 45,858	
Reconciliation of Non-GAAP Financial Measures									
Bank-owned life insurance		(1,802)			(2,311)			(1,753)	
Tax-equivalent basis adjustment		(535)			(531)			(549)	
Net interest income (GAAP)		<u>\$ 46,336</u>			<u>\$ 46,331</u>			<u>\$ 43,556</u>	
Interest rate spread (1)			3.10%			3.09%			3.26%
Interest expense as a percent of average earning assets			0.58%			0.58%			0.60%
Net interest margin (tax equivalent basis) (2)			3.37%			3.36%			3.52%
Total cost of deposits			0.43%			0.42%			0.40%

- (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.

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	Increase/(Decrease) Three Months Ended March 31, 2016 Compared to Three Months Ended December 31, 2015			Increase/(Decrease) Three Months Ended March 31, 2016 Compared to Three Months Ended March 31, 2015		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	\$ 521	\$ (590)	\$ (69)	\$ 5,391	\$ (2,500)	\$ 2,891
Taxable investment securities	(105)	173	68	19	234	253
Tax-exempt investment securities	(26)	8	(18)	(108)	(17)	(125)
Interest-bearing deposits	(21)	140	119	49	156	205
Loans held for sale	(176)	4	(172)	108	20	128
Bank-owned life insurance	19	(528)	(509)	123	(74)	49
Total earning assets	212	(793)	(581)	5,582	(2,181)	3,401
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	1	62	63	110	107	217
Savings	1	15	16	(9)	26	17
Certificates of deposit	53	(38)	15	239	316	555
Total interest-bearing deposits	55	39	94	340	449	789
Borrowings	(28)	(147)	(175)	171	(374)	(203)
Total interest-bearing liabilities	27	(108)	(81)	511	75	586
Net interest income	\$ 185	\$ (685)	\$ (500)	\$ 5,071	\$ (2,256)	\$ 2,815

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

Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended March 31, 2016, was \$32.42 million, an increase of \$3.65 million, or 12.68%, compared to the same period in 2015 and an increase of \$7.34 million, or 29.25%, compared to the fourth quarter of 2015. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for the first quarter of 2016 was 41.16%, compared with 39.78% for comparative 2015 and 35.12% for the fourth quarter of 2015.

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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 March 31,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Residential mortgage banking income, net	\$ 7,118	\$ 8,443	\$ (1,325)	(15.69)%
Real estate brokerage and property management, net	4,827	3,955	872	22.05 %
Insurance commissions and other title fees and income, net	14,033	11,049	2,984	27.01 %
Service charges on deposit accounts	2,176	2,197	(21)	(0.96)%
Credit card merchant fees, net	895	432	463	107.18 %
Other income	3,366	2,691	675	25.08 %
Subtotal before gain on investment securities	32,415	28,767	3,648	12.68 %
Net gain on investment securities	—	49	(49)	(100.00)%
Total noninterest income	<u>\$ 32,415</u>	<u>\$ 28,816</u>	<u>\$ 3,599</u>	<u>12.49 %</u>

	Three Months Ended		Increase/(Decrease) First Quarter 2016 over Fourth Quarter 2015	
	March 31, 2016	December 31, 2015	Amount	Percent
Residential mortgage banking income, net	\$ 7,118	\$ 7,255	\$ (137)	(1.89)%
Real estate brokerage and property management, net	4,827	2,438	2,389	97.99 %
Insurance commissions and other title fees and income, net	14,033	8,997	5,036	55.97 %
Service charges on deposit accounts	2,176	2,254	(78)	(3.46)%
Credit card merchant fees, net	895	767	128	16.69 %
Other income	3,366	3,368	(2)	(0.06)%
Subtotal before gain on investment securities	32,415	25,079	7,336	29.25 %
Net gain on investment securities	—	—	—	— %
Total noninterest income	<u>\$ 32,415</u>	<u>\$ 25,079</u>	<u>\$ 7,336</u>	<u>29.25 %</u>

For the first quarter of 2016, residential mortgage banking income, net of commission expense, was \$7.12 million, a decrease of \$1.33 million, or 15.69%, compared to first quarter 2015 and a decrease of \$0.14 million, or 1.89%, compared to fourth quarter 2015. The decrease from first quarter 2015 was primarily due to slightly lower production volumes and a reduction in 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 increase in mortgage banking income of \$0.38 million associated with an increase in the value of rate lock commitments recorded as of March 31, 2016, as compared to a decrease of \$0.49 million and an increase of \$1.03 million recognized for the quarters ended December 31, 2015 and March 31, 2015, respectively.

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Real estate brokerage and property management income, net of commission expense, for first quarter 2016 was \$4.83 million, which was \$0.87 million, or 22.05%, higher than comparative 2015, and \$2.39 million, or 97.99%, higher than fourth quarter 2015. The increase from the prior periods was primarily a result of an increase in property management fees associated with our purchase of Oak Island Accommodations, Inc. ("Oak Island") on January 14, 2016, and increased revenue from our South Carolina-based resort property management business. The increase from the comparative prior year quarter was partially offset by the second quarter 2015 sale of our Corolla, North Carolina-based property management business ("Corolla"), which generated management fee revenue of \$1.80 million in first quarter 2015.

For the first quarter of 2016, insurance commissions and other title income, net of commission expense, was \$14.03 million, which was \$2.98 million, or 27.01%, higher than comparative 2015, and \$5.04 million, or 55.97%, higher than fourth quarter 2015. The increase from the comparative prior year quarter was largely due to the acquisition of five insurance agencies in 2015, which contributed additional commission and fee income of \$1.78 million. Also contributing to the increase was organic growth in commercial lines commissions and an increase in commissions from travel insurance. In comparison to fourth quarter 2015, the acquired agencies accounted for additional commission and fee income of \$0.54 million, while the Company recognized an increase in contingency and bonus revenue income of \$3.36 million from fourth quarter 2015 as contingent commissions are mostly received during the first quarter of each year. The Company recognized contingency income of \$2.52 million in first quarter 2015.

