FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C. 20429

FORM 10-K

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

For the fiscal year ended December 31, 2017

FDIC Insurance Certificate Number: 35095

TOWNEBANK

(Exact name of registrant as specified in its charter)

VIRGINIA	**54-1910608**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
5716 High Street, Portsmouth, VA	**23703**
(Address of principal executive offices)	(Zip Code)

(757) 638-7500

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☐ (Do not check if a smaller reporting company)	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 aggregate market value of the common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $1.72 billion.

Number of shares of common stock outstanding at February 26, 2018: 72,052,310 shares

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Registrant's 2017 Annual Report to Shareholders are incorporated by reference into Parts I, II, and IV; and
(2) Portions of the Registrant's 2018 Proxy Statement for its Annual Meeting of Shareholders to be held May 23, 2018 are incorporated by reference into Part III.

TOWNEBANK

Cross Reference Index

FORM 10-K

Part I

Part II

Part III

Part IV

Forward-Looking Statements

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

Item 1. BUSINESS

Overview

TowneBank began operations as a Virginia chartered bank in April 1999. We offer retail and commercial banking services to Richmond, Virginia, the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. On January 26, 2018, the Company completed its acquisition of Paragon Commercial Corporation ("Paragon"), and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices serving the Raleigh and Charlotte, North Carolina metropolitan areas. The Company acquired approximately $1.43 billion in loans and assumed approximately $1.25 billion in deposits. The Company will continue to operate in the Raleigh and Charlotte markets under the Paragon brand as "Paragon Bank, a division of TowneBank." We place special emphasis on serving the financial needs of individuals and small and medium-sized businesses.

We offer a diversified range of financial services through our banking and non-banking subsidiaries. Our principal subsidiaries include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, LLC ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; The Frieden Agency LLC, d/b/a Towne

Benefits ("Towne Benefits"); Out of Town, LLC, d/b/a Red Sky Travel Insurance ("Red Sky"); Towne Financial Services Group, LLC; Towne Mortgage, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; Towne Center Mortgage, LLC; Towne First Mortgage, LLC; Advance Financial Group, LLC; Coastal Home Mortgage, LLC; Homesale Mortgage, LLC; SimonTowne Mortgage, LLC; Towne 1031 Exchange, LLC ("Towne 1031 Exchange"); Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head ("Beach Properties"); Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations ("Towne Oak Island"); Towne Vacations Deep Creek, LLC, d/b/a Railey Mountain Lake Vacations ("Deep Creek"); and Towne Realty, LLC, d/b/a Berkshire Hathaway HomeServices Towne Realty ("Towne Realty"), which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements ("Virginia Home Title"). We also have two controlled divisions: Towne Investment Group, which provides investment and asset management services, and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries.

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

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

Additional information relating to our business and our subsidiaries is included in the 2017 Annual Report to Shareholders ("Annual Report") filed as Exhibit 13 hereto and incorporated herein by reference.

Organization

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

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

Realty Segment. The Realty segment provides residential real estate services, originations of a variety of mortgage loans, resort property management, and residential and commercial title insurance. It includes TowneBank Mortgage; Towne Mortgage, LLC; NewTowne Mortgage, LLC; 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; Homesale Mortgage, LLC; Beach Properties; Towne Oak Island; Deep Creek; Virginia Home Title; and Towne Realty.

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

Operating Philosophy

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

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

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

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

Services

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

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

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

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

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

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

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

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

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

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

Competition

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

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

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

Market Area

Our primary service area is Richmond, Virginia, the Greater Hampton Roads region in southeastern Virginia, northeastern North Carolina, and following our acquisition of Paragon, the Raleigh and Charlotte metropolitan areas in North Carolina. This market includes the Virginia cities and counties of Chesapeake, Chesterfield County, Gloucester County, Hampton, Hanover County, Henrico County, James City County, Newport News, Norfolk, Poquoson, Portsmouth, Richmond, Suffolk, Virginia Beach, Williamsburg, and York County, and the North Carolina cities and counties of Raleigh, Charlotte, Cary, Camden County, Corolla, Grandy, Kill Devil Hills, Moyock, and Southern Shores.

In Virginia, our service area encompasses the Virginia Beach-Norfolk-Newport News, VA-NC ("Hampton Roads") Metropolitan Statistical Area ("MSA"), the 37th largest metropolitan area in the United States, with a population of approximately 1.73 million as of July 2016, and the Richmond, VA ("Richmond") MSA, the 45th largest metropolitan area in the United States, with a population of approximately 1.28 million as of July 2016. In North Carolina, our service area now encompasses the Raleigh, North Carolina MSA, the 43rd largest metropolitan area in the United States, with a population of approximately 1.30 million as of July 2016. Including nearby Chapel Hill and Durham, North Carolina, the area has a combined population of over 2.0 million. Our service area also now includes the Charlotte, North Carolina MSA, the 22nd largest metropolitan area in the United States, with a population of approximately 2.47 million as of July 2016.

We also offer residential mortgages in Charlottesville, Virginia, the North Carolina cities of Charlotte, Elizabeth City, Raleigh, and Wilmington, in the Washington-Arlington-Alexandria, DC-VA-MD-WV MSA, in the Baltimore-Columbia-Towson, MD MSA, in Frederick, Maryland, and in Lancaster, Pennsylvania. Additionally, we have insurance offices located in Greenville and Raleigh, North Carolina, and the counties of Essex, Gloucester, Northumberland, Prince William, and Richmond in Virginia.

Concentrations

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

Governmental Monetary Policies

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

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

Development of Business

The following is a summary of the major developments in our business since January 1, 2017:

- TowneBank remained in first place, ahead of Wells Fargo, Bank of America, SunTrust, and BB&T, in the latest Hampton Roads Annual Deposit Market Share Report released by the FDIC. The report ranks institutions by share of FDIC-insured deposits in the Hampton Roads MSA as of June 30, 2017. TowneBank had a 22.01% share of deposits in Hampton Roads and was the only community bank with a share greater than 5%. TowneBank was in eighth place in the Richmond MSA in the FDIC's Annual Deposit Market Share Report with $785.65 million in deposits as of June 30, 2017.

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

- Effective 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 purchase price for the transaction was $8.93 million in cash.

- Effective August 1, 2017, the Company acquired W.A. Moore & Company, an independent insurance agency, which was merged with the operations of Towne Insurance, a wholly owned subsidiary of TowneBank. The total purchase price for the transaction was $4.14 million in cash, common stock, and contingent common stock.

- Effective January 26, 2018, the Company completed its acquisition of 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 Company acquired approximately $1.43 million in loans and assumed approximately $1.25 billion in deposits. The purchase price for the transaction was $294.07 million in common stock.

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

Supervision and Regulation

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

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

We are also subject to the enforcement and rule-making authority of the Consumer Financial Protection Bureau ("CFPB") regarding consumer financial products. The CFPB has the authority to create and enforce consumer protection rules and regulations and has the power to examine us for compliance with such rules and regulations. The CFPB also has the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets, which we exceeded following the Paragon acquisition that was effective January 26, 2018.

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

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

The Basel III Capital Rules, among other things, (i) introduce as a new capital measure "Common Equity Tier 1" ("CET1"), (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expand the scope of the adjustments as compared to existing regulations. CET1 capital consists of common stock instruments that meet eligibility criteria in the final rules, retained earnings, and common equity Tier 1 minority interest. The capital rules require banks to include accumulated other comprehensive income ("AOCI") into CET1 unless the bank uses a one-time election to exclude AOCI from its regulatory capital metrics. We elected to exclude AOCI from CET1.

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

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

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

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

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income, and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, and is being phased in over a five-year period (20% per year). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and is phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

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

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

In September 2017, the federal bank regulators proposed to revise and simplify the capital treatment for certain deferred tax assets, mortgage servicing assets, investments in non-consolidated financial entities and minority interests for banking organizations, such as TowneBank, that are not subject to the advanced approaches requirements. In November 2017, the federal banking regulators revised the Basel III Capital Rules to extend the current transitional treatment of these items for non-advanced approaches banking organizations until the September 2017 proposal is finalized. The September 2017 proposal would also change the capital treatment of certain commercial real estate loans under the standardized approach, which we use to calculate our capital ratios.

In December 2017, the Basel Committee on Banking Supervision (the "Basel Committee") published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as "Basel IV"). Among other things, these standards revise the Basel Committee's standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain "unconditionally cancellable commitments," such as unused credit card lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Company. The impact of Basel IV on us will depend on the manner in which it is implemented by the federal bank regulators.

At December 31, 2017, we had the following risk-based capital and leverage ratios relative to regulatory minimums.

Ratio	TowneBank	Minimum	Well Capitalized
Common equity Tier 1	12.19%	4.50%	6.50%
Tier 1 risk-based capital	12.23%	6.00%	8.00%
Total risk-based capital	16.48%	8.00%	10.00%
Tier 1 leverage	10.17%	4.00%	5.00%

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

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

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

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

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

In addition, because our assets exceed $10 billion following the acquisition of Paragon on January 26, 2018, we are subject to the Durbin Amendment promulgated under the Dodd-Frank Act. Under the rule, the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and five basis points multiplied by the value of the transaction. The rules also allow for an upward adjustment of no more than one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. This limitation on interchange fees will adversely impact our results of operations.

The Dodd-Frank Act created the CFPB, an independent federal agency, with broad rule-making, supervisory, and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets, such as the Company following the Paragon acquisition. Smaller institutions are subject to rules promulgated by the CFPB, but are examined and supervised by federal banking regulators for consumer compliance purposes.

In 2017, both the House of Representatives and the Senate introduced legislation that would repeal or modify provisions of the Dodd-Frank Act and significantly impact financial services regulation. Although the bills vary in content, certain key aspects include revisions to rules related to mortgage loans, delayed implementation of rules related to the Home Mortgage Disclosure Act, reform and simplification of certain Volcker Rule requirements, and raising the threshold for applying enhanced prudential standards to bank holding companies with total consolidated assets equal to or greater than $50 billion to those with total consolidated assets equal to or greater than $250 billion.

The Dodd-Frank Act has had, and may in the future have, a material impact on the Company's operations, particularly through increased compliance costs resulting from new and possible future consumer and fair lending regulations. See Part I, Item 1A, "Risk Factors" for additional discussion of this topic.

Stress Testing Requirements. In October 2012, as required by the Dodd-Frank Act, the FDIC published final rules regarding company-run stress testing. Pursuant to the rules, a bank with average consolidated assets over the four most recent consecutive quarters of greater than $10 billion is required to conduct an annual stress test of capital, consolidated earnings and losses under one base and at least two stress scenarios provided by federal bank regulators. We expect to exceed this threshold in 2018 and to conduct our first stress test in 2020. We have been actively preparing for these tests in anticipation of exceeding the $10 billion threshold. We expect that the results of the tests will be an important factor for our regulators in evaluating our capital adequacy, examining our operations generally and considering any request for regulatory approval we may make, even requests for approvals on unrelated matters.

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

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

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

The FDIC's risk-based premium system provides for quarterly assessments. Each insured institution is placed in one of four risk categories, depending on supervisory and capital considerations. Within its risk category, an institution is assigned to an initial base assessment rate, which is then adjusted to determine its final assessment rate based on its brokered deposits, secured liabilities, and unsecured debt. Assessment rates are between 1.5 to 16 basis points for banks in the lowest risk category, and between 11 to 30 basis points for banks in the highest risk category.

FDIC insurance expense totaled $2.45 million, $3.02 million, and $3.50 million in 2017, 2016, and 2015. FDIC insurance expense includes deposit insurance assessments and Financing Corporation ("FICO") assessments related to outstanding FICO bonds. FICO is a mixed-ownership government corporation established to recapitalize a predecessor to the DIF. The current annualized FICO assessment rate is 0.46 basis points, or 0.115 basis points per quarter. These assessments will continue until the Financing Corporation bonds mature in 2019.

Following the fourth consecutive quarter (and any applicable phase-in period) in which our total consolidated assets equal or exceed $10 billion, the FDIC will use a performance score and a loss-severity score to calculate our assessment rate. We expect to exceed this threshold in 2018. In calculating these scores, the FDIC uses a bank's capital level and regulatory supervisory ratings and certain financial measures to assess an institution's ability to withstand asset-related stress and funding-related stress. The FDIC also has the ability to make discretionary adjustments to the total score based upon significant risk factors that are not adequately captured in the calculations. In addition to ordinary assessments described above, the FDIC has the ability to impose special assessments in certain instances.

Historically, deposit insurance premiums we have paid to the FDIC have been deductible for federal income tax purposes; however, the Tax Cuts and Jobs Act of 2017 (the "Tax Reform Act") disallows the deduction of such premium payments for banking organizations with total consolidated assets of $50 billion or more. For banks with less than $50 billion in total consolidated assets, such as the Company, the premium deduction is phased out based on the proportion of a bank's assets exceeding $10 billion. We anticipate the after-tax cost of our deposit insurance premium payments to increase in 2018 as a result of the Tax Reform Act and the Company's assets exceeding the $10 billion threshold following the Company's acquisition of Paragon on January 26, 2018.

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

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

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

These publicly available reports must include: (i) annual financial statements prepared in accordance with accounting principles generally accepted in the United States and such other disclosure requirements as required by the FDIC or the appropriate agency, and (ii) a management report signed by the Chief Executive Officer and the Chief Financial Officer or Chief Accounting Officer of the institution that contains a statement of management's responsibilities for: (a) preparing the annual financial statements, (b) establishing and maintaining an adequate internal control structure and procedures for financial reporting, and (c) complying with the laws and regulations designated by the FDIC relating to safety and soundness, and an assessment of: (1) the effectiveness of the system of internal control and procedures for financial reporting as of the end of the fiscal year, and (2) the institution's compliance during the fiscal year with applicable laws and regulations designated by the FDIC relating to safety and soundness.

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

Privacy Legislation. Several laws, including the Right to Financial Privacy Act and related regulations issued by federal bank regulatory agencies, provide protections against the transfer and use of customer information by financial institutions. A financial institution must provide to its customers information regarding its policies and procedures with respect to the handling of customers' personal information. Each institution must conduct an internal risk assessment of its ability to protect customer information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated parties without prior notice and approval from the customer.

Bank Secrecy Act. The Bank Secrecy Act ("BSA"), which is intended to require financial institutions to develop policies, procedures, and practices to prevent and deter money laundering, mandates that every bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA. The program must, at a minimum: (i) provide for a system of internal controls to assure ongoing compliance; (ii) provide for independent testing for compliance; (iii) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (iv) provide training for appropriate personnel. In addition, a bank is required to adopt a customer identification program as part of its BSA compliance program. Financial institutions are generally required to report cash transactions involving more than $10,000 to the U.S. Department of the Treasury. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than $5,000 and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA, or has no lawful purpose. The USA PATRIOT Act of 2001, enacted in response to the September 11, 2001, terrorist attacks, requires bank regulators to consider a financial institution's compliance with the BSA when reviewing applications from a financial institution. In May 2016, the regulations implementing the BSA were amended to explicitly include risk-based procedures for conducting ongoing customer due diligence, to include understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile. In addition, banks must identify and verify the identity of the beneficial owners of all legal entity customers (other than those that are excluded) at the time a new account is opened (other than accounts that are exempted). We must comply with these amendments and new requirements by May 11, 2018.

Volcker Rule. On December 10, 2013, five U.S. financial regulators, including the FDIC, adopted final rules implementing the Volcker Rule. The final rules prohibit banking entities from (i) engaging in short-term proprietary trading for their own accounts, and (ii) having certain ownership interests in and relationships with hedge funds or private equity funds. The Volcker Rule is intended to provide greater clarity with respect to both the extent of those primary prohibitions and the related exemptions and exclusions. On December 18, 2014, the Federal Reserve announced that it had acted under Section 619 of the Dodd-Frank Act to give banking entities until July 21, 2016, to conform investments in and relationships with covered funds and foreign funds that were in place prior to December 31, 2013 (“legacy covered funds”). The Federal Reserve also announced its intention to grant banking entities an additional one-year extension of the conformance period until July 21, 2017, to conform ownership interests in and relationships with legacy covered funds. The Company has evaluated the impact of the Volcker Rule and does not anticipate that it will have a material effect on our operations, as we do not engage in activities prohibited by the Volcker Rule.

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

Section 956 of the Dodd-Frank Act requires the federal banking agencies and the Securities and Exchange Commission to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities that encourage inappropriate risk-taking by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. The federal banking agencies issued such proposed rules in March 2011 and issued a revised proposed rule in June 2016 implementing the requirements and prohibitions set forth in Section 956. The revised proposed rule would apply to all banks, among other institutions, with at least $1 billion in average total consolidated assets, for which it would go beyond the existing *Interagency Guidance on Sound Incentive Compensation Policies* to (i) prohibit certain types and features of incentive-based compensation arrangements for senior executive officers, (ii) require incentive-based compensation arrangements to adhere to certain basic principles to avoid a presumption of encouraging inappropriate risk, (iii) require appropriate board or committee oversight, (iv) establish minimum recordkeeping, and (v) mandate disclosures to the appropriate federal banking agency.

