FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended September 30, 2017

FDIC Insurance Cert. Number: 35095

TOWNEBANK

(Exact name of registrant as specified in its charter)

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

(757) 638-7500

(Registrant's telephone number, including area code)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
☐

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

The number of shares of the Company's common stock outstanding as of October 31, 2017 was 62,622,861 shares.

TOWNEBANK

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

(In thousands, except share data)	September 30, 2017	September 30, 2016	December 31, 2016
	(unaudited)	(unaudited)	(audited)
ASSETS			
Cash and due from banks	$ 647,728	$ 147,887	$ 130,967
Interest-bearing deposits in financial institutions	5,055	6,891	5,581
Total Cash and Cash Equivalents	652,783	154,778	136,548
Securities available for sale, at fair value	831,483	704,418	812,974
Securities held to maturity, at amortized cost	62,487	70,304	66,490
Federal Home Loan Bank stock, at amortized cost	29,586	24,888	35,937
Total Securities	923,556	799,610	915,401
Mortgage loans held for sale	318,595	439,451	314,046
Loans, net of unearned income and deferred costs:			
Real estate - residential 1-4 family	1,239,886	1,208,001	1,215,823
Real estate - commercial	2,303,263	2,189,489	2,251,312
Real estate - construction and land development	880,655	820,453	826,027
Real estate - multifamily	185,323	206,623	222,791
Commercial and industrial business	1,084,555	1,033,797	1,089,539
Consumer and other loans	216,797	193,279	201,729
Loans, net of unearned income and deferred costs	5,910,479	5,651,642	5,807,221
Less: Allowance for loan losses	(44,398)	(40,655)	(42,001)
Net Loans	5,866,081	5,610,987	5,765,220
Premises and equipment, net	196,975	202,955	198,568
Goodwill	270,901	264,578	264,910
Other intangible assets, net	39,751	39,747	37,856
Bank-owned life insurance policies	193,823	163,385	189,499
Other assets	152,329	154,651	151,867
TOTAL ASSETS	$ 8,614,794	$ 7,830,142	$ 7,973,915
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 2,212,047	$ 1,974,395	$ 1,947,312
Interest-bearing:			
Demand and money market accounts	2,253,746	2,207,962	2,263,894
Savings	320,028	315,477	319,611
Certificates of deposit	1,762,641	1,649,113	1,504,380
Total Deposits	6,548,462	6,146,947	6,035,197
Advances from the Federal Home Loan Bank	527,072	427,655	687,511
Subordinated debt, net	247,128	—	—
Repurchase agreements and other borrowings	23,195	31,927	32,540
Total Borrowings	797,395	459,582	720,051
Other liabilities	128,086	144,735	132,109
TOTAL LIABILITIES	7,473,943	6,751,264	6,887,357
Shareholders' Equity			
Preferred stock:			
Authorized and unissued shares - 2,000,000	—	—	—
Common stock, $1.667 par: 90,000,000 shares authorized 62,619,857; 62,387,564; and 62,492,168 shares issued at September 30, 2017 and 2016 and December 31, 2016, respectively	104,387	104,000	104,174
Capital surplus	748,444	743,223	745,411
Retained earnings	279,165	218,631	229,503
Common stock issued to deferred compensation trust, at cost 723,304; 683,833; and 692,431 shares at September 30, 2017 and 2016 and December 31, 2016, respectively	(12,304)	(10,969)	(11,168)
Deferred compensation trust	12,304	10,969	11,168
Accumulated other comprehensive income (loss)	(2,408)	1,339	(3,986)
TOTAL SHAREHOLDERS' EQUITY	1,129,588	1,067,193	1,075,102
Noncontrolling interests	11,263	11,685	11,456
TOTAL EQUITY	1,140,851	1,078,878	1,086,558
TOTAL LIABILITIES AND EQUITY	$ 8,614,794	$ 7,830,142	$ 7,973,915

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 September 30, 2017	Three Months Ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
INTEREST INCOME:				
Loans, including fees	$ 68,969	$ 64,623	$ 204,667	$ 166,313
Investment securities	3,076	3,099	9,466	9,703
Interest-bearing deposits in financial institutions and federal funds sold	2,745	(36)	4,819	658
Mortgage loans held for sale	3,081	4,137	7,687	6,124
Total Interest Income	77,871	71,823	226,639	182,798
INTEREST EXPENSE:				
Deposits	7,810	5,909	20,690	16,389
Advances from the Federal Home Loan Bank	1,750	3,276	8,044	9,606
Subordinated capital debentures	2,368	—	2,368	—
Repurchase agreements and other borrowings	20	33	81	79
Total Interest Expense	11,948	9,218	31,183	26,074
Net Interest Income	65,923	62,605	195,456	156,724
PROVISION FOR LOAN LOSSES	696	1,686	4,557	3,526
Net Interest Income after Provision for Loan Losses	65,227	60,919	190,899	153,198
NONINTEREST INCOME:				
Residential mortgage banking income, net	19,087	21,430	58,314	40,696
Insurance commissions and other title fees and income, net	12,116	11,258	39,818	36,918
Real estate brokerage and property management income, net	10,042	6,647	22,664	17,591
Service charges on deposit accounts	2,670	2,552	7,785	7,012
Credit card merchant fees, net	1,388	1,365	3,804	3,373
Bank-owned life insurance	1,425	1,264	4,321	3,616
Other income	2,688	2,305	7,940	6,498
Net loss on investment securities	—	—	(1)	—
Total Noninterest Income	49,416	46,821	144,645	115,704
NONINTEREST EXPENSE:				
Salaries and employee benefits	43,467	40,497	128,509	100,776
Occupancy expense	6,635	6,656	19,977	16,831
Furniture and equipment	3,710	3,199	10,616	7,937
Other expenses	20,374	20,581	63,451	69,448
Total Noninterest Expense	74,186	70,933	222,553	194,992
Income before income tax expense and noncontrolling interest	40,457	36,807	112,991	73,910
Provision for income tax expense	11,862	10,974	33,488	21,538
Net income	$ 28,595	$ 25,833	$ 79,503	$ 52,372
Net income attributable to noncontrolling interest	(1,445)	(1,657)	(4,173)	(4,118)
Net income attributable to TowneBank	$ 27,150	$ 24,176	$ 75,330	$ 48,254
Net income available to common shareholders	$ 27,150	$ 24,176	$ 75,330	$ 48,254
Per common share information				
Basic earnings	$ 0.44	$ 0.39	$ 1.21	$ 0.88
Diluted earnings	$ 0.44	$ 0.39	$ 1.21	$ 0.87
Cash dividends declared	$ 0.14	$ 0.13	$ 0.41	$ 0.38

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

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

(Dollars in thousands)	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net income	$ 28,595	$ 25,833	$ 79,503	$ 52,372
Other comprehensive income (loss)				
Unrealized gains on securities				
Unrealized holding gains (losses) arising during the period	(305)	(516)	2,428	6,294
Deferred tax benefit (expense)	106	180	(851)	(2,203)
Realized losses reclassified into earnings	—	—	1	—
Net unrealized gains (losses)	(199)	(336)	1,578	4,091
Pension and postretirement benefit plans				
Actuarial gain (loss)	143	—	(252)	109
Deferred tax benefit (expense)	(49)	—	90	(38)
Amortization of prior service costs	41	110	133	263
Deferred tax expense	(14)	(38)	(46)	(91)
Amortization of net actuarial (gain) loss	39	(2)	117	(2)
Deferred tax benefit (expense)	(14)	1	(42)	1
Change in retirement plans, net of tax	146	71	—	242
Other comprehensive income (loss), net of tax	(53)	(265)	1,578	4,333
Comprehensive income	$ 28,542	$ 25,568	$ 81,081	$ 56,705

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

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

(Dollars in thousands)	Nine Months Ended September 30, 2017	2016
OPERATING ACTIVITIES:		
Net income	$ 79,503	$ 52,372
Adjustments to reconcile net income to net cash from (used for) operating activities:		
Net amortization of securities	1,805	1,934
Investment securities loss	1	—
Depreciation, amortization, and other intangible amortization	18,451	14,573
Amortization of debt issuance costs	56	—
Provision for loan losses	4,557	3,526
Bank-owned life insurance income	(4,321)	(3,616)
Deferred income tax (benefit) expense	(1,527)	2,058
Share-based compensation expense	2,012	1,495
Originations of mortgage loans held for sale	(2,539,870)	(1,964,447)
Proceeds from sales of mortgage loans held for sale	2,621,095	1,978,432
Gain on sales of mortgage loans held for sale	(85,774)	(67,719)
Loss on sale and write-down of foreclosed assets	485	105
Changes in:		
Interest receivable	(149)	(6,178)
Other assets	3,038	29,266
Interest payable	2,696	910
Other liabilities	(14,245)	27,206
Net cash from operating activities	87,813	69,917
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(746,657)	(608,877)
Purchase of held-to-maturity securities	—	(6,062)
Sale of available-for-sale securities	306	—
Sale of FHLB stock	6,816	3,121
Proceeds from maturities, calls, and prepayments of available-for-sale securities	728,150	648,967
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	3,850	4,646
Net increase in loans	(109,325)	(327,790)
Purchase of premises and equipment	(11,211)	(16,855)
Proceeds from sales of premises and equipment	580	1,476
Proceeds from sales of foreclosed assets	5,630	12,093
Investment from noncontrolling interest in consolidated joint ventures	1,029	—
Acquisition of business, net of cash acquired	(11,469)	61,930
Net cash used for investing activities	(132,301)	(227,351)
FINANCING ACTIVITIES:		
Net change in deposit accounts	513,264	171,300
Net change in borrowings	(169,762)	(88,972)
Proceeds from issuance of subordinated debt, net of issuance costs	247,072	—
Distribution of interest in joint ventures	(5,395)	(1,706)
Proceeds from issuance of common stock	1,212	2,171
Cash dividends paid	(25,668)	(22,418)
Net cash from financing activities	560,723	60,375
Change in cash and cash equivalents	516,235	(97,059)
Cash and cash equivalents at beginning of year	136,548	251,837
Cash and cash equivalents at end of period	$ 652,783	$ 154,778
Supplemental cash flow information:		
Cash paid for interest	$ 28,487	$ 25,662
Cash paid for income taxes	$ 34,834	$ 14,592
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	$ 3,907	$ 2,449
Sales of foreclosed assets financed by the Company	$ 260	$ 4,117
Transfers from premises and equipment to foreclosed property	$ 821	$ —
Net unrealized gains on available-for-sale securities, net of tax	$ 1,578	$ 4,091
Common stock issued in connection with business acquisitions	$ —	$ 222,431
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 22	$ 6

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	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, 2017	**62,492,168**	**$ 104,174**	**$ 745,411**	**$ 229,503**	**$ 11,168**	**$ (11,168)**	**$ (3,986)**	**$ 11,456**	**$ 1,086,558**
Net income	—	—	—	75,330	—	—	—	4,173	79,503
Other comprehensive loss, net of taxes	—	—	—	—	—	—	1,578	—	1,578
Cash dividends declared on common stock	—	—	—	(25,668)	—	—	—	—	(25,668)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	1,029	1,029
Directors' deferred compensation	—	—	—	—	1,136	(1,136)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(5,395)	(5,395)
Conversion of convertible debt into common stock	1,528	2	20	—	—	—	—	—	22
Issuance of common stock - net contingent consideration earned on acquisitions	46,039	77	1,306	—	—	—	—	—	1,383
Issuance of common stock - stock compensation plans	80,122	134	1,707	—	—	—	—	—	1,841
Balance, September 30, 2017	**62,619,857**	**$ 104,387**	**$ 748,444**	**$ 279,165**	**$ 12,304**	**$ (12,304)**	**$ (2,408)**	**$ 11,263**	**$ 1,140,851**

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

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of TowneBank (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes necessary for a complete presentation of financial position, results of operations, and cash flow activity required in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments 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 2016 audited Consolidated Financial Statements and the 2016 Annual Report on Form 10-K. Results of operations for the three- and nine-month period ended September 30, 2017, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Reclassifications and Corrections

During the second quarter of 2017, the Company determined that certain purchased loans acquired in the acquisition of Monarch Financial Holdings, Inc. ("Monarch") in 2016 had revolving credit privileges in place at the time of the transaction and were incorrectly classified as purchased impaired credits. During the quarter, the Company reclassified these loans as purchased performing loans and recorded a cumulative adjustment to interest income related to the accretion of purchased loan discounts. Additionally, certain purchased impaired loans were removed from pools and accounted for using the cost recovery method. The Company assessed the materiality of the misclassifications in accordance with SEC Staff Accounting Bulletin ("SAB") No. 99, *Materiality*, codified in Accounting Standards Codification ("ASC") 250, *Presentation of Financial Statements*, and concluded that these misstatements were not material to the current year or any prior annual or interim periods. The reclassification of these purchased loans resulted in an increase in interest income of $3.89 million for the three-month period ended June 30, 2017.

To maintain consistency and comparability, certain amounts from prior periods have been reclassified to conform to current period presentation with no effect on net income or shareholders' equity as previously reported.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers*. The ASU will supersede most of the existing revenue recognition requirements in GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. The pronouncement is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period, or retrospectively with the cumulative effect of initially applying the pronouncement recognized at the date of initial application. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The amendments could potentially impact accounting procedures and processes over the recognition of certain revenue sources, including, but not limited to, non-interest income. The Company is currently evaluating the standard and the impact of these amendments, although it does not expect the amendments to have a material impact on its 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 No. 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 No. 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 cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2016, and early adoption was permitted. The Company adopted the accounting standard during the first quarter of 2017 and recognized a $0.49 million reduction in income taxes for the excess tax benefits on stock-based compensation.

In June 2016, the FASB issued No. ASU 2016-13*, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU was issued to change the accounting for credit losses and modify the impairment model for certain debt securities. The ASU is effective for the Company for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the effect that implementation of the new standard will have on its Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* The ASU was issued with the intent to simplify goodwill impairment testing by eliminating the second step of the analysis under which the implied fair value of goodwill is determined as if the reporting unit were being acquired in a business combination. The update instead requires entities to compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for any amount by which the carrying amount exceeds the reporting unit's fair value, to the extent that the loss recognized does not exceed the amount of goodwill allocated to that reporting unit. ASU 2017-04 must be applied prospectively and is effective for the Company on January 1, 2020. Early adoption is permitted. The Company does not expect the new guidance to have a material impact on its Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. The ASU shortens the amortization period for certain callable debt securities held at a premium. Specifically, the update requires the premium to be amortized to the earliest call date. The ASU does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The ASU should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the effect that implementation of the new standard will have on its Consolidated Financial Statements.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments in this update better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The ASU is effective for the Company in annual and interim periods beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of this guidance, but does not expect the guidance to have a material impact on its Consolidated Financial Statements.

Note 2. Earnings per Share and Shareholders' Equity

Earnings per share

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

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

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Basic				
Net income available to common shareholders	$ 27,150	$ 24,176	$ 75,330	$ 48,254
Weighted-average common shares outstanding	62,210,834	61,908,316	62,144,905	55,113,221
Basic earnings per common share	$ 0.44	$ 0.39	$ 1.21	$ 0.88
Diluted				
Net income available to common shareholders, for diluted EPS	$ 27,150	$ 24,176	$ 75,330	$ 48,254
Weighted-average common shares outstanding	62,210,834	61,908,316	62,144,905	55,113,221
Effect of dilutive securities:				
Stock compensation plans, net of tax benefit (1)	199,727	159,516	224,024	124,918
Weighted-average diluted shares outstanding	62,410,561	62,067,832	62,368,929	55,238,139
Diluted earnings per common share	$ 0.44	$ 0.39	$ 1.21	$ 0.87

(1) Stock options and restricted stock shares totaling 2 and 0 were excluded from the computation of diluted earnings per share during the third quarter of 2017 and 2016, respectively, and 14,306 and 91,720 were excluded from the computation of diluted earnings per share during the nine months ended September 30, 2017 and 2016, respectively, because their inclusion would be anti-dilutive.