Service charges on deposit accounts were \$2.18 million for the first quarter of 2016, compared with \$2.20 million for the comparative 2015 period, and \$2.25 million for the fourth quarter of 2015. The slight decrease from the prior periods was mostly due to reductions in overdraft checking fees.

For the first quarter of 2016, credit card merchant fees totaled \$0.90 million, which was \$0.46 million, or 107.18%, higher than comparative 2015, and \$0.13 million, or 16.69%, higher than the fourth quarter of 2015. The increases from the prior periods were primarily related to a decrease in prior year merchant fees related to structural changes in vendor contractual terms and nonrecurring expenses related to a platform change and equipment purchases associated with Europay, MasterCard, and Visa (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 months ended March 31, 2016 was \$3.37 million and included income generated by Towne Investment Group, net of commission expense. For the three months ended March 31, 2016, net commission income for Towne Investment Group totaled \$0.60 million as compared to \$0.69 million for the first quarter of 2015 and \$0.74 million for the fourth quarter of 2015.

Noninterest Expense. For the quarter ended March 31, 2016, total noninterest expense was \$52.16 million, which was \$1.72 million, or 3.41%, higher than comparative 2015, and \$0.58 million, or 1.10%, lower than the quarter ended December 31, 2015.

As a percentage of operating income, noninterest expense was 66.24% for the first quarter of 2016, 69.74% for comparative 2015, and 73.86% for the quarter ended December 31, 2015. The primary components of noninterest expense in the first quarter of 2016 were salaries and employee benefits of \$30.19 million, occupancy expenses of \$5.02 million, furniture and equipment expenses of \$2.36 million, advertising and marketing expenses of \$1.90 million, software expenses of \$1.62 million, and professional fees of \$1.45 million. In comparison to the prior year comparative quarter, a significant portion of the increase in total noninterest expense is due to insurance agency acquisitions in 2015, which contributed additional

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operational expenses of \$1.05 million, and the Oak Island acquisition in January 2016, which contributed \$0.96 million of additional expenses. Also contributing to the increase from first quarter 2015 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 \$0.09 million. The decrease from the linked quarter was driven by reductions in personnel expenses and occupancy costs.

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)			
	March 31,		December 31,	March 31, 2016 over		March 31, 2016 over	
	March 31,		December 31,	March 31, 2015		December 31, 2015	
	2016	2015	2015	Amount	Percent	Amount	Percent
Salaries and benefits	\$ 30,187	\$ 27,679	\$ 30,826	\$ 2,508	9.06 %	\$ (639)	(2.07)%
Occupancy expense	5,017	4,930	5,156	87	1.76 %	(139)	(2.70)%
Furniture and equipment	2,357	2,369	2,390	(12)	(0.51)%	(33)	(1.38)%
Other							
Advertising and marketing	1,902	1,780	1,965	122	6.85 %	(63)	(3.21)%
Acquisition-related expenses	414	415	285	(1)	(0.24)%	129	45.26 %
Other	1,174	1,725	1,526	(551)	(31.94)%	(352)	(23.07)%
Charitable contributions	1,048	1,413	1,084	(365)	(25.83)%	(36)	(3.32)%
Outside processing	1,397	1,422	1,099	(25)	(1.76)%	298	27.12 %
Professional fees	1,451	1,464	1,501	(13)	(0.89)%	(50)	(3.33)%
Stationery and supplies	594	666	686	(72)	(10.81)%	(92)	(13.41)%
FDIC and other insurance	991	1,099	1,275	(108)	(9.83)%	(284)	(22.27)%
Foreclosed property expenses	113	873	(188)	(760)	(87.06)%	301	(160.11)%
Software expense	1,622	1,293	1,592	329	25.44 %	30	1.88 %
Telephone and postage	1,210	1,227	1,177	(17)	(1.39)%	33	2.80 %
Amortization - intangibles	1,092	845	972	247	29.23 %	120	12.35 %
Bank franchise tax/SCC fees	941	629	604	312	49.60 %	337	55.79 %
Directors fees and expenses	271	332	326	(61)	(18.37)%	(55)	(16.87)%
Travel/meals/entertainment	380	279	467	101	36.20 %	(87)	(18.63)%
Total other expenses	14,600	15,462	14,371	(862)	(5.57)%	229	1.59 %
Total noninterest expense	\$ 52,161	\$ 50,440	\$ 52,743	\$ 1,721	3.41 %	\$ (582)	(1.10)%

Salary and benefits expense, the largest portion of noninterest expense, was \$30.19 million, representing 57.87% of total noninterest expense for the quarter ended March 31, 2016, and \$27.68 million, or 54.88%, for the three months ended March 31, 2015. Salary and benefits expense increased \$2.51 million, or 9.06%, over the comparative period in 2015 and decreased \$0.64 million, or 2.07%, from fourth quarter 2015. The increase from first quarter 2015 is primarily due to company-wide annual salary adjustments effective July 1, 2015, combined with the addition of staff resulting from the expansion of our Insurance and Realty segment businesses, which resulted in an increase of \$1.33 million. The decrease from the linked quarter is primarily due to lower employee profit sharing and 401(k) matching expenses, which were partially offset by higher payroll tax expenses.

In our Banking segment, we had a total of 712 full-time equivalent employees ("FTE") at March 31, 2016, which was up from 704 at March 31, 2015, and 710 at December 31, 2015. In our non-Banking segments at

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March 31, 2016, we had a total of 739 FTEs, excluding real estate sales agents, which was down from 749 at March 31, 2015, and 767 at December 31, 2015. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE was \$54,000 for the quarter ended March 31, 2016, increased from \$50,000 and \$48,000 for the three-month periods ended March 31, 2015, and December 31, 2015, respectively.