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

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

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

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

Future Legislation and Regulation. Congress may enact legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulation, or the application thereof, cannot be predicted, although enactment of the proposed legislation could impact the regulatory structure under which we operate and may significantly increase costs, impede the efficiency of internal business processes, require an increase in regulatory capital, require modifications to business strategy, and limit the ability to pursue business opportunities in an efficient manner.

Tax Reform. On December 22, 2017, the President of the United States signed into law the Tax Cut and Jobs Act of 2017. The legislation made key changes to the U.S. tax law, including the reduction of the U.S. federal corporate tax rate from 35% to 21%, effective January 1, 2018. As a result of the reduction in the U.S. corporate income tax rate from 35% to 21% under the Tax Reform Act, the Company revalued its ending net deferred tax assets at December 31, 2017 and recognized a provisional $10.11 million tax expense in the Company's consolidated statement of income for the year ended December 31, 2017. We are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018.

The Tax Reform Act also disallows the deduction of FDIC insurance premium payments for banking organizations with total consolidated assets of $50 billion or more. For banks with less than $50 billion in total consolidated assets, such as the Company, the premium deduction is phased out based on the proportion of a bank's assets exceeding $10 billion. We anticipate the after-tax cost of our deposit insurance premium payments to increase in 2018 as a result of the Tax Reform Act and the Company's assets exceeding the $10 billion threshold.

A "publicly held corporation," such as the Company, is not permitted to deduct compensation in excess of $1 million per year paid to certain employees. The Tax Reform Act eliminates certain exceptions to the $1 million limit applicable under prior law related to performance-based compensation, such as equity grants and cash bonuses that are paid only on the attainment of performance goals. As a result, our ability to deduct certain compensation paid to our most highly compensated employees will now be limited.

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

Employees

As of December 31, 2017, we had 2,313 full-time equivalent employees, excluding real estate agents. There were 414 real estate sales agents at December 31, 2017. Our real estate agents are independent contractors and not included as our employees. None of our employees are represented by any collective bargaining agreements, and relations with employees are considered good.

Available Information

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

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

Item 1A. RISK FACTORS

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

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

Like all financial institutions, we are subject to the effects of any economic downturn. During the past decade, the U.S. economy faced a severe economic crisis, including a major recession. Business activity across a wide range of industries and regions in the U.S. was reduced, and local governments and many businesses experienced financial difficulty. Our business is concentrated in the Richmond, Virginia region, the Greater Hampton Roads region in southeastern Virginia, northeastern North Carolina, and, following our acquisition of Paragon on January 26, 2018, the Raleigh and Charlotte metropolitan areas in North Carolina. As a result, the financial condition and results of operations may be affected by changes in the economies of these regions. Adverse changes in economic conditions in our market areas would likely impair the ability to collect loans and could otherwise have a material adverse effect on our financial condition and results of operations. While conditions have improved since the recession, there can be no assurance that this improvement will be sustained, and any declines may have a negative effect on our financial conditions and results of operations.

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

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

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

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

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

Economic and other conditions may cause volatility in the price of our common stock.

In the current economic environment, the prices of publicly traded stocks in the financial services sector have been volatile. However, even in a more stable economic environment, the price of our common stock can be affected by a variety of factors, such as expected or actual results of operations, changes in analysts' recommendations or projections, announcements of developments related to our businesses, operating and stock performance of other companies deemed to be peers, news or expectations based on the performance of others in the financial services industry, and expected impacts of a changing regulatory environment. These factors not only impact the price of our common stock but could also affect the liquidity of the stock, given the Company's size, geographical footprint, and industry. The price for shares of our common stock may fluctuate significantly in the future, and these fluctuations may be unrelated to the Company's performance. General market price declines or market volatility in the future could adversely affect the price for shares of our common stock, and the current market price of such shares may not be indicative of future market prices.

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

As of December 31, 2017, we had $308.82 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates, or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our financial condition and results of operations.

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

We are a relationship-driven organization. A key aspect of our business strategy is for our senior officers to have primary contact with our customers. Our growth and development to date have been, in large part, a result of these personalized relationships with our customer base. The success of our acquisitions also often depends on our ability to retain and integrate the senior officers of acquired businesses.

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

Reliance on certain external vendors could adversely affect our operations.

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

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

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

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

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

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

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

Security breaches and other disruptions could compromise our information and expose us to liability or result in the loss of money, which could damage our reputation and our business.

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

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

Our risk-management framework may not be effective in mitigating risk and loss.

We maintain an enterprise risk management program that is designed to identify, quantify, monitor, report, and control the risks that we face. These risks include: strategic, reputational, credit, liquidity, interest rate, operational, compliance, pricing, legal and cybersecurity. While we assess and improve this program on an ongoing basis, there can be no assurance that our approach and framework for risk management and related controls will effectively mitigate all risk and limit losses in our business. If conditions or circumstances arise that expose flaws or gaps in our risk-management program, or if our controls break down, our results of operations and financial condition may be adversely affected.

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

Effective internal and disclosure controls and procedures are necessary to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. Our management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, no matter how well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our results of operations and financial condition.

Negative perception of the Company through media may adversely affect our reputation and business.

The Company's reputation is critical to the success of its business. We believe that our brand image has been well received by customers, reflecting the fact that the brand image, like our business, is based in part on trust and confidence. Our reputation and brand image could be negatively affected by rapid and widespread distribution of publicity through social and traditional media channels. Our reputation could also be affected by our association with clients affected negatively through media distribution, or other third parties, or by circumstances outside of our control. Negative publicity, whether true or untrue, could affect our ability to attract or retain customers, or cause us to incur additional liabilities or costs, or result in additional regulatory scrutiny.

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

Certain provisions of our articles of incorporation and bylaws could delay or frustrate the removal of incumbent directors and could make a merger, tender offer, or proxy contest more difficult, even in instances where shareholders deem the proposed transaction to be beneficial to their interests. These provisions, among others, provide for staggered terms for the Board of Directors and that a plan of merger, share exchange, sale of all or substantially all of our assets, or similar transaction must be approved and recommended by the affirmative vote of at least two-thirds of the directors in office or, if not so approved and recommended, by the affirmative vote of the holders of 80% of our outstanding shares, and limit the ability of shareholders to call a special meeting. In addition, certain provisions of state and federal law may also have the effect of discouraging or prohibiting a future takeover attempt in which our shareholders might otherwise receive a substantial premium for their shares over then-current market prices. To the extent that these provisions discourage or prevent takeover attempts, they may tend to reduce the market price for our common stock and the notes.

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

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

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

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

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

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

Combining the Company and Paragon may be more difficult, costly or time-consuming than we expect.

The success of the Paragon acquisition will depend, in part, on our ability to realize the anticipated benefits and cost savings from combining the businesses of the Company and Paragon without materially disrupting existing customer relationships. The Company and Paragon operated independently until the acquisition was consummated on January 26, 2018, and we are in the process of integrating Paragon's business with our operations. The integration process could result in the loss of key employees, the disruption of our ongoing business, and inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers and employees or achieve the anticipated benefits of the merger. The loss of key employees could adversely affect our ability to successfully conduct our business, which could have an adverse effect on our financial results and the value of our common stock. If we experience difficulties with the integration process, the anticipated benefits of the merger may not be realized, fully or at all, or may take longer to realize than expected. As with any merger of financial institutions, there also may be disruptions that cause us to lose customers or cause customers to withdraw their deposits, or other unintended consequences that could have a material adverse effect on our results of operations or financial condition.

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

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

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

We offer a variety of loan products, including residential mortgage, consumer, construction, and commercial loans. At December 31, 2017, approximately 56.68% of loans were commercial loans, including those secured by commercial real estate. It is expected that, as we grow, this percentage will remain fairly constant.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We may be required to repurchase residential mortgage loans or reimburse investors and others as a result of breaches in contractual representations and warranties.

We sell residential mortgage loans to various parties, which may include government sponsored entities and other bank and non-bank financial institutions that purchase residential mortgage loans for investment or private label securitization. We may be required to repurchase residential mortgage loans, indemnify the securitization trust, investor or insurer, or reimburse the securitization trust, investor or insurer for credit losses incurred on loans in the event of a breach of contractual representations or warranties that is not remedied within a specified period (usually 60 days or less) after we receives notice of the breach. Contracts for residential mortgage loan sales to these entities include various types of specific remedies and penalties that could be applied to inadequate responses to repurchase requests. If economic conditions and the housing market deteriorate or future investor repurchase demand and our success at appealing repurchase requests differ from past experience, we could have increased repurchase obligations and increased loss severity on repurchases, that could adversely affect operations.

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

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

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

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

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

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

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms (the standards are commonly referred to as "Basel IV"). Among other things, these standards revise the Basel Committee's standardized approach for credit risk (including by recalibrating risk weights and introducing new capital requirements for certain "unconditionally cancellable commitments," such as unused credit card lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Company. The impact of Basel IV on us will depend on the manner in which it is implemented by the federal bank regulators.

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

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

Extensive government regulation and monetary policy could adversely affect operations.

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

We will be subject to additional regulatory scrutiny because our total assets exceed $10 billion as of the Paragon acquisition.

As of December 31, 2017, we had $8.52 billion in total consolidated assets. However, the Paragon acquisition, which closed on January 26, 2018, caused us to exceed the $10 billion consolidated assets threshold. 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, banks with $10 billion or more in total assets are primarily examined by the CFPB with respect to various federal consumer financial protection laws and regulations. Previously, we were subject to regulations adopted by the CFPB, but the FDIC was primarily responsible for examining our compliance with consumer protection laws and those CFPB regulations.

Under the Dodd-Frank Act, the minimum ratio of net worth to insured deposits of the Deposit Insurance Fund was increased from 1.15% to 1.35% and the FDIC is required, in setting deposit insurance assessments, to offset the effect of the increase on institutions with assets of less than $10 billion, which results in institutions with assets greater than $10 billion paying higher assessments. In addition, institutions with assets greater than $10 billion are subject to a deposit assessment based on a new scorecard issued by the FDIC. The scorecard method uses a performance score and a loss severity score, which are combined and converted into an initial base assessment rate. The performance score is based on measures of a bank's ability to withstand asset-related stress and funding-related stress and weighted CAMELS ratings, which are ratings ascribed under the CAMELS supervisory rating system and assigned based on a supervisory authority's analysis of a bank's financial statements and on-site examinations. The loss severity score is a measure of potential losses to the FDIC in the event of the bank's failure. Under a formula, the performance score and loss severity score are combined and converted to a total score that determines the bank's initial base assessment rate. The FDIC has the discretion to alter the total score based on factors not captured by the scorecard. The resulting initial base assessment rate is also subject to adjustments downward based on long-term unsecured debt issued by the bank, to adjustment upward based on long-term unsecured debt held by the bank that is issued by other FDIC-insured institutions, and to further adjustment upward if the bank's brokered deposits exceed 10% of its domestic deposits.

In addition, because our assets now exceed $10 billion, we are subject to the Durbin Amendment promulgated under the Dodd-Frank Act. Under the Durbin Amendment, the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and five basis points multiplied by the value of the transaction. The rules also allow for an upward adjustment of no more than one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. This limitation on interchange fees will adversely impact our results of operations.

In October 2012, as required by the Dodd-Frank Act, the FDIC published final rules regarding company-run stress testing. Pursuant to the rules, a bank with average consolidated assets over the four most recent consecutive quarters of greater than $10 billion is required to conduct an annual stress test of capital, consolidated earnings and losses under one base and at least two stress scenarios provided by federal bank regulators. We expect to exceed this threshold in 2018 and to conduct our first stress test in 2020. We expect that the results of the tests will be an important factor for our regulators in evaluating our capital adequacy, examining our operations generally and considering any request for regulatory approval we may make, even requests for approvals on unrelated matters, and poor test results could have a negative impact on our business and growth initiatives. Compliance with the annual stress testing requirements, part of which must be publicly disclosed, may also be misinterpreted by the market generally or our customers and, as a result, may adversely affect our stock price or our ability to retain customers or effectively compete for new business opportunities.

Compliance with these requirements may necessitate that we hire additional compliance or other personnel, design and implement additional internal controls, or incur other significant expenses, any of which could have a material adverse effect on our business, financial condition or results of operations.

Changes in the federal, state or local tax laws may negatively impact our financial performance.

Changes in tax law could increase our effective tax rates. Such changes may be retroactive to previous periods and as a result could negatively affect our current and future financial performance. The Tax Reform Act, the full impact of which we are still analyzing, is likely to have both positive and negative effects on our financial performance. For example, the new legislation will result in a reduction in our federal corporate tax rate from 35% to 21% beginning in 2018, which will have a favorable impact on our earnings and capital generation abilities. However, the new legislation also enacted limitations on certain deductions, such as the deduction of FDIC deposit insurance premiums, which will partially offset the anticipated increase in net earnings from the lower tax rate. In addition, as a result of the lower corporate tax rate, the Company revalued its ending net deferred tax assets at December 31, 2017 and recognized a provisional $10.11 million tax expense in the Company's consolidated statement of income for the year ended December 31, 2017. The impact of the Tax Reform Act may differ from the foregoing, possibly materially, due to changes in interpretations or in assumptions that we have made, guidance or regulations that may be promulgated, and other actions that we may take as a result of the Tax Reform Act. Similarly, our customers are likely to experience varying effects from both the individual and business tax provisions of the Tax Reform Act and such effects, whether positive or negative, may have a corresponding impact on our business and the economy as a whole.

Potential downgrades of U.S. government securities by one or more of the credit ratings agencies could have a material adverse effect on our operations, earnings and financial condition.

A possible future downgrade of the sovereign credit ratings of the U.S. government and/or a decline in the perceived creditworthiness of U.S. government-related obligations could impact our ability to obtain funding that is collateralized by affected instruments, as well as affect the pricing of that funding when it is available. A downgrade may also adversely affect the market value of such instruments. We cannot predict if, when or how any changes to the credit ratings or perceived creditworthiness of these obligations will affect economic conditions. A downgrade of the sovereign credit ratings of the U.S. government or the credit ratings of related institutions, agencies or instruments could have a material adverse effect our business, financial condition and results of operations.

Loss of deposits or a change in deposit mix could increase our funding costs.

Deposits are a low cost and stable source of funding. We compete with banks and other financial institutions for deposits. Funding costs may increase because we may lose deposits and replace them with more expensive sources of funding, clients may shift their deposits into higher cost products or we may need to raise interest rates to avoid losing deposits. Higher funding costs reduce our net interest margin, net interest income and net income.

There are risks resulting from the use of models in our business.

We rely on quantitative models to measure risks and to estimate certain financial values. Models may be used in such processes as determining the pricing of various products, grading loans and extending credit, measuring interest rate and other market risks, predicting or estimating losses, assessing capital adequacy and calculating economic and regulatory capital levels, as well as to estimate the value of financial instruments and balance sheet items. Poorly designed or implemented models present the risk that our business decisions based on information incorporating model output would be adversely affected due to the inadequacy of that information. Also, information we provide to the public or to our regulators based on poorly designed or implemented models could be inaccurate or misleading.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our bank's main office is located in Portsmouth, Virginia, and our Corporate Administration and Member Service Center is located in Suffolk, Virginia; we own both of these locations. As of December 31, 2017, we occupied an additional 123 properties, of which we own 43, in the cities and counties in which we operate. Additional information with respect to the amounts at which company premises and equipment are carried and commitments under long-term leases is set forth in Note 6 - Premises, Equipment, and Leases in the Annual Report and incorporated herein.

Item 3. LEGAL PROCEEDINGS

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

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

Market Information

Our common stock is listed on the Nasdaq Global Select Market under the symbol TOWN. The following chart shows the high and low quarterly closing sale prices in 2017 and 2016 for the Company's common stock.

	2017		2016	
Quarter	High	Low	High	Low
First	$ 33.50	$ 30.60	$ 20.88	$ 16.65
Second	34.35	29.00	22.64	19.10
Third	33.50	29.50	24.03	21.66
Fourth	34.90	30.75	34.10	23.83

Holders

As of December 31, 2017, we had issued and outstanding 62,629,001 shares of common stock. These shares were held by approximately 10,521 shareholders of record.