Note 3. Investment Securities

Available-for-sale securities

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

September 30, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 297,624	$ 64	$ (1,060)	$ 296,628
U.S. Treasury notes	301,972	—	—	301,972
Municipal securities	17,630	202	(30)	17,802
Trust preferred and other corporate securities	3,491	628	—	4,119
Mortgage-backed securities issued by GSE	213,122	476	(2,636)	210,962
Total available-for-sale securities	$ 833,839	$ 1,370	$ (3,726)	$ 831,483

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 293,663	$ 102	$ (1,295)	$ 292,470
U.S. Treasury notes	251,994	9	(2)	252,001
Municipal securities	23,502	184	(134)	23,552
Trust preferred and other corporate securities	3,493	555	—	4,048
Mortgage-backed securities issued by GSE	245,106	352	(4,555)	240,903
Total available-for-sale securities	$ 817,758	$ 1,202	$ (5,986)	$ 812,974

Held-to-maturity securities

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

September 30, 2017	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Trust preferred corporate securities	$ 500	$ 223	$ —	$ 723
Municipal securities	40,847	2,227	—	43,074
Mortgage-backed securities issued by GSE	21,140	99	(341)	20,898
Total held-to-maturity securities	$ 62,487	$ 2,549	$ (341)	$ 64,695

December 31, 2016	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Trust preferred corporate securities	$ 500	$ 204	$ —	$ 704
Municipal securities	40,922	1,824	—	42,746
Mortgage-backed securities issued by GSE	25,068	122	(444)	24,746
Total held-to-maturity securities	$ 66,490	$ 2,150	$ (444)	$ 68,196

Maturities of investment securities

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and estimated fair value of investment securities are shown by contractual maturity (including mortgage-backed securities) as of September 30, 2017, and December 31, 2016, in the following table (in thousands):

September 30, 2017	**Available for Sale**		**Held to Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 361,639	$ 361,549	$ 2,025	$ 2,051
Due after one year through five years	233,601	232,722	4,939	4,987
Due after five years through 10 years	44,726	44,795	40,661	41,421
Due after 10 years	192,361	190,905	14,862	16,236
	832,327	829,971	62,487	64,695
Other equity securities	1,512	1,512	—	—
	$ 833,839	$ 831,483	$ 62,487	$ 64,695

December 31, 2016	**Available for Sale**		**Held to Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 311,908	$ 311,895	$ —	$ —
Due after one year through five years	251,962	250,690	2,881	2,967
Due after five years through 10 years	30,467	30,306	43,638	43,877
Due after 10 years	221,906	218,568	19,971	21,352
	816,243	811,459	66,490	68,196
Other equity securities	1,515	1,515	—	—
	$ 817,758	$ 812,974	$ 66,490	$ 68,196

Unrealized losses

The following table shows the Company's gross unrealized losses and fair values of available-for-sale and held-to-maturity securities, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	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	$ 131,181	$ (610)	$ 110,551	$ (450)	$ 241,732	$ (1,060)
Municipal securities	4,578	(22)	910	(8)	5,488	(30)
Mortgage-backed securities issued by GSE	166,186	(2,390)	34,344	(587)	200,530	(2,977)
Total temporarily impaired securities	$ 301,945	$ (3,022)	$ 145,805	$ (1,045)	$ 447,750	$ (4,067)

December 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	$ 241,582	$ (1,297)	$ —	$ —	$ 241,582	$ (1,297)
Municipal securities	12,176	(134)	—	—	12,176	(134)
Mortgage-backed securities issued by GSE	230,504	(4,897)	5,122	(102)	235,626	(4,999)
Total temporarily impaired securities	$ 484,262	$ (6,328)	$ 5,122	$ (102)	$ 489,384	$ (6,430)

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 September 30, 2017, 21 securities had an aggregate unrealized loss of $1.06 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on investments in municipal securities were caused by interest rate fluctuations. At September 30, 2017, nine securities had an aggregate unrealized loss of $0.03 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At September 30, 2017, 30 securities had an aggregate unrealized loss of $2.98 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 September 30, 2017.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at September 30, 2017.

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 $29.59 million and $35.94 million of FHLB stock at September 30, 2017, and December 31, 2016, 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 $44.40 million adequate to cover estimated loan losses inherent in the loan portfolio at September 30, 2017.

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

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three- and nine-month periods ended September 30, 2017 and 2016 (in thousands):

Three Months Ended September 30, 2017	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	$ 5,458	$ 16,839	$ 1,191	$ 9,096	$ 6,571	$ 4,976	$ 44,131
Provision for loan losses	(57)	128	(354)	592	215	172	696
Losses charged off	—	—	—	(377)	(192)	(146)	(715)
Recoveries	9	58	—	105	14	100	286
Balance, end of period	$ 5,410	$ 17,025	$ 837	$ 9,416	$ 6,608	$ 5,102	$ 44,398

Nine Months Ended September 30, 2017	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	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
Provision charged to expense	1,105	679	(534)	2,257	463	587	4,557
Losses charged off	—	(67)	—	(2,097)	(342)	(477)	(2,983)
Recoveries	25	165	1	206	77	349	823
Balance, end of period	$ 5,410	$ 17,025	$ 837	$ 9,416	$ 6,608	$ 5,102	$ 44,398

Three Months Ended September 30, 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	$ 4,630	$ 15,596	$ 870	$ 8,775	$ 5,846	$ 3,901	$ 39,618
Provision charged to expense	(105)	(25)	339	316	500	661	1,686
Losses charged off	(26)	—	—	(245)	(390)	(226)	(887)
Recoveries	5	14	—	146	3	70	238
Balance, end of period	$ 4,504	$ 15,585	$ 1,209	$ 8,992	$ 5,959	$ 4,406	$ 40,655

Nine Months Ended September 30, 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 charged to expense	(494)	912	263	733	567	1,545	3,526
Losses charged off	(92)	(66)	—	(1,140)	(462)	(250)	(2,010)
Recoveries	106	52	1	409	80	132	780
Balance, end of period	$ 4,504	$ 15,585	$ 1,209	$ 8,992	$ 5,959	$ 4,406	$ 40,655

The following table presents, by portfolio segment, the allocation of the allowance for loan losses at September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 37	$ 945	$ 12	$ 996	$ 64	$ 7	$ 2,061
Loans collectively evaluated for impairment	5,336	16,080	825	8,417	6,544	5,095	42,297
Loans acquired with deteriorated credit quality	37	—	—	3	—	—	40
Balance, end of period	$ 5,410	$ 17,025	$ 837	$ 9,416	$ 6,608	$ 5,102	$ 44,398
December 31, 2016							
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 61	$ 1,078	$ 13	$ 1,384	$ 71	$ 14	$ 2,621
Loans collectively evaluated for impairment	4,179	15,102	1,357	7,473	6,339	4,629	39,079
Loans acquired with deteriorated credit quality	40	68	—	193	—	—	301
Balance, end of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001

The following table presents, by portfolio segment, the Company's investment in loans at September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 2,658	$ 23,748	$ 1,153	$ 16,773	$ 3,739	$ 638	$ 48,709
Ending balance: collectively evaluated for impairment	866,856	2,250,178	168,844	1,195,322	1,080,816	216,159	5,778,175
Ending balance: loans acquired with deteriorated credit quality	11,141	29,337	15,326	27,791	—	—	83,595
Ending Balance	$ 880,655	$2,303,263	$ 185,323	$1,239,886	$ 1,084,555	$ 216,797	$5,910,479

December 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
Ending balance: individually evaluated for impairment	$ 18,923	$ 31,586	$ 1,507	$ 21,128	$ 3,247	$ 348	$ 76,739
Ending balance: collectively evaluated for impairment	797,575	2,186,027	205,551	1,163,958	1,084,620	201,381	5,639,112
Ending balance: loans acquired with deteriorated credit quality	9,529	33,699	15,733	30,737	1,672	—	91,370
Ending Balance	$ 826,027	$2,251,312	$ 222,791	$1,215,823	$ 1,089,539	$ 201,729	$5,807,221

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 changes in the accretable yield for purchased impaired loans for the nine months ended September 30, 2017 and 2016 (in thousands):

	September 30,	
	2017	2016
Balance at beginning of period	$ 40,467	$ 43,959
Additions	—	2,207
Accretion	(7,594)	(4,845)
Reclassifications from nonaccretable balance, net	4,277	3,685
Other changes, net	2,209	(2,027)
Balance at end of period	$ 39,359	$ 42,979

Portfolio quality indicators

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

The Company’s internally assigned grades are as follows:

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

- Special Mention – Loans in this category are considered to have potential weaknesses that deserve management’s attention. The borrower’s ability to repay from the primary (intended) sources is currently adequate, but threatened by potential weaknesses which may, if not corrected, result in the deterioration of 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 that jeopardizes ultimate repayment of the loan.

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

The following table represents credit exposures by internally assigned grades as of September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	**Construction and Land Development**	**Commercial Real Estate**	**Multi-Family Real Estate**	**1-4 Family Residential Real Estate**	**Commercial and Industrial Business**	**Consumer Loans and Other**	**Total**
Pass	$ 873,752	$ 2,265,512	$ 184,170	$ 1,218,655	$ 1,069,148	$ 216,159	$ 5,827,396
Special Mention	3,633	17,046	—	4,869	11,676	—	37,224
Substandard	3,270	20,705	1,153	16,362	3,731	638	45,859
Doubtful	—	—	—	—	—	—	—
Total	$ 880,655	$ 2,303,263	$ 185,323	$ 1,239,886	$ 1,084,555	$ 216,797	$ 5,910,479

December 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**
Pass	$ 802,941	$ 2,204,051	$ 221,284	$ 1,191,410	$ 1,083,798	$ 201,406	$ 5,704,890
Special Mention	5,327	16,944	—	2,405	1,866	—	26,542
Substandard	17,759	30,317	1,507	22,008	3,795	323	75,709
Doubtful	—	—	—	—	80	—	80
Total	$ 826,027	$ 2,251,312	$ 222,791	$ 1,215,823	$ 1,089,539	$ 201,729	$ 5,807,221

Age analysis of past-due financing receivables by class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of September 30, 2017, and December 31, 2016. 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):

September 30, 2017	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 348	$ —	$ —	$ 286	$ 634	$ 880,021	$ 880,655	$ —
Commercial real estate	1,700	227	—	3,308	5,235	2,298,028	2,303,263	—
Multifamily real estate	—	—	—	640	640	184,683	185,323	—
1-4 family residential real estate	2,227	48	224	3,475	5,974	1,233,912	1,239,886	—
Commercial and industrial business loans	392	—	—	707	1,099	1,083,456	1,084,555	—
Consumer loans and other	679	267	74	352	1,372	215,425	216,797	74
Total	$ 5,346	$ 542	$ 298	$ 8,768	$ 14,954	$ 5,895,525	$ 5,910,479	$ 74

December 31, 2016	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 67	$ —	$ 396	$ 696	$ 1,159	$ 824,868	$ 826,027	$ —
Commercial real estate	2,133	1,354	19	5,110	8,616	2,242,696	2,251,312	—
Multifamily real estate	—	—	—	690	690	222,101	222,791	—
1-4 family residential real estate	5,170	77	1,157	6,113	12,517	1,203,306	1,215,823	—
Commercial and industrial business loans	792	75	4	362	1,233	1,088,306	1,089,539	—
Consumer loans and other	678	113	76	128	995	200,734	201,729	76
Total	$ 8,840	$ 1,619	$ 1,652	$ 13,099	$ 25,210	$ 5,782,011	$ 5,807,221	$ 76

The following table includes an aging analysis of the recorded investment of purchased impaired loans as of September 30, 2017, and December 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
September 30, 2017						
Construction and land development	$ —	$ —	$ —	$ —	$ 11,141	$ 11,141
Commercial real estate	—	—	—	—	29,337	29,337
Multifamily real estate	—	—	—	—	15,326	15,326
1-4 family residential real estate	209	—	224	433	27,358	27,791
Commercial and industrial business loans	—	—	—	—	—	—
Consumer loans and other	—	—	—	—	—	—
Total	$ 209	$ —	$ 224	$ 433	$ 83,162	$ 83,595

	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
December 31, 2016						
Construction and land development	$ —	$ —	$ 396	$ 396	$ 9,133	$ 9,529
Commercial real estate	—	346	19	365	33,334	33,699
Multifamily real estate	—	—	—	—	15,733	15,733
1-4 family residential real estate	902	—	1,158	2,060	28,678	30,738
Commercial and industrial business loans	205	75	4	284	1,387	1,671
Consumer loans and other	—	—	—	—	—	—
Total	$ 1,107	$ 421	$ 1,577	$ 3,105	$ 88,265	$ 91,370

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 $1,000,000) 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 $4.56 million in excess of deferred loan costs at September 30, 2017, $3.78 million at September 30, 2016, and $4.02 million at December 31, 2016. There were $8.77 million, $11.34 million, and $13.10 million in nonaccrual loans at September 30, 2017, September 30, 2016, and December 31, 2016, respectively. The Company would have earned $33,000 in third quarter 2017 if interest on the loans had been accrued.

The following tables include the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable, as of September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ —	$ —	$ —	$ —	$ —
Commercial real estate	12,850	12,629	—	12,959	534
Multifamily real estate	513	513	—	531	30
1-4 family residential real estate	3,868	3,604	—	4,000	126
Commercial and industrial business loans	1,726	1,546	—	1,845	77
Consumer loans and other	—	—	—	—	—
Total	$ 18,957	$ 18,292	$ —	$ 19,335	$ 767
Loans with a specific valuation allowance					
Construction and land development	$ 3,024	$ 2,658	$ 37	$ 3,048	$ 95
Commercial real estate	11,198	11,119	945	12,316	429
Multifamily real estate	723	640	12	729	33
1-4 family residential real estate	13,375	13,169	996	13,613	505
Commercial and industrial business loans	2,295	2,193	64	2,518	92
Consumer loans and other	666	638	7	811	24
Total	$ 31,281	$ 30,417	$ 2,061	$ 33,035	$ 1,178
Total impaired loans					
Construction and land development	$ 3,024	$ 2,658	$ 37	$ 3,048	$ 95
Commercial real estate	24,048	23,748	945	25,275	963
Multifamily real estate	1,236	1,153	12	1,260	63
1-4 family residential real estate	17,243	16,773	996	17,613	631
Commercial and industrial business loans	4,021	3,739	64	4,363	169
Consumer loans and other	666	638	7	811	24
Total	$ 50,238	$ 48,709	$ 2,061	$ 52,370	$ 1,945

Note: Included in the table above are accruing TDRs of $22.28 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $4.85 million.

December 31, 2016	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 15,933	$ 15,842	$ —	$ 16,454	$ 808
Commercial real estate	18,495	18,251	—	20,024	1,006
Multifamily real estate	1,288	1,239	—	1,313	69
1-4 family residential real estate	7,569	7,445	—	7,711	323
Commercial and industrial business loans	1,892	1,749	—	1,904	106
Consumer loans and other	—	—	—	—	—
Total	$ 45,177	$ 44,526	$ —	$ 47,406	$ 2,312
Loans with a specific valuation allowance					
Construction and land development	$ 3,431	$ 3,082	$ 61	$ 3,459	$ 146
Commercial real estate	13,533	13,336	1,078	13,742	692
Multifamily real estate	268	268	13	274	15
1-4 family residential real estate	14,084	13,682	1,384	14,322	642
Commercial and industrial business loans	1,579	1,497	71	1,867	97
Consumer loans and other	351	348	14	392	16
Total	$ 33,246	$ 32,213	$ 2,621	$ 34,056	$ 1,608
Total impaired loans					
Construction and land development	$ 19,364	$ 18,924	$ 61	$ 19,913	$ 954
Commercial real estate	32,028	31,587	1,078	33,766	1,698
Multifamily real estate	1,556	1,507	13	1,587	84
1-4 family residential real estate	21,653	21,127	1,384	22,033	965
Commercial and industrial business loans	3,471	3,246	71	3,771	203
Consumer loans and other	351	348	14	392	16
Total	$ 78,423	$ 76,739	$ 2,621	$ 81,462	$ 3,920

Note: Included in the table above are accruing TDRs of $31.35 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $6.10 million.

Troubled debt restructurings

In order to maximize the collection of loan balances, the Company evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: (1) a creditor has granted a concession to the debtor, and (2) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. 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 and nine months ended September 30, 2017 and 2016 (in thousands, except number of loans):

	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	—	$ —	$ —	—	$ —	$ —
Commercial real estate	—	—	—	—	—	—
Multifamily real estate	—	—	—	—	—	—
1-4 family residential real estate	1	20	20	1	20	20
Commercial and industrial	—	—	—	1	14	13
Consumer loans and other	—	—	—	—	—	—
Total	1	$ 20	$ 20	2	$ 34	$ 33

	Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	—	$ —	$ —	1	$ 150	$ 148
Commercial real estate	2	587	587	5	4,820	4,817
Multifamily real estate	—	—	—	—	—	—
1-4 family residential real estate	—	—	—	3	827	822
Commercial and industrial	—	—	—	—	—	—
Consumer loans and other	—	—	—	1	25	25
Total	2	$ 587	$ 587	10	$ 5,822	$ 5,812

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 three commercial loans, which totaled $0.27 million, that were restructured within the last 12 months and subsequently defaulted.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At September 30, 2017, the large majority of significant impaired loans have been determined to be collateral-dependent.

Nonaccrual loans

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

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

The table below presents a summary of activity related to OREO for the three- and nine-month periods ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Beginning balance	$ 26,047	$ 25,707	$ 24,505	$ 34,420
Additions and capital improvements	822	1,600	6,171	5,012
Franklin merger	—	—	—	(234)
Sales	(2,420)	(4,113)	(5,889)	(16,209)
Net change in valuation allowance	—	—	86	(90)
Loss on sale and write-downs, net	(147)	(310)	(571)	(15)
Transfer from premises and equipment	821	—	821	—
Ending balance	$ 25,123	$ 22,884	$ 25,123	$ 22,884

As of September 30, 2017, the Company's recorded investment in OREO collateralized by residential real estate was $4.84 million. As of September 30, 2017, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $0.38 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; Towne Center Mortgage, LLC; Towne First Mortgage, LLC; Advance Financial Group, LLC; Coastal Home Mortgage, LLC; NewTowne Mortgage, LLC; Homesale Mortgage, LLC; Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head; Towne Vacations Deep Creek, LLC, d/b/a Railey Mountain Vacations; 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 Agency, LLC, and Towne Benefits.