Occupancy expense for the first quarter of 2016 experienced a \$0.09 million, or 1.76%, increase from the comparative quarter of 2015, and a \$0.14 million, or 2.70%, decrease from the fourth quarter of 2015. The increase from the comparative periods of the prior year was primarily driven by increases related to the Insurance and Realty 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 maintenance and utility expenses.

For the three months ended March 31, 2016, furniture and equipment expense decreased by \$0.01 million over comparative 2015, and decreased \$0.03 million over fourth quarter 2015. The slight decreases from prior periods were primarily related to lower facilities maintenance costs and a reduction in purchases of non-capitalized items.

Other noninterest expenses for the first quarter of 2016 were \$14.60 million, a decrease of \$0.86 million, or 5.57%, while there was a slight increase of \$0.23 million, or 1.59%, compared to fourth quarter 2015. The variance from first quarter 2015 was primarily due to decreases in foreclosed property expense of \$0.76 million and charitable contributions of \$0.36 million, partially offset by increases in bank franchise tax and amortization expense. In the linked quarter comparison, the increase in foreclosed property expenses of \$0.30 million and bank franchise tax of \$0.34 million was partially offset by the reduction in Federal Deposit Insurance Corporation ("FDIC") and other expenses.

Provision for Income Taxes. We reported a provision for income tax expense of \$8.19 million, representing an effective tax rate of 31.48%, in the first quarter of 2016. The provision for income tax expense was \$6.39 million for the first quarter of 2015, with an effective rate of 30.52%, and \$4.85 million, with an effective rate of 27.99%, in the fourth quarter of 2015. The variance from both prior periods was primarily a result of an increase in taxable income subject to the federal statutory rate of 35%. Additionally, the fourth quarter 2015 rate was affected by the utilization of a capital loss carryforward and an increase in nontaxable income arising from bank-owned life insurance.

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

Banking Segment. For the three months ended March 31, 2016, the Banking segment represented 79.31%, or \$14.13 million, of our total consolidated net income compared to 76.41%, or \$11.11 million, for comparative 2015.

Pre-tax earnings for the three months ended March 31, 2016 for the Banking segment were \$19.86 million, increasing \$4.63 million, or 30.35%, from comparative 2015. The increase in earnings from the comparative 2015 quarter was primarily driven by an increase in net interest income of \$2.64 million, an increase in noninterest income of \$0.77 million, a decrease in the provision for loan losses of \$0.58 million, and a decrease in noninterest expenses of \$0.56 million. The increase in net interest income was primarily a result

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of additional interest income from earning assets as average loan balances increased \$449.79 million to \$4.52 billion. The increase in noninterest income was due to an increase in credit card merchant fees of \$0.46 million and other noninterest income of \$0.38 million.

The decrease in noninterest expense was due to a reduction in other expenses of \$1.30 million related to decreases in charitable contributions and foreclosed property expenses. The decrease was partially offset by an increase in salary and employee benefits of \$0.66 million, primarily a result of company-wide annual salary adjustments effective July 1, 2015.

Pre-tax earnings were up \$2.78 million compared to the linked quarter ended December 31, 2015. The increase in earnings was a result of an overall increase in revenue of \$0.24 million and a decrease in the provision for loan losses of \$1.11 million. A decrease in noninterest expenses of \$1.40 million also increased earnings. The increase in net interest income of \$0.11 million was primarily due to loan growth in the first 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 decrease in noninterest expense in the linked quarter ended December 31, 2015 was driven by a decrease in salaries and employee benefits of \$0.95 million, primarily due to lower employee profit sharing and 401(k) matching expenses, combined with a decrease in other expenses of \$0.23 million, as acquisition-related expenses and marketing costs decreased.

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)			
	March 31,		December 31, 2015	2016 over 2015		March over December	
	2016	2015		Amount	Percent	Amount	Percent
Net interest income	\$ 45,823	\$ 43,185	\$ 45,709	\$ 2,638	6.11 %	\$ 114	0.25 %
Service charges on deposit accounts	2,176	2,197	2,254	(21)	(0.96)%	(78)	(3.46)%
Credit card merchant fees	895	433	767	462	106.70 %	128	16.69 %
Other income	2,530	2,148	2,452	382	17.78 %	78	3.18 %
Net gain on investment securities	—	49	—	(49)	(100.00)%	—	— %
Total noninterest income	5,601	4,827	5,473	774	16.03 %	128	2.34 %
Total revenue	51,424	48,012	51,182	3,412	7.11 %	242	0.47 %
Provision for loan losses	(259)	323	852	(582)	(180.19)%	(1,111)	(130.40)%
Salaries and employee benefits	17,513	16,855	18,463	658	3.90 %	(950)	(5.15)%
Occupancy expense	3,475	3,424	3,674	51	1.49 %	(199)	(5.42)%
Furniture and equipment	1,865	1,842	1,887	23	1.25 %	(22)	(1.17)%
Other expenses	9,328	10,623	9,554	(1,295)	(12.19)%	(226)	(2.37)%
Total noninterest expenses	32,181	32,744	33,578	(563)	(1.72)%	(1,397)	(4.16)%
Income before income tax and corporate allocation	19,502	14,945	16,752	4,557	30.49 %	2,750	16.42 %
Corporate allocation	360	292	332	68	23.29 %	28	8.43 %
Income before income tax provision	19,862	15,237	17,084	4,625	30.35 %	2,778	16.26 %
Provision for income tax expense	5,729	4,129	4,865	1,600	38.75 %	864	17.76 %
Net income	\$ 14,133	\$ 11,108	\$ 12,219	\$ 3,025	27.23 %	\$ 1,914	15.66 %
Efficiency ratio (1)	62.58%	68.27%	65.61%	(5.69)%	(8.33)%	(3.03)%	(4.62)%

(1) Excludes gain on investment securities.