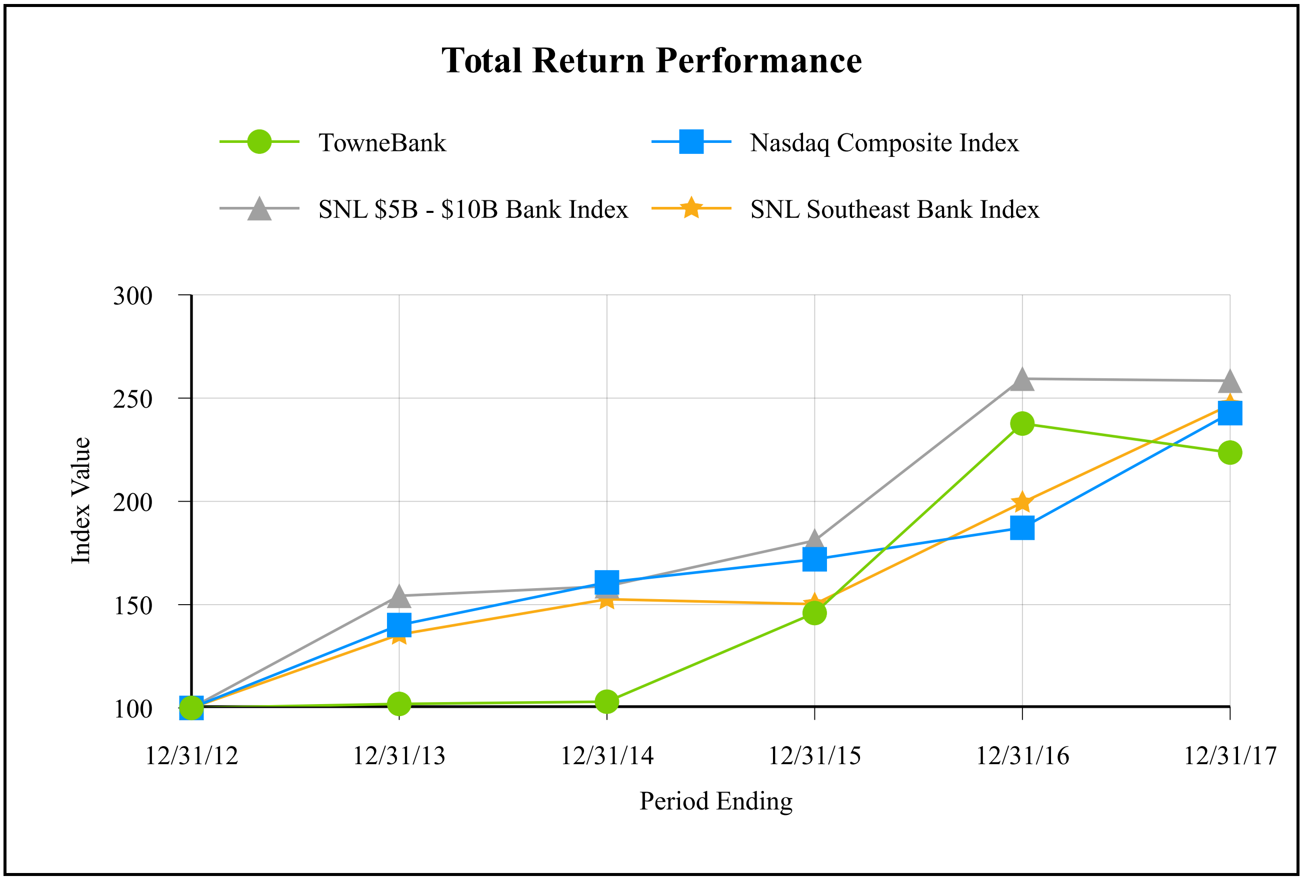
Dividends

In the first quarter of 2016, we declared a quarterly cash dividend of $0.12 per common share. Beginning in the second quarter of 2016 through the first quarter of 2017, we declared cash dividends of $0.13 per common share. In May, August, and November 2017, the Company declared quarterly dividends of $0.14 per common share. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory guidelines.

Our future dividend policy is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. We are also subject to certain restrictions imposed by the reserve and capital requirements of federal and Virginia banking statutes and regulations. See "Part I, Item 1. Business - Supervision and Regulation," for information on regulatory restrictions on dividends.

Stock Performance Graph

The following stock performance graph presents the cumulative total return comparison through December 31, 2017, of stock appreciation for our common stock, the Nasdaq Composite Index measuring all Nasdaq domestic and international-based common type stocks listed on the Nasdaq Stock Market ("Nasdaq Composite"), the SNL Securities Index including banks between $5 billion and $10 billion in total assets ("SNL $5B-$10B Bank Index"), and the SNL Securities Index including only banks in the Southeast ("SNL Southeast Bank Index"). Returns assume an initial investment of $100 at the market close of December 31, 2012, and reinvestment of dividends.



Index	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017
TowneBank	$ 100.00	$ 101.94	$ 103.02	$ 145.94	$ 237.68	$ 223.63
Nasdaq Composite Index	100.00	140.12	160.78	171.97	187.22	242.71
SNL $5B - $10B Bank Index	100.00	154.28	158.92	181.04	259.37	258.40
SNL Southeast Bank Index	100.00	135.52	152.63	150.24	199.45	246.72

Item 6. SELECTED FINANCIAL DATA

Reference is made to the information in the section entitled, "Selected Financial Highlights," of our Annual Report for the year ended December 31, 2017, which is incorporated herein by reference.

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

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) was carried out as of December 31, 2017, under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer, and several other members of our senior management. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report.

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

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

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Reference is made to the information in the sections entitled, "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," and "Board of Directors and Committees: *Audit Committee,"* of our Proxy Statement for the Annual Meeting of Stockholders to be held May 23, 2018 ("Proxy Statement"), which sections are incorporated herein by reference. The following information is provided, as of February 28, 2018, for those executive officers who are not directors.

Name (Age)	Principal Occupation During Past Five Years
W. Jeffrey Dyckman (67)	President of Towne Business Strategy Group since 2009.
Keith D. Horton (59)	Senior Executive Vice President and Chief Administrative Officer since January 2005; Executive Vice President of Operations from 1999 to January 2005.
William B. Littreal (47)	Senior Executive Vice President and Chief Strategy Officer and Director of Investor Relations since June 2016; Senior Executive Vice President and Chief Operating Officer from April 2011 to June 2016; Executive Vice President and Director of Finance from April 2008 to April 2011.
Clyde E. McFarland, Jr. (63)	Senior Executive Vice President and Chief Financial Officer since January 2005; Executive Vice President and Chief Financial Officer from 1999 to January 2005.
U. Starr Oliver (66)	Senior Executive Vice President and Chief Marketing and Human Resources Officer since May 2011; Executive Vice President of Marketing and Retail Banking from 1999 to May 2011.
Philip M. Rudisill (52)	Senior Executive Vice President and Chief Credit Officer since July 2011; Senior Executive Vice President of Corporate Administration from March 2006 to May 2011.
Thomas V. Rueger (70)	Senior Executive Vice President since January 2013; President and Chief Executive Officer of SunTrust Bank, Hampton Roads from August 2006 to May 2012.
George P. Whitley (65)	Senior Executive Vice President and Chief Legal Officer since October 2016. Partner, LeClair Ryan, Richmond, Virginia, from May 1994 to September 2016.

As previously announced, Mr. Littreal has been promoted to the position of Senior Executive Vice President and Chief Financial Officer, effective upon the retirement of Mr. McFarland, who has served in that role since the founding of the Company. Mr. Littreal will continue in his investor relations role when he assumes his new post, which is expected to occur on March 1, 2018.

Code of Ethical Conduct

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

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

Item 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to our definitive proxy statement for our 2018 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

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

The information concerning security ownership of certain beneficial owners and management required by this item is incorporated herein by reference to our definitive proxy statement for our 2018 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

The following table summarizes information, as of December 31, 2017, relating to our stock incentive plans, pursuant to which grants of options to acquire shares of common stock may be awarded from time to time.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans [1]
	(A)	(B)	(C)
Equity compensation plans approved by security holders	46,391	$14.97	2,491,746
Equity compensation plans not approved by security holders	—	—	—
Total	46,391	$14.97	2,491,746

(1) Consists of shares available for future issuance under the TowneBank 2017 Stock Incentive Plan.

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

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

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

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

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

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

(1) Financial Statements

The following documents are included in the 2017 Annual Report to Shareholders and are incorporated by reference in this report:

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

(2) Financial Statement Schedules

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

(3) Exhibits

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

Exhibit No.	Description
1.1	Purchase Agreement, dated July 12, 2017, by and between TowneBank and Sandler O'Neill + Partners, L.P. (incorporated herein by reference to Exhibit 1.1 to our Form 8-K, previously filed with the FDIC on July 14, 2017).
2.1	Agreement and Plan of Reorganization, dated 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 with the FDIC on May 2, 2017).
2.2	Agreement and Plan of Reorganization, dated as of December 16, 2015, by and among TowneBank, Monarch Financial Holdings, Inc. and Monarch Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on December 22, 2015).
2.3	Agreement and Plan of Reorganization, dated as of July 14, 2014, by and among TowneBank, Franklin Financial Corporation and Franklin Federal Savings Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on July 16, 2014).
3.1	Articles of Incorporation, as amended (incorporated herein by reference to Exhibit 3.1 to our Form 10-Q, previously filed with the FDIC on August 6, 2014).
3.2	Bylaws, as amended (incorporated herein by reference to Exhibit 3.2 to our Form 8-K, previously filed with the FDIC on January 31, 2018).

PART IV

Exhibits continued

4.1	Form of Global 4.50% Subordinated Note due 2027 (incorporated herein by reference to Exhibit 4.1 to our Form 8-K, previously filed with the FDIC on July 17, 2017).
10.1	TowneBank 1999 Stock Incentive Plan, as amended and restated effective March 24, 2004 (incorporated herein by reference to Exhibit 10.1 to our 2004 Form 10-K, previously filed with the FDIC on March 22, 2005).
10.2	Employment Agreement, dated October 1, 2005, between TowneBank and Jacqueline B. Amato (incorporated herein by reference to Exhibit 10 to our Form 8-K, previously filed with the FDIC on February 15, 2006).
10.3	Form of Employment Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.5 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).
10.4	Form of Employment Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, Clyde E. McFarland, Jr., and U. Starr Oliver (incorporated herein by reference to Exhibit 10.4 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).
10.5	Form of Change in Control Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.4 to our 2003 Form 10-K, previously filed with the FDIC on February 25, 2004).
10.6	Form of Change in Control Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, Clyde E. McFarland, Jr., and U. Starr Oliver (incorporated herein by reference to Exhibit 10.5 to our 2004 Form 10-K, previously filed with the FDIC on February 23, 2005).
10.7	Employment Agreement, dated April 19, 2011, between TowneBank and William B. Littreal (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on April 20, 2011).
10.8	Form of Supplemental Executive Retirement Plan (incorporated herein by reference to Exhibit 10.7 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.9	TowneBank 2008 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.10	TowneBank Annual Incentive Plan applicable prior to 2017 (incorporated herein by reference to Appendix A to the Proxy Statement for the 2012 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 20, 2012).
10.11	TowneBank 2017 Stock Incentive Plan (incorporated herein by reference to Appendix A to the Proxy Statement for the 2017 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 21, 2017).

PART IV

Exhibits continued

10.12	TowneBank Annual Incentive Compensation Plan (incorporated herein by reference to Appendix B to the Proxy Statement for the 2017 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 21, 2017).
10.13	Amended and Restated Split Dollar Life Insurance Agreement, dated as of August 24, 2016, entered into between TowneBank and the trustees of two separate irrevocable life insurance trusts established by G. Robert Aston, Jr., for the benefit of certain family members (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on August 30, 2016).
10.14	Transition and Consulting Agreement, dated as of November 9, 2016, entered into between TowneBank and Jacqueline B. Amato (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on November 15, 2016).
10.15	Employment Agreement, dated December 16, 2015, by and between TowneBank and Brad E. Schwartz (incorporated herein by reference to Exhibit 10.1 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.16	Employment Agreement, dated December 16, 2015, by and between TowneBank and William T. Morrison (incorporated herein by reference to Exhibit 10.3 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.17	Change in Control Employment Agreement, dated December 16, 2015, by and between TowneBank and Brad E. Schwartz (incorporated herein by reference to Exhibit 10.4 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.18	Change in Control Employment Agreement, dated December 16, 2015, by and between TowneBank and William T. Morrison (incorporated herein by reference to Exhibit 10.6 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.19	Retirement Agreement, dated February 5, 2018, by and between TowneBank and Clyde E. McFarland, Jr. (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on February 9, 2018).
10.20	Consulting Agreement, dated February 5, 2018, by and between TowneBank and Clyde E. McFarland, Jr. (incorporated herein by reference to Exhibit 10.2 to our Form 8-K, previously filed with the FDIC on February 9, 2018).
10.21	Employment and Consulting Agreement, dated April 26, 2017, by and between TowneBank and Robert C. Hatley.
10.22	Securities Purchase Agreement, dated September 22, 2011, between the Company and the Secretary of the U.S. Treasury (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on September 23, 2011).
11	Statement re: Computation of Per Share Earnings (incorporated by reference to our 2017 Annual Report to Shareholders).
13	2017 Annual Report to Shareholders.
14	Code of Ethical Conduct.
21	Subsidiaries of TowneBank.

PART IV

Exhibits continued

31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification Pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.

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

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TOWNEBANK

Registrant

March 1, 2018	/s/ G. Robert Aston, Jr.
Date	By: G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 1, 2018:

SIGNATURES

/s/ Jacqueline B. Amato Jacqueline B. Amato	Director
/s/ G. Robert Aston, Jr. G. Robert Aston, Jr.	Chairman of the Board, Chief Executive Officer
/s/ E. Lee Baynor E. Lee Baynor	Director
/s/ Jeffrey F. Benson Jeffrey F. Benson	Vice Chairman of the Board, Director
/s/ Richard S. Bray Richard S. Bray	Lead Director
/s/ Thomas C. Broyles Thomas C. Broyles	Director

SIGNATURES

/s/ Bradford L. Cherry Bradford L. Cherry	Director
/s/ J. Morgan Davis J. Morgan Davis	President and Chief Banking Officer, Director
/s/ Douglas D. Ellis Douglas D. Ellis	Director
/s/ John W. Failes John W. Failes	Vice Chairman of the Board, Director
/s/ Paul J. Farrell Paul J. Farrell	Director
/s/ Andrew S. Fine Andrew S. Fine	Director
/s/ William I. Foster, III William I. Foster, III	President and Regional Executive Officer of TowneBank Virginia Beach, Director
/s/ Gordon L. Gentry, Jr. Gordon L. Gentry, Jr.	Chairman of TowneBank Peninsula, Director
/s/ Robert C. Hatley Robert C. Hatley	President of TowneBank North Carolina, Director
/s/ Howard Jung Howard Jung	Director

/s/ John R. Lawson, II John R. Lawson, II	Director
/s/ Harry T. Lester Harry T. Lester	Director
/s/ W. Ashton Lewis W. Ashton Lewis	Director
/s/ Stephanie J. Marioneaux Stephanie J. Marioneaux	Director
/s/ Clyde E. McFarland, Jr. Clyde E. McFarland, Jr.	Senior Executive Vice President, Chief Financial Officer (principal financial officer)
/s/ Juan M. Montero, II Juan M. Montero, II	Director
/s/ R. Scott Morgan R. Scott Morgan	Director
/s/ William T. Morrison William T. Morrison	Chairman and Chief Executive Officer of TowneBank Mortgage and Realty Group, Director
Thomas K. Norment, Jr.	Director
/s/ Robert M. Oman Robert M. Oman	Director

SIGNATURES

/s/ R.V. Owens, III R.V. Owens, III	Director
/s/ David A. Patterson David A. Patterson	Executive Vice President, Chief Accounting Officer (principal accounting officer)
/s/ Elizabeth T. Patterson Elizabeth T. Patterson	Director
/s/ Elizabeth W. Robertson Elizabeth W. Robertson	Director
/s/ Dwight C. Schaubach Dwight C. Schaubach	Director
/s/ Brad E. Schwartz Brad E. Schwartz	Senior Executive Vice President and Chief Operating Officer, Director
/s/ Richard B. Thurmond Richard B. Thurmond	Director
/s/ Richard T. Wheeler, Jr. Richard T. Wheeler, Jr.	Director
/s/ Alan S. Witt Alan S. Witt	Director
/s/ F. Lewis Wood F. Lewis Wood	Director

Exhibit (10.21)

EMPLOYMENT AND CONSULTING AGREEMENT

This Employment and Consulting Agreement (this "Agreement") is dated as of April 26, 2017, by and between TowneBank, a Virginia banking corporation (the "Company"), and Robert C. Hatley.

WHEREAS, the Company, Paragon Commercial Corporation, a North Carolina corporation ("Paragon"), and Paragon Commercial Bank, a North Carolina banking corporation and wholly-owned subsidiary of Paragon ("Paragon Bank"), have entered into the Agreement and Plan of Reorganization dated as of April 26, 2017 (the "Merger Agreement"), under which Paragon Bank will merge with and into the Company, with the Company being the surviving corporation (the "Merger");

WHEREAS, you have been employed by Paragon and Paragon Bank as the President and Chief Executive Officer under an Employment Agreement, dated September 1, 2013, as amended by the First Amendment, dated October 2, 2015, and the Second Amendment, dated December 29, 2016 (collectively the "Prior Employment Agreement");

WHEREAS, based on your position as a key executive officer of Paragon and Paragon Bank and as a material inducement for the Company to enter into the Merger Agreement, you and the Company have agreed that upon the consummation of the Merger you shall become President, TowneBank North Carolina for a period of time, and then will provide consulting services for a period of time, under the terms and conditions set forth herein; and

WHEREAS, you are willing to make your services available to the Company on the terms and subject to the conditions set forth herein.

NOW, THEREFORE, the parties, intending to be legally bound, agree as follows:

1. Employment and Acceptance. Conditional upon consummation of the Merger and you being employed by Paragon Bank on the effective date of the Merger, as evidenced by the date and time shown on the certificate of merger issued by the Virginia State Corporation Commission effecting the Merger (the "Merger Date"), and effective at the Merger Date, you shall be employed as President, TowneBank North Carolina and will report directly to the Company's Chief Executive Officer. You shall have the duties and responsibilities that are commensurate with your position and shall also render such other services and duties as may be reasonably assigned to you from time to time by the Company, consistent with your position with the Company. You accept and agree to such employment and agree to carry out your duties and responsibilities to the best of your ability in a competent, efficient and businesslike manner. You further agree to comply with all the policies, standards and codes of conduct of the Company now or hereafter adopted.