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

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

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

Three Months Ended September 30, 2017	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 63,094	$ 2,829	$ —	$ 65,923
Provision for loan losses	696	—	—	696
Net interest income after provision for loan losses	62,398	2,829	—	65,227
Residential mortgage banking income, net	(109)	19,196	—	19,087
Insurance commissions and other title fees and income, net	114	509	11,493	12,116
Real estate brokerage and property management income, net	—	10,042	—	10,042
Other noninterest income	7,312	627	232	8,171
Noninterest expense	38,547	26,187	9,452	74,186
Income before income tax, corporate allocation and noncontrolling interest	31,168	7,016	2,273	40,457
Corporate allocation	400	(267)	(133)	—
Income before income tax provision and noncontrolling interest	31,568	6,749	2,140	40,457
Provision for income tax expense	9,002	2,115	745	11,862
Net income	22,566	4,634	1,395	28,595
Noncontrolling interest	3	(1,189)	(259)	(1,445)
Net income attributable to TowneBank	$ 22,569	$ 3,445	$ 1,136	$ 27,150
Net income as percentage of total	83.13%	12.69%	4.18%	100.00%
Total assets	$ 7,920,496	$ 513,938	$ 180,360	$ 8,614,794

Three Months Ended September 30, 2016	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 58,919	$ 3,686	$ —	$ 62,605
Provision for loan losses	1,686	—	—	1,686
Net interest income after provision for loan losses	57,233	3,686	—	60,919
Residential mortgage banking income, net	(262)	21,692	—	21,430
Insurance commissions and other title fees and income, net	191	562	10,505	11,258
Real estate brokerage and property management income, net	—	6,647	—	6,647
Other noninterest income	6,689	562	235	7,486
Noninterest expense	38,671	23,766	8,496	70,933
Income before income tax, corporate allocation and noncontrolling interest	25,180	9,383	2,244	36,807
Corporate allocation	439	(278)	(161)	—
Income before income tax provision and noncontrolling interest	25,619	9,105	2,083	36,807
Provision for income tax expense	7,325	2,921	728	10,974
Net income	18,294	6,184	1,355	25,833
Noncontrolling interest	(18)	(1,369)	(270)	(1,657)
Net income attributable to TowneBank	$ 18,276	$ 4,815	$ 1,085	$ 24,176
Net income as percentage of total	75.60%	19.92%	4.48%	100.00%
Total assets	$ 7,076,311	$ 597,486	$ 156,345	$ 7,830,142

Nine Months Ended September 30, 2017	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 187,972	$ 7,484	$ —	$ 195,456
Provision for loan losses	4,557	—	—	4,557
Net interest income after provision for loan losses	183,415	7,484	—	190,899
Residential mortgage banking income, net	(387)	58,701	—	58,314
Insurance commissions and other title fees and income, net	350	1,446	38,022	39,818
Real estate brokerage and property management income, net	—	22,664	—	22,664
Other noninterest income	21,354	1,776	719	23,849
Noninterest expense	118,870	75,965	27,718	222,553
Income before income tax, corporate allocation and noncontrolling interest	85,862	16,106	11,023	112,991
Corporate allocation	1,295	(841)	(454)	—
Income before income tax provision and noncontrolling interest	87,157	15,265	10,569	112,991
Provision for income tax expense	25,074	4,631	3,783	33,488
Net income	62,083	10,634	6,786	79,503
Noncontrolling interest	—	(3,061)	(1,112)	(4,173)
Net income attributable to TowneBank	$ 62,083	$ 7,573	$ 5,674	$ 75,330
Net income as percentage of total	82.42%	10.05%	7.53%	100.00%
Total assets	$ 7,920,496	$ 513,938	$ 180,360	$ 8,614,794

Nine Months Ended September 30, 2016	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 151,630	$ 5,094	$ —	$ 156,724
Provision for loan losses	3,526	—	—	3,526
Net interest income after provision for loan losses	148,104	5,094	—	153,198
Residential mortgage banking income, net	(796)	41,492	—	40,696
Insurance commissions and other title fees and income, net	191	1,461	35,266	36,918
Real estate brokerage and property management income, net	—	17,591	—	17,591
Other noninterest income	18,367	1,464	668	20,499
Noninterest expense	120,828	48,095	26,069	194,992
Income before income tax, corporate allocation and noncontrolling interest	45,038	19,007	9,865	73,910
Corporate allocation	1,054	(570)	(484)	—
Income before income tax provision and noncontrolling interest	46,092	18,437	9,381	73,910
Provision for income tax expense	12,377	5,829	3,332	21,538
Net income	33,715	12,608	6,049	52,372
Noncontrolling interest	(18)	(2,994)	(1,106)	(4,118)
Net income attributable to TowneBank	$ 33,697	$ 9,614	$ 4,943	$ 48,254
Net income as percentage of total	69.83%	19.92%	10.25%	100.00%
Total assets	$ 7,076,311	$ 597,486	$ 156,345	$ 7,830,142

Note 7. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers, provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2017, the amounts of off-balance sheet commitments to extend credit were $2.13 billion.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At September 30, 2017, standby letters of credit and financial guarantees were $82.78 million.

Additionally, the Company had $62.10 million in mortgage loans sold to investors with various recourse and warranty provisions as of September 30, 2017.

Note 8. Mergers and Acquisitions

W.A. Moore & Company: Effective August 1, 2017, the Company acquired W.A. Moore & Company, an independent insurance agency, which was merged with the operations of Towne Insurance Agency, LLC, a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. Such fair values were preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing August 1, 2017. The total purchase price for the transaction was $4.14 million in cash, common stock, and contingent common stock. The allocation of the purchase price resulted in tangible assets of $0.39 million, assumed liabilities of $0.48 million, goodwill of $2.66 million, and other intangible assets including customer lists of $1.57 million.

Railey Mountain Lake Vacations, LLC: Effective April 11, 2017, the Company acquired Railey Mountain Lake Vacations, LLC, an independent resort property management company that was merged with the operations of Towne Vacations Deep Creek, 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. Such fair values were preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing April 11, 2017. The purchase price for the transaction was $8.93 million in cash. The allocation of the purchase price resulted in tangible assets of $6.36 million, assumed liabilities of $5.79 million, goodwill of $3.34 million, and other intangible assets of $5.02 million.

Paragon Commercial Corporation: On April 27, 2017, the Company announced the signing of a definitive agreement and plan of reorganization, dated April 26, 2017 (the "Paragon merger agreement"), pursuant to which the Company will acquire Paragon Commercial Corporation ("Paragon"), and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices servicing Raleigh, Cary, and Charlotte, North Carolina. The proposed acquisition of Paragon and Paragon Commercial Bank has been approved by the Boards of Directors of TowneBank, Paragon, and Paragon Commercial Bank and is expected to close in the first quarter of 2018, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of Paragon's shareholders. At June 30, 2017, Paragon had total assets of $1.64 billion, gross loans of $1.34 billion, and total deposits of $1.17 billion.

Under the terms of the Paragon merger agreement, Paragon shareholders will receive 1.725 shares of the Company's common stock for each share of Paragon common stock held immediately prior to the effective date of the merger. As a result of the merger, unexercised Paragon stock options, whether or not vested, will be converted into replacement option awards of TowneBank on the same terms and conditions applicable to Paragon stock options, as adjusted based on the 1.725 exchange ratio. Similarly, restricted stock awards will be converted into replacement restricted stock awards of TowneBank on the same terms and conditions applicable to the Paragon restricted stock awards, adjusted based on the 1.725 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.

Monarch Financial Holdings: Effective June 24, 2016, the Company completed its acquisition of Monarch Financial Holdings, Inc. ("Monarch"), and its wholly owned bank subsidiary, Monarch Bank, which were merged with and into TowneBank.

In the merger with Monarch, each outstanding share of common stock of Monarch was converted into 0.8830 shares of TowneBank common stock. TowneBank issued an aggregate of 10.49 million shares of TowneBank common stock to Monarch stockholders. Based on the closing price of TowneBank's common stock on June 24, 2016, of $21.21 per share, the aggregate consideration paid to Monarch common stockholders to acquire Monarch common stock was approximately $222.44 million.

Monarch Bank had 12 branches, of which 11 branches were closed and one branch was re-opened on June 27, 2016, as a TowneBank branch. The integration of Monarch Bank's deposit system and the conversion of the re-opened Monarch Bank branch to TowneBank's operating platform were completed over the weekend of June 25-26, 2016.

The Monarch 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 June 24, 2016, merger date. Such fair values were preliminary estimates and were subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. Application of the acquisition method of accounting resulted in goodwill of approximately $108.05 million. All of the recognized goodwill is expected to be nondeductible for tax purposes.

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The following table presents the estimated fair values of the assets acquired and liabilities assumed for Monarch as of June 24, 2016 (dollars in thousands):

Fair value of assets acquired:		
Cash and cash equivalents	$	67,457
Securities available for sale		20,818
Loans held for sale		283,528
Loans held for investment		808,137
Bank premise and equipment		23,998
Intangible assets		13,210
Other assets		62,427
Total assets	$	1,279,575
Fair value of liabilities assumed:		
Deposits	$	1,061,620
Total borrowings		82,046
Other liabilities		21,513
Total liabilities	$	1,165,179
Net identifiable assets acquired		114,396
Goodwill		108,048
Net assets acquired	$	222,444
Purchase price:		
Company common shares issued		10,487,069
Purchase price per share of Company’s common stock	$	21.21
Common stock issued	$	222,431
Cash exchanged for fractional shares		13
Fair value of total consideration transferred	$	222,444

During the year ended December 31, 2016, adjustments were made to the purchase price allocations that resulted in a decrease to the initial fair value estimate of loans of $9.98 million, an increase in deferred tax assets of $3.37 million, and a decrease in acquired net assets of $0.83 million resulting from adjustments to other assets and liabilities. The Company made these measurement period adjustments to reflect facts and circumstances that existed as of the merger date and did not result from intervening events subsequent to such date. The revised fair value estimates resulted in an increase to goodwill of $7.44 million. As of December 31, 2016, the Company finalized its valuation of all assets and liabilities acquired.

The loans acquired in the Monarch merger were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 (purchased impaired), and loans that do not meet this criteria, which are accounted for under ASC 310-20 (purchased performing). As of June 24, 2016, as revised for measurement period adjustments, the estimated fair value of the Monarch purchased performing loans acquired was $793.10 million, the related gross contractual amount was $917.34 million, and the estimated contractual cash flows not expected to be collected were $7.33 million.

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

Contractual principal and interest at acquisition	$	36,510
Nonaccretable difference		(19,264)
Expected cash flows at acquisition		17,246
Accretable yield		(2,207)
Estimated fair value of loans acquired with a deterioration of credit quality	$	15,039

The following table presents unaudited pro forma results of operations for the comparative periods presented as if the Monarch acquisition had been completed on January 1, 2015. The pro forma results of operations include the historical accounts of the Company and Monarch, and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. Pro forma earnings were adjusted to exclude $0.97 million and $18.44 million of acquisition-related expenses for the three- and nine-month periods ended September 30, 2016. The pro forma information is intended for informational purposes only and is not necessarily indicative of our future operating results, or operating results that would have occurred had the Monarch acquisition been completed at the beginning of 2015. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies, or asset dispositions.

(in thousands)	Pro Forma for the Three Months Ended September 30, 2016		Pro Forma for the Nine Months Ended September 30, 2016	
Revenues (net interest income plus noninterest income)	$	107,685	$	339,741
Net income	$	23,751	$	63,185

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 $5.52 million in cash. The allocation of the purchase price resulted in tangible assets of $0.36 million, goodwill of $1.58 million, and other intangible assets of $3.58 million.

Note 9. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually, or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 7 – Goodwill and Intangible Assets* of the 2016 Annual Report to the Stockholders for more information on the Company's goodwill and other intangibles. The following table presents the gross carrying amount and accumulated amortization for the Company's intangible assets as of the dates indicated (in thousands):

	September 30,					
	2017		2016		December 31, 2016	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	$ 9,818	$ 3,578	$ 9,818	$ 1,196	$ 9,818	$ 1,827
Non-compete agreements	1,693	755	2,201	1,325	2,201	1,407
Customer lists	47,369	19,380	43,291	16,326	43,291	17,493
Trade name	211	201	211	158	211	169
Total intangible assets subject to amortization	59,091	23,914	55,521	19,005	55,521	20,896
Contractual agreements	4,574	—	3,231	—	3,231	—
Total intangible assets not subject to amortization	4,574	—	3,231	—	3,231	—
Total intangible assets	$ 63,665	$ 23,914	$ 58,752	$ 19,005	$ 58,752	$ 20,896

Amortization expense for intangible assets was $1.95 million and $1.92 million for the three-month periods, and $5.82 million and $4.11 million for the nine-month periods ended September 30, 2017 and 2016, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2016, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2016	$ 194,913	$ 23,495	$ 46,502	$ 264,910
Additions to goodwill	—	3,336	2,655	5,991
Other adjustments	—	—	—	—
Balance, September 30, 2017	$ 194,913	$ 26,831	$ 49,157	$ 270,901

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies (“BOLI”) as of September 30, 2017, was $193.82 million. The Company had $163.39 million and $189.50 million of BOLI as of September 30, 2016, and December 31, 2016, respectively. The Company recognized BOLI income, included in other noninterest income, of $1.43 million and $1.26 million for the three-month periods, and $4.32 million and $3.62 million for the nine-month periods ended September 30, 2017 and 2016, 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.

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 September 30,		Three Months Ended September 30,	
	2017	2016	2017	2016
Service cost	$ 573	$ 689	$ 12	$ (11)
Interest cost	310	292	4	(4)
Amortization of prior service costs	41	38	—	—
Amortization of actuarial (gain) loss	37	14	2	(15)
Net periodic postretirement benefit cost	$ 961	$ 1,033	$ 18	$ (30)

	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Service cost	$ 1,780	$ 1,579	$ (22)	$ 19
Interest cost	907	799	21	12
Amortization of prior service costs	133	114	—	—
Amortization of actuarial (gain) loss	111	52	6	(45)
Net periodic postretirement benefit cost	$ 2,931	$ 2,544	$ 5	$ (14)

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2017 and 2016 (in thousands), and changes in the nine months then ended. The amounts reclassified from accumulated other comprehensive income ("AOCI") 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 AOCI 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, 2016	$ (3,109)	$ (877)	$ (3,986)
Other comprehensive income before reclassifications	1,577	(162)	1,415
Amounts reclassified from AOCI	1	162	163
Net change	1,578	—	1,578
Balance, September 30, 2017	$ (1,531)	$ (877)	$ (2,408)

	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	4,091	71	4,162
Amounts reclassified from AOCI	—	171	171
Net change	4,091	242	4,333
Balance, September 30, 2016	$ 2,286	$ (947)	$ 1,339

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

Note 13. Other Expenses

The following table shows a summary of other expenses for the three- and nine-month periods ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Advertising and marketing	$ 2,019	$ 2,327	$ 7,650	$ 6,207
Acquisition-related expenses	466	969	1,743	19,817
Other	3,047	3,040	9,086	6,258
Charitable contributions	1,491	1,045	4,579	3,466
Outside processing	1,952	1,931	5,395	4,723
Professional fees	1,281	1,220	4,581	3,830
Stationery and supplies	678	890	2,074	2,030
FDIC and other insurance	1,129	1,352	3,398	3,624
Foreclosed property expenses	208	157	484	727
Software expense	1,984	1,904	6,283	5,064
Telephone and postage	1,743	1,758	5,195	4,171
Amortization-intangibles	1,953	1,920	5,822	4,112
Bank franchise tax/SCC fees	1,349	1,151	3,834	3,032
Directors fees and expenses	478	385	1,247	985
Travel/meals/entertainment	596	532	2,080	1,402
Total other expenses	$ 20,374	$ 20,581	$ 63,451	$ 69,448

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.

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 that 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 $91.46 million, $84.76 million, and $92.44 million were not included in the Consolidated Balance Sheets at September 30, 2017, September 30, 2016, and December 31, 2016, respectively. These limited partner interests had carrying values of $18.84 million, $14.95 million, and $14.94 million at September 30, 2017, September 30, 2016, and December 31, 2016, 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 $18.98 million, $21.04 million, and $21.02 million at September 30, 2017, September 30, 2016, and December 31, 2016, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments, along with $0.14 million of loans to the entities at September 30, 2017. As of September 30, 2017, the Company had $20.27 million in funding commitments that are dependent on certain contractual milestones and $0.14 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the three- and nine-month periods ended September 30, 2017, tax benefits totaling $0.40 million and $1.35 million, net of amortization expenses of $0.99 million and $3.37 million, respectively, were recognized as a component of income tax expense.

Note 15. Fair Value Disclosures

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

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

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

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

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

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

Derivative Financial Instruments: 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 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 September 30, 2017 and 2016, and the year ended December 31, 2016, the Company used weighted average fall-out rates of 17.14%, 18.80%, and 17.99%, respectively.

To mitigate the effect of the interest rate risk inherent in providing rate lock commitments to borrowers, the Company enters into either a forward sales contract to sell loans to investors when using best efforts or a "to be announced" ("TBA") mortgage-backed security under mandatory delivery. The forward sales contracts lock in a price for the sale of loans with similar characteristics to the specific rate lock commitments. The Company has not formally designated these derivatives as a qualifying hedge relationship; accordingly, changes to fair value are recorded to earnings each period. These valuations fall into a Level 2 category.