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Realty Segment. For the three months ended March 31, 2016, the Realty segment had income before income tax provision and noncontrolling interest of \$2.06 million, as compared to \$2.86 million for the comparative 2015 period, and \$0.30 million for the linked quarter ended December 31, 2015. Total revenue decreased slightly to \$13.41 million in the first quarter of 2016 from \$13.43 million in the first quarter of 2015. The \$1.20 million, or 14.14%, decrease in residential mortgage banking income resulted from a decline in margins combined with slightly lower production volumes. Residential mortgage banking income included an increase in the value of rate lock commitments of \$0.38 million for the quarter ended March 31, 2016, compared to an increase of \$1.03 million in the same period of 2015. The increase in property management fees from 2015 was primarily due to increased revenue from our South Carolina-based property management business and our purchase of Oak Island on January 14, 2016. The increase was partially offset by fees lost due to the sale of Corolla on April 1, 2015. The increase in net interest and other income was a result of a higher balance of average mortgage loans held for sale, resulting in additional net interest income of \$0.14 million on a prior year quarter comparison.

Expenses for the Realty segment increased 7.17%, or \$0.75 million, when compared to the same period in 2015, and increased by 2.04%, or \$0.22 million, when compared to the quarter ended December 31, 2015. The increase from the first and fourth quarters of 2015 was primarily due to additional operating expenses of \$0.96 million related to Oak Island operations. In comparison to first quarter 2015, expenses decreased slightly, when excluding Oak Island, primarily due to the sale of Corolla and a decline in occupancy costs. Excluding Oak Island expenses, expenses decreased from the linked quarter driven by lower personnel costs related to profit sharing and incentive pay combined with a decrease in loan costs.

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

	Three Months Ended			Increase/(Decrease)			
	March 31,		December 31,	March 31, 2016		March 31, 2016	
	March 31,		December 31,	March 31, 2015		December 31, 2015	
	2016	2015	2015	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	\$ 7,310	\$ 8,514	\$ 7,446	\$ (1,204)	(14.14)%	\$ (136)	(1.83)%
Real estate brokerage income, net	1,412	1,266	1,654	146	11.53 %	(242)	(14.63)%
Title insurance and settlement fees	350	301	363	49	16.28 %	(13)	(3.58)%
Property management fees, net	3,415	2,689	784	726	27.00 %	2,631	335.59 %
Income from unconsolidated subsidiary	165	125	200	40	32.00 %	(35)	(17.50)%
Net interest and other income	762	536	944	226	42.16 %	(182)	(19.28)%
Total revenue	13,414	13,431	11,391	(17)	(0.13)%	2,023	17.76 %
Salaries and employee benefits	6,706	6,030	6,501	676	11.21 %	205	3.15 %
Occupancy expense	1,013	1,049	944	(36)	(3.43)%	69	7.31 %
Furniture and equipment	268	285	267	(17)	(5.96)%	1	0.37 %
Amortization of intangible assets	353	304	241	49	16.12 %	112	46.47 %
Other expenses	2,844	2,768	3,007	76	2.75 %	(163)	(5.42)%
Total expenses	11,184	10,436	10,960	748	7.17 %	224	2.04 %
Income before income tax, corporate allocation and noncontrolling interest	2,230	2,995	431	(765)	(25.54)%	1,799	417.40 %
Corporate allocation	(170)	(132)	(131)	(38)	(28.79)%	(39)	(29.77)%
Income before income tax provision and noncontrolling interest	2,060	2,863	300	(803)	(28.05)%	1,760	586.67 %
Provision for income tax	659	960	(86)	(301)	(31.35)%	745	N/M
Net income	1,401	1,903	386	(502)	(26.38)%	1,015	262.95 %
Noncontrolling interest	(368)	(256)	(380)	(112)	(43.75)%	12	3.16 %
Net income attributable to TowneBank	\$ 1,033	\$ 1,647	\$ 6	\$ (614)	(37.28)%	\$ 1,027	N/M
Key data:							
Efficiency ratio	83.38%	77.70%	96.22%	5.68%	7.31 %	(12.84)%	(13.34)%
Number of units sold	804	736	942	68	9.24 %	(138)	(14.65)%
Volume of units sold	\$ 224,701	\$ 192,861	\$ 275,193	\$ 31,840	16.51 %	\$ (50,492)	(18.35)%
Number of real estate agents	416	381	410	35	9.19 %	6	1.46 %
Loans originated, mortgage	\$ 162,990	\$ 160,872	\$ 178,899	\$ 2,118	1.32 %	\$ (15,909)	(8.89)%
Loans originated, joint venture	150,147	157,553	174,618	(7,406)	(4.70)%	(24,471)	(14.01)%
Total loans originated	\$ 313,137	\$ 318,425	\$ 353,517	\$ (5,288)	(1.66)%	\$ (40,380)	(11.42)%
Number of loans, mortgage	681	716	789	(35)	(4.89)%	(108)	(13.69)%
Number of loans, joint venture	736	746	802	(10)	(1.34)%	(66)	(8.23)%
Total number of loans	1,417	1,462	1,591	(45)	(3.08)%	(174)	(10.94)%
Average loan amount, mortgage	\$ 239	\$ 225	\$ 227	\$ 14	6.22 %	\$ 12	5.29 %
Average loan amount, joint venture	204	211	218	(7)	(3.32)%	(14)	(6.42)%
Average loan amount	\$ 221	\$ 218	\$ 222	\$ 3	1.38 %	\$ (1)	(0.45)%
Average number of originators, mortgage	68	68	71	—	— %	(3)	(4.23)%
Average number of originators, joint venture	53	52	50	1	1.92 %	3	6.00 %
Average number of originators	121	120	121	1	0.83 %	—	— %

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Mortgage. The loan volume for the combined mortgage operations increased in the quarter ended March 31, 2016 as compared to the same period in 2015. Total loans originated in the first quarter of 2016 were \$313.14 million, a 1.66% decrease, or \$5.29 million, from \$318.43 million in the comparative period of 2015. This was a \$40.38 million, or 11.42%, decrease compared to the volume for the quarter ended December 31, 2015. Refinance activity comprised \$49.09 million of loan volume for the quarter ended March 31, 2016, while purchases accounted for the remaining \$264.05 million in loan volume for the quarter. For the quarters ended March 31, 2015 and December 31, 2015, refinance volume was \$76.96 million and \$53.05 million, respectively, while purchase volume was \$241.47 million and \$300.47 million, respectively.