References in this Agreement to services rendered for the Company and compensation and benefits payable or provided by the Company shall include services rendered for, and compensation and benefits payable or provided by, any Affiliate (as defined below). Unless the context otherwise requires, references in this Agreement to the "Company" also shall mean and refer to any business entity that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the Company (each, an "Affiliate").

2. Term. This Agreement is effective on the Merger Date and shall continue until the fifth anniversary of the Merger Date (the "Term"). Your employment hereunder shall commence on the Merger Date and continue until December 31, 2018; provided that the Company may extend the term of your employment hereunder by such period set forth in written notice to you at least 30 days before December 31, 2018 or before any extended period of employment ends. In no event will such period extend beyond December 31, 2020. The term of your employment, including any extension described herein, is referred to as the "Employment Period." The last day of the Employment Period is sometimes referred to in this Agreement as the "Employment Expiration Date." On the day following the Employment Expiration Date, you will begin providing services as a special consultant to the Company, as described in Section 6, and will continue providing such services until the earlier of (i) the fifth anniversary of the Merger Date, or (ii) the termination of the consulting arrangement as described in Section 6(c). The period commencing on the day following the Employment Expiration Date and ending on the fifth anniversary of the Merger Date shall be referred to herein as the "Consulting Period." Notwithstanding anything in this Agreement to the contrary, in the event that the Merger Agreement is terminated pursuant to its terms prior to the Merger Date, this Agreement, including but not limited to Section 7, will expire and be of no further force or effect on the date of termination of the Merger Agreement.

3. Board of Directors. Upon the Merger Date, and pursuant to the terms of the Merger Agreement, the Company shall cause you to be appointed to the Board of Directors of the Company to serve in such capacity until the next annual meeting of the stockholders of the Company following the Merger Date, and, subject to the good faith consideration by the Nominating Committee of the Company's Board of Directors of the selection criteria set forth in its charter, you shall be nominated to sit for election by the Company's stockholders at such annual meeting of stockholders.

4. Compensation.

(a) Base Salary During the Employment Period. During the Employment Period, you shall receive for your services rendered under this Agreement an annual base salary (the "Base Salary") of $455,000. You shall not receive Base Salary in any period following the commencement of the Consulting Period described in Section 6 (but shall receive the compensation provided in Section 6(b)).

(b) Annual Incentive During Employment Period. During the Employment Period, you may be entitled to receive annual incentive payments in such amounts (which may include shares of stock) and at such times as may be determined by the Company pursuant to its incentive program for officers of the Company. Any annual incentive will paid to you no later than two and one-half months after the end of the year for which the incentive is awarded. To be eligible to receive any incentive, you must be employed by the Company on the date such incentive is paid, unless you are providing services to the Company on such date during the Consulting Period.

(c) Stock Compensation During Employment Period. During the Employment Period, you may be entitled to receive stock awards under the Company's Stock Incentive Plan in such amounts and subject to such terms and conditions as determined by the Compensation Committee or the Board of Directors of the Company.

(d) Restricted Stock Grant. Subject to the approval of the Board of Directors of the Company and as soon as practicable after the Merger Closing, the Company will make a restricted stock grant to you covering shares of common stock of the Company with a market value of $400,000 as of the date of grant. The restricted stock grant will be presented for approval by the Board of Directors of the Company at the first regular meeting of the Board of Directors after the Merger Date. The restricted stock grant will provide that the restricted shares will vest in five equal, annual increments each beginning on the first anniversary of the date of grant and continuing on each anniversary date thereafter until the restricted shares are fully vested, provided you remain employed by the Company on such anniversary date or are providing services during the Consulting Period on such anniversary date. You will be liable for the payment of any and all income tax attributable to the vesting of such restricted stock grants.

(e) Benefits During Employment Period. The Company shall make available to you family health, dental and supplemental disability insurance benefits on the same basis as other similarly situated officers of the Company during the Employment Period, and the Company reserves the right to modify or eliminate the amount(s) it may contribute towards the payment of such insurance benefits. In addition, you will be entitled to participate in any and all incentive, savings, retirement, life insurance, medical, sick leave, vacation and other employee benefit plans and programs of the Company that may be in effect from time to time, to the extent you are eligible under the terms of those plans and programs. The Company reserves the right to modify, add or eliminate benefits for its employees as it deems appropriate. You will be entitled to continued health care benefits under COBRA following the end of the Employment Period to the extent you are eligible and a timely election is made by you.

(f) Business Expenses. During the Employment Period and the Consulting Period, the Company will pay on your behalf (or reimburse you for) reasonable expenses incurred by you at the request of, or on behalf of, the Company in the performance of your duties pursuant to this Agreement and in accordance with the Company's policies.

(g) Automobile. During the Employment Period and the Consulting Period, the Company will provide you with an appropriate automobile or automobile allowance, including appropriate insurance coverage, fuel and maintenance expenses, in accordance with the Company's policies.

5. Early Termination of Employment and Termination Benefits. Notwithstanding the provisions of Section 2, the Employment Period may terminate earlier under the following circumstances and will be subject to the following provisions:

(a) Termination as a Consequence of Death or Disability. If you die while employed by the Company, the Company will pay your beneficiary designated in writing (provided such writing is executed and dated by you and delivered to the Company in a form acceptable to the Company prior to your death) and surviving you or, if none, your estate your Accrued Obligations (as defined below) through the end of the calendar month in which your death occurs. If you become "disabled" (as defined below), the Company may give you written notice of its intention to terminate your employment, in which event your employment with the Company will terminate on the 30th day after receipt of such notice by you, and you shall receive your Accrued Obligations through the date of termination within 30 days after the date of termination.

For purposes of this Section 5, you are "disabled" if you are entitled to receive long-term disability benefits under the Company's long-term disability plan, or, if there is no such plan, your inability to perform any of your essential job functions, which disability lasts for an uninterrupted period of at least 180 days or a total of at least 240 days out of any consecutive 360 day period, as a result of your incapacity due to physical or mental illness (as determined by the opinion of an independent physician selected by the Company).

(b) Termination for Cause. Your employment may be terminated for Cause at any time without further liability on the part of the Company. If the Company terminates you for Cause, you shall have no right to render services or to receive compensation or other benefits under this Agreement for any period after such termination. In such event, you will be paid your Base Salary through the effective date of termination. Only the following shall constitute "Cause" for such termination:

(i) willful misconduct or deliberate neglect by you in the performance of your material duties and responsibilities as established from time to time by the Company or your willful failure to follow reasonable instructions or policies of the Company, after being advised in writing and being given a period of at least 10 days to remedy such misconduct, neglect or failure, except no such 10-day period will be given in the event that the misconduct, neglect or failure cannot, by its nature, be reasonably expected to be remedied;

(ii) conviction of or entering of a guilty plea or plea of no contest with respect to a felony, a crime of moral turpitude or any other crime with respect to which imprisonment is a possible punishment, or the commission of an act of embezzlement or fraud against the Company or an Affiliate;

(iii) breach by you of a material term of this Agreement, or violation in any material respect of any code or standard of behavior generally applicable to officers of the Company, after being advised in writing of such breach or violation and being given a period of at least 10 days to remedy such breach or violation, except no such 10-day period will be given in the event that the breach or violation cannot, by its nature, be reasonably expected to be remedied; or

(iv) the willful engaging by you in misconduct that is reasonably likely to result, or has resulted, in material injury to the Company, reputational, financial or otherwise.

(c) Termination by You Without Good Reason. You may terminate your employment under this Agreement without Good Reason (as defined below) by written notice to the Company effective 30 days after receipt of such notice by the Company. If you terminate your employment without Good Reason, you shall have no right to render services or to receive compensation or other benefits under this Agreement for any period after such termination. It shall not constitute a breach of this Agreement for the Company to suspend your duties and to place you on paid leave during the notice period.

(d) Termination by the Company Without Cause. Your employment may be terminated by the Company without Cause before the end of the Employment Period upon written notice to you by the Company effective 30 days after receipt of such notice by you, which termination will be effective as specified in the written notice. In the event your employment is terminated without Cause, you shall receive the Accrued Obligations through the date of termination within 30 days after the date of termination. In addition, you shall receive the following benefits, provided you sign a release and waiver of claims in favor of the Company, its Affiliates and their respective officers and directors in a form provided by the Company no later than the date of termination and such release has become effective (the "Release") no later than 30 days following your date of termination (the "Release Execution Period") with such payments beginning within 60 days following your date of termination; provided, however, if the Release Execution Period begins in one taxable year and ends in another taxable year, payments shall not begin until the beginning of the second taxable year:

(i) For the period subsequent to the date of termination until the Employment Expiration Date (the "Severance Period"), the Company shall continue to pay your Base Salary in effect on the date of termination in equal installments over the Severance Period, to be paid on the same periodic dates as salary payments would have been made to you had your employment not been terminated, subject to compliance with Section 13(k) of this Agreement regarding the requirements of Section 409A of the Internal Revenue Code of 1986 (the "Code").

(ii) If you timely and properly elect continuation coverage under the Consolidated Omnibus Reconciliation Act of 1985 ("COBRA"), the Company will reimburse you for the difference between the monthly COBRA premium amount paid by you for your and your eligible dependents' group health insurance coverage and the monthly premium amount paid by similarly situated active employees (the "Monthly COBRA Subsidy"). The Monthly COBRA Subsidy will be paid to you by the 10th day of the month immediately following the month in which you timely remit the COBRA premium payment. You shall be eligible to receive the Monthly COBRA Subsidy until the earliest of: (A) the date that is 18 months after the date of termination of employment; (B) the date you are no longer eligible to receive COBRA continuation coverage; or (C) the date on which you become eligible to receive substantially similar coverage from another employer. Notwithstanding the foregoing, if the payments by the Company under this Section 5(d)(ii) would violate any nondiscrimination rules applicable to non-grandfathered plans or would result in the imposition of penalties under any applicable law, regulations or guidance, the parties agree to reform this Section 5(d)(ii) in a manner as is necessary to comply with such law, regulations, or guidance.

(iii) In the event the 18-month period referenced in subparagraph (ii)(A) above is not sufficient to cover the period between the date of termination of employment and the end of the Severance Period, and the Company is not permitted to extend the COBRA continuation coverage under its group health insurance coverage up to and including the last day of the Severance Period, the Company will pay you an amount equal to the product of (A) the number of months remaining between the date the Company is no longer permitted to provide COBRA continuation coverage and the last day of the Severance Period, including pro-rated credit for any partial month, times (B) the Monthly COBRA Subsidy. This amount will be paid to you in a lump sum cash payment not later than the 10th day of the month immediately following the month in which the Company makes its final Monthly COBRA Subsidy payment.

(iv) The Company shall pay to you in a lump sum the Consulting Fees (as defined below) that would have been payable during the Consulting Period had the Consulting Period commenced on the Employment Expiration Date.

(e) Termination by You for Good Reason. You may voluntarily terminate your employment under this Agreement at any time for Good Reason and be entitled to receive the compensation and other benefits set forth in Section 5(d) relating to a termination without Cause, provided you sign a Release and it becomes effective. You must provide written notice to the Company of the existence of the event or condition constituting such Good Reason within 90 days of the occurrence of an event or condition alleged to constitute Good Reason. Upon delivery of such notice by you, the Company shall have a period of 30 days during which it may remedy in good faith the event or condition constituting Good Reason, and your employment shall continue in effect during such time, but not beyond the Employment Expiration Date, so long as the Company is making diligent efforts to cure. In the event the Company shall remedy in good faith the event or condition constituting Good Reason, then such notice of termination shall be null and void, and the Company shall not be required to pay the amount due to you under this Section 5(e).

For purposes of this Agreement, Good Reason shall mean, during the Employment Period, any of the following actions, without your written consent:

(i) any action taken by the Company that results in a substantial reduction in your status with the Company as such existed prior to such action, including a material diminution in your Base Salary, position, authority, duties or responsibilities;

(ii) the relocation of your primary office by more than 35 miles from its location as of the date of this Agreement; or

(iii) the failure of the Company to comply with the provisions of Section 4 or a material breach by the Company of any other provision of this Agreement or any other written agreement entered into between you and the Company.

(f) Accrued Obligations. The Accrued Obligations are the sum of: (1) your Annual Base Salary through the Date of Termination at the rate in effect just prior to the time a Notice of Termination is given; (2) the amount, if any, of any incentive or bonus compensation theretofore earned which has not yet been paid; and (3) any benefits or awards (including both the cash and stock components) which pursuant to the terms of any plans, policies or programs have been earned or become payable, but which have not yet been paid to you (but not including amounts that previously had been deferred at your request, which amounts will be paid in accordance with your existing directions).

6. Consulting Arrangement. During the Consulting Period, you will provide consulting services to the Company as reasonably requested as an independent contractor (and not as an employee) in the nature of customer and community relations, business development, employee relations and general advice and assistance relating to the Company's customers and employees and to the growth and development in North Carolina and surrounding areas of the business of the Company. Such services shall be rendered at such times and on such schedule as shall be determined by you, and as shall be reasonably convenient to both the Company and you. You shall not be required to maintain records of hours worked or to work in accordance with any fixed schedule during the period that you render consulting services.

(a) Status. Notwithstanding any other provisions of this Agreement, during the Consulting Period you shall relinquish your responsibilities as an employee and officer of the Company, but not as a director, and shall become an independent consultant to the Company. During the Consulting Period, you acknowledge that you will be an independent contractor and not an employee of the Company. As an independent contractor, you will not be entitled to participate in any employee benefit plans or programs which the Company maintains for the benefit of its employees. The Company will not withhold or pay any payroll taxes or income taxes on your behalf during the Consulting Period, and you hereby acknowledge your responsibility therefor and agree to pay all such taxes when due.

(b) Compensation During the Consulting Period. In exchange for your services and availability as a consultant under this Section 6, and in consideration for your agreement to continuation of the covenants in Section 6, the Company shall pay to you (i) the sum of $20,833.33 per month during the first 24 months of the Consulting Period, and (ii) the sum of $8,333.33 per month for each month thereafter during the remainder of the Consulting Period (collectively, the "Consulting Fees"). Such monthly amounts shall be payable for each month no later than the 10th day of the month.

(c) Termination of Consulting. Either you or the Company may terminate the independent consultant relationship for any reason or no reason. If the consultant relationship is terminated by the Company, you shall nevertheless be entitled to receive the payments you would have received until the end of the Consulting Period, and you shall be obligated to comply with the covenants in Section 7 to the same extent you would have been obligated, for the remainder of the Consulting Period. If (i) the consultant relationship is terminated by you, (ii) you shall fail or refuse to render consulting services as requested hereunder by the Company and shall not remedy such failure within 20 days following your receipt of notice of such failure, or (iii) you shall violate any one of the covenants in Section 7, the Consulting Period shall immediately end and the payments described under paragraph (b) of this Section 6 shall thereupon cease and you shall have no further rights to compensation hereunder.

7. Covenants of Hatley.

(a) Noncompetition. You agree that during the Employment Period and for the longer of (i) a 24-month period following the expiration of the Employment Period or, if sooner, the termination of your employment with the Company for any reason, including resignation or retirement, during the Employment Period, or (ii) the Consulting Period, you will not directly or indirectly, as a principal, agent, employee, employer, investor, director, consultant, co-partner or in any other individual or representative capacity whatsoever, engage in a Competitive Business anywhere in the Market Area (as such terms are defined below) in a competitive capacity holding a similar office or engaging in similar duties to those which you held or performed on behalf of the Company or any of its Affiliates during the Employment Period. Notwithstanding the foregoing, you may purchase or otherwise acquire up to (but not more than) 1% of any class of securities of any business enterprise (but without otherwise participating in the activities of such enterprise) that engages in a Competitive Business in the Market Area and whose securities are listed on any national or regional securities exchange or have been registered under Section 12 of the Securities Exchange Act of 1934, as amended.

(b) Nonsolicitation. You further agree that during the Employment Period and for the longer of (i) a 24-month period following the expiration of the Employment Period or, if sooner, the termination of your employment with the Company for any reason, including resignation or retirement, during the Employment Period, or (ii) the Consulting Period, you will not directly or indirectly: (A) solicit, or assist any other Person (as defined below) in soliciting, any Customers (as defined below) to make deposits in, borrow money from, or become customers of any other company conducting a Competitive Business in the Market Area; (B) induce any Customers to terminate their relationship with the Company or its Affiliates; or (C) contact, solicit or assist in the solicitation of any employee of the Company or its Affiliates or any person who had been an employee of the Company within the six-month period preceding the date of termination of your employment to terminate or resign his or her employment with the Company or any of its Affiliates.