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2017, and December 31, 2016 (in thousands):

	September 30, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
U.S. agency securities	$ —	$ 296,628	$ —	$ 296,628
U.S. Treasury notes	—	301,972	—	301,972
Municipal securities	—	17,802	—	17,802
Mortgage-backed securities issued by GSEs	—	210,962	—	210,962
Trust preferred and other corporate securities	—	4,119	—	4,119
Derivative assets	—	312	3,027	3,339
Derivative liabilities	—	188	—	188

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 292,470	$ —	$ 292,470
U.S. Treasury notes	—	252,001	—	252,001
Municipal securities	—	23,552	—	23,552
Mortgage-backed securities issued by GSEs	—	240,903	—	240,903
Trust preferred and other corporate securities	—	4,048	—	4,048
Derivative assets	—	1,547	2,282	3,829
Derivative liabilities	—	647	—	647

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at September 30, 2017, and December 31, 2016 (in thousands):

September 30, 2017	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ —	$ —	$ 8,676	$ 8,676
Other real estate owned and other nonperforming assets	—	—	25,123	25,123

December 31, 2016	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ —	$ —	$ 12,097	$ 12,097
Other real estate owned and other nonperforming assets	—	—	24,505	24,505

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

Loans: Impaired loans for which repayment of the loan is expected to be provided solely by the value of the underlying collateral are considered collateral-dependent and are valued based on the fair value of such collateral. Collateral values are estimated using inputs based on observable market data or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically, discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 2% to 33%, with a weighted average of 14.19%.

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 measured at fair value on a nonrecurring basis (upon initial recognition or subsequent impairment) and is classified within Level 3 of the valuation hierarchy. When transferred from the loan portfolio, other real estate is adjusted to fair value less estimated selling costs and is subsequently carried at the lower of carrying value or fair value less estimated selling costs. The fair value is generally determined using an external appraisal process and is discounted based on internal criteria when deemed necessary. At September 30, 2017, one property included in foreclosed assets was valued using a management-applied discount to the appraisal of 5.86%.

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 approximates the carrying amount payable on demand. 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.

Subordinated debt: The fair value of subordinated debt is determined using the discounted cash flow method that considers current offering rates for debt with similar characteristics.

Repurchase agreements: The fair value of securities sold under agreements to repurchase is calculated using discounted cash flows, applying discount rates based on market yield curve rates for similar maturities.

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

The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of September 30, 2017, and December 31, 2016, are as follows (in thousands):

September 30, 2017	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 647,728	$ 647,728	$ 647,728	$ —	$ —
Interest-bearing deposits in financial institutions	5,055	5,055	5,055	—	—
Securities available for sale	831,483	831,483	—	831,483	—
Securities held to maturity	62,487	64,695	—	64,695	—
Mortgage loans held for sale	318,595	318,865	—	318,865	—
Net loans	5,910,479	5,937,812	—	—	5,937,812
Interest receivable	20,437	20,437	—	20,437	—
Non-maturity deposits	4,666,541	4,666,541	—	4,666,541	—
Time deposits	1,881,921	1,871,838	—	1,871,838	—
Advances from the Federal Home Loan Bank of Atlanta	527,072	523,973	—	523,973	—
Subordinated debt	247,128	255,900	—	255,900	—
Repurchase agreements and other borrowings	23,195	23,198	—	23,198	—
Interest payable	6,249	6,249	—	6,249	—

December 31, 2016	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 130,967	$ 130,967	$ 130,967	$ —	$ —
Interest-bearing deposits in financial institutions	5,581	5,581	5,581	—	—
Securities available for sale	812,974	812,974	—	812,974	—
Securities held to maturity	66,490	68,196	—	68,196	—
Mortgage loans held for sale	314,046	314,338	—	314,338	—
Net loans	5,807,221	5,828,335	—	—	5,828,335
Interest receivable	20,288	20,288	—	20,288	—
Non-maturity deposits	4,411,835	4,411,835	—	4,411,835	—
Time deposits	1,623,362	1,611,537	—	1,611,537	—
Advances from the Federal Home Loan Bank of Atlanta	687,511	687,100	—	687,100	—
Repurchase agreements and other borrowings	32,540	32,543	—	32,543	—
Interest payable	3,320	3,320	—	3,320	—

Note 16. Derivative Instruments and Hedging Activities

The Company enters into rate lock commitments with its mortgage customers. The Company is also a party to forward mortgage loan sales contracts to sell loans servicing released and sales of TBA mortgage-backed securities. When the interest rate is locked with the borrower, the rate lock commitment, forward sale agreement, and mortgage-backed security position are undesignated derivatives and marked to fair value through earnings. The fair value of the rate lock derivative is based on quoted prices for similar loans in the secondary market adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. Both the rate lock commitment and the corresponding forward sales contracts are considered derivatives, but are not accounted for using hedge accounting. As such, changes in the estimated fair value of the derivatives during the commitment period are recorded in current earnings and included in net residential mortgage banking income in the Consolidated Statements of Income.

We also participate in a "mandatory" delivery program for mortgage loans. Under the mandatory delivery system, loans with interest rate locks are paired with the sale of a TBA mortgage-backed security bearing similar attributes. Under the mandatory delivery program, we commit to deliver loans to an investor at an agreed-upon price upon the closing of such loans. This differs from a "best efforts" delivery, which sets the sale price with the investor on a loan-by-loan basis at the time each loan is locked with the respective borrower.

The following table reflects the amount and market value of mortgage banking derivatives included in the Consolidated Balance Sheets (in thousands):

	September 30, 2017		December 31, 2016	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 37,945	$ 58	$ 14,923	$ 78
Interest rate lock commitments	288,979	3,027	215,166	2,282
TBA mortgage-backed securities	85,000	254	73,500	1,469
Total included in other assets		$ 3,339		$ 3,829
Included in other liabilities:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 64,245	$ 186	$ 29,881	$ 647
TBA mortgage-backed securities	5,500	2	—	—
Total included in other liabilities		$ 188		$ 647

The following table indicates the gain or loss recognized in income on derivatives for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest rate lock commitments	$ (176)	$ (1,249)	$ 746	$ (509)
Forward sales contracts	124	116	86	443
	$ (52)	$ (1,133)	$ 832	$ (66)

Note 17. 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, therefore, are accounted for as a secured borrowing. Mortgage-backed securities and U.S. government agency securities with a total carrying value of $38.87 million at September 30, 2017, and $42.01 million at December 31, 2016, were pledged as collateral for these secured transactions. The pledged securities are held in safekeeping at the FHLB. Due to the overnight, short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily.

Note 18. Subordinated Debt Offering

On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027 in a public offering. The Company received $247.07 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.550%. The Company may redeem the subordinated notes in whole or in part, on or after July 30, 2022. The subordinated notes are unsecured obligations subordinated in right of payment to all of the Company's existing and future senior indebtedness, whether secured or unsecured, including claims of depositors and general creditors, and rank equally in right of payment with any unsecured, subordinated indebtedness that the Company may incur in the future that rank equally with the subordinated notes. At September 30, 2017, the carrying value of the notes totaled $247.13 million.

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2017	Second Quarter 2017	First Quarter 2017	Fourth Quarter 2016	Third Quarter 2016
Results of Operations:					
Interest income	$ 77,871	$ 78,681	$ 70,087	$ 71,818	$ 71,823
Interest expense	11,948	9,428	9,806	9,667	9,218
Net interest income	65,923	69,253	60,281	62,151	62,605
Provision for loan losses	696	1,320	2,541	1,831	1,686
Net interest income after provision for loan losses	65,227	67,933	57,740	60,320	60,919
Noninterest income:					
Residential mortgage banking income, net	19,087	21,594	17,632	18,096	21,430
Insurance commissions and other title fees and income, net	12,116	12,902	14,800	9,823	11,258
Real estate brokerage and property management income, net	10,042	7,629	4,993	2,925	6,647
Service charges on deposit accounts	2,670	2,644	2,472	2,535	2,552
Credit card merchant fees, net	1,388	1,298	1,118	1,135	1,365
Bank-owned life insurance	1,425	1,421	1,474	2,377	1,264
Other income	2,688	2,856	2,397	2,621	2,305
Gain (loss) on investment securities	—	(1)	—	6	—
Total noninterest income	49,416	50,343	44,886	39,518	46,821
Noninterest expense:					
Salaries and benefits	43,467	44,834	40,208	43,071	40,497
Occupancy expense	6,635	6,658	6,684	6,885	6,656
Furniture and equipment	3,710	3,563	3,343	3,378	3,199
Other expenses	20,374	23,064	20,013	19,500	20,581
Total noninterest expense	74,186	78,119	70,248	72,834	70,933
Income before noncontrolling interest and income tax	40,457	40,157	32,378	27,004	36,807
Provision for income tax expense	11,862	12,240	9,386	7,160	10,974
Net income	28,595	27,917	22,992	19,844	25,833
Net income attributable to noncontrolling interest	(1,445)	(1,704)	(1,024)	(848)	(1,657)
Net income attributable to TowneBank	$ 27,150	$ 26,213	$ 21,968	$ 18,996	$ 24,176
Net income available to common shareholders	$ 27,150	$ 26,213	$ 21,968	$ 18,996	$ 24,176

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2017	Second Quarter 2017	First Quarter 2017	Fourth Quarter 2016	Third Quarter 2016
Per Share Data:					
Net income:					
Basic	$ 0.44	$ 0.42	$ 0.35	$ 0.31	$ 0.39
Diluted	0.44	0.42	0.35	0.31	0.39
Book value at period end	18.04	17.74	17.42	17.20	17.11
Tangible book value at period end	13.08	12.81	12.59	12.36	12.23
Cash dividends declared	0.14	0.14	0.13	0.13	0.13
Common Stock Closing Price:					
High	33.50	34.35	33.50	34.10	24.03
Low	29.50	29.00	30.60	23.83	21.66
Close	33.50	30.80	32.40	33.25	24.03
Selected Financial Ratios (annualized):					
Return on average assets	1.26%	1.29%	1.11%	0.95%	1.20%
Return on average tangible assets	1.37%	1.40%	1.22%	1.05%	1.32%
Return on average equity	9.49%	9.43%	8.15%	6.95%	8.95%
Return on average tangible equity	13.67%	13.67%	11.88%	10.27%	13.09%
Net interest margin (tax-equivalent basis)	3.43%	3.84%	3.45%	3.52%	3.55%
Daily Averages:					
Total assets	$ 8,570,019	$ 8,180,959	$ 8,000,366	$ 7,965,438	$ 7,991,213
Total tangible assets	8,259,587	7,873,036	7,698,310	7,661,845	7,689,122
Loans, net of unearned income, excluding nonaccrual loans	5,897,169	5,926,336	5,862,799	5,705,832	5,583,711
Total earning assets	7,710,245	7,318,667	7,177,697	7,125,739	7,088,493
Total deposits	6,539,740	6,268,138	6,059,996	6,099,708	6,178,341
FHLB advances	609,939	527,219	723,506	628,272	479,660
Total equity	1,135,218	1,115,008	1,093,490	1,087,382	1,075,023
Tangible equity	824,787	807,085	791,433	783,789	772,932
Basic weighted average shares outstanding	62,210,834	62,145,045	62,075,983	61,963,948	61,908,316
Diluted weighted average shares outstanding	62,410,591	62,364,260	62,262,789	62,175,705	62,067,832

PART I. FINANCIAL INFORMATION

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2016 audited Consolidated Financial Statements included in our 2016 Annual Report to Stockholders and our 2016 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 (including the pending acquisition of Paragon Commercial Corporation), competitive and legislative or regulatory factors, and other factors described in our 2016 Annual Report on Form 10-K and Quarterly Report on Form 10-Q for the quarter ended March 31, 2017 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.

PART I. FINANCIAL INFORMATION

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

The following is a summary of the Company's financial performance in the quarter ended September 30, 2017:

- Net income for the three months ended September 30, 2017, was $27.15 million, or $0.44 per common diluted share, compared with $24.18 million, or $0.39 per common diluted share, in the same period in 2016. Net income for the nine months ended September 30, 2017, was $75.33 million, or $1.21 per common diluted share, compared with $48.25 million, or $0.87 per common diluted share, in the same period in 2016.

- Net interest income increased $3.32 million, or 5.30%, in third quarter 2017 from the comparable period in 2016. The increase was primarily due to an increase in income from loans held for investment and interest-bearing deposits.

- The provision for loan losses decreased $0.99 million from the provision of $1.69 million in the comparative three-month period of 2016, and increased $1.03 million compared to the nine-month period ended September 30, 2016. The loan loss reserve was 0.75% of total loans at September 30, 2017, as compared to 0.74% at June 30, 2017, and 0.72% at September 30, 2016. The decrease in the provision for loan losses in comparison to prior year and linked quarters was primarily a result of the slight decrease in the loan portfolio in the current quarter combined with a decrease in historical loss ratios. The increase in the provision for loan losses in comparison to the prior year nine-month period was primarily a result of loan growth. Loan loss reserve as a percentage of total loans, excluding purchased loans, remained steady at 0.86% at September 30, 2017, unchanged from June 30, 2017, which is consistent with continued stability in credit quality.

- Noninterest income for the three- and nine-month periods ended September 30, 2017, increased by $2.60 million, or 5.54%, and $28.94 million, or 25.01%, respectively, from the comparative periods in 2016. The increase from third quarter 2016 and prior year nine-month period was primarily due to an increase in property management income from our April 2017 acquisition of a Maryland resort property management company combined with an increase in insurance commissions, partially offset by a decrease in residential mortgage banking income in the third quarter 2017 but with an overall increase year to date. The decrease from the linked quarter was primarily related to a seasonal decrease in residential mortgage banking income and a decrease in benefit insurance income, partially offset by a seasonal increase in resort property management fee income.

- For the three- and nine-month periods ended September 30, 2017, noninterest expense increased $3.25 million, or 4.59%, and increased $27.56 million, or 14.13%, respectively, compared to the same periods in 2016. The increase from the comparable three-month period of 2016 was primarily driven by increased operating expenses related to the April 2017 acquisition of the previously mentioned resort property management company, partially offset by a decrease in acquisition-related expenses. The decrease from the linked quarter was primarily due to lower personnel expenses, combined with a decrease in acquisition-related expenses and marketing costs. The increase from comparable nine-month period of 2016 was primarily driven by increased operating expenses related to the June 2016 acquisition of Monarch and the previously mentioned resort property management company acquisition, partially offset by a decrease in acquisition-related expenses.

- Our effective tax rate was 30.41% for the third quarter of 2017, a decrease from 31.22% in the comparative period of 2016 and from 31.83% in the second quarter of 2017. For the first nine months of 2017, the effective tax rate decreased to 30.77% compared to 30.86% for the same period in 2016. The decrease from the prior year periods was primarily a result of an increase in federal tax credits, combined with the effect of the adoption of Accounting Standards Update ("ASU") No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which resulted in a $0.14 million and $0.76 million reduction in income taxes for the excess tax benefits on stock-based compensation for the three and nine months ended September 30, 2017, respectively. The decrease from the linked quarter was primarily due to an increase in federal tax credits, combined with a decrease in nondeductible acquisition-related expense.

Pending Acquisition of Paragon Commercial Corporation

On April 27, 2017, the Company announced the signing of a definitive agreement and plan of reorganization, dated April 26, 2017 (the "Paragon merger agreement"), pursuant to which the Company will acquire Paragon Commercial Corporation ("Paragon") and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices servicing Raleigh, Cary, and Charlotte, North Carolina. The proposed acquisition of Paragon and Paragon Commercial Bank is expected to close in the first quarter of 2018, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of Paragon's shareholders. Under terms of the Paragon merger agreement, Paragon shareholders will receive 1.725 shares of the Company's common stock for each share of Paragon common stock held immediately prior to the effective date of the merger. For further information, see *Note 8 - Mergers and Acquisitions* of the Notes to Consolidated Financial Statements in this report.

We expect to exceed $10 billion in total consolidated assets at the time of the closing of this transaction. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and its implementing regulations impose various additional requirements on banks with $10 billion or more in total assets, including compliance with portions of the Federal Reserve's enhanced prudential oversight requirements and annual stress testing requirements. In addition, once our assets exceed $10 billion, we will be subject to the Durbin Amendment promulgated under the Dodd-Frank Act. Under the Durbin Amendment, interchange fees for debit card transactions are capped at $0.21 plus five basis points. This limitation on interchange fees will adversely impact our results of operations.

Subordinated Debt Offering

On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027, in a public offering. The Company received $247.10 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.550%. The Company may redeem the subordinated notes, in whole or in part, on or after July 30, 2022.

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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 2016 Annual Report to Stockholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 1.26% for third quarter 2017, compared to 1.20% for third quarter 2016, and 1.29% for second quarter 2017. The annualized return on average tangible assets was 1.37%, 1.32%, and 1.40% for the same respective periods. ROA for the nine-month period ended September 30, 2017, was 1.22%, compared to 0.93% for the nine-month period ended September 30, 2016.

The annualized return on average equity ("ROE") was 9.49% for third quarter 2017, 8.95% for third quarter 2016, and 9.43% for second quarter 2017, while the annualized return on average tangible equity was 13.67%, 13.09%, and 13.67% for the same respective periods. ROE for the nine-month period ended September 30, 2017, was 9.04%, compared to 6.99% for the nine-month period ended September 30, 2016.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $115.34 million for the quarter ended September 30, 2017, which increased $5.91 million, or 5.40%, compared to the quarter ended September 30, 2016. Operating income was $119.60 million for the quarter ended June 30, 2017. For the nine-month period ended September 30, 2017, operating income was $340.10 million, an increase of $67.68 million, or 24.84%, over comparative 2016.