Insurance Segment. The Insurance segment comprises property and casualty and group benefit divisions. The Insurance segment represented 14.89%, or \$2.65 million, of total consolidated net income at March 31, 2016, and 12.26%, or \$1.78 million, at March 31, 2015.

Earnings before income taxes and noncontrolling interests for the three months ended March 31, 2016 were \$4.93 million, increasing \$1.42 million, or 40.41%, from comparative 2015, and up \$4.50 million from the linked quarter ended December 31, 2015. The primary factors affecting earnings in comparison to the prior periods were income related to insurance agencies acquired in 2015, an increase in contingency revenue, and growth in our travel insurance business.

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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)			
	March 31,		December 31,	March 31, 2016		March 31, 2016	
	March 31,		December 31,	March 31, 2015		December 31, 2015	
	2016	2015	2015	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	\$ 8,263	\$ 6,446	\$ 7,371	\$ 1,817	28.19 %	\$ 892	12.10 %
Employee benefits	2,721	2,670	2,588	51	1.91 %	133	5.14 %
Travel insurance	1,456	1,131	630	325	28.74 %	826	131.11 %
Specialized benefit services	153	133	144	20	15.04 %	9	6.25 %
Total net commissions and fees	12,593	10,380	10,733	2,213	21.32 %	1,860	17.33 %
Contingency and bonus revenue	3,411	2,523	53	888	35.20 %	3,358	N/M
Other income	77	48	58	29	60.42 %	19	32.76 %
Total revenues	16,081	12,951	10,844	3,130	24.17 %	5,237	48.29 %
Employee commission expense	2,168	2,022	2,008	146	7.22 %	160	7.97 %
Revenue, net of commission expense	\$ 13,913	\$ 10,929	\$ 8,836	2,984	27.30 %	5,077	57.46 %
Salaries and employee benefits	5,968	4,794	5,863	1,174	24.49 %	105	1.79 %
Occupancy expense	529	456	537	73	16.01 %	(8)	(1.49)%
Furniture and equipment	224	242	235	(18)	(7.44)%	(11)	(4.68)%
Amortization of intangible assets	685	526	676	159	30.23 %	9	1.33 %
Other expenses	1,390	1,242	892	148	11.92 %	498	55.83 %
Total operating expenses	8,796	7,260	8,203	1,536	21.16 %	593	7.23 %
Income before income tax, corporate allocation and noncontrolling interest	5,117	3,669	633	1,448	39.47 %	4,484	708.37 %
Corporate allocation	(190)	(160)	(201)	(30)	18.75 %	11	(5.47)%
Income before income tax provision and noncontrolling interest	4,927	3,509	432	1,418	40.41 %	4,495	1,040.51 %
Provision for income tax	1,800	1,296	68	504	38.89 %	1,732	N/M
Net income	3,127	2,213	364	914	41.30 %	2,763	759.07 %
Noncontrolling interest	(474)	(430)	(123)	(44)	10.23 %	(351)	285.37 %
Net income attributable to TowneBank	\$ 2,653	\$ 1,783	\$ 241	\$ 870	48.79 %	\$ 2,412	1,000.83 %
Efficiency ratio	63.22%	66.43%	92.84%	(3.21)%	(4.83)%	(29.62)%	(31.90)%

Total revenues for the first quarter of 2016 increased \$3.13 million, or 24.17%, when compared to the same period in 2015, and increased \$5.24 million, or 48.29%, for the three months ended December 31, 2015. The increase from the comparative prior year period was affected by the aforementioned insurance agency acquisitions, which contributed additional revenue, net of commission expense of \$1.78 million in first quarter 2016. Also contributing to the increase was organic growth in commercial lines commissions and an increase in commissions from travel insurance of \$0.33 million. The increase from the acquisitions on a linked quarter basis totaled \$0.54 million. Also contributing to the linked quarter increase was higher contingency and bonus revenue of \$3.36 million combined with a seasonal increase in travel insurance

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commissions of \$0.83 million. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other things. Such commissions are seasonal in nature and are mostly received during the first quarter of each year.

Total operating expenses for the first quarter of 2016 increased \$1.54 million, or 21.16%, when compared to the same period in 2015, and increased \$0.59 million, or 7.23%, when compared to the three months ended December 31, 2015. The largest factor in the increase from the comparative prior year period was salaries and employee benefits expense, which increased \$1.17 million, or 24.49%. The increase was largely driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of \$0.80 million. The increase in operating expenses from the linked quarter was driven by an increase in other expenses of \$0.50 million caused by a reversal of contingent consideration in fourth quarter 2015 related to a prior insurance agency acquisition.

Occupancy expense increased \$0.07 million, or 16.01%, when comparing the three months ended March 31, 2016 to the same period for 2015, which was also a result of the acquisitions.

The increase in other expenses from first quarter 2015 of \$0.15 million was driven by higher outside processing fees and professional fees.

ANALYSIS OF FINANCIAL CONDITION

Overview. At March 31, 2016, total assets were \$6.37 billion, which is \$0.54 billion, or 9.20%, higher than the period-end balance for comparative 2015, and \$68.60 million, or 1.09%, greater than the balance at December 31, 2015. Our loan portfolio, less unearned income and deferred costs, made up 71.52% of our period-end assets and totaled \$4.55 billion at March 31, 2016. Average assets for the quarter ended March 31, 2016 were \$6.31 billion, up \$0.48 billion, or 8.30%, from comparative March 31, 2015, and up \$7.67 million, or 0.12%, from the quarter ended December 31, 2015.