(c) Definitions. As used in this Agreement, the term “Competitive Business” means any of the following businesses in which you have been significantly engaged in during the last year of your employment with the Company on behalf of the Company: consumer and commercial banking (including the offering of depository accounts and consumer and commercial lending products and services); insurance brokerage, securities brokerage and asset management, residential and commercial mortgage lending, and any other business in which the Company or any of its Affiliates are engaged; the term “Market Area” means any county in which, during the last year of your employment with the Company (including, if applicable, with Paragon or Paragon Bank), the Company (or Paragon or Paragon Bank) had an office (i) from which you worked on a regular basis, (ii) from which someone who reported to you worked on a regular basis, (iii) over which you had responsibility, or (iv) where a department over which you had responsibility was located; the term “Customer” means customers or clients (including any prospective customers or clients) of the Company or its Affiliates you contacted in any manner during the last year of your employment in furtherance of the business of the Company or its Affiliates or about whom you have information that is confidential or that is not available publicly; the term “Person” means any person, partnership, corporation, company, group or other entity; and the term “Confidential Information” shall include, but not be limited to, all financial and personnel data, computer software and all data base technologies, capital plans, customer lists and requirements, market studies, know-how, processes, trade secrets, and any other information concerning the non-public business and affairs of the Company.

(d) Confidentiality. During the Employment Period and thereafter, and except as required by any court, supervisory authority or administrative agency or as may be otherwise required by applicable law, you shall not, without the written consent of a person duly authorized by the Company, disclose to any Person (other than your personal attorney, or an employee of the Company or an Affiliate, or a Person to whom disclosure is reasonably necessary or appropriate in connection with the performance by you of your duties as an employee of the Company) or utilize in conducting a business any Confidential Information obtained by you while in the employ of the Company, unless such information has become a matter of public knowledge at the time of such disclosure.

(e) Notice. The U.S. Defense of Trade Secrets Act provides civil and criminal immunity to certain whistleblowers for the confidential disclosure of trade secrets (i) to relevant Federal government officials or an engaged attorney, when such disclosure is made solely for the purpose of reporting or investigating a suspected violation of law or (ii) in a document filed under seal in a lawsuit or other proceeding.

(f) Acknowledgment. The covenants contained in this Section 7 shall be construed and interpreted in any proceeding to permit their enforcement to the maximum extent permitted by law. You agree that the restrictions imposed herein are necessary for the reasonable and proper protection of the Company and its Affiliates, and that each and every one of the restrictions is reasonable in respect to length of time, geographic area and scope of prohibited activities, and that the restrictions are neither overly restrictive on your post-employment activity nor overly burdensome for you to abide by. You covenant that you will not make any contention contrary to any of the foregoing representations in the future and agree that you will be estopped to deny or contradict the truth or accuracy of these representations. If, however, the time, geographic and/or scope of activity restrictions set forth in Section 7 are found by an arbitrator or court to exceed the standards deemed enforceable, the arbitrator or court, as applicable, is empowered and directed to modify the restriction(s) to the extent necessary to make them enforceable. Notwithstanding anything to the contrary herein, nothing in this Agreement shall be construed to prohibit any activity that cannot reasonably be construed to further in any meaningful way any actual or potential competition against the Company or an Affiliate.

(g) Enforcement. You acknowledge that damages at law would not be a measurable or adequate remedy for breach of the covenants contained in this Section 7 and, accordingly, you agree to submit to the equitable jurisdiction of any court of competent jurisdiction in connection with any action to enjoin you from violating any such covenants. In the event legal action is commenced with respect to the provisions of this Section 7 and you have not strictly observed the restrictions set forth in this Section 7, then the restricted periods described in paragraphs (a) and (b) shall be tolled during and for any period in which there is a breach hereof and any periods during which there is litigation pending relating to such breach. All the provisions of this Section 7 will survive termination and expiration of this Agreement.

(h) Change in Control. Notwithstanding anything to the contrary contained in this Agreement, in the event of a Change in Control of the Company (as such term is defined in Section 13(g) of this Agreement), (i) the non-competition restrictions imposed by paragraph (a) of this Section 7 shall not apply to you after you cease to be employed by the Company, and (ii) the non-solicitation restrictions imposed by paragraph (b) of this Section 7 shall apply only for a 12-month period following your termination of employment.

8. Dispute Resolution.

(a) Except as provided in Section 8(c) below, Paragon Bank, the Company and you acknowledge and agree that any dispute or controversy arising out of, relating to, or in connection with this Agreement, or the interpretation, validity, construction, performance, breach, or termination thereof, shall be settled by binding arbitration before a single arbitrator, to be held in Raleigh, North Carolina in accordance with the JAMS Employment Arbitration Rules & Procedures. The arbitrator shall: (a) have the authority to compel adequate discovery for the resolution of the dispute and to award such relief as would otherwise be permitted by law; and (b) issue a written arbitration decision including the arbitrator's essential findings and conclusions and a statement of the award. You and the Company shall be entitled to all rights and remedies that either would be entitled to pursue in a court of law. The decision of the arbitrator shall be final, conclusive and binding on the parties to the arbitration. Both you and the Company acknowledge that by agreeing to this arbitration procedure, you each waive the right to resolve any such dispute through a trial by jury or judge or administrative proceeding. Judgment may be entered on the arbitrator's decision in any court having jurisdiction.

(b) The arbitrator(s) shall apply North Carolina law to the merits of any dispute or claim, without reference to rules of conflicts of law. You hereby consent to the personal jurisdiction of the state and federal courts located in North Carolina for any action or proceeding arising from or relating to this Agreement or relating to any arbitration in which the parties are participants.

(c) Nothing in this Agreement is intended to prevent either the Company or you from obtaining injunctive relief in court to prevent irreparable harm pending the conclusion of any such arbitration.

(d) YOU HEREBY CONFIRM YOU HAVE READ AND UNDERSTAND THIS SECTION 8, WHICH DISCUSSES ARBITRATION, AND UNDERSTAND THAT BY SIGNING THIS AGREEMENT, YOU AGREE, EXCEPT AS PROVIDED IN SECTION 8(c), TO SUBMIT ANY CLAIMS ARISING OUT OF, RELATING TO, OR IN CONNECTION WITH THIS AGREEMENT, OR THE INTERPRETATION, VALIDITY, CONSTRUCTION, PERFORMANCE, BREACH OR TERMINATION THEREOF TO BINDING ARBITRATION, UNLESS OTHERWISE REQUIRED BY LAW, AND THAT THIS ARBITRATION CLAUSE CONSTITUTES A WAIVER OF YOUR RIGHT and the company's right TO A JURY TRIAL AND RELATES TO THE RESOLUTION OF ALL DISPUTES RELATING TO ALL ASPECTS OF the employment RELATIONSHIP between you and THE COMPANY.

9. Non-disparagement. Both you and the Company agree that neither will at any time during or after the term of this Agreement make, publish or communicate to any Person or in any public forum any defamatory or disparaging remarks, comments or statements concerning the other party, or their business, performance, or any of the Company's directors, employees, customers, and other associated third parties. This Section 9 does not, in any way, restrict or impede you from exercising protected rights to the extent that such rights cannot be waived by agreement. Similarly, it does not prevent either you or the Company from complying with any applicable law or regulation or a valid order of a court of competent jurisdiction or an authorized government agency, provided that such compliance does not exceed that required by law, regulation or order. Should you receive such order, you shall promptly provide written notice of any such order to the Company.

10. Possible Reduction in Payment and Benefits. No amounts will be payable and no benefits will be provided under this Agreement to the extent that such payments or benefits, together with other payments or benefits under other plans, agreements or arrangements, would make you liable for the payment of an excise tax under Section 4999 of the Code or any successor provision. The amounts otherwise payable and the benefits otherwise to be provided under this Agreement shall be reduced in a manner determined by the Company (by the minimum possible amount) that is consistent with the requirements of Section 409A of the Code until no amount payable to you will be subject to such excise tax. All calculations and determinations under this Section 10 shall be made by an independent accounting firm or independent tax counsel appointed by the Company (the "Tax Advisor") whose determinations shall be conclusive and binding on the Company and you for all purposes. The Tax Advisor may rely on reasonable, good faith assumptions and approximations concerning the application of Section 280G and Section 4999 of the Code. The Company shall bear all costs of the Tax Advisor.

11. Indemnification. During the Employment Period and the Consulting Period, you shall be entitled to insurance under Company's directors' and officers' indemnification policies comparable to the senior executives of the Company. Further, the Company's Articles of Incorporation shall contain provisions granting you the maximum indemnity protection allowed under applicable law and the Company hereby agrees to indemnify and hold you harmless in accordance with such maximum indemnity protection allowed under applicable law.

12. Prior Employment Agreement. You and the Company agree that upon the Merger Date, the Prior Employment Agreement shall terminate; provided further, however, that Articles 6 and 8 of the Prior Employment Agreement, as modified by the Excess Parachute Payment Agreement, executed simultaneously with this Agreement, shall survive such termination.

13. Miscellaneous.

(a) Severability. If any clause or provision of this Agreement is held to be illegal, invalid or unenforceable under present or future laws effective during the term hereof, then the remainder of this Agreement shall not be affected thereby, and in lieu of each clause or provision of this Agreement which is illegal, invalid or unenforceable, there shall be added, as part of this Agreement, a clause or provision as similar in terms to such illegal, invalid or unenforceable clause or provision as may be possible and as may be legal, valid and enforceable.

(b) Applicable Law. This Agreement shall be construed, interpreted, and governed in accordance with and by North Carolina law. Any and all claims, controversies, and causes of action arising out of or relating to this Agreement, whether sounding in contract, tort, or statute, shall be governed by the laws of North Carolina, without giving effect to any North Carolina conflict-of-laws rule that would result in the application of the laws of a different jurisdiction.

(c) Entire Agreement; Amendments. Nothing in this Agreement is intended to nor does it limit or modify your Salary Continuation Agreement, dated as of December 29, 2016, with Paragon Bank (the "Salary Continuation Agreement") or the Excess Parachute Payment Agreement, which are being assumed by the Company in full. Except as otherwise specifically provided for herein, this Agreement constitutes the entire agreement between the parties with respect to the subject matter hereof and no agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement.

(d) Waiver. The rights and remedies of the parties to this Agreement are cumulative and not alternative. Neither the failure nor any delay by either party in exercising, in whole or in part, any right, power, or privilege under this Agreement will operate as a waiver of such right, power, or privilege.

(e) Binding Effect; Survival. This Agreement is binding upon and shall inure to the benefit of the parties and their respective successors, heirs and assigns, provided that no part of this Agreement is assignable by you. The Company will require any successor (whether direct or indirect, by purchase, merger or otherwise) to all or substantially all of the business and/or assets of the Company to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform if no such succession had taken place. Except as otherwise expressly provided herein, upon the termination or expiration of this Agreement the respective rights and obligations of the parties hereto shall survive such termination or expiration to the extent necessary to carry out the intentions of the parties set forth in this Agreement; provided, however, that notwithstanding anything in this Agreement to the contrary, in the event that the Merger Agreement is terminated pursuant to its terms prior to the Merger Date, this Agreement will expire and be of no further force or effect on the date of termination of the Merger Agreement.

(f) Resignation of All Other Positions. Effective upon the early termination of your employment pursuant to Section 5 or upon the early termination of the Consulting Period pursuant to Section 6(c), you shall be deemed to have resigned from all positions that you hold as an officer or member of the Board of Directors (or committee thereof) of the Company or any of its Affiliates.

(g) Change in Control Defined. For purposes of this Agreement, a "Change in Control" of the Company shall mean:

(i) Individuals who constitute the Board of Directors of the Company on the Merger Date (the "Incumbent Board") cease to constitute a majority of the Board of Directors of the Company, provided that any director whose nomination was approved by a vote of at least two-thirds of the directors then comprising the Incumbent Board will be considered a member of the Incumbent Board, but excluding any such individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company;

(ii) Consummation by the Company after the Merger Date of a reorganization, merger, share exchange or consolidation (a "Reorganization"), provided that a Reorganization will not constitute a Change in Control if, upon consummation of the Reorganization, each of the following conditions is satisfied:

> a. more than 50% of the then outstanding shares of common stock of the corporation resulting from the Reorganization is beneficially owned by all or substantially all of the shareholders of the Company immediately prior to the Reorganization in substantially the same proportions, relative to each other, as their ownership existed in the Company immediately prior to the Reorganization; and
>
> b. at least a majority of the members of the board of directors of the corporation resulting from the Reorganization were members of the Incumbent Board at the time of the execution of the initial agreement providing for the Reorganization; or

(iii) Approval by the shareholders of the Company after the Merger Date of a complete liquidation or dissolution of the Company or the consummation of a sale or other disposition of all or substantially all of the assets of the Company.

(h) No Construction Against Any Party. This Agreement is the product of informed negotiations between parties. If any part of this Agreement is deemed to be unclear or ambiguous, it shall be construed as if it were drafted jointly by all parties. The parties agree neither party was in a superior bargaining position regarding the substantive terms of this Agreement.

(i) Clawback. Any incentive based compensation or award that you receive, or have received, from the Company or its Affiliates under this Agreement or otherwise, will be subject to clawback by the Company as may be required by applicable law or stock exchange listing requirement and on such basis as the Board of Directors of the Company determines, including pursuant to any incentive compensation clawback policy adopted by the Board of Directors.

(j) Documents. All documents, records, tapes and other media of any kind or description relating to the business of the Company or its Affiliates (the "Documents"), whether or not prepared by you, shall be the sole and exclusive property of the Company. The Documents and any copies thereof stored in any manner, together with any Company issued equipment, vehicles, keys, security devices, identification cards, computers, cell phones and other devices, that are in your possession or control shall be returned to the Company immediately upon your termination of employment for any reason or at such earlier time as the Board of Directors of the Company or its designees may specify.

(k) Section 409A Compliance. This Agreement is intended to comply with Section 409A of the Code or an exemption thereunder and shall be construed and administered in accordance with Section 409A. Notwithstanding any other provision of this Agreement, payments provided under this Agreement may only be made upon an event and in a manner that complies with Section 409A or an applicable exemption. Any payments under this Agreement that may be excluded from Section 409A either as separation pay due to an involuntary separation from service or as a short-term deferral shall be excluded from Section 409A to the maximum extent possible. For purposes of Section 409A, each installment payment provided under this Agreement shall be treated as a separate payment. Any payments to be made under this Agreement upon a termination of employment shall only be made upon a "separation from service" under Section 409A. Notwithstanding the foregoing, the Company makes no representations that the payments and benefits provided under this Agreement comply with Section 409A and in no event shall the Company be liable for all or any portion of any taxes, penalties, interest or other expenses that may be incurred by you on account of non-compliance with Section 409A.

Notwithstanding any other provision of this Agreement, if any payment or benefit provided to you in connection with your termination of employment is determined to constitute "nonqualified deferred compensation" within the meaning of Section 409A and you are determined to be a "specified employee" as defined in Section 409A(a)(2)(b)(i), then such payment or benefit shall not be paid until the first payroll date to occur following the six-month anniversary of the date of termination (the "Specified Employee Payment Date"). The aggregate of any payments that would otherwise have been paid before the Specified Employee Payment Date shall be paid to you in a lump sum on the Specified Employee Payment Date and thereafter, any remaining payments shall be paid without delay in accordance with their original schedule.

(l) Notices. Notices and all other communications required to be delivered under this Agreement shall be in writing and shall delivered personally or sent by mail or overnight carrier addressed, in the case of the Company, to the Chief Executive Officer or the President of the Company at the Company's principal corporate offices and, in your case, to you at your address as shown in the records of the Company. Either party may designate another address in writing (or by such other method approved by the Company) from time to time.

(m) Acknowledgement of Full Understanding. You acknowledge and agree: (i) that you have fully read, understand and are voluntarily entering into this Agreement; AND (ii) THAT, you have had an opportunity to ask questions and consult with an attorney of your choice before signing this Agreement.

(Signatures appear on the following page)

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement on the day and year first above written.

TOWNEBANK

By: /s/ G. Robert Aston, Jr.
G. Robert Aston, Jr.
Chairman and Chief Executive Officer

/s/ Robert C. Hatley
Robert C. Hatley

Exhibit (13)

TOWNEBANK

2017 Annual Report

TowneBank
TABLE OF CONTENTS

TOWNEBANK
BUSINESS PROFILE AND CORPORATE MISSION STATEMENT

BUSINESS PROFILE

TowneBank was organized in 1998 under the laws of the Commonwealth of Virginia to engage in a general retail and commercial banking business and began operations on April 8, 1999. We place special emphasis on serving the financial needs of small and medium-sized businesses, professionals, and individuals in Richmond, Virginia, the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. On January 26, 2018, the Company completed its acquisition of Paragon Commercial Corporation ("Paragon"), and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices serving the Raleigh and Charlotte, North Carolina metropolitan areas. The Company acquired approximately $1.43 billion in loans and assumed approximately $1.25 billion in deposits. The Company will continue to operate in the Raleigh and Charlotte markets under the Paragon brand as "Paragon Bank, a division of TowneBank."