Basic earnings per share were $0.44 for the three months ended September 30, 2017, compared to $0.39 in comparative 2016, while basic earnings per share for the nine months ended September 30, 2017, were $1.21, compared to $0.88 in comparative 2016. Diluted earnings per share were $0.44 for the three months ended September 30, 2017, compared to $0.39 in comparative 2016, while diluted earnings per share for the nine months ended September 30, 2017, were $1.21, up from $0.87 in comparative 2016.

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 $66.63 million for the quarter ended September 30, 2017, which was $3.41 million, or 5.39%, higher than the year-ago amount of $63.23 million.

On a linked-quarter basis, tax-equivalent net interest income decreased by $3.34 million, or 4.78%, from the $69.98 million reported for second quarter 2017. In comparison to prior year comparative periods, net interest income rose primarily due to increased balances of earning assets, partially offset by an increase in interest expense related to the issuance of $250.0 million of subordinated notes in July 2017. The decrease from the linked quarter was primarily due to a decline in accretion of purchased loans related to a reclassification of purchased-impaired loans in second quarter 2017 and a combination of higher time-deposit costs and interest on subordinated notes. Accretion of purchase accounting marks added $2.36 million, or 12 basis points, to margin in the current quarter, $2.63 million, or 17 basis points, in third quarter 2016, and $5.57 million, or 31 basis points, in the linked quarter. In second quarter 2017, accretion of purchase accounting marks included $3.89 million, or 21 basis points, due to the reclassification of certain purchased impaired loans.

Interest income, on a tax-equivalent basis, was $78.58 million for the quarter ended September 30, 2017, which was $6.14 million, or 8.47%, higher than the $72.45 million reported for the quarter ended September 30, 2016. On a linked-quarter basis, tax-equivalent interest income decreased $0.82 million, or 1.04%, from $79.41 million in second quarter 2017. Average earning assets grew to $7.71 billion in the quarter ended September 30, 2017, from $7.09 billion in the comparative prior year quarter, an increase of $621.75 million, or 8.77%. In the linked quarter comparison, average earning assets increased by $391.58 million, or 5.35%, from $7.32 billion in second quarter 2017. The yield on earning assets was 4.04% in the quarter ended September 30, 2017, which compared to 4.07% in the comparative prior year and 4.35% in the linked period. Average loan balances, excluding nonaccrual loans, of $5.90 billion were $313.46 million, or 5.61%, higher in third quarter 2017 than in the same period a year ago, while loan yields increased by 4 basis points. In the linked quarter, average loans decreased by $29.17 million, or 0.49%, and loan yields decreased by 19 basis points. The increase in interest income from the prior year third quarter was primarily driven by growth in loans and interest-bearing deposits, partially offset by a decrease in loans held for sale. The decrease from the linked quarter was primarily due to the decrease in loan yields related to purchased loan accretion, partially offset by an increase in interest-bearing deposits and loans held for sale.

Interest expense for the quarter ended September 30, 2017, was $11.95 million, which was $2.73 million, or 29.62%, higher than the $9.22 million amount in the year-ago quarter. The average balance of interest-bearing liabilities increased to $5.12 billion in third quarter 2017 from $4.74 billion in the comparative prior year quarter, an increase of 8.05%. On a linked-quarter basis, interest expense increased by 26.73% from $9.43 million in second quarter 2017. In the linked quarter, average interest-bearing liabilities increased by $296.05 million, or 6.13%, from $4.83 billion in the quarter ended June 30, 2017. The increase in interest expense as compared to prior year periods was primarily due to the issuance of $250.0 million of subordinated notes in July 2017 and an increase in time deposit costs, partially offset by lower borrowing costs. During fourth quarter 2016, the Company pre-funded $260 million of Federal Home Loan Bank of Atlanta ("FHLB") advances with maturities in 2017. The existing cost on these funds was an average of 4.28% and was replaced at a cost of 1.26%. On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027 in a public offering. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.550%.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.43% in the quarter ended September 30, 2017, which was 12 basis points lower than the 3.55% margin of the September 30, 2016, quarter, and 41 basis points lower than the 3.84% margin from the June 30, 2017, quarter. The decrease in margin from the prior year and prior quarter was driven by rate increases in interest-bearing liabilities due to the issuance of the subordinated notes and higher time deposit rates, partially offset by rate decreases in borrowings. The decrease in margin from the prior quarter was further accentuated by the reclassification of purchased-impaired loans, which resulted in increased accretion of purchase accounting marks in second quarter 2017. Excluding the effects of the reclassification of revolving credits from purchased impaired to purchased performing loans, net interest margin was 3.63% in the quarter ended June 30, 2017. As the positive effect of the Monarch acquisition on net interest margin diminishes, the Company expects compression in the net interest margin to continue in the coming quarters. The rate of compression will reflect the impacts of the merger, including acquisition accounting impacts. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

The following table sets forth an estimate, excluding any potential impact of the pending Paragon merger, of the expected effects of the estimated aggregate acquisition accounting adjustments on pre-tax net interest income for the periods shown (in thousands):

	Discount Accretion (Premium Amortization)			
	For the three months ended			
	December 31, 2017	March 31, 2018	June 30, 2018	September 30, 2018
Assets:				
Investment Securities	$ (35)	$ (29)	$ (23)	$ (17)
Loans	1,149	1,046	826	733
Liabilities:				
Deposits	136	111	85	72
Total estimated effect on net interest income	$ 978	$ 906	$ 718	$ 644

Note: This information is intended for informational purposes only and is not necessarily indicative of future results. Actual results may differ due to factors such as changes in estimated prepayment speeds or projected credit loss rates.

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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 and nine-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 periods (dollars in thousands):

	Three Months Ended September 30, 2017			Three Months Ended June 30, 2017			Three Months Ended September 30, 2016		
	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	$5,897,169	$ 69,679	4.69%	$5,926,336	$ 72,167	4.88%	$5,583,711	$ 65,245	4.65 %
Taxable investment securities	582,747	2,717	1.86%	597,231	2,801	1.88%	687,480	2,702	1.57 %
Tax-exempt investment securities	47,087	360	3.06%	48,560	370	3.05%	53,180	396	2.98 %
Interest-bearing deposits	870,480	2,745	1.25%	455,489	1,188	1.05%	287,672	(36)	(0.05)%
Loans held for sale	312,762	3,081	3.94%	291,051	2,879	3.96%	476,450	4,138	3.47 %
Total earning assets	7,710,245	78,582	4.04%	7,318,667	79,405	4.35%	7,088,493	72,445	4.07 %
Less: allowance for loan losses	(44,198)			(43,501)			(40,004)		
Total nonearning assets	903,972			905,793			942,724		
Total assets	$8,570,019			$8,180,959			$7,991,213		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$2,284,995	$ 2,107	0.37%	$2,235,869	$ 1,957	0.35%	$2,216,987	$ 1,674	0.30 %
Savings	320,891	862	1.07%	318,323	815	1.03%	318,193	723	0.90 %
Certificates of deposit	1,759,934	4,841	1.09%	1,632,127	4,105	1.01%	1,684,136	3,512	0.83 %
Total interest-bearing deposits	4,365,820	7,810	0.71%	4,186,319	6,877	0.66%	4,219,316	5,909	0.56 %
Borrowings	554,147	1,770	1.25%	641,748	2,551	1.57%	523,018	3,309	2.48 %
Subordinated capital debentures	204,146	2,368	4.64%	—	—	—%	—	—	— %
Total interest-bearing liabilities	5,124,113	11,948	0.93%	4,828,067	9,428	0.78%	4,742,334	9,218	0.77 %
Demand deposits	2,173,920			2,081,819			1,959,025		
Other noninterest-bearing liabilities	136,768			156,065			214,831		
Total liabilities	7,434,801			7,065,951			6,916,190		
Shareholders' equity	1,135,218			1,115,008			1,075,023		
Total liabilities and equity	$8,570,019			$8,180,959			$7,991,213		
Net interest income (tax-equivalent basis)		$ 66,634			$ 69,977			$ 63,227	
Reconcilement of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(711)			(724)			(622)	
Net interest income (GAAP)		$ 65,923			$ 69,253			$ 62,605	
Interest rate spread (1)			3.11%			3.57%			3.30 %
Interest expense as a percent of average earning assets			0.61%			0.52%			0.52 %
Net interest margin (tax equivalent basis) (2)			3.43%			3.84%			3.55 %
Total cost of deposits			0.47%			0.44%			0.38 %

(1) Interest rate 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.

	Increase/(Decrease) Three Months Ended September 30, 2017 Compared to Three Months Ended June 30, 2017			Increase/(Decrease) Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ (271)	$ (2,217)	$ (2,488)	$ 3,855	$ 579	$ 4,434
Taxable investment securities	(67)	(17)	(84)	(446)	461	15
Tax-exempt investment securities	(11)	1	(10)	(46)	10	(36)
Interest-bearing deposits	1,281	276	1,557	64	2,717	2,781
Loans held for sale	214	(12)	202	(1,559)	502	(1,057)
Total earning assets	1,146	(1,969)	(823)	1,868	4,269	6,137
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	51	99	150	54	379	433
Savings	8	39	47	6	133	139
Certificates of deposit	360	376	736	166	1,163	1,329
Total interest-bearing deposits	419	514	933	226	1,675	1,901
Borrowings	(312)	(469)	(781)	183	(1,722)	(1,539)
Subordinated capital debentures	2,368	—	2,368	2,368	—	2,368
Total interest-bearing liabilities	2,475	45	2,520	2,777	(47)	2,730
Net interest income	$ (1,329)	$ (2,014)	$ (3,343)	$ (909)	$ 4,316	$ 3,407

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

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	Nine Months Ended September 30, 2017			Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2017 Compared with September 30, 2016		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change due to Rate	Change due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$5,895,560	$ 206,825	4.69%	$4,936,641	$ 168,257	4.55%	$ 38,568	$ 5,195	$ 33,373
Taxable investment securities	602,272	8,360	1.85%	704,532	8,492	1.61%	(132)	1,192	(1,324)
Tax-exempt investment securities	48,701	1,106	3.03%	52,854	1,211	3.05%	(105)	(11)	(94)
Interest-bearing deposits	623,670	4,819	1.03%	280,900	658	0.31%	4,161	2,719	1,442
Loans held for sale	264,065	7,687	3.88%	236,336	6,124	3.45%	1,563	802	761
Total earning assets	7,434,268	228,797	4.11%	6,211,263	184,742	3.97%	44,055	9,897	34,158
Less: allowance for loan losses	(43,442)			(38,996)					
Total nonearning assets	861,708			777,718					
Total assets	$8,252,534			$6,949,985					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$2,264,636	$ 5,929	0.35%	$1,938,818	$ 4,300	0.30%	$ 1,629	$ 846	$ 783
Savings	319,847	2,435	1.02%	306,644	2,132	0.93%	303	209	94
Certificates of deposit	1,634,566	12,326	1.01%	1,510,707	9,957	0.88%	2,369	1,514	855
Total interest-bearing deposits	4,219,049	20,690	0.66%	3,756,169	16,389	0.58%	4,301	2,569	1,732
Borrowings	639,180	8,125	1.68%	488,132	9,685	2.61%	(1,560)	(4,035)	2,475
Subordinated capital debentures	68,796	2,368	4.59%	—	—	—%	2,368	—	2,368
Total interest-bearing liabilities	4,927,025	31,183	0.85%	4,244,301	26,074	0.82%	5,109	(1,466)	6,575
Demand deposits	2,072,000			1,638,902					
Other noninterest-bearing liabilities	138,784			144,510					
Total liabilities	7,137,809			6,027,713					
Shareholders' equity	1,114,725			922,272					
Total liabilities and equity	$8,252,534			$6,949,985					
Net interest income (tax-equivalent basis)		$ 197,614			$ 158,668		$ 38,946	$ 11,363	$ 27,583
Reconcilement of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(2,158)			(1,944)		(214)		
Net interest income (GAAP)		$ 195,456			$ 156,724		$ 38,732		
Interest rate spread (1)			3.27%			3.15%			
Interest expense as a percent of average earning assets			0.56%			0.56%			
Net interest margin (tax equivalent basis) (2)			3.55%			3.41%			
Total cost of deposits			0.44%			0.41%			

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

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

Noninterest Income. Total noninterest income for the quarter ended September 30, 2017, was $49.42 million, an increase of $2.60 million, or 5.54%, compared to the same period in 2016, and a decrease of $0.93 million, or 1.84%, compared to second quarter 2017. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for third quarter 2017 was 42.84%, compared with 42.79% for comparative 2016 and 42.09% for second quarter 2017.

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 September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Residential mortgage banking income, net	$ 19,087	$ 21,430	$ (2,343)	(10.93)%
Insurance commissions and other title fees and income, net	12,116	11,258	858	7.62 %
Real estate brokerage and property management, net	10,042	6,647	3,395	51.08 %
Service charges on deposit accounts	2,670	2,552	118	4.62 %
Credit card merchant fees, net	1,388	1,365	23	1.68 %
Bank-owned life insurance	1,425	1,264	161	12.74 %
Other income	2,688	2,305	383	16.62 %
Subtotal before loss on investment securities	49,416	46,821	2,595	5.54 %
Net loss on investment securities	—	—	—	—
Total noninterest income	$ 49,416	$ 46,821	$ 2,595	5.54 %

	Three Months Ended		Increase/(Decrease) Third Quarter 2017 over Second Quarter 2017	
	September 30, 2017	June 30, 2017	Amount	Percent
Residential mortgage banking income, net	$ 19,087	$ 21,594	$ (2,507)	(11.61)%
Insurance commissions and other title fees and income, net	12,116	12,902	(786)	(6.09)%
Real estate brokerage and property management, net	10,042	7,629	2,413	31.63 %
Service charges on deposit accounts	2,670	2,644	26	0.98 %
Credit card merchant fees, net	1,388	1,298	90	6.93 %
Bank-owned life insurance	1,425	1,421	4	0.28 %
Other income	2,688	2,856	(168)	(5.88)%
Subtotal before loss on investment securities	49,416	50,344	(928)	(1.84)%
Net loss on investment securities	—	(1)	1	(100.00)%
Total noninterest income	$ 49,416	$ 50,343	$ (927)	(1.84)%

	Nine Months Ended September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Residential mortgage banking income, net	$ 58,314	$ 40,696	$ 17,618	43.29%
Insurance commissions and other title fees and income, net	39,818	36,918	2,900	7.86%
Real estate brokerage and property management, net	22,664	17,591	5,073	28.84%
Service charges on deposit accounts	7,785	7,012	773	11.02%
Credit card merchant fees, net	3,804	3,373	431	12.78%
Bank-owned life insurance	4,321	3,616	705	19.50%
Other income	7,940	6,498	1,442	22.19%
Subtotal before loss on investment securities	144,646	115,704	28,942	25.01%
Net loss on investment securities	(1)	—	(1)	N/M
Total noninterest income	$ 144,645	$ 115,704	$ 28,941	25.01%

For the third quarter of 2017, residential mortgage banking income, net of commission expense, was $19.09 million, a decrease of $2.34 million, or 10.93%, compared to third quarter 2016, and a decrease of $2.51 million, or 11.61%, compared to second quarter 2017. For the nine-month period ended September 30, 2017, residential mortgage banking income, net of commission expense, was $58.31 million, reflecting an increase of $17.62 million, or 43.29%, compared to the same period in 2016. The decrease from third quarter 2016 was primarily due to lower production volumes, 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 decrease in mortgage banking income of $0.05 million associated with a decrease in the value of rate lock commitments and forward contracts recorded as of September 30, 2017, as compared to a decrease of $0.31 million and a decrease of $1.13 million recognized for the quarters ended June 30, 2017, and September 30, 2016, respectively.

For the third quarter of 2017, insurance commissions and other title income, net of commission expense, was $12.12 million, which was $0.86 million, or 7.62%, higher than comparative 2016, and $0.79 million, or 6.09%, lower than second quarter 2017. For the 2017 nine-month period, insurance commissions and other title income, net of commission expense, was $2.90 million, or 7.86%, higher than comparative 2016. The increase from the comparative prior year quarter was largely due to growth in property and casualty insurance and employee benefits insurance. In comparison to second quarter 2017, the Company saw a decrease in employee benefits bonus income, combined with a seasonal decrease in travel insurance. The variance from the prior periods was also impacted by the acquisition of an insurance agency in August 2017, which contributed additional commission and fee income of $0.39 million in third quarter 2017.

Real estate brokerage and property management income, net of commission expense, for third quarter 2017 was $10.04 million, which was $3.40 million, or 51.08%, higher than comparative 2016, and $2.41 million, or 31.63%, higher than second quarter 2017. The increase for the 2017 nine-month period was $5.07 million, or 28.84%, higher than the comparative period in 2016. The increase from the prior year comparative period was primarily a result of an increase in property management fees associated with our purchase of Railey Mountain Lake Vacations, LLC ("Deep Creek") on April 11, 2017. The increase from the linked quarter was primarily due to a seasonal increase in resort property management fees.

Service charges on deposit accounts were $2.67 million for third quarter 2017, compared with $2.55 million for the comparative 2016 period, and $2.64 million for second quarter 2017. For the nine-month period ended September 30, 2017, service charges on deposit accounts were $7.79 million, which was $0.77 million, or 11.02%, higher than comparative 2016. The increase from the prior periods was primarily due to slightly higher checking account service fees.