Average earning assets increased \$0.52 billion, or 9.92%, from \$5.29 billion for the first quarter of 2015 to \$5.82 billion for the first quarter of 2016. Compared to the fourth quarter of 2015, average earning assets increased \$14.48 million.

Our average total deposits were \$4.92 billion for first quarter 2016, reflecting growth of \$410.54 million, or 9.11%, compared to first quarter 2015. Growth continued in average noninterest-bearing deposits, which increased \$159.77 million, or 12.72%, from March 31, 2015.

Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest-bearing deposit balances at March 31, 2016 were \$176.23 million and consisted mainly of overnight deposits with the Federal Reserve Bank of Richmond.

The average balance of interest-bearing deposits in other banks and federal funds sold during the first quarter of 2016 was \$265.26 million, or 4.56%, of average total earning assets compared with \$202.85 million, or 3.83%, of average total earning assets for comparative 2015. For the fourth quarter of 2015, the average balance of interest-bearing deposits in other banks was \$292.09 million, or 5.04%, of average total earning assets.

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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 \$821.55 million at March 31, 2016, compared with \$771.21 million at March 31, 2015. The average balance during the first quarter of 2016 was \$700.47 million, compared to the 2015 period average of \$693.85 million, or 12.05%, and 13.11% of average earning assets, respectively. During the three months ended March 31, 2016, we had sales, maturities, and calls totaling \$108.84 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 \$66.92 million at March 31, 2016, and \$83.75 million at March 31, 2015. The average balance during the first quarter of 2016 was \$67.82 million, compared with \$84.51 million in the 2015 period, representing 1.17% and 1.60% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At March 31, 2016, we held \$97.49 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$102.85 million at March 31, 2015, and \$102.35 million at December 31, 2015. Average loans held for sale were 1.32% and 1.21% of average earning assets for the quarters ended March 31, 2016 and 2015, respectively. Average loans held for sale were 1.65% of average earning assets for the quarter ended December 31, 2015. The majority of mortgage loans held for sale have been pre-committed to investors, which minimizes our interest rate risk.

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

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

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Loan Portfolio. Loans, net of unearned income and deferred costs, were \$4.55 billion at March 31, 2016, which was \$456.57 million, or 11.15%, above the \$4.10 billion reported at March 31, 2015, and \$32.87 million, or 0.73%, above the \$4.52 billion at December 31, 2015. The primary factor that contributed to the increase in loans from the prior year was 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 77.66% for the quarter ended March 31, 2016, compared with 76.86% for comparable 2015 and 76.31% for the quarter ended December 31, 2015.

Allowance for Loan Losses and Asset Quality. The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on management's evaluation of the risk inherent in the loan portfolio at the balance sheet date and changes in the nature and volume of loan activity. This evaluation includes a review of loans for which collection may not be reasonably assured. It considers internal risk grades, 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

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concentrations of credit; (vi) the effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis to determine an appropriate general valuation allowance.

The allowance for loan losses at March 31, 2016, March 31, 2015, and December 31, 2015 was \$37.76 million, \$35.91 million, and \$38.36 million, respectively. The allowance was equal to 0.83% of total loans outstanding at March 31, 2016, compared with 0.88% and 0.85% at March 31, 2015 and December 31, 2015, respectively. Excluding purchased loans, the allowance was equal to 0.92% of loans outstanding at March 31, 2016, compared with 1.00% and 0.94% at March 31, 2015 and December 31, 2015, respectively. We believe the decline in the ratio, excluding purchased loans, is appropriate given continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Reflective of improving credit quality, classified loans, defined as loans in the substandard and doubtful categories, remained low at 1.61% of total loans at March 31, 2016, down from 1.67% at March 31, 2015, with a slight increase from 1.47% at December 31, 2015. Additionally, loans 30 to 89 days past due were \$12.06 million, including purchased impaired loans of \$1.01 million, at March 31, 2016, as compared to \$19.54 million and \$7.48 million at March 31, 2015 and December 31, 2015, respectively, and total past due and nonaccruing loans were \$21.15 million, including purchased impaired past-due loans of \$2.16 million, at March 31, 2016, from \$27.74 million and \$17.85 million at March 31, 2015 and December 31, 2015, 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 4.75x of nonperforming loans at March 31, 2016, compared with 5.10x and 4.42x at March 31, 2015 and December 31, 2015, respectively. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at March 31, 2016.

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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		
	March 31,		December 31,
	2016	2015	2015
Allowance for loan losses			
Balance beginning of period	\$ 38,359	\$ 35,917	\$ 37,351
Loans charged off:			
Residential 1-4 family	(321)	(347)	(353)
Multifamily	—	—	—
Commercial real estate	(66)	(174)	(1)
Construction	(62)	(51)	(10)
Commercial and industrial	(72)	(5)	(5)
Consumer and other	(12)	(13)	(18)
Total	(533)	(590)	(387)
Loans recovered:			
Residential 1-4 family	114	129	268
Multifamily	—	—	1
Commercial real estate	16	13	161
Construction	5	1	5
Commercial and industrial	30	85	78
Consumer and other	28	29	30
Total	193	257	543
Net loans charged off (recovered)	(340)	(333)	156
Provision for loan losses	(259)	323	852
Balance end of period	\$ 37,760	\$ 35,907	\$ 38,359
Nonperforming assets			
Nonperforming loans	\$ 7,944	\$ 7,045	\$ 8,670
Foreclosed property	29,740	51,698	34,420
Total nonperforming assets	\$ 37,684	\$ 58,743	\$ 43,090
Loans past due 90 days and still accruing interest	\$ —	\$ 3	\$ 424
Asset Quality Ratios			
Allowance for loan losses to nonperforming loans	4.75x	5.10x	4.42x
Allowance for loan losses to period end loans	0.83%	0.88%	0.85%
Allowance for loan losses to period end loans excluding purchased loans	0.92%	1.00%	0.94%
Nonperforming loans to period end loans	0.17%	0.17%	0.19%
Nonperforming assets to period end assets	0.59%	1.01%	0.68%
Net charge-offs (recoveries) to average loans (annualized)	0.03%	0.03%	(0.01)%