We offer a full range of banking and related financial services through our controlled divisions and subsidiaries, which include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, LLC ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; The Frieden Agency LLC, d/b/a Towne Benefits ("Towne Benefits"); Out of Town, LLC, d/b/a Red Sky Travel Insurance ("Red Sky"); Towne Financial Services Group, LLC; Towne Mortgage, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; Towne Center Mortgage, LLC; Towne First Mortgage, LLC; Advance Financial Group, LLC; Coastal Home Mortgage, LLC; Homesale Mortgage, LLC; SimonTowne Mortgage, LLC; Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head ("Beach Properties"); Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations ("Towne Oak Island"); Towne Vacations Deep Creek, LLC, d/b/a Railey Mountain Lake Vacations ("Deep Creek"); Towne 1031 Exchange, LLC ("Towne 1031 Exchange"); and Towne Realty, LLC, d/b/a Berkshire Hathaway HomeServices Towne Realty ("Towne Realty"), which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements ("Virginia Home Title"); Towne Investment Group, which provides investment and asset management services; and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries.

Since our inception, we have expanded our financial services to include banking, real estate, mortgage, title, insurance, employee benefit services, and investments. We have three reportable segments: Banking, Realty, and Insurance.

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

Realty Segment. The Realty segment provides residential real estate services, originations of a variety of mortgage loans, resort property management, and residential and commercial title insurance. It includes TowneBank Mortgage; Towne Mortgage, LLC; NewTowne Mortgage, LLC; 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; Homesale Mortgage, LLC; Beach Properties; Towne Oak Island; Deep Creek; Virginia Home Title; and Towne Realty.

Insurance Segment. The Insurance segment provides individual and business members with a wide array of insurance products, including life, property, casualty, travel, and vehicle insurance, as well as employee and group benefits. Through Towne Insurance, we offer a full line of commercial and consumer insurance products and financial services. Through Towne Benefits, we offer health, life dental, vision, and disability plans to employers, brokers, and individuals. Through Red Sky we offer travel, medical, and baggage protection insurance for travelers via vacation property management companies.

CORPORATE MISSION STATEMENT

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

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

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2017	2016	Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 261,121	$ 218,876	$ 42,245	19.30 %
Noninterest income (1)	188,121	155,216	32,905	21.20 %
Total revenue	449,242	374,098	75,144	20.09 %
Noninterest expenses	296,214	267,828	28,386	10.60 %
Provision for loan losses	5,426	5,357	69	1.29 %
Net income attributable to TowneBank	87,663	67,250	20,413	30.35 %
Net income per common share - basic	1.41	1.18	0.23	19.49 %
Net income per common share - diluted	1.41	1.18	0.23	19.49 %
Period End Data:				
Total assets	$ 8,522,176	$ 7,973,915	$ 548,261	6.88 %
Total assets - tangible (2)	8,213,358	7,671,149	542,209	7.07 %
Earning assets	7,706,747	7,157,391	549,356	7.68 %
Loans (net of unearned income and deferred costs)	5,946,965	5,807,221	139,744	2.41 %
Allowance for loan losses	45,131	42,001	3,130	7.45 %
Goodwill and other intangibles	308,819	302,766	6,053	2.00 %
Noninterest-bearing deposits	2,157,338	1,947,312	210,026	10.79 %
Interest-bearing deposits	4,290,882	4,087,885	202,997	4.97 %
Total deposits	6,448,220	6,035,197	413,023	6.84 %
Equity	1,142,505	1,086,558	55,947	5.15 %
Equity - tangible (2)	833,686	783,792	49,894	6.37 %
Book value per share	18.06	17.20	0.86	5.00 %
Book value per share - tangible (2)	13.13	12.36	0.77	6.23 %
Cash dividends declared per share	0.55	0.51	0.04	7.84 %
Daily Average Balances:				
Total assets	$ 8,334,999	$ 7,205,236	$ 1,129,763	15.68 %
Total assets - tangible (2)	8,027,381	6,958,267	1,069,114	15.36 %
Earning assets	7,517,473	6,442,385	1,075,088	16.69 %
Loans, excluding nonaccrual loans (net of unearned income)	5,901,797	5,129,990	771,807	15.05 %
Allowance for loan losses	43,760	39,547	4,213	10.65 %
Goodwill and other intangibles	307,618	246,968	60,650	24.56 %
Noninterest-bearing deposits	2,094,753	1,720,093	374,660	21.78 %
Interest-bearing deposits	4,248,571	3,852,100	396,471	10.29 %
Total deposits	6,343,324	5,572,193	771,131	13.84 %
Equity	1,123,588	963,775	159,813	16.58 %
Equity - tangible (2)	815,969	716,807	99,162	13.83 %
Key Ratios:				
Return on average assets	1.05%	0.93%	0.12 %	12.90 %
Return on average tangible assets (2)	1.15%	1.02%	0.13 %	12.75 %
Return on average equity	7.80%	6.98%	0.82 %	11.75 %
Return on average tangible equity (2)	11.35%	9.93%	1.42 %	14.30 %
Net interest margin (3)	3.51%	3.44%	0.07 %	2.03 %
Efficiency ratio (1)	65.94%	71.59%	(5.65)%	(7.89)%
Average earning assets/total average assets	90.19%	89.41%	0.78 %	0.87 %
Average loans/average deposits	93.04%	92.06%	0.98 %	1.06 %
Average noninterest deposits/total average deposits	33.02%	30.87%	2.15 %	6.96 %
Allowance for loan losses/period end loans	0.76%	0.72%	0.04 %	5.56 %
Period end equity/period end total assets	13.41%	13.63%	(0.22)%	(1.61)%

Notes:
(1) Excludes investment securities losses of $0.001 million in 2017 and securities gains of $0.01 million in 2016.
(2) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of Management's Discussion and Analysis for reconciliation.
(3) Presented on a tax-equivalent basis.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2015	2014	2013
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 180,442	$ 145,736	$ 143,895
Noninterest income (1)	116,379	96,744	89,917
Total revenue	297,725	242,465	234,423
Noninterest expenses	202,157	178,864	168,792
Provision for loan losses	3,027	492	4,248
Net income attributable to TowneBank	62,382	42,169	41,762
Net income per common share - basic	1.22	1.18	1.14
Net income per common share - diluted	1.22	1.18	1.14
Period End Data:			
Total assets	$ 6,296,574	$ 4,982,485	$ 4,672,997
Total assets - tangible (2)	6,115,579	4,846,816	4,552,935
Earning assets	5,827,888	4,610,142	4,296,486
Loans (net of unearned income and deferred costs)	4,519,393	3,564,389	3,381,194
Allowance for loan losses	38,359	35,917	38,380
Goodwill and other intangibles	180,995	135,668	120,061
Noninterest-bearing deposits	1,393,264	1,224,466	1,037,028
Interest-bearing deposits	3,520,763	2,622,136	2,530,076
Total deposits	4,914,027	3,846,602	3,567,104
Equity	820,194	618,276	585,318
Equity - tangible (2)	639,199	482,608	465,257
Book value per share	15.71	14.88	14.16
Book value per share - tangible (2)	12.21	11.09	10.76
Cash dividends declared per share	0.47	0.43	0.38
Daily Average Balances:			
Total assets	$ 6,039,418	$ 4,866,584	$ 4,507,233
Total assets - tangible (2)	5,858,762	4,738,306	4,387,578
Earning assets	5,380,881	4,414,274	4,067,314
Loans, excluding nonaccrual loans (net of unearned income)	4,239,887	3,450,730	3,258,562
Allowance for loan losses	37,194	37,168	39,698
Goodwill and other intangibles	180,656	128,278	119,655
Noninterest-bearing deposits	1,343,360	1,158,888	1,022,168
Interest-bearing deposits	3,324,533	2,590,162	2,415,178
Total deposits	4,667,893	3,749,050	3,437,346
Equity	804,744	606,777	574,558
Equity - tangible (2)	624,088	478,499	454,903
Key Ratios:			
Return on average assets	1.03%	0.87%	0.93%
Return on average tangible assets (2)	1.10%	0.93%	0.95%
Return on average equity	7.75%	6.95%	7.27%
Return on average tangible equity (2)	10.34%	9.16%	9.18%
Net interest margin (3)	3.39%	3.35%	3.58%
Efficiency ratio (1)	68.11%	73.76%	72.19%
Average earning assets/total average assets	89.10%	90.71%	90.24%
Average loans/average deposits	90.83%	92.04%	94.80%
Average noninterest deposits/total average deposits	28.78%	30.91%	29.74%
Allowance for loan losses/period end loans	0.85%	1.01%	1.14%
Period end equity/period end total assets	13.03%	12.41%	12.53%

Notes:
(1) Excludes investment securities gains of $0.90 million, $0.02 million, and $0.61 million in 2015, 2014, and 2013, respectively.
(2) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of Management's Discussion and Analysis for reconciliation.
(3) Presented on a tax-equivalent basis.

OVERVIEW

TowneBank is a retail and commercial banking business serving Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina. On January 26, 2018, the Company completed its acquisition of Paragon Commercial Corporation ("Paragon"), and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices serving the Raleigh and Charlotte, North Carolina metropolitan areas. The Company acquired approximately $1.43 billion in loans and assumed approximately $1.25 billion in deposits. The Company will continue to operate in the Raleigh and Charlotte markets under the Paragon brand as "Paragon Bank, a division of TowneBank." 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 and also provides commercial mortgage brokerage services and a variety of investment and asset management services. The Realty segment offers residential real estate services, originations of a variety of mortgage loans, resort property management, and residential and commercial title insurance. The Insurance segment provides property and casualty insurance as well as employee and group benefits through Towne Insurance and Towne Benefits. Through Towne Insurance, we offer a full line of commercial and consumer insurance products and financial services. Through Towne Benefits, we offer health, life, dental, vision, and disability plans to employers, brokers, and individuals.

The following is a summary of the Company's 2017 financial performance:

- Net income increased to $87.66 million compared with $67.25 million in 2016. Fully diluted earnings were $1.41 per common share as compared to $1.18 per common share in 2016.

- Net interest income increased $42.25 million or 19.30%, primarily due to an increase in income from loans held for investment and interest-bearing deposits.

- The provision for loan losses increased slightly by $0.07 million, or 1.29%, from 2016. The loan loss reserve was 0.76% of loans at December 31, 2017, up from 0.72% at year-end 2016. The increase in the provision for loan losses from the prior year was primarily a result of loan growth, mostly offset by a decrease in historical loss ratios. Loan loss reserve as a percentage of total loans, excluding purchased loans, remained steady at 0.86% at December 31, 2017, unchanged from year-end 2016, which is consistent with continued stability in credit quality.

- Noninterest income increased by $32.90 million, or 21.20%, over 2016. The primary driver of the increase was an increase in residential mortgage banking income due to a full year of results related to the Monarch Financial Holdings, Inc. ("Monarch") acquisition in June 2016, combined with increases resulting from our August 2017 insurance agency acquisition and our acquisition of a Maryland resort property management company in April 2017.

- Noninterest expense increased $28.39 million, or 10.60%, compared to 2016. The increase was driven by a full year of increased operating expenses related to the June 2016 acquisition of Monarch. Also contributing to the increase were increased operating expenses related to insurance agency and resort property management company acquisitions.

- The effective tax rate increased to 38.47% in 2017 compared to 29.91% in 2016. The increase from the prior year was primarily driven by the enactment of the Tax Cut and Jobs Act of 2017 ("Tax Reform Act"), combined with higher taxable income from operations. The Tax Reform Act, among other things, reduces the federal corporate income tax rate to 21% from 35%, effective January 1, 2018, resulting in a net income tax expense of $10.11 million in 2017 primarily related to a revaluation of deferred tax assets at the lower statutory rate. Excluding the impacts of the Tax Reform Act, our effective income tax rate in 2017 would have been 31.37%.

MERGER ACTIVITY

On April 11, 2017, the Company acquired Railey Mountain Lake Vacations, LLC ("Railey Mountain"), an independent resort property management company that was merged with the operations of Towne Vacations Deep Creek, LLC ("Deep Creek"), a division of TowneBank's Realty segment. The purchase price for the transaction was $8.93 million in cash.

On 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 total purchase price for the transaction was $4.14 million in cash, common stock, and contingent common stock.

On January 26, 2018, the Company completed its acquisition of 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 Company acquired approximately $1.43 million in loans and assumed approximately $1.25 billion in deposits. The purchase price for the transaction was $294.07 million in common stock.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the Consolidated Financial Statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, other real estate owned, deferred income taxes, estimates of fair value of financial instruments, mergers and acquisitions, and goodwill and other intangibles to be critical accounting policies. Significant accounting policies and effects of new accounting pronouncements are discussed in detail in Note 1, "Summary of Significant Accounting Policies," in the "Notes to Consolidated Financial Statements."

The following is a summary of our critical accounting policies that are highly dependent on estimates, assumptions, and judgments.

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

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

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

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

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

On December 22, 2017, the President of the United States signed into law the Tax Reform Act. The legislation significantly changes U.S. tax law by, among other things, lowering corporate income tax rates, implementing a territorial tax system, and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The Tax Reform Act permanently reduces the U.S. corporate income tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018. The Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118 to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Reform Act. The Company has recognized the provisional tax impacts related to the revaluation of deferred tax assets and liabilities and included these amounts in its Consolidated Financial Statements for the year ended December 31, 2017. The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Reform Act. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018.

Estimates of Fair Value of Financial Instruments. The estimation of fair value is significant to certain assets, including loans held for sale, available-for-sale securities, on-balance-sheet commitments to originate loans held for sale, and other real estate held for sale. These assets and liabilities are recorded either at fair value or at the lower of cost or fair value, as applicable. The fair values of loans held for sale are based on commitments on hand from investors or, if commitments have not yet been obtained, prevailing market rates. The fair values of available-for-sale securities are based on published market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The fair values of commitments to originate loans held for sale are based on fees currently charged to enter into similar agreements and, for fixed-rate commitments, also consider the difference between current levels of interest rates and committed rates.

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

Mergers and Acquisitions. Mergers and acquisitions are accounted for using the acquisition method, as required by Accounting Standards Codification Topic ("ASC") 805, *Business Combinations*. Under this method, the cost of the acquired entity will be allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The excess of the cost over the fair value of the acquired net assets is recognized as goodwill.

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

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

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

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Results of Operations: We reported net income for the years ended December 31, 2017, 2016, and 2015, of $87.66 million, $67.25 million, and $62.38 million, respectively. Diluted earnings per share were $1.41, $1.18, and $1.22 for the years ended December 31, 2017, 2016, and 2015, respectively. Earnings per share were affected by the enactment of the Tax Reform Act, which resulted in a net income tax expense of $10.11 million in 2017, primarily related to a revaluation of deferred tax assets at the lower statutory rate. Earnings per share in 2016 were affected by the issuance of 10.49 million shares of TowneBank common stock related to the acquisition of Monarch on June 24, 2016. Additionally, earnings in 2016 included acquisition-related expenses of $12.90 million on an after-tax basis. Earnings per share in 2015 were affected by the issuance of 15.55 million shares of TowneBank common stock related to the acquisition of Franklin Financial Corporation ("Franklin") on January 2, 2015.

Profitability, as measured by our return on average assets ("ROA"), was 1.05%, 0.93%, and 1.03% for the years ended December 31, 2017, 2016, and 2015, respectively. Return on average tangible assets was 1.15%, 1.02%, and 1.10% for the same respective periods. Return on average equity ("ROE") was 7.80%, 6.98%, and 7.75% for years ended December 31, 2017, 2016, and 2015, respectively, while return on average tangible equity was 11.35%, 9.93%, and 10.34% for the same respective years.

Our operating income, calculated as net interest income and noninterest income less gains on investment securities, was $449.24 million for the year ended December 31, 2017, compared to $374.09 million and $296.82 million for 2016 and 2015, respectively.

Net Interest Income: Net interest income, the major source of our earnings, is the income generated by interest-earning assets reduced by the total interest cost of the funds incurred to carry them. It is impacted by market interest rates and the mix and volume of earning assets and interest-bearing liabilities. The yields and rates in this discussion and in the following tables have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 35% federal marginal tax rate for all periods shown.

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

Net interest income, on a tax-equivalent basis, was $263.99 million for the year ended December 31, 2017, which was $42.26 million, or 19.06%, more than the $221.73 million reported in the previous year. In comparison to the prior year, net interest income rose primarily due to increased balances of earning assets related to the Monarch merger coupled with organic growth in earning assets. Accretion of purchase accounting marks added $10.53 million, or 15 basis points, to margin in the current year and added $6.24 million, or 10 basis points, to margin in 2016.

Interest income, on a tax-equivalent basis, was $307.98 million for the year ended December 31, 2017, which was $50.51 million, or 19.62%, greater than the $257.47 million for the year ended December 31, 2016. Average earning assets grew to $7.52 billion in 2017 from $6.44 billion in 2016, an increase of $1.08 billion, or 16.69%. The yield on earning assets was 4.10% in the year ended December 31, 2017, compared to 4.00% in the prior year. Average loan balances, excluding nonaccrual loans, of $5.90 billion were $771.81 million, or 15.04%, higher in 2017 than in 2016, while loan yields increased by 12 basis points. The increase in interest income from the prior year was primarily driven by growth in loans and interest-bearing deposits, combined with an increase in yields on all earning assets.