For the third quarter of 2017, credit card merchant fees totaled $1.39 million, which was $0.02 million, or 1.68%, higher than comparative 2016, and $0.09 million, or 6.93%, higher than second quarter 2017. For the nine-month period ended September 30, 2017, credit card merchant fees totaled $3.80 million, which was $0.43 million, or 12.78%, higher than comparative 2016. The increase from the prior comparative periods was primarily related to increases in merchant discount fees.

Income from bank-owned life insurance ("BOLI") was $1.43 million in third quarter 2017, compared to $1.26 million in third quarter 2016, and $1.42 million in second quarter 2017. The increase from third quarter 2016 and from the linked quarter was primarily due to a higher average BOLI balance in the current quarter.

Other noninterest income for the three and nine months ended September 30, 2017, was $2.69 million and $7.94 million, respectively, and included income generated by Towne Wealth Management, net of commission expense. For the three months ended September 30, 2017, net commission income for Towne Wealth Management totaled $1.13 million, as compared to $0.94 million for third quarter 2016 and $1.09 million for second quarter 2017.

Noninterest Expense. For the quarter ended September 30, 2017, total noninterest expense was $74.19 million, which was $3.25 million, or 4.59%, higher than comparative 2016, and $3.93 million, or 5.03%, lower than the quarter ended June 30, 2017. For the nine-month period ended September 30, 2017, total noninterest expense increased $27.56 million, or 14.13%, from comparative 2016 to $222.55 million.

As a percentage of operating income, noninterest expense was 64.32% for the third quarter of 2017, 64.82% for comparative 2016, and 65.32% for the quarter ended June 30, 2017. The primary components of noninterest expense in the third quarter of 2017 were salaries and employee benefits of $43.47 million, occupancy expenses of $6.64 million, furniture and equipment expenses of $3.71 million, advertising and marketing expenses of $2.02 million, outside processing of $1.95 million, software expenses of $1.98 million, and amortization expense of $1.95 million. In comparison to the third quarter of the prior year, the primary driver of the increase in total noninterest expense was due to an increase in salaries and benefits of $2.97 million. In the linked quarter comparison, the decrease was due to a reduction in salaries and benefits expense of $1.37 million, combined with decreases in marketing costs and acquisition-related expenses. Also contributing to the increase from the prior year was the Deep Creek acquisition in April 2017, which contributed additional operating expenses of $1.92 million and $3.64 million in the three- and nine-month periods ending September 30, 2017, respectively.

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

	Three Months Ended			Increase/(Decrease) September 30, 2017 over September 30, 2016		Increase/(Decrease) September 30, 2017 over June 30, 2017	
	September 30, 2017	September 30, 2016	June 30, 2017	Amount	Percent	Amount	Percent
Salaries and benefits	$ 43,467	$ 40,497	$ 44,834	$ 2,970	7.33 %	$ (1,367)	(3.05)%
Occupancy expense	6,635	6,656	6,658	(21)	(0.32)%	(23)	(0.35)%
Furniture and equipment	3,710	3,199	3,563	511	15.97 %	147	4.13 %
Other							
Advertising and marketing	2,019	2,327	2,989	(308)	(13.24)%	(970)	(32.45)%
Acquisition-related expenses	466	969	1,281	(503)	(51.91)%	(815)	(63.62)%
Other	3,047	3,040	3,228	7	0.23 %	(181)	(5.61)%
Charitable contributions	1,491	1,045	1,690	446	42.68 %	(199)	(11.78)%
Outside processing	1,952	1,931	1,808	21	1.09 %	144	7.96 %
Professional fees	1,281	1,220	1,471	61	5.00 %	(190)	(12.92)%
Stationery and supplies	678	890	787	(212)	(23.82)%	(109)	(13.85)%
FDIC and other insurance	1,129	1,352	1,332	(223)	(16.49)%	(203)	(15.24)%
Foreclosed property expenses	208	157	144	51	32.48 %	64	44.44 %
Software expense	1,984	1,904	2,048	80	4.20 %	(64)	(3.13)%
Telephone and postage	1,743	1,758	1,782	(15)	(0.85)%	(39)	(2.19)%
Amortization - intangibles	1,953	1,920	2,006	33	1.72 %	(53)	(2.64)%
Bank franchise tax/SCC fees	1,349	1,151	1,243	198	17.20 %	106	8.53 %
Directors fees and expenses	478	385	453	93	24.16 %	25	5.52 %
Travel/meals/entertainment	596	532	802	64	12.03 %	(206)	(25.69)%
Total other expenses	20,374	20,581	23,064	(207)	(1.01)%	(2,690)	(11.66)%
Total noninterest expense	$ 74,186	$ 70,933	$ 78,119	$ 3,253	4.59 %	$ (3,933)	(5.03)%

	Nine Months Ended September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Salaries and benefits	$ 128,509	$ 100,776	$ 27,733	27.52 %
Occupancy expense	19,977	16,831	3,146	18.69 %
Furniture and equipment	10,616	7,937	2,679	33.75 %
Other				
Advertising and marketing	7,650	6,207	1,443	23.25 %
Acquisition-related expenses	1,743	19,817	(18,074)	(91.20)%
Other	9,086	6,258	2,828	45.19 %
Charitable contributions	4,579	3,466	1,113	32.11 %
Outside processing	5,395	4,723	672	14.23 %
Professional fees	4,581	3,830	751	19.61 %
Stationery and supplies	2,074	2,030	44	2.17 %
FDIC and other insurance	3,398	3,624	(226)	(6.24)%
Foreclosed property expenses	484	727	(243)	(33.43)%
Software expense	6,283	5,064	1,219	24.07 %
Telephone and postage	5,195	4,171	1,024	24.55 %
Amortization - intangibles	5,822	4,112	1,710	41.59 %
Bank franchise tax/SCC fees	3,834	3,032	802	26.45 %
Directors fees and expenses	1,247	985	262	26.60 %
Travel/meals/entertainment	2,080	1,402	678	48.36 %
Total other expenses	63,451	69,448	(5,997)	(8.64)%
Total noninterest expense	$ 222,553	$ 194,992	$ 27,561	14.13 %

Salary and benefits expense, the largest portion of noninterest expense, was $43.47 million, representing 58.59% of total noninterest expense for the quarter ended September 30, 2017, and $128.51 million, or 57.74% of total noninterest expense for the nine months ended September 30, 2017. Salary and benefits expense increased $2.97 million, or 7.33%, and increased $27.73 million, or 27.52% over the comparative three- and nine-month periods in 2017, and decreased $1.37 million, or 3.05%, from second quarter 2017. The increase from prior year third quarter was primarily due to additional personnel costs in our Banking and Insurance segments, combined with the addition of staff resulting from the Deep Creek acquisition. The decrease from the linked quarter was primarily due to decreases in employee profit-sharing expenses and lower payroll tax expenses.

In our Banking segment, we had a total of 879 full-time equivalent employees ("FTE") at September 30, 2017, as compared to 810 at September 30, 2016, and 867 at June 30, 2017. In our non-Banking segments at September 30, 2017, we had a total of 1,289 FTEs, excluding real estate sales agents, which was up from 1,245 at September 30, 2016, and unchanged from June 30, 2017. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE was $53,000 for the quarter ended September 30, 2017, unchanged from the three-month period ended September 30, 2016, and decreased from $55,000 for the three-month period ended June 30, 2017.

Occupancy expense for the third quarter of 2017 experienced a $0.02 million, or 0.32%, decrease from the comparative quarter of 2016, and a $0.02 million, or 0.35%, decrease from second quarter 2017. Occupancy expense for the first nine months of 2017 increased $3.15 million, or 18.69%, from comparative 2016. The slight decrease from prior year third quarter was primarily related to a lower level of expenses related to maintenance and cleaning services partially offset by facilities acquired in the Deep Creek acquisition, while the slight decrease from second quarter 2017 was due to decreases in rent expense and depreciation of leasehold improvements.

For the three- and nine-month periods ended September 30, 2017, furniture and equipment expense increased by $0.51 million and $2.68 million over the comparative 2016 periods, and increased $0.15 million over second quarter 2017. The increase from prior periods was primarily a result of higher equipment lease and maintenance contract expenses, combined with an increase in depreciation expense.

Other noninterest expenses for the third quarter of 2017 were $20.37 million, a decrease of $0.21 million, or 1.01%, compared to the same period in 2016, and for the first nine months of 2017 decreased $6.00 million, or 8.64%, compared to the same period in 2016, while there was also a decrease of $2.69 million, or 11.66%, compared to second quarter 2017. Acquisition-related expenses in 2016 from the Monarch merger and in second quarter 2017 from the pending Paragon merger were the primary drivers of the decrease from the comparative prior year periods, combined with decreases in advertising and marketing of $0.31 million and $0.97 million for the three months ended September 30, 2016, and June 30, 2017, respectively.

Provision for Income Taxes. We reported a provision for income tax expense of $11.86 million, representing an effective tax rate of 30.41%, in the third quarter of 2017. The provision for income tax expense was $10.97 million for the third quarter of 2016, with an effective rate of 31.22%, and $12.24 million, with an effective rate of 31.83%, for the second quarter of 2017. For the first nine months of 2017, the effective rate decreased to 30.77% compared to 30.86% in the same period of 2016. The decrease from the prior year periods was primarily a result of an increase in federal tax credits, combined with the effect of the adoption of ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which resulted in a $0.14 million and $0.76 million reduction in income taxes for the excess tax benefits on stock-based compensation for the three and nine months ended September 30, 2017, respectively. The decrease from the linked quarter was primarily due to an increase in federal tax credits, combined with a decrease in nondeductible acquisition-related expense.

Segment Performance Summary

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

Banking Segment. For the three months ended September 30, 2017, the Banking segment represented 83.13%, or $22.57 million, of our total consolidated net income, compared to 75.60%, or $18.28 million, for comparative 2016. For the nine months ended September 30, 2017, the Banking segment represented 82.42%, or $62.08 million, of our consolidated income compared to 69.83%, or $33.70 million, for comparative 2016.

Pre-tax earnings for the three months ended September 30, 2017, for the Banking segment were $31.57 million, increasing $5.95 million from comparative 2016. The increase in earnings from the comparative 2016 quarter was driven by an increase in net interest income of $4.18 million, which was primarily a result of additional interest income resulting from an increase in earning assets, partially offset by interest expense related to the issuance of subordinated notes in July 2017. Also contributing was a decrease in the provision for loan losses of $0.99 million and a decrease in noninterest expenses of $0.12 million, primarily due to a decrease in other expenses of $0.63 million, which included a reduction of acquisition-related expenses of $0.57 million. The decrease in other noninterest expenses was partially offset by an increase in personnel costs of $1.13 million and additional charitable contribution expenses of $0.46 million.

Pre-tax earnings increased $0.71 million compared to the linked quarter ended June 30, 2017. The increase in earnings was driven by a decrease in noninterest expenses of $3.43 million, which included decreases in personnel costs of $1.88 million, advertising and marketing expenses of $0.58 million, and other expenses of $0.76 million. Additionally, there was a decrease in the provision for loan losses of $0.62 million. The increase in earnings was partially offset by a decrease in net interest income of $3.34 million caused by a combination of a decrease in accretion of purchase accounting marks from $5.57 million in second quarter 2017 to $2.36 million in third quarter 2017, and increased interest expense related to the issuance of subordinated notes in July 2017.

Pre-tax earnings were up $41.07 million for the nine months ended September 30, 2017, compared to the same period in 2016. The increase in earnings was driven by an increase in net interest income of $36.34 million, which was due to a combination of increased earning assets and higher loan yields. Additionally, there was a decrease in noninterest expenses of $1.96 million, as increases in personnel costs of $10.36 million, charitable contributions of $1.16 million, and furniture and equipment expenses of $1.01 million were more than offset by the decrease in acquisition-related expenses of $18.11 million. These factors were partially offset by an increase in the provision for loan losses of $1.03 million.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2017 September 30, 2016		September 30, 2017 June 30, 2017	
	2017	2016	2017	Amount	Percent	Amount	Percent
Net interest income	$ 63,094	$ 58,919	$ 66,434	$ 4,175	7.09 %	$ (3,340)	(5.03)%
Service charges on deposit accounts	2,670	2,552	2,644	118	4.62 %	26	0.98 %
Credit card merchant fees	1,388	1,365	1,297	23	1.68 %	91	7.02 %
Other income	3,259	2,701	3,362	558	20.66 %	(103)	(3.06)%
Total noninterest income	7,317	6,618	7,303	699	10.56 %	14	0.19 %
Total revenue	70,411	65,537	73,737	4,874	7.44 %	(3,326)	(4.51)%
Provision for loan losses	696	1,686	1,320	(990)	(58.72)%	(624)	(47.27)%
Salaries and employee benefits	21,643	20,509	23,519	1,134	5.53 %	(1,876)	(7.98)%
Occupancy expense	3,992	4,197	3,828	(205)	(4.88)%	164	4.28 %
Furniture and equipment	2,434	2,358	2,372	76	3.22 %	62	2.61 %
Advertising and marketing	624	922	1,207	(298)	(32.32)%	(583)	(48.30)%
Charitable contributions	1,380	919	1,647	461	50.16 %	(267)	(16.21)%
Outside processing	1,113	1,280	1,112	(167)	(13.05)%	1	0.09 %
Foreclosed property expenses	186	157	141	29	18.47 %	45	31.91 %
FDIC and other insurance	953	1,224	1,131	(271)	(22.14)%	(178)	(15.74)%
Professional fees	750	965	748	(215)	(22.28)%	2	0.27 %
Telephone and postage	922	962	963	(40)	(4.16)%	(41)	(4.26)%
Other expenses	4,550	5,178	5,305	(628)	(12.13)%	(755)	(14.23)%
Total noninterest expenses	38,547	38,671	41,973	(124)	(0.32)%	(3,426)	(8.16)%
Income before income tax and corporate allocation	31,168	25,180	30,444	5,988	23.78 %	724	2.38 %
Corporate allocation	400	439	410	(39)	(8.88)%	(10)	(2.44)%
Income before income tax provision and noncontrolling interest	31,568	25,619	30,854	5,949	23.22 %	714	2.31 %
Provision for income tax expense	9,002	7,325	9,307	1,677	22.89 %	(305)	(3.28)%
Net income	22,566	18,294	21,547	4,272	23.35 %	1,019	4.73 %
Noncontrolling interest	3	(18)	(1)	21	(116.67)%	4	(400.00)%
Net income attributable to TowneBank	$ 22,569	$ 18,276	$ 21,546	$ 4,293	23.49 %	$ 1,023	4.75 %
Efficiency ratio	54.75%	59.01%	56.92%	(4.26)%	(7.22)%	(2.17)%	(3.81)%

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	Nine Months Ended September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Net interest income	$ 187,972	$ 151,630	$ 36,342	23.97 %
Service charges on deposit accounts	7,785	7,012	773	11.02 %
Credit card merchant fees	3,804	3,373	431	12.78 %
Other income	9,728	7,377	2,351	31.87 %
Total noninterest income	21,317	17,762	3,555	20.01 %
Total revenue	209,289	169,392	39,897	23.55 %
Provision for loan losses	4,557	3,526	1,031	29.24 %
Salaries and employee benefits	65,503	55,140	10,363	18.79 %
Occupancy expense	11,947	11,261	686	6.09 %
Furniture and equipment	7,080	6,070	1,010	16.64 %
Advertising and marketing	2,873	2,729	144	5.28 %
Charitable contributions	4,340	3,182	1,158	36.39 %
Outside processing	3,379	3,052	327	10.71 %
Foreclosed property expenses	457	727	(270)	(37.14)%
FDIC and other insurance	3,071	3,395	(324)	(9.54)%
Professional fees	2,779	2,900	(121)	(4.17)%
Telephone and postage	2,790	2,423	367	15.15 %
Other expenses	14,651	29,949	(15,298)	(51.08)%
Total expenses	118,870	120,828	(1,958)	(1.62)%
Income before income tax and corporate allocation	85,862	45,038	40,824	90.64 %
Corporate allocation	1,295	1,054	241	22.87 %
Income before income tax provision and noncontrolling interest	87,157	46,092	41,065	89.09 %
Provision for income tax expense	25,074	12,377	12,697	102.59 %
Net income	62,083	33,715	28,368	84.14 %
Noncontrolling interest	—	(18)	18	(100.00)%
Net income attributable to TowneBank	$ 62,083	$ 33,697	$ 28,386	84.24 %
Efficiency ratio	56.80%	71.33%	(14.53)%	(20.37)%

Realty Segment. For the three months ended September 30, 2017, the Realty segment had income before income tax provision and noncontrolling interest of \$6.75 million, as compared to \$9.11 million for the comparative 2016 period, and \$6.45 million for the linked quarter ended June 30, 2017. Total revenue increased slightly to \$33.20 million in third quarter 2017 from \$33.15 million in third quarter 2016. The \$2.50 million, or 11.51%, decrease in residential mortgage banking income resulted primarily from lower production volumes. Residential mortgage banking income included a decrease in the value of rate lock commitments and forward contracts of \$0.05 million for the quarter ended September 30, 2017, compared to a decrease of \$1.13 million in the same period of 2016. The increase in property management fees from 2016 was primarily due to increased revenue from our purchase of Deep Creek on April 11, 2017. The decrease in net interest and other income of \$0.72 million was a result of a reduction in net interest income resulting from a lower balance of average mortgage loans held for sale. The decrease in revenue from the linked quarter was due to seasonal decreases in mortgage banking and real estate brokerage, partially offset the seasonal increase in resort property management fees.