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

At March 31, 2016, we had \$37.68 million in nonperforming assets, which amounted to 0.59% of total assets. Additionally, there were no loans past due 90 days or more that were accruing interest. Nonperforming assets consist of \$7.94 million in nonperforming loans as well as \$29.74 million in foreclosed property. Nonperforming loans decreased by \$0.73 million from December 31, 2015, as additions to nonaccrual loans during the first quarter of 2016 were outpaced by transfers to other real estate owned ("OREO"), charge-offs, and payments received. Nonperforming residential loans decreased by \$0.42 million, with paydowns of \$0.80 million, transfers to OREO of \$1.14 million, and charge-offs of \$0.27 million. Additionally, new construction and development nonperforming loans decreased \$0.40 million. There was also a slight reduction in nonperforming commercial real estate loans, which decreased by \$0.05 million, with paydowns of \$0.60 million, and charge-offs of \$0.07 million. At March 31, 2016, foreclosed property totaled \$29.74 million, a decrease from \$34.42 million at December 31, 2015, and a decrease from \$51.70 million at March 31, 2015. Included in foreclosed property at March 31, 2016, was OREO of \$5.76 million acquired in the Franklin merger. The nine largest foreclosed property developments represented approximately 84% of total foreclosed property at March 31, 2016, with the largest development representing approximately 45%. Foreclosed property consists of 30 residential properties, 28 construction and development properties, and three commercial properties.

At March 31, 2016, loans 60-89 days past due, excluding nonperforming loans, totaled \$1.40 million. Additionally, there are other performing loans, totaling \$43.82 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.

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At March 31, 2016, nonaccruing TDRs, which are included in nonperforming loans, totaled \$4.87 million, and accruing TDRs totaled \$24.96 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 longer, 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):

	March 31, 2016	December 31, 2015
Construction and land development	\$ 839	\$ 1,243
Commercial real estate	2,048	2,093
Multifamily real estate	715	731
1-4 family residential real estate	3,850	4,267
Commercial and industrial business loans	369	282
Consumer loans and other	123	54
Total nonperforming loans	<u>\$ 7,944</u>	<u>\$ 8,670</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):

	March 31, 2016	March 31, 2015	December 31, 2015
Real estate loans:			
Residential 1-4 family	\$ 8,212	\$ 8,543	\$ 8,990
Commercial	14,833	14,927	14,687
Construction	5,015	5,547	4,984
Multifamily	922	700	945
Total real estate loans	<u>28,982</u>	<u>29,717</u>	<u>29,606</u>
Commercial and industrial loans	<u>5,390</u>	<u>4,658</u>	<u>5,774</u>
Consumer loans and other	<u>3,388</u>	<u>1,532</u>	<u>2,979</u>
Total	<u>\$ 37,760</u>	<u>\$ 35,907</u>	<u>\$ 38,359</u>

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Deposits. Total deposits at March 31, 2016 were \$4.96 billion, representing an increase of 9.98%, or \$449.51 million, over March 31, 2015, and an increase of \$41.10 million, or 0.84%, compared to December 31, 2015. Total average deposits were \$4.92 billion during the first quarter of 2016, compared to \$4.50 billion during the first quarter of 2015, and \$4.88 billion during the fourth quarter of 2015.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 28.80% during the first quarter of 2016 and 27.88% during the same period in 2015. Average noninterest-bearing demand deposits were 29.11% of average total deposits for the fourth quarter of 2015. The cost of interest-bearing deposits was 0.60% for the first quarter of 2016, compared with 0.55% for the first quarter of 2015, and 0.59% for the fourth 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					
	March 31,				December 31,	
	2016		2015		2015	
Interest-bearing demand and money market accounts	\$ 1,782,908	0.30%	\$ 1,635,454	0.28%	\$ 1,780,151	0.28%
Regular savings	300,070	0.94%	305,016	0.91%	299,503	0.91%
Certificates of deposit	1,416,629	0.90%	1,308,364	0.82%	1,378,943	0.91%
Total interest-bearing	3,499,607	0.60%	3,248,834	0.55%	3,458,597	0.59%
Noninterest-bearing	1,415,793		1,256,025		1,420,047	
Total	<u>\$ 4,915,400</u>	0.43%	<u>\$ 4,504,859</u>	0.40%	<u>\$ 4,878,644</u>	0.42%

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					
	March 31,				December 31,	
	2016		2015		2015	
Interest-bearing demand and money market accounts	\$ 1,782,908	36.27%	\$ 1,635,454	36.31%	\$ 1,780,151	36.49%
Regular savings	300,070	6.11%	305,016	6.77%	299,503	6.14%
Certificates of deposit	1,416,629	28.82%	1,308,364	29.04%	1,378,943	28.27%
Total interest-bearing	3,499,607	71.20%	3,248,834	72.12%	3,458,597	70.89%
Noninterest-bearing	1,415,793	28.80%	1,256,025	27.88%	1,420,047	29.11%
Total	<u>\$ 4,915,400</u>	100.00%	<u>\$ 4,504,859</u>	100.00%	<u>\$ 4,878,644</u>	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the Federal Home Loan Bank of Atlanta ("FHLB") at March 31, 2016 were \$428.94 million, compared to \$397.88 million at March 31, 2015, and \$429.08 million at December 31, 2015. The average borrowing cost for the first quarter of 2016 was 2.96%, 3.32% in the first quarter of 2015, and 3.08% in the fourth quarter of 2015.