Interest expense for the year ended December 31, 2017, increased by $8.24 million, or 23.06%, to $43.98 million, compared to $35.74 million for the year ended December 31, 2016. The balance of average interest-bearing liabilities increased to $4.98 billion in 2017 from $4.38 billion in 2016, an increase of $604.58 million, or 13.82%. The increase in interest expense as compared to the prior year was primarily due to an increase in costs related to interest-bearing deposits, combined with the issuance of $250.0 million of subordinated notes in July 2017. The increase was partially offset by a reduction in rates on Federal Home Loan Bank of Atlanta ("FHLB") advances. 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 3.51% in the year ended December 31, 2017, which was 7 basis points higher than the 3.44% a year ago. The margin improvement in comparison to prior year periods was driven by accretion of purchase accounting marks and rate increases on earning assets, combined with rate decreases on FHLB advances. Partially offsetting the increase were rate increases in interest-bearing liabilities due to the issuance of the subordinated notes and higher time deposit rates. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

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

	Year Ended December 31,								
	2017			2016			2015		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans (2)	$ 5,901,797	$ 276,869	4.69%	$ 5,129,990	$ 234,318	4.57%	$ 4,239,887	$ 196,868	4.64%
Taxable investment securities	616,141	11,597	1.88%	695,082	11,254	1.62%	786,737	11,849	1.51%
Tax-exempt investment securities	48,228	1,467	3.04%	52,689	1,601	3.04%	61,489	1,952	3.17%
Interest-bearing deposits	680,026	7,481	1.10%	300,130	1,145	0.38%	188,546	499	0.26%
Mortgage loans held for sale	271,281	10,561	3.89%	264,494	9,152	3.46%	104,222	3,836	3.68%
Total earning assets	7,517,473	307,975	4.10%	6,442,385	257,470	4.00%	5,380,881	215,004	4.00%
Less: allowance for loan losses	(43,760)			(39,547)			(37,194)		
Total nonearning assets	861,286			802,398			695,731		
Total assets	$ 8,334,999			$ 7,205,236			$ 6,039,418		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 2,260,378	$ 8,020	0.35%	$ 2,012,061	$ 6,043	0.30%	$ 1,689,185	$ 4,721	0.28%
Savings	319,940	3,305	1.03%	309,049	2,859	0.93%	300,620	2,755	0.92%
Certificates of deposit	1,668,253	17,467	1.05%	1,530,990	13,414	0.88%	1,334,728	11,390	0.85%
Total interest-bearing deposits	4,248,571	28,792	0.68%	3,852,100	22,316	0.58%	3,324,533	18,866	0.57%
FHLB advances and repurchase agreements	617,720	9,942	1.61%	523,366	13,424	2.56%	463,153	13,565	2.93%
Subordinated debt	113,752	5,249	4.61%	—	—	—%	—	—	—%
Total interest-bearing liabilities	4,980,043	43,983	0.88%	4,375,466	35,740	0.82%	3,787,686	32,431	0.86%
Noninterest-bearing liabilities									
Demand deposits	2,094,753			1,720,093			1,343,360		
Other noninterest-bearing liabilities	136,615			145,902			103,628		
Total liabilities	7,211,411			6,241,461			5,234,674		
Shareholders' equity	1,123,588			963,775			804,744		
Total liabilities and equity	$ 8,334,999			$ 7,205,236			$ 6,039,418		
Net interest income (tax-equivalent basis)		$ 263,992			$ 221,730			$ 182,573	
Reconcilement of Non-GAAP Financial Measures:									
Tax-equivalent basis adjustment		(2,871)			(2,854)			(2,131)	
Net interest income (GAAP)		$ 261,121			$ 218,876			$ 180,442	
Interest rate spread (3)			3.22%			3.17%			3.14%
Interest expense as a percent of average earning assets			0.59%			0.55%			0.60%
Net interest margin (tax-equivalent basis) (4)			3.51%			3.44%			3.39%
Total cost of deposits			0.45%			0.40%			0.40%

(1) Yields and interest income are presented on a taxable-equivalent basis using the federal statutory tax rate of 35%.
(2) Excludes average nonaccrual loans of $10.43 million in 2017, $10.05 million in 2016, and $8.77 million in 2015.
(3) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
(4) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.

(in thousands)	2017 vs 2016 Increase (Decrease) Due to Changes In			2016 vs 2015 Increase (Decrease) Due to Changes In		
	Volume	**Rate (1)**	**Total**	**Volume**	**Rate (1)**	**Total**
Assets:						
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 36,062	$ 6,489	$42,551	$ 40,705	$ (3,255)	$37,450
Taxable investment securities	(1,364)	1,707	343	(1,444)	849	(595)
Tax-exempt investment securities	(136)	2	(134)	(270)	(81)	(351)
Interest-bearing deposits	2,547	3,789	6,336	370	276	646
Loans held for sale	123	1,286	1,409	5,534	(218)	5,316
Total earning assets	37,232	13,273	50,505	44,895	(2,429)	42,466
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	800	1,177	1,977	951	371	1,322
Savings	104	342	446	78	26	104
Certificates of deposit	1,277	2,776	4,053	1,712	312	2,024
Total interest-bearing deposits	2,181	4,295	6,476	2,741	709	3,450
FHLB advances and repurchase agreements	2,126	(5,608)	(3,482)	1,652	(1,793)	(141)
Subordinated debt	5,249	—	5,249	—	—	—
Total interest-bearing liabilities	9,556	(1,313)	8,243	4,393	(1,084)	3,309
Net interest income (tax equivalent basis)	$ 27,676	$ 14,586	$42,262	$ 40,502	$ (1,345)	$39,157

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

Provision for Loan Losses: The provision for loan losses is charged against earnings in order to establish and maintain the allowance for loan losses at a level that reflects management's evaluation of the risk inherent in the portfolio. Management considers continuing assessments of nonperforming and "watch list" loans, analytical reviews of loan loss experience in relation to outstanding loans, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. The provisions for loan losses recorded in 2017, 2016, and 2015 were $5.43 million, $5.36 million, and $3.03 million, respectively. Net charge-offs were $2.30 million, $1.72 million, and $0.59 million for 2017, 2016, and 2015, respectively. The increase in the provision for loan losses in the current year period from the prior year and the increase in 2016 from 2015 was primarily due to loan growth. The allowance for loan losses as a percentage of period-end loans was 0.76% and 0.72% at December 31, 2017 and 2016, respectively. The allowance for loan losses as a percentage of period-end loans, excluding purchased loans, was 0.86% and 0.87% at December 31, 2017 and 2016, respectively. For further discussion and analysis of the loan portfolio and the allowance for loan losses, see the "Analysis of Financial Condition" section found later in this report. Also, see Note 4, "Loans and Allowance for Loan Losses," in the Notes to Consolidated Financial Statements.

Noninterest Income: Total noninterest income for the year ended December 31, 2017, was $188.12 million, or $32.90 million, and 21.19% higher than 2016. Total noninterest income for the year ended December 31, 2016, was $155.22 million, representing a $37.94 million, or 32.35%, increase from 2015. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2017, was 41.88% of total operating income, compared with 41.49% for 2016 and 39.21% for 2015.

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

				2017/2016 Increase/(Decrease)		2016/2015 Increase/(Decrease)	
For the Year Ended December 31,	**2017**	**2016**	**2015**	**Amount**	**%**	**Amount**	**%**
Residential mortgage banking income, net	$ 75,851	$ 58,792	$ 34,211	$ 17,059	29.02 %	$ 24,581	71.85 %
Real estate brokerage and property management income, net	27,487	20,515	16,326	6,972	33.98 %	4,189	25.66 %
Insurance commissions and other title fees and income, net	51,933	46,741	39,641	5,192	11.11 %	7,100	17.91 %
Service charges on deposit accounts	10,594	9,547	9,165	1,047	10.97 %	382	4.17 %
Credit card merchant fees	5,008	4,508	2,588	500	11.09 %	1,920	74.19 %
Other income							
Other	3,448	3,509	5,059	(61)	(1.74)%	(1,550)	(30.64)%
Towne Investment income, net	4,870	3,246	2,851	1,624	50.03 %	395	13.85 %
Bank-owned life insurance income	6,262	5,993	5,190	269	4.49 %	803	15.47 %
Service fees on loans	1,629	1,108	639	521	47.02 %	469	73.40 %
Income from equity method investments	838	913	541	(75)	(8.21)%	372	68.76 %
Commercial mortgage brokerage fees, net	202	344	168	(142)	(41.28)%	176	104.76 %
Total other income	17,249	15,113	14,448	2,136	14.13 %	665	4.60 %
Noninterest income before securities gain/(loss)	188,122	155,216	116,379	32,906	21.20 %	38,837	33.37 %
Gain/(loss) on securities available for sale	(1)	6	904	(7)	(116.67)%	(898)	(99.34)%
Total noninterest income	$ 188,121	$ 155,222	$ 117,283	$ 32,899	21.19 %	$ 37,939	32.35 %

For the year ended December 31, 2017, residential mortgage banking income, net of commission expense, was $75.85 million, reflecting an increase of $17.06 million, or 29.02%, compared to 2016, which was $24.58 million, or 71.85%, higher than 2015. The increase in 2017 from 2016 was primarily due to higher production volumes resulting from a full year of mortgage operations subsequent to the Monarch merger in June 2016. Also factoring in the variance from the prior period was an increase in mortgage banking income of $0.33 million in 2017 as compared to a decrease of $1.50 million in 2016 associated with the change in the value of rate lock commitments and forward contracts recorded as of December 31, 2017. The increase in net mortgage banking income in 2016 from 2015 was also primarily due to higher production volumes resulting from the Monarch merger. Also factoring in the variance from the prior period was a decrease in mortgage banking income of $1.50 million in 2016 as compared to an increase of $0.29 million in 2015 associated with the change in the value of rate lock commitments recorded as of December 31, 2016. For further information, refer to our discussion of the Realty segment in this Annual Report, which provides a comparative schedule of operations.

Real estate brokerage and property management income, net of commission expense, for the year ended December 31, 2017, was $27.49 million, an increase of $6.97 million, or 33.98%, from 2016, which was $4.19 million, or 25.66%, higher than 2015. The increase in 2017 from 2016 was primarily a result of an increase in property management fees associated with our purchase of Railey Mountain Lake in April 2017, combined with a slight increase of $0.16 million in real estate brokerage income. The total dollar volume of units sold increased by $71.93 million, or 5.66%, while the number of units sold was 4,388, an increase of 49 units, or 1.13%, from

2016. The increase in 2016 from 2015 was primarily attributable to an increase in property management fees associated with our purchase of Oak Island Accommodations, Inc. ("Oak Island") on January 14, 2016, combined with an increase of $0.96 million in real estate brokerage income. The increase was partially offset by the sale of our Corolla, North Carolina-based property management business ("Corolla") on April 1, 2015, which generated management fee revenue of $1.80 million in 2015. The Company recognized a nonrecurring gain of $1.36 million on the sale, which was recorded in other noninterest income.

For the year ended December 31, 2017, insurance commissions and other title income, net of commission expense, was $51.93 million, which was $5.19 million, or 11.11%, higher than comparative 2016. The increase from the prior year was largely due to an increase in property and casualty insurance commissions partially related to the acquisition of an insurance agency in August 2017, combined with an increase in contingent commission revenue. The acquired agency contributed additional net commission and fee income of $0.81 million in 2017. The year ended December 31, 2017, included contingency and bonus revenue income of $6.32 million, compared to $4.01 million and $3.22 million for 2016 and 2015, respectively. When compared to 2015, insurance commissions for the year ended December 31, 2016, were $46.74 million, or 17.91%, higher, largely due to a full year of operations from three insurance agencies acquired in the second half of 2015. The acquired agencies contributed additional net commission and fee income of $3.63 million in 2016.

Service charges on deposit accounts were $10.59 million for 2017, compared with $9.55 million and $9.16 million for 2016 and 2015, respectively. The increase from prior periods was primarily due to the addition of accounts as average deposits increased 13.84% and 19.37% in the years ended December 31, 2017 and 2016, respectively.

For the year ended December 31, 2017, credit card merchant fees totaled $5.01 million, which was $0.50 million, or 11.09%, higher than comparative 2016, which was $1.92 million, or 74.19%, higher than 2015. The increase from the prior year was largely due to higher transaction volume. The increase in 2016 from 2015 was primarily related to the effects of the Monarch merger, combined with a decrease in prior year merchant fees related to structural changes in vendor contractual terms and nonrecurring expenses due to a platform change and equipment purchases associated with Europay, MasterCard, and Visa (EMV) compliance.

Other noninterest income for the year ended December 31, 2017 was $17.25 million, compared with $15.11 million for the year ended December 31, 2016, and $14.45 million for the year ended December 31, 2015. Other noninterest income includes income generated by Towne Investment Group, net of commission expense of $4.87 million, $3.25 million, and $2.85 million for the years ended December 31, 2017, 2016, and 2015, respectively. The increase in 2017 from 2016 was due to the increase in income from Towne Investment Group, combined with an increase in loan service fees, and an increase in income from bank-owned life insurance ("BOLI") policies of $0.27 million. The increase in 2016 was largely due to an increase in income from BOLI policies of $3.05 million combined with an increase in loan service fees, partially offset by a decrease in other income related to nonrecurring gains in 2015 of $1.36 million on the sale of Corolla and $0.57 million on the sale of land in Virginia Beach.

Noninterest Expense: Total noninterest expense for 2017 was $296.21 million, which was $28.39 million, or 10.60%, higher than 2016. Primary components of 2017 noninterest expense were salaries and employee benefits of $170.99 million, occupancy expenses of $26.85 million, furniture and equipment expenses of $14.07 million, advertising and marketing expenses of $9.87 million, acquisition-related expenses of $2.27 million, software expense of $8.52 million, and professional fees of $7.14 million. In comparison to 2016, the primary driver of the increase in total noninterest expense was a full year of operating expenses related to the Monarch acquisition. Additionally, the Railey Mountain Lake acquisition in April 2017 and the W.A. Moore insurance agency acquisition in August 2017 contributed combined additional operational expenses of $6.22 million. The primary driver of the increase in total noninterest expense in 2016 from 2015 was the Monarch acquisition, which resulted in acquisition-related expenses of $19.11 million and additional increases in operational expenses. Additionally, insurance agency acquisitions in 2015 and the Oak Island acquisition in January 2016 contributed combined additional operational expenses of $7.11 million. Also contributing to the increase from 2015 was the opening of a new banking office in downtown Richmond, Virginia, in September 2016, which resulted in additional noninterest expenses of $1.0 million.

Total noninterest expense to total operating revenue was 65.94% for the year ended December 31, 2017, compared with 71.59% for 2016 and 68.11% for 2015. The following table provides an analysis of noninterest expense (dollars in thousands):

				2017/2016 Increase/(Decrease)		2016/2015 Increase/(Decrease)	
For the year ended December 31,	**2017**	**2016**	**2015**	**Amount**	**%**	**Amount**	**%**
Salaries and benefits	$170,989	$143,847	$113,959	$ 27,142	18.87 %	$ 29,888	26.23 %
Occupancy	26,855	23,717	19,645	3,138	13.23 %	4,072	20.73 %
Furniture and equipment	14,072	11,315	9,339	2,757	24.37 %	1,976	21.16 %
Other expenses							
Advertising and marketing	9,867	8,443	7,515	1,424	16.87 %	928	12.35 %
Acquisition-related expenses	2,268	19,111	1,312	(16,843)	(88.13)%	17,799	1,356.63 %
Charitable contributions	5,550	4,582	5,193	968	21.13 %	(611)	(11.77)%
Telephone and postage	6,907	5,996	4,701	911	15.19 %	1,295	27.55 %
Outside processing	6,975	6,420	4,844	555	8.64 %	1,576	32.54 %
Professional fees	7,144	5,329	5,764	1,815	34.06 %	(435)	(7.55)%
Other	11,796	9,417	6,019	2,379	25.26 %	3,398	56.45 %
Stationery and office supplies	2,730	2,978	2,479	(248)	(8.33)%	499	20.13 %
Amortization expense of intangibles	7,656	6,010	3,537	1,646	27.39 %	2,473	69.92 %
Foreclosed property expenses	782	1,335	1,785	(553)	(41.42)%	(450)	(25.21)%
FDIC and other insurance	4,249	4,613	4,954	(364)	(7.89)%	(341)	(6.88)%
Software expense	8,517	7,116	5,916	1,401	19.69 %	1,200	20.28 %
Travel/Meals/Entertainment	2,820	2,044	1,452	776	37.96 %	592	40.77 %
Directors' expense	1,734	1,371	1,244	363	26.48 %	127	10.21 %
Bank franchise tax/SCC fees	5,303	4,184	2,499	1,119	26.74 %	1,685	67.43 %
Total other expenses	84,298	88,949	59,214	(4,651)	(5.23)%	29,735	50.22 %
Total noninterest expense	$296,214	$267,828	$202,157	$ 28,386	10.60 %	$ 65,671	32.49 %

Salaries and employee benefits, the largest portion of noninterest expense, were $170.99 million, representing 57.73% of total noninterest expense for the year ended December 31, 2017. This was a $27.14 million, or 18.87%, increase over comparative 2016. The increase from prior year was primarily due to a full year of expense related to the addition of staff resulting from the Monarch acquisition. Also contributing to the increase was the addition of staff from Insurance and Realty segment acquisitions, which resulted in an increase of $3.72 million. Salaries and benefits expense for the year ended December 31, 2016, was $143.85 million, up 26.23%, or $29.89 million, over 2015. The increase was primarily due to the addition of staff resulting from the Monarch acquisition. Also, the addition of staff resulting from Insurance and Realty segment acquisitions resulted in an increase of $4.57 million.