Expenses for the Realty segment increased 10.19%, or \$2.42 million, when compared to the same period in 2016, and decreased by 1.93%, or \$0.51 million, when compared to the quarter ended June 30, 2017. The increase from third quarter 2016 was primarily due to an increase in operating expenses related to the Deep Creek acquisition, while a decrease in occupancy expense and marketing costs drove the linked quarter variance.

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

	Three Months Ended			Increase/(Decrease)			
				September 30, 2017		September 30, 2017	
	September 30,		June 30,	September 30, 2016		June 30, 2017	
	2017	2016	2017	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	$ 19,196	$ 21,692	$ 21,730	$ (2,496)	(11.51)%	$ (2,534)	(11.66)%
Real estate brokerage income, net	2,103	2,267	2,337	(164)	(7.23)%	(234)	(10.01)%
Title insurance and settlement fees	509	562	582	(53)	(9.43)%	(73)	(12.54)%
Property management fees, net	7,939	4,381	5,293	3,558	81.21 %	2,646	49.99 %
Income from unconsolidated subsidiary	214	283	250	(69)	(24.38)%	(36)	(14.40)%
Net interest and other income	3,242	3,964	3,229	(722)	(18.21)%	13	0.40 %
Total revenue	33,203	33,149	33,421	54	0.16 %	(218)	(0.65)%
Salaries and employee benefits	15,421	14,198	15,220	1,223	8.61 %	201	1.32 %
Occupancy expense	2,045	1,922	2,269	123	6.40 %	(224)	(9.87)%
Furniture and equipment	1,036	762	999	274	35.96 %	37	3.70 %
Amortization of intangible assets	718	559	718	159	28.44 %	—	— %
Other expenses	6,967	6,325	7,495	642	10.15 %	(528)	(7.04)%
Total expenses	26,187	23,766	26,701	2,421	10.19 %	(514)	(1.93)%
Income before income tax, corporate allocation and noncontrolling interest	7,016	9,383	6,720	(2,367)	(25.23)%	296	4.40 %
Corporate allocation	(267)	(278)	(266)	11	3.96 %	(1)	(0.38)%
Income before income tax provision and noncontrolling interest	6,749	9,105	6,454	(2,356)	(25.88)%	295	4.57 %
Provision for income tax	2,115	2,921	1,889	(806)	(27.59)%	226	11.96 %
Net income	4,634	6,184	4,565	(1,550)	(25.06)%	69	1.51 %
Noncontrolling interest	(1,189)	(1,369)	(1,361)	180	13.15 %	172	12.64 %
Net income attributable to TowneBank	$ 3,445	$ 4,815	$ 3,204	$ (1,370)	(28.45)%	$ 241	7.52 %

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2017 September 30, 2016		September 30, 2017 June 30, 2017	
	2017	2016	2017	Amount	Percent	Amount	Percent
Key data:							
Efficiency ratio	78.87%	71.69%	79.89%	7.18%	10.02 %	(1.02)%	(1.28)%
Number of units sold	1,114	1,220	1,292	(106)	(8.69)%	(178)	(13.78)%
Volume of units sold	$ 340,942	$ 363,927	$ 402,154	$ (22,985)	(6.32)%	$ (61,212)	(15.22)%
Number of real estate agents	409	398	404	11	2.76 %	5	1.24 %
Loans originated, mortgage	$ 671,639	$ 974,975	$ 782,384	$(303,336)	(31.11)%	$ (110,745)	(14.15)%
Loans originated, joint venture	276,019	271,702	296,143	4,317	1.59 %	(20,124)	(6.80)%
Total loans originated	$ 947,658	$ 1,246,677	$ 1,078,527	$(299,019)	(23.99)%	$ (130,869)	(12.13)%
Number of loans, mortgage	2,535	3,729	3,069	(1,194)	(32.02)%	(534)	(17.40)%
Number of loans, joint venture	1,276	1,193	1,312	83	6.96 %	(36)	(2.74)%
Total number of loans	3,811	4,922	4,381	(1,111)	(22.57)%	(570)	(13.01)%
Average loan amount, mortgage	$ 265	$ 261	$ 255	$ 4	1.53 %	$ 10	3.92 %
Average loan amount, joint venture	216	228	226	(12)	(5.26)%	(10)	(4.42)%
Average loan amount	$ 249	$ 253	$ 246	$ (4)	(1.58)%	$ 3	1.22 %
Average number of originators, mortgage	230	250	243	(20)	(8.00)%	(13)	(5.35)%
Average number of originators, joint venture	85	56	71	29	51.79 %	14	19.72 %
Average number of originators	315	306	314	9	2.94 %	1	0.32 %

	Nine Months Ended September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Residential mortgage banking income, net	$ 58,701	$ 41,492	$ 17,209	41.48 %
Real estate brokerage income, net	5,899	6,072	(173)	(2.85)%
Title insurance and settlement fees	1,446	1,461	(15)	(1.03)%
Property management fees, net	16,765	11,519	5,246	45.54 %
Income from unconsolidated subsidiary	588	663	(75)	(11.31)%
Net interest and other income	8,672	5,895	2,777	47.11 %
Total revenue	92,071	67,102	24,969	37.21 %
Salaries and employee benefits	44,349	28,155	16,194	57.52 %
Occupancy expense	6,277	3,988	2,289	57.40 %
Furniture and equipment	2,904	1,306	1,598	122.36 %
Amortization of intangible assets	1,994	1,264	730	57.75 %
Other expenses	20,441	13,382	7,059	52.75 %
Total expenses	75,965	48,095	27,870	57.95 %
Income before income tax, corporate allocation and noncontrolling interest	16,106	19,007	(2,901)	(15.26)%
Corporate allocation	(841)	(570)	(271)	(47.54)%
Income before income tax provision and noncontrolling interest	15,265	18,437	(3,172)	(17.20)%
Provision for income tax	4,631	5,829	(1,198)	(20.55)%
Net income	10,634	12,608	(1,974)	(15.66)%
Noncontrolling interest	(3,061)	(2,994)	(67)	(2.24)%
Net income attributable to TowneBank	$ 7,573	$ 9,614	$ (2,041)	(21.23)%
Key data:				
Efficiency ratio	82.51%	71.67%	10.84%	15.12 %
Number of units sold	3,202	3,280	(78)	(2.38)%
Volume of units sold	$ 965,191	$ 960,751	$ 4,440	0.46 %
Number of real estate agents	409	398	11	2.76 %
Loans originated, mortgage	$ 1,994,982	$ 1,464,806	$ 530,176	36.19 %
Loans originated, joint venture	737,259	686,795	50,464	7.35 %
Total loans originated	$ 2,732,241	$ 2,151,601	$ 580,640	26.99 %
Number of loans, mortgage	7,762	5,723	2,039	35.63 %
Number of loans, joint venture	3,369	3,161	208	6.58 %
Total number of loans	11,131	8,884	2,247	25.29 %
Average loan amount, mortgage	$ 257	$ 256	$ 1	0.39 %
Average loan amount, joint venture	219	217	2	0.92 %
Average loan amount	$ 245	$ 242	$ 3	1.24 %
Average number of originators, mortgage	241	128	113	88.28 %
Average number of originators, joint venture	74	55	19	34.55 %
Average number of originators	315	183	132	72.13 %

Mortgage. Loan volume for the combined mortgage operations decreased in the quarter ended September 30, 2017, as compared to the same period in 2016. Total loans originated in the third quarter of 2017 were $0.95 billion, a 23.99% decrease, or $299.02 million, from $1.25 billion in the comparative period of 2016, and a $130.87 million, or 12.13%, seasonal decrease compared to the volume for the quarter ended June 30, 2017. Refinance activity comprised $145.09 million of loan volume for the quarter ended September 30, 2017, while purchases accounted for the remaining $802.57 million in loan volume for the quarter. For the quarters ended September 30, 2016, and June 30, 2017, refinance volume was $325.18 million and $117.23 million, respectively, while purchase volume was $921.50 million and $961.30 million, respectively.

Insurance Segment. The Insurance segment comprises property and casualty and group benefit divisions. The Insurance segment represented 4.18%, or $1.14 million, of total consolidated net income at September 30, 2017, and 4.48%, or $1.09 million, at September 30, 2016.

Earnings before income taxes and noncontrolling interest for the three months ended September 30, 2017, were $2.14 million, increasing $0.06 million, or 2.74%, from comparative 2016, and decreasing $0.71 million from the linked quarter ended June 30, 2017. The primary factors affecting earnings in comparison to the prior year periods were income related to growth in property and casualty and employee benefits lines, partially offset by an increase in operating cost.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2017 September 30, 2016		September 30, 2017 June 30, 2017	
	2017	2016	2017	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 9,768	$ 9,052	$ 9,271	$ 716	7.91 %	$ 497	5.36 %
Employee benefits	3,132	2,947	3,280	185	6.28 %	(148)	(4.51)%
Travel insurance	970	926	1,159	44	4.75 %	(189)	(16.31)%
Specialized benefit services	165	154	158	11	7.14 %	7	4.43 %
Total net commissions and fees	14,035	13,079	13,868	956	7.31 %	167	1.20 %
Contingency and bonus revenue	180	61	948	119	195.08 %	(768)	(81.01)%
Other income	67	82	76	(15)	(18.29)%	(9)	(11.84)%
Total revenues	14,282	13,222	14,892	1,060	8.02 %	(610)	(4.10)%
Employee commission expense	2,557	2,482	2,454	75	3.02 %	103	4.20 %
Revenue, net of commission expense	11,725	10,740	12,438	985	9.17 %	(713)	(5.73)%
Salaries and employee benefits	6,403	5,790	6,095	613	10.59 %	308	5.05 %
Occupancy expense	599	537	562	62	11.55 %	37	6.58 %
Furniture and equipment	240	78	192	162	207.69 %	48	25.00 %
Amortization of intangible assets	675	706	704	(31)	(4.39)%	(29)	(4.12)%
Other expenses	1,535	1,385	1,892	150	10.83 %	(357)	(18.87)%
Total operating expenses	9,452	8,496	9,445	956	11.25 %	7	0.07 %
Income before income tax, corporate allocation and noncontrolling interest	2,273	2,244	2,993	29	1.29 %	(720)	(24.06)%
Corporate allocation	(133)	(161)	(144)	28	(17.39)%	11	(7.64)%
Income before income tax provision and noncontrolling interest	2,140	2,083	2,849	57	2.74 %	(709)	(24.89)%
Provision for income tax	745	728	1,044	17	2.34 %	(299)	(28.64)%
Net income	1,395	1,355	1,805	40	2.95 %	(410)	(22.71)%
Noncontrolling interest	(259)	(270)	(342)	11	(4.07)%	83	(24.27)%
Net income attributable to TowneBank	$ 1,136	$ 1,085	$ 1,463	$ 51	4.70 %	$ (327)	(22.35)%
Efficiency ratio	80.61%	79.11%	75.94%	1.50%	1.90 %	4.67%	6.15 %

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

	Nine Months Ended September 30,		Increase/(Decrease) 2017 over 2016	
	2017	2016	Amount	Percent
Net commission and fee income				
Property and casualty	$ 27,496	$ 25,930	$ 1,566	6.04 %
Employee benefits	9,386	8,753	633	7.23 %
Travel insurance	3,756	3,546	210	5.92 %
Specialized benefit services	488	459	29	6.32 %
Total net commissions and fees	41,126	38,688	2,438	6.30 %
Contingency and bonus revenue	4,668	3,941	727	18.45 %
Other income	231	208	23	11.06 %
Total revenues	46,025	42,837	3,188	7.44 %
Employee commission expense	7,284	6,903	381	5.52 %
Revenue, net of commission expense	38,741	35,934	2,807	7.81 %
Salaries and employee benefits	18,658	17,481	1,177	6.73 %
Occupancy expense	1,753	1,582	171	10.81 %
Furniture and equipment	632	562	70	12.46 %
Amortization of intangible assets	2,077	2,083	(6)	(0.29)%
Other expenses	4,598	4,361	237	5.43 %
Total operating expenses	27,718	26,069	1,649	6.33 %
Income before income tax, corporate allocation and noncontrolling interest	11,023	9,865	1,158	11.74 %
Corporate allocation	(454)	(484)	30	(6.20)%
Income before income tax provision and noncontrolling interest	10,569	9,381	1,188	12.66 %
Provision for income tax	3,783	3,332	451	13.54 %
Net income	6,786	6,049	737	12.18 %
Noncontrolling interest	(1,112)	(1,106)	(6)	0.54 %
Net income attributable to TowneBank	$ 5,674	$ 4,943	$ 731	14.79 %
Efficiency ratio	71.55%	72.55%	(1.00)%	(1.38)%

Total revenues for the third quarter of 2017 increased $1.06 million, or 8.02%, when compared to the same period in 2016, and increased $3.19 million, or 7.44%, for the nine months ended September 30, 2017, compared to the same period of 2016. The increase from the comparative prior year period was due to organic growth across the lines of business, an increase in contingency and bonus revenue, and the acquisition of an insurance agency in August 2017. The acquired insurance agency resulted in additional net commission and fee income of $0.39 million in third quarter 2017. The decrease in revenues of $0.61 million on a linked quarter basis was primarily a result of a decrease in bonus revenue of $0.77 million related to an employee benefits lines bonus received in second quarter 2017, combined with a seasonal decrease in travel insurance commissions of $0.19 million. The decrease was partially offset by an increase in property and casualty commissions of $0.50 million, primarily due to the August 2017 insurance agency acquisition.

Total operating expenses for the third quarter of 2017 increased $0.96 million, or 11.25%, when compared to the same period in 2016, and increased $1.65 million, or 6.33%, for the nine months ended September 30, 2017, when compared to the nine months ended September 30, 2016. The largest factor in the increase from the comparative prior year period was salaries and employee benefits expense, which increased

$0.61 million, or 10.59%, and $1.18 million, and 6.73%, when comparing the three- and nine-month periods ended September 30, 2017, to the same periods for 2016. The linked quarter increase was primarily due to higher personnel and occupancy costs, partially offset by decreases acquisition-related expenses. The increases were partially driven by the insurance agency acquisition, which resulted in additional salaries and employee benefit expenses of $0.23 million in third quarter 2017.

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2017, total assets were $8.61 billion, which is $784.65 million, or 10.02%, higher than the period-end balance for comparative 2016, and $187.75 million, or 2.23%, higher than the balance at June 30, 2017. Our loan portfolio, less unearned income and deferred costs, made up 68.61% of our period-end assets and totaled $5.91 billion at September 30, 2017. Average assets for the quarter ended September 30, 2017, were $8.57 billion, up $0.58 billion, or 7.24%, from the comparative September 30, 2016 quarter, and up $389.06 million, or 4.76%, from the quarter ended June 30, 2017.

Average earning assets increased $0.62 billion, or 8.77%, from $7.09 billion for the third quarter of 2016 to $7.71 billion for the third quarter of 2017. Compared to second quarter 2017, average earning assets increased $391.58 million.

Our average total deposits were $6.54 billion for third quarter 2017, reflecting growth of $0.36 billion, or 5.85%, compared to third quarter 2016. Growth continued in average noninterest-bearing deposits, which increased $214.90 million, or 10.97%, from September 30, 2016.

Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest-bearing deposit balances at September 30, 2017, were $581.33 million and consisted mainly of overnight deposits with the Federal Reserve Bank of Richmond.

The average balance of interest-bearing deposits in other banks and federal funds sold during the third quarter of 2017 was $870.48 million, or 11.29%, of average total earning assets compared with $287.67 million, or 4.06%, of average total earning assets for comparative 2016. For the second quarter of 2017, the average balance of interest-bearing deposits in other banks was $455.49 million, or 6.22%, of average total earning assets.

Securities Available for Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The available-for-sale securities portfolio was $831.48 million at September 30, 2017, compared with $704.42 million at September 30, 2016. The average balance during the third quarter of 2017 was $523.47 million, compared to the 2016 period average of $628.45 million, or 6.79%, and 8.87% of average earning assets, respectively. During the nine months ended September 30, 2017, we had sales, maturities, and calls totaling $728.46 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 $62.49 million at September 30, 2017, and $70.30 million at September 30, 2016. The average balance during the third quarter of 2017 was $63.28 million, compared with $66.0 million in the 2016 period, representing 0.82% and 0.93% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At September 30, 2017, we held $318.60 million in mortgage loans originated and intended for sale in the secondary market, as compared with $439.45 million at September 30, 2016, and $388.52 million at June 30, 2017. Average loans held for sale were 4.06% and 6.72% of average earning assets for the quarters ended September 30, 2017 and 2016, respectively. Average loans held for sale were 3.98% of average earning assets for the quarter ended June 30, 2017. 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 locked with the customer. The commitments are generally for periods of 60 days and are at market rates. In order to mitigate the effect of the interest rate risk inherent in providing rate lock commitments, we economically hedge our commitments by entering into either a forward loan sales contract under best efforts or a trade of "to be announced" ("TBA") mortgage-backed securities ("notional securities") for mandatory delivery. The changes in fair value related to movements in market rates of the rate lock commitments and the forward loan sales contracts and notional securities generally move in opposite directions, and the net impact of changes in these valuations on net income during the loan commitment period is generally inconsequential. The Company has not formally designated these derivatives as a qualifying hedge relationship and, accordingly, accounts for such forward contracts as freestanding derivatives with changes in fair value recorded to earnings each period.