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The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at March 31, 2016, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call Date	Outstanding Amount
03/06/2017	4.08%	06/06/2016	\$ 100,000
05/18/2017	4.35%	05/18/2016	80,000
05/18/2017	4.48%	05/18/2016	80,000
01/29/2018	3.05%	—	13,000
11/15/2028	3.43%	—	5,201
12/01/2028	2.83%	—	3,739
05/16/2016	0.44%	—	40,000
09/28/2016	0.58%	—	33,000
12/07/2020	0.44%	—	74,000
Total FHLB Loans			\$ 428,940

At March 31, 2016, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of \$737.46 million collateralized the advances from the FHLB. At March 31, 2015, certain loans with carrying values of \$707.41 million collateralized the advances from the FHLB. At December 31, 2015, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of \$752.81 million collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of March 31, 2016, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the first quarter of 2016 were \$468.80 million, compared with \$447.20 million for the first quarter of 2015, and \$471.93 million for the fourth quarter of 2015, while the average cost of these funds was 2.69%, 3.03%, and 2.79%, respectively.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* on page 40 in this report.

On February 24, 2016, we declared a quarterly shareholder cash dividend of \$0.12 per common share. The dividend was paid on April 12, 2016, to shareholders of record on March 30, 2016.

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 FDIC, and the Office of the Comptroller of the Currency. Per

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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 began on January 1, 2016, and will end January 1, 2019.

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 12.66% for common equity tier I, 12.73% for tier I capital, and 13.46% 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 March 31, 2016.

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

	March 31,		December 31,
	2016	2015	2015
Tier I Capital:			
Shareholders' equity	\$ 836,003	\$ 791,580	\$ 820,194
Less: goodwill and disallowed intangible assets, net of deferred tax	173,563	163,454	164,258
AOCI-related adjustments	17	2,359	(2,994)
Noncontrolling interests	9,128	8,424	9,273
Total common equity tier I capital	653,295	617,343	649,657
Included noncontrolling interests	3,847	5,244	5,680
Total tier I capital	657,142	622,587	655,337
Tier II Capital:			
Qualifying allowance for loan losses (1)	37,760	35,907	38,359
Total tier II capital	37,760	35,907	38,359
Total Risk-Based Capital	\$ 694,902	\$ 658,494	\$ 693,696
Total assets	\$ 6,365,169	\$ 5,828,703	\$ 6,296,574
Total risk-weighted assets (2)	5,161,961	4,716,018	5,161,728
Average assets for leverage capital purposes	6,139,674	5,666,078	6,141,313
Risk-weighted assets to total assets	81.10%	80.91%	81.98%
Risk-based capital ratios:			
Common equity tier I (4.5% minimum requirement)	12.66%	13.09%	12.59%
Tier I (6% minimum requirement)	12.73%	13.20%	12.70%
Total (8% minimum requirement)	13.46%	13.96%	13.44%
Tier I leverage ratio (4% minimum requirement)	10.70%	10.99%	10.67%

(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 March 31,	
		2016	2015
Return on average assets (GAAP basis)		1.14%	1.01%
Impact of excluding average goodwill and other intangibles and amortization		0.07%	0.07%
Return on average tangible assets		1.21%	1.08%

		Three Months Ended March 31,	
		2016	2015
Return on average equity (GAAP basis)		8.63%	7.54%
Impact of excluding average goodwill and other intangibles and amortization		2.93%	2.73%
Return on average tangible equity		11.56%	10.27%

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

		Three Months Ended March 31,	
		2016	2015
Book value (GAAP basis)		\$ 16.00	\$ 15.22
Impact of excluding goodwill and other intangibles and amortization		(3.62)	(3.49)
Tangible book value		\$ 12.38	\$ 11.73

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 March 31, 2016, we had \$669.74 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

Item 4. Controls and Procedures

Controls and Procedures. As of March 31, 2016, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2016. 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 2015 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 2015 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>
(2.1)	Agreement and Plan of Reorganization, dated as of December 16, 2015, by and among TowneBank, Monarch Financial Holdings, Inc. and Monarch Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on December 22, 2015).
(2.2)	Agreement and Plan of Reorganization, dated as of July 14, 2014, by and among TowneBank, Franklin Financial Corporation and Franklin Federal Savings Bank (incorporated by reference to Exhibit 2.1 to TowneBank's Current Report on Form 8-K filed on July 16, 2014).
(10.1)	Split Dollar Life Insurance Agreement, dated as of April 8, 2016, entered into between TowneBank and the trustees of two separate irrevocable life insurance trusts established by G. Robert Aston, Jr., Chairman and Chief Executive Officer of TowneBank, for the benefit of certain family members (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed on April 8, 2016).
(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

PART II. OTHER INFORMATION

- (32) Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
- (99) Independent Accountants' Report by Dixon Hughes Goodman LLP, dated May 9, 2016

Signatures

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

TOWNEBANK

May 9, 2016

Date

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

G. Robert Aston, Jr.

Chairman of the Board/Chief Executive
Officer

May 9, 2016

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 March 31, 2016 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.

May 9, 2016

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 March 31, 2016 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.

May 9, 2016

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 March 31, 2016 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, our financial condition and result of operations as of and for the period covered by the Report.

May 9, 2016

Date

/s/ G. Robert Aston, Jr.

G. Robert Aston, Jr.

Chairman of the Board/Chief Executive Officer

May 9, 2016

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 March 31, 2016 and 2015, the related consolidated statements of income, comprehensive income, and cash flows for the three months ended March 31, 2016 and 2015, and the related consolidated statement of equity for the three months ended March 31, 2016. 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, 2015, 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 February 29, 2016, 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, 2015, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Dixon Hughes Goodman LLP

Norfolk, Virginia
May 9, 2016