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 a loan contract and the subject loan is closed.

Loan Portfolio. Loans, net of unearned income and deferred costs, were $5.91 billion at September 30, 2017, which was $258.84 million, or 4.58%, above the $5.65 billion reported at September 30, 2016, and $38.58 million, or 0.65%, less than the $5.95 billion at June 30, 2017. As a percentage of total average earning assets, average loans were 76.48% for the quarter ended September 30, 2017, compared with 78.77% for comparable 2016 and 80.98% for the quarter ended June 30, 2017.

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 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 September 30, 2017, September 30, 2016, and June 30, 2017, was $44.40 million, $40.66 million, and $44.13 million, respectively. The allowance was equal to 0.75% of total loans outstanding at September 30, 2017, compared with 0.72% and 0.74% at September 30, 2016, and June 30, 2017, respectively. Excluding purchased loans, the allowance was equal to 0.86% of loans outstanding at September 30, 2017, compared with 0.91% and 0.86% at September 30, 2016, and June 30, 2017, respectively. We believe the decline in the ratio from the prior year, 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 0.78% of total loans at September 30, 2017, down from 1.36% at September 30, 2016, and 1.31% at December 31, 2016. Additionally, loans 30 to 89 days past due were $5.89 million, including purchased impaired loans of $0.21 million, at September 30, 2017, as compared to $6.71 million and $10.46 million at September 30, 2016, and December 31, 2016, respectively. Total past due and nonaccruing loans were $14.95 million, including purchased impaired past-due loans of

$0.43 million, at September 30, 2017, from $19.30 million and $25.21 million at September 30, 2016, and December 31, 2016, respectively. Also reflecting improvement in our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 5.06x of nonperforming loans at September 30, 2017, compared with 3.59x and 4.58x at September 30, 2016, and June 30, 2017, respectively. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at September 30, 2017.

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

	Three Months Ended			Nine Months Ended	
	September 30,		June 30,	September 30,	
	2017	2016	2017	2017	2016
Allowance for loan losses					
Balance beginning of period	$ 44,131	$ 39,618	$ 43,195	$ 42,001	$ 38,359
Loans charged off:					
Residential 1-4 family	(377)	(245)	(432)	(2,097)	(1,140)
Multifamily	—	—	—	—	—
Commercial real estate	—	—	—	(67)	(66)
Construction	—	(26)	—	—	(92)
Commercial and industrial	(192)	(390)	(116)	(342)	(462)
Consumer and other	(146)	(226)	(103)	(477)	(250)
Total	(715)	(887)	(651)	(2,983)	(2,010)
Loans recovered:					
Residential 1-4 family	105	146	—	206	409
Multifamily	—	—	1	1	1
Commercial real estate	58	14	97	165	52
Construction	9	5	5	25	106
Commercial and industrial	14	3	65	77	80
Consumer and other	100	70	99	349	132
Total	286	238	267	823	780
Net loans charged off	(429)	(649)	(384)	(2,160)	(1,230)
Provision for loan losses	696	1,686	1,320	4,557	3,526
Balance end of period	$ 44,398	$ 40,655	$ 44,131	$ 44,398	$ 40,655
Nonperforming assets					
Nonperforming loans	$ 8,768	$ 11,337	$ 9,645	$ 8,768	$ 11,337
Former bank premises	3,619	—	2,798	3,619	—
Foreclosed property	21,504	22,884	23,249	21,504	22,884
Total nonperforming assets	$ 33,891	$ 34,221	$ 35,692	$ 33,891	$ 34,221
Loans past due 90 days and still accruing interest	$ 74	$ —	$ 206	$ 74	$ —
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	5.06x	3.59x	4.58x	5.06x	3.59x
Allowance for loan losses to period end loans	0.75%	0.72%	0.74%	0.75%	0.72%
Allowance for loan losses to period end loans excluding purchased loans	0.86%	0.91%	0.86%	0.86%	0.91%
Nonperforming loans to period end loans	0.15%	0.20%	0.16%	0.15%	0.20%
Nonperforming assets to period end assets	0.39%	0.44%	0.42%	0.39%	0.44%
Net charge-offs to average loans (annualized)	0.03%	0.05%	0.03%	0.05%	0.03%

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

At September 30, 2017, we had $33.89 million in nonperforming assets, which amounted to 0.39% of total assets. Additionally, there were $0.07 million loans past due 90 days or more that were accruing interest. Nonperforming assets consist of $8.77 million in nonperforming loans, $3.62 million in former bank premises related to the Monarch merger, as well as $21.50 million in foreclosed property. Nonperforming loans decreased by $0.88 million from June 30, 2017, as additions to nonaccrual loans during the third quarter of 2017 were outpaced by transfers to other real estate owned ("OREO"), charge-offs, and payments received. Nonperforming residential loans decreased by $0.11 million as new nonperforming loans of $0.70 million were outpaced by paydowns of $0.26 million, transfers to OREO of $0.19 million, and charge-offs of $0.36 million. There was also a decrease in nonperforming commercial real estate loans, which declined by $0.90 million, the result of paydowns. Additionally, consumer nonperforming loans increased by $0.19 million as new nonperforming loans of $0.50 million were outpaced by paydowns of $0.17 million, and charge-offs of $0.15 million. Foreclosed property decreased from $23.25 million at June 30, 2017, and $22.88 million at September 30, 2016. The 10 largest foreclosed property developments represented approximately 90.76% of total foreclosed property at September 30, 2017, with the largest development representing approximately 42.19%. Foreclosed property consists of 14 residential properties, 14 construction and development properties, one multifamily property, and four commercial properties.

At September 30, 2017, loans 60-89 days past due, excluding nonperforming loans, totaled $0.54 million. Additionally, there are other performing loans, totaling $20.05 million, that are current but have certain documentation deficiencies or other potential weaknesses that management has determined warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At September 30, 2017, nonaccruing TDRs, which are included in nonperforming loans, totaled $4.85 million, and accruing TDRs totaled $22.28 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):

	September 30, 2017	December 31, 2016
Construction and land development	$ 286	$ 696
Commercial real estate	3,308	5,110
Multifamily real estate	640	690
1-4 family residential real estate	3,475	6,113
Commercial and industrial business loans	707	362
Consumer loans and other	352	128
Total nonperforming loans	$ 8,768	$ 13,099

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

	September 30,		June 30,
	2017	2016	2017
Real estate loans:			
Residential 1-4 family	$ 9,416	$ 8,992	$ 9,096
Commercial	17,025	15,585	16,839
Construction	5,410	4,504	5,458
Multifamily	837	1,209	1,191
Total real estate loans	32,688	30,290	32,584
Commercial and industrial loans	6,608	5,959	6,571
Consumer loans and other	5,102	4,406	4,976
Total	$ 44,398	$ 40,655	$ 44,131

Deposits. Total deposits at September 30, 2017, were $6.55 billion, representing an increase of 6.53%, or $401.51 million, over September 30, 2016, and a decrease of $47.31 million, or 0.72%, compared to June 30, 2017. Total average deposits were $6.54 billion during the third quarter of 2017, compared to $6.18 billion during the third quarter of 2016, and $6.27 billion during the second quarter of 2017.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 33.24% during the third quarter of 2017 and 31.71% during the same period in 2016. Average noninterest-bearing demand deposits were 33.21% of average total deposits for the second quarter of 2017. The cost of interest-bearing deposits was 0.71% for the third quarter of 2017, compared with 0.56% for the third quarter of 2016, and 0.66% for the second quarter of 2017.

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

	Average Balance/Cost Rate Three Months Ended					
	September 30,				June 30,	
	2017		2016		2017	
Interest-bearing demand and money market accounts	$ 2,284,995	0.37%	$ 2,216,987	0.30%	$ 2,235,869	0.35%
Regular savings	320,891	1.07%	318,193	0.90%	318,323	1.03%
Certificates of deposit	1,759,934	1.09%	1,684,136	0.83%	1,632,127	1.01%
Total interest-bearing	4,365,820	0.71%	4,219,316	0.56%	4,186,319	0.66%
Noninterest-bearing	2,173,920		1,959,025		2,081,819	
Total	$ 6,539,740	0.47%	$ 6,178,341	0.38%	$ 6,268,138	0.44%

	Average Balance/Cost Rate Nine Months Ended			
	September 30,		September 30,	
	2017		2016	
Interest-bearing demand and money market accounts	$ 2,264,636	0.35%	$ 1,938,818	0.30%
Regular savings	319,847	1.02%	306,644	0.93%
Certificates of deposit	1,634,566	1.01%	1,510,707	0.88%
Total interest-bearing	4,219,049	0.66%	3,756,169	0.58%
Noninterest-bearing	2,072,000		1,638,902	
Total	$ 6,291,049	0.44%	$ 5,395,071	0.41%

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

	Average Balance and Composition Three Months Ended			
	September 30,				June 30,	
	2017		2016		2017	
Interest-bearing demand and money market accounts	$ 2,284,995	34.94%	$ 2,216,987	35.88%	$ 2,235,869	35.67%
Regular savings	320,891	4.91%	318,193	5.15%	318,323	5.08%
Certificates of deposit	1,759,934	26.91%	1,684,136	27.26%	1,632,127	26.04%
Total interest-bearing	4,365,820	66.76%	4,219,316	68.29%	4,186,319	66.79%
Noninterest-bearing	2,173,920	33.24%	1,959,025	31.71%	2,081,819	33.21%
Total	$ 6,539,740	100.00%	$ 6,178,341	100.00%	$ 6,268,138	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2017, were \$527.07 million, compared to \$427.65 million at September 30, 2016, and \$527.22 million at June 30, 2017. The average borrowing cost for the third quarter of 2017 was 1.30%, 2.72% in the third quarter of 2016, and 1.27% in the second quarter of 2017.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2017, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
01/29/2018	3.05%	—	$ 13,000
11/15/2028	3.43%	—	4,703
12/01/2028	2.83%	—	3,369
12/07/2020	1.17%	10/10/2017	74,000
08/29/2019	1.17%	10/30/2017	72,000
11/04/2019	1.26%	—	260,000
03/06/2020	1.21%	10/06/2017	100,000
		Total FHLB Loans	**$ 527,072**

During fourth quarter 2016, the Company pre-funded \$260 million of FHLB advances that had maturities in the first and second quarters of 2017. The existing cost on these funds was an average of 4.28% and was replaced at a cost of 1.26%.

At September 30, 2017, certain residential home equity lines of credit ("HELOCS"), second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of \$1.10 billion collateralized the advances from the FHLB. At September 30, 2016, certain loans with carrying values of \$1.01 billion collateralized the advances from the FHLB. At June 30, 2017, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of \$1.19 billion 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 September 30, 2017, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the third quarter of 2017 were $554.15 million, compared with $523.02 million for the third quarter of 2016, and $641.75 million for the second quarter of 2017, while the average cost of these funds was 1.25%, 2.48%, and 1.57%, respectively.

Subordinated Capital Debentures. On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027, in a public offering. The Company received $247.07 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.550%. The Company may redeem the subordinated notes, in whole or in part, on or after July 30, 2022. At September 30, 2017, the carrying value of the notes totaled $247.13 million and average subordinated debt during the third quarter of 2017 was $204.15 million, while the average cost of the debentures was 4.64%.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* starting on page 46 in this report.

On February 22, 2017, we declared a quarterly shareholder cash dividend of $0.13 per common share. The dividend was paid April 12, 2017, to shareholders of record on March 30, 2017.

On May 23, 2017, we declared a quarterly shareholder cash dividend of $0.14 per common share. The dividend was paid July 12, 2017, to shareholders of record on June 30, 2017.

On August 23, 2017, we declared a quarterly shareholder cash dividend of $0.14 per common share. The dividend was paid October 12, 2017, to shareholders of record on September 29, 2017. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

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

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

In July 2013, the FDIC and the other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the FDIC final rule's revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. A transition period for the capital conservation buffer under Basel III for all banking organizations 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 12.36% for common equity tier I, 12.40% for tier I capital, and 16.71% for total capital, which are well above the required minimums of 4.50%, 6.00%, and 8.00%, respectively. Under the FDIC rules, we are considered "well capitalized" as of September 30, 2017.

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

	September 30, 2017	September 30, 2016	June 30, 2017
Tier I Capital:			
Shareholders' equity	$ 1,140,851	$ 1,078,878	$ 1,122,998
Less: goodwill and disallowed intangible assets, net of deferred tax	296,229	286,665	293,580
AOCI-related adjustments	(2,408)	1,339	(2,355)
Noncontrolling interests	11,263	11,685	12,317
Total common equity tier I capital	835,767	779,189	819,456
Included noncontrolling interests	3,062	4,984	3,186
Total tier I capital	838,829	784,173	822,642
Tier II Capital:			
Qualifying allowance for loan losses (1)	44,398	40,655	44,131
Qualifying subordinated debt	247,128	—	—
Total tier II capital	291,526	40,655	44,131
Total Risk-Based Capital	$ 1,130,355	$ 824,828	$ 866,773
Total assets	$ 8,614,794	$ 7,830,142	$ 8,427,042
Total risk-weighted assets (2)	6,762,783	6,639,020	6,837,630
Average assets for leverage capital purposes	8,276,653	7,704,548	7,890,484
Risk-weighted assets to total assets	78.50%	84.79%	81.14%
Risk-based capital ratios:			
Common equity tier I (4.5% minimum requirement)	12.36%	11.74%	11.98%
Tier I (6% minimum requirement)	12.40%	11.81%	12.03%
Total (8% minimum requirement)	16.71%	12.42%	12.68%
Tier I leverage ratio (4% minimum requirement)	10.14%	10.18%	10.43%

(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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Return on average assets (GAAP basis)	1.26%	1.20%	1.22%	0.93%
Impact of excluding average goodwill and other intangibles and amortization	0.11%	0.12%	0.11%	0.08%
Return on average tangible assets	1.37%	1.32%	1.33%	1.01%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Return on average equity (GAAP basis)	9.49%	8.95%	9.04%	6.99%
Impact of excluding average goodwill and other intangibles and amortization	4.18%	4.14%	4.05%	2.81%
Return on average tangible equity	13.67%	13.09%	13.09%	9.80%

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

	Three Months Ended September 30,	
	2017	**2016**
Book value (GAAP basis)	$ 18.04	17.11
Impact of excluding goodwill and other intangibles and amortization	(4.96)	(4.88)
Tangible book value	$ 13.08	12.23

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 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.

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

At September 30, 2017, we had $53.83 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

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

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

Change in Prime Rate	% Change in Net Interest Income
+ 300 basis points	16.05 %
+ 200 basis points	11.03 %
+ 100 basis points	5.87 %
- 100 basis points	(9.56)%

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

Change in Prime Rate	Change in Net Market Value (dollars in thousands)	
+ 300 basis points	$	4,792
+ 200 basis points	$	23,263
+ 100 basis points	$	37,189
- 100 basis points	$	(155,838)

PART I. FINANCIAL INFORMATION
Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2017, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2017. 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 2016 Annual Report on Form 10-K and Part I, Item 1A, of TowneBank's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017. 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 2016 Annual Report on Form 10-K and TowneBank's Quarterly Report on Form 10-Q for the quarter ended March 31, 2017.

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

Item 3. Defaults Upon Senior Securities
None

Item 4. Mine Safety Disclosures
Not applicable

Item 5. Other Information
None

Item 6. Exhibits

Exhibit No.	Description
(2.1)	Agreement and Plan of Reorganization, dated as of April 26, 2017, by and among TowneBank, TB Acquisition, LLC, Paragon Commercial Corporation and Paragon Commercial Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on May 2, 2017).
(3.2)	Bylaws, as amended (incorporated herein by reference to Exhibit 3.2 to our Form 10-Q, previously filed with the FDIC on August 8, 2017).
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
(99)	Report of Independent Registered Public Accounting Firm dated November 9, 2017.

Signatures

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

TOWNEBANK

November 9, 2017	By:	/s/ G. Robert Aston, Jr.
Date		G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
November 9, 2017	By:	/s/ Clyde E. McFarland, Jr.
Date		Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

Exhibit (31.1)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2017 of TowneBank;

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

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

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

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

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

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

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

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

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

Exhibit (31.1)

continued

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

November 9, 2017	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr.
	Chairman of the Board/Chief Executive Officer

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

Exhibit (31.2)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2017 of TowneBank;

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

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

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

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

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

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

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

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

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

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

November 9, 2017	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

Exhibit (32)

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

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

1. Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2017 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

November 9, 2017	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
November 9, 2017	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

Exhibit 99

DIXON HUGHES GOODMAN LLP

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of *TowneBank*

We have reviewed the consolidated balance sheets of TowneBank and subsidiaries (the Company) as of September 30, 2017 and 2016, the related consolidated statements of income, comprehensive income, and cash flows for the three and nine-month periods ended September 30, 2017 and 2016, and the related consolidated statement of equity for the nine months ended September 30, 2017. These financial statements are the responsibility of the Company's management.

We conducted our review 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 statements 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 financial statements referred to above for them 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, 2016, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated March 1, 2017, 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, 2016, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Dixon Hughes Goodman LLP

Norfolk, Virginia
November 9, 2017