In our Banking segment, we had a total of 877 full-time equivalent employees ("FTE") at December 31, 2017, which was up from 848 and 710 at December 31, 2016 and 2015, respectively. In our non-Banking segments at

December 31, 2017, we had a total of 1,436 FTEs, excluding real estate sales agents, increased from 1,272 at December 31, 2016, and 767 at December 31, 2015. Real estate agents are independent contractors and, therefore, not included as the Company's employees. There were 414 real estate agents at December 31, 2017.

For the year ended December 31, 2017, occupancy expense totaled $26.85 million, representing an increase of $3.14 million, or 13.23%, over comparative 2016. Occupancy expense for 2016 was $4.07 million, or 20.73%, over the 2015 amount of $19.65 million. The increase from 2016 was primarily related to a full year of operations of mortgage facilities acquired in the Monarch acquisition, combined with the acquisition of Deep Creek in April 2017. The increases in occupancy expense in 2016 from 2015 were primarily driven by facilities acquired in the Monarch acquisition, combined with the opening of a new banking office in Richmond, Virginia, in September 2016.

Furniture and equipment expense was $14.07 million for 2017, or $2.76 million and 24.37% higher than 2016. Furniture and equipment expense was $11.32 million for 2016, or $1.98 million and 21.16% higher than comparative 2015. The increase from 2016 was primarily related to a full year of operations of mortgage facilities acquired in the Monarch acquisition. The increase in 2016 from 2015 was primarily related to facilities acquired in the Monarch acquisition.

Other expenses for 2017 were $84.30 million, which was $4.65 million, or 5.23%, less than the 2016 amount of $88.95 million. The primary driver of the decrease from 2016 to 2017 was the reduction in acquisition-related expenses of $16.84 million, which was primarily the result of the Monarch acquisition in 2016, combined with decreases in foreclosed property expenses and Federal Deposit Insurance Corporation and other insurance expenses. Partially offsetting the decreases were increases in amortization expense of $1.65 million, professional fees of $1.82 million, advertising and marketing expense of $1.42 million, and software expense of $1.40 million. Other expenses for 2016 were $88.95 million, or 50.22%, higher than the 2015 amount of $59.21 million. The increase primarily related to the Monarch acquisition, which resulted in an increase in acquisition-related expense of $17.80 million. Additionally, there were increases in amortization expense, bank franchise tax, and outside processing.

Income Taxes: Income taxes for the year ended December 31, 2017, were $54.81 million. This was $26.12 million higher than the 2016 amount of $28.70 million, which was $1.82 million higher than the 2015 amount of $26.88 million. The effective tax rate for 2017 was 38.47% versus 29.91% for 2016 and 30.11% for 2015. The rate increase from 2016 was primarily driven by the enactment of the Tax Reform Act, combined with higher taxable income from operations. The Tax Reform Act, among other things, reduces the federal corporate income tax rate to 21% from 35% effective January 1, 2018, resulting in a net income tax expense of $10.11 million in 2017 primarily related to a revaluation of deferred tax assets at the lower statutory rate. Excluding the impacts of the Tax Reform Act, our effective income tax rate in 2017 would have been 31.37%. The rate decrease in 2016 from 2015 was primarily a result of the increase in non-taxable income arising from BOLI and a decrease in nondeductible expenses, partially offset by an increase in taxable income subject to the federal statutory rate of 35%.

SEGMENT PERFORMANCE SUMMARY

Our reportable segments are a traditional full-service community bank, a full-service realty business, and a full-service insurance agency. In this section, we discuss the performance and financial results of our segments. For further financial details, see Note 25 in the Notes to Consolidated Financial Statements.

Banking Segment: For the year ended December 31, 2017, the Banking segment represented 83.97%, or $73.62 million, of our total consolidated net income, compared to 76.77% and 81.03% for 2016 and 2015, respectively.

Pre-tax earnings for the year ended December 31, 2017, for the Banking segment were $118.20 million, increasing $47.62 million, or 67.47%, from comparative 2016. The increase in earnings was driven by a $43.97 million, or 18.58%, increase in total revenues, and a decrease in total expenses of $3.49 million, or 2.15%.

The increase in net interest income for the year ended December 31, 2017, of $39.89 million, or 18.90%, was primarily a result of additional interest income from a combination of higher yields and increased earning assets, as average loan balances increased by $771.81 million to $5.90 billion. The increase was partially offset by additional interest expense of $7.36 million, the majority of which is due to increased costs related to interest-bearing deposits, combined with the issuance of subordinated notes in July 2017.

The increase in noninterest income of $4.08 million, or 15.97%, was primarily due to a combination of an increase in income from BOLI policies of $0.27 million, an increase in credit card merchant fees of $0.50 million, and an increase of service charges on deposit accounts of $1.05 million.

Noninterest expense for the year ended December 31, 2017, decreased $3.49 million, or 2.15%, over 2016. The primary factor resulting in the decrease was a significant reduction in merger and acquisition expenses of $17.14 million, which were higher in 2016 due to the Monarch merger. This reduction was partially offset by an increase in salaries and employee benefits of $8.23 million, or 10.43%, occupancy expense of $0.76 million, or 4.84%, furniture and equipment expense of $0.96 million, or 11.38%, and charitable contributions of $1.04 million, or 24.79%.

The increase in salaries and employee benefits was primarily due to a full year of expense related to the addition of staff resulting from the Monarch acquisition, combined with increases in salaries due to annual salary adjustments. The increase was partially offset by decreased profit sharing accruals.

The total increase in occupancy and furniture and equipment expense was primarily a full year of expenses related to the Monarch acquisition combined with a full year of expenses related to a branch opened in September 2016.

Pre-tax earnings for the year ended December 31, 2016, for the Banking segment were $70.58 million, increasing $0.75 million, or 1.07%, from comparative 2015. The increase in earnings was driven by a $36.30 million, or 18.12%, increase in total revenues, partially offset by a $2.30 million increase in the provision for loan losses and a $33.60 million, or 26.09%, increase in expenses.

The increase in net interest income for the year ended December 31, 2016, of $33.40 million, or 18.79%, was due to additional interest income from earning assets related to the Monarch merger, as average loan balances increased by $890.10 million to $5.13 billion. The increase was partially offset by additional interest expense of $1.88 million, as the Monarch merger resulted in an increase in average interest-bearing deposits of $527.57 million.

The increase in noninterest income of $2.91 million, or 12.82%, was primarily due to a combination of an increase in income from BOLI policies of $0.80 million and an increase in credit card merchant fees of $1.92 million. The increase was partially offset by a decrease in gains on securities sales of $0.90 million.

Noninterest expense for the year ended December 31, 2016, increased $33.60 million, or 26.09%, over 2015. Primary factors resulting in the increase were additional salaries and employee benefits of $9.84 million, or 14.25%, occupancy expense of $1.82 million, or 13.19%, furniture and equipment expense of $1.04 million, or 14.06%, and other expenses of $21.65 million, or 172.66%, which were partially offset by decreases in foreclosed property expense of $0.45 million, or 25.21%, advertising and marketing of $0.48 million, or 12.17%, and other charitable contributions of $0.75 million, or 15.19%.

The increase in salaries and employee benefits was primarily due to the addition of staff resulting from the Monarch acquisition combined with increases in profit sharing accruals, salaries due to annual salary adjustments, and matching contributions to employee retirement plans.

The total increase in occupancy and furniture and equipment expense was primarily related to the Monarch acquisition combined with the addition of a new branch in September 2016 and a full year of expenses related to a branch opened in May 2015.

The increase in other noninterest expenses in 2016 was driven by an increase in acquisition-related expenses of $17.39 million primarily related to the Monarch merger and additional amortization of intangible assets expense of $1.17 million.

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

	Year Ended December 31,			Increase/(Decrease) 2017 over 2016		2016 over 2015	
	2017	2016	2015	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 251,003	$ 211,112	$ 177,715	$ 39,891	18.90 %	$ 33,397	18.79 %
Noninterest income							
Service charges on deposit accounts	10,594	9,547	9,165	1,047	10.97 %	382	4.17 %
Credit card merchant fees	5,008	4,508	2,588	500	11.09 %	1,920	74.19 %
Other income	14,046	11,503	10,002	2,543	22.11 %	1,501	15.01 %
Subtotal	29,648	25,558	21,755	4,090	16.00 %	3,803	17.48 %
Gain (loss) on investment securities	(1)	6	904	(7)	(116.67)%	(898)	(99.34)%
Total noninterest income	29,647	25,564	22,659	4,083	15.97 %	2,905	12.82 %
Total revenue	280,650	236,676	200,374	43,974	18.58 %	36,302	18.12 %
Provision for loan losses	5,426	5,326	3,027	100	1.88 %	2,299	75.95 %
Expenses							
Salaries and employee benefits	87,140	78,910	69,070	8,230	10.43 %	9,840	14.25 %
Occupancy expense	16,365	15,610	13,791	755	4.84 %	1,819	13.19 %
Furniture and equipment	9,406	8,445	7,404	961	11.38 %	1,041	14.06 %
Advertising and marketing	3,646	3,478	3,960	168	4.83 %	(482)	(12.17)%
Charitable contributions	5,231	4,192	4,943	1,039	24.79 %	(751)	(15.19)%
Outside processing	4,434	4,439	3,373	(5)	(0.11)%	1,066	31.60 %
Foreclosed property expenses	753	1,335	1,785	(582)	(43.60)%	(450)	(25.21)%
FDIC and other insurance	3,739	4,243	4,624	(504)	(11.88)%	(381)	(8.24)%
Professional fees	4,691	4,081	4,330	610	14.95 %	(249)	(5.75)%
Telephone and postage	3,649	3,420	2,928	229	6.70 %	492	16.80 %
Other expenses	19,800	34,191	12,540	(14,391)	(42.09)%	21,651	172.66 %
Total expenses	158,854	162,344	128,748	(3,490)	(2.15)%	33,596	26.09 %
Income before income tax expense and corporate allocation	116,370	69,006	68,599	47,364	68.64 %	407	0.59 %
Corporate allocation	1,828	1,573	1,234	255	16.21 %	339	27.47 %
Income before income tax provision	118,198	70,579	69,833	47,619	67.47 %	746	1.07 %
Provision for income tax expense	(44,584)	(18,923)	(19,290)	(25,661)	135.61 %	367	(1.90)%
Net income	73,614	51,656	50,543	21,958	42.51 %	1,113	2.20 %
Noncontrolling interest	1	(28)	—	29	(103.57)%	(28)	N/M
Net income attributable to TowneBank	$ 73,615	$ 51,628	$ 50,543	$ 21,987	42.59 %	$ 1,085	2.15 %

Realty Segment: For the year ended December 31, 2017, the Realty segment represented 8.39%, or $7.35 million, of our total consolidated net income, compared to 15.30%, or $10.29 million, for 2016, and 12.38%, or $7.73 million, for 2015.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2017, for the Realty segment were $16.90 million, decreasing 16.09% from 2016. Total revenue increased to $118.0 million in 2017 from $92.0 million in 2016.

Net residential mortgage banking income increased by $16.38 million to $76.24 million from 2016 primarily as a result of a full year of mortgage operations subsequent to the Monarch merger in June 2016. Residential mortgage banking income included an increase in the value of rate lock commitments and forward contracts of

$0.33 million in 2017, as compared to a decrease of $1.50 million in 2016. The increase in property management fees from 2016 was primarily due to increased revenue from our purchase of Railey Mountain Lake in April 2017. The increase in net interest and other income primarily resulted from a higher balance of average mortgage loans held for sale.

Expenses for the Realty segment increased 40.89%, or $29.0 million, when compared to 2016. The increase in expenses was primarily due to a full year of mortgage operation expenses related to the Monarch merger. Also contributing to the increase in expenses over the prior year were additional operating expenses of $5.38 million related to Deep Creek operations.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2016, for the Realty segment were $20.14 million, increasing 36.57% from 2015. Total revenue increased to $92.0 million in 2016 from $58.52 million in 2015. Net residential mortgage banking income increased by $24.92 million to $59.87 million from 2015 as a result of increased production volume due to the Monarch acquisition in June 2016. Residential mortgage banking income included a decrease in the value of rate lock commitments of $1.50 million in 2016, as compared to an increase of $0.29 million in 2015. The increase in property management fees from 2015 was primarily due to increased revenue from our purchase of Oak Island on January 14, 2016. The increase in net interest and other income resulted from a higher balance of average mortgage loans held for sale, leading to additional net interest income of $5.04 million as compared to the prior year.

Expenses for the Realty segment increased 64.02%, or $27.69 million, when compared to 2015. The increase in expenses was primarily due to mortgage operation expenses resulting from the Monarch merger and additional operating expenses of $4.47 million resulting from the Oak Island acquisition.

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

	Year Ended December 31,			Increase/(Decrease) 2017 over 2016		Increase/(Decrease) 2016 over 2015	
	2017	2016	2015	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage banking income, net	$ 76,245	$ 59,870	$ 34,952	$ 16,375	27.35 %	$ 24,918	71.29%
Real estate brokerage income, net	7,991	7,833	6,874	158	2.02 %	959	13.95%
Title insurance and settlement fees	1,877	1,883	1,574	(6)	(0.32)%	309	19.63%
Property management fees, net	19,496	12,682	9,452	6,814	53.73 %	3,230	34.17%
Income from unconsolidated subsidiary	704	881	648	(177)	(20.09)%	233	35.96%
Net interest and other income	11,724	8,854	5,022	2,870	32.41 %	3,832	76.30%
Total revenue	118,037	92,003	58,522	26,034	28.30 %	33,481	57.21%
Expenses							
Salaries and employee benefits	58,639	41,706	24,916	16,933	40.60 %	16,790	67.39%
Occupancy expense	8,171	5,989	3,900	2,182	36.43 %	2,089	53.56%
Furniture and equipment	3,865	2,113	1,030	1,752	82.92 %	1,083	105.15%
Amortization of intangible assets	2,566	1,829	1,027	737	40.30 %	802	78.09%
Other expenses	26,688	19,292	12,371	7,396	38.34 %	6,921	55.95%
Total expenses	99,929	70,929	43,244	29,000	40.89 %	27,685	64.02%
Income before income tax, corporate allocation, and noncontrolling interest	18,108	21,074	15,278	(2,966)	(14.07)%	5,796	37.94%
Corporate allocation	(1,210)	(935)	(532)	(275)	29.41 %	(403)	75.75%
Income before income tax provision and noncontrolling interest	16,898	20,139	14,746	(3,241)	(16.09)%	5,393	36.57%
Provision for income tax	(5,791)	(6,184)	(4,770)	393	(6.36)%	(1,414)	29.64%
Net income	11,107	13,955	9,976	(2,848)	(20.41)%	3,979	39.89%
Noncontrolling interest	(3,756)	(3,669)	(2,250)	(87)	2.37 %	(1,419)	63.07%
Net income attributable to TowneBank	$ 7,351	$ 10,286	$ 7,726	$ (2,935)	(28.53)%	$ 2,560	33.13%

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

	Year Ended December 31,			Increase/(Decrease)			
				2017 over 2016		2016 over 2015	
	2017	2016	2015	Amount	Percent	Amount	Percent
Key data							
Number of units sold	4,388	4,339	3,912	49	1.13%	427	10.92 %
Volume of units sold	$1,342,828	$1,270,900	$1,081,353	$ 71,928	5.66%	$ 189,547	17.53 %
Number of real estate agents	414	409	412	5	1.22%	(3)	(0.73)%
Loans originated, mortgage	$2,580,913	$2,254,975	$ 795,087	$ 325,938	14.45%	$1,459,888	183.61 %
Loans originated, joint ventures	988,645	902,607	777,906	86,038	9.53%	124,701	16.03 %
Total loans originated	$3,569,558	$3,157,582	$1,572,993	$ 411,976	13.05%	$1,584,589	100.74 %
Number of loans, mortgage	9,887	8,712	3,440	1,175	13.49%	5,272	153.26 %
Number of loans, joint ventures	4,488	4,190	3,629	298	7.11%	561	15.46 %
Total number of loans	14,375	12,902	7,069	1,473	11.42%	5,833	82.52 %
Average loan amount, mortgage	$ 261	$ 259	$ 231	$ 2	0.77%	$ 28	12.12 %
Average loan amount, joint ventures	220	215	214	5	2.33%	1	0.47 %
Average loan amount	$ 248	$ 245	$ 223	$ 3	1.22%	$ 22	9.87 %
Average number of originators, mortgage	238	158	70	80	50.63%	88	125.71 %
Average number of originators, joint ventures	78	56	52	22	39.29%	4	7.69 %
Average number of originators	316	214	122	102	47.66%	92	75.41 %

Mortgage. The loan volume for combined mortgage operations showed increases during the year ended December 31, 2017, as compared to 2016. Total loans originated in 2017 were $3.57 billion, a 13.05%, or $0.41 billion, increase from $3.16 billion in 2016, which was a $1.58 billion, or 100.74%, increase compared to the 2015 volume of $1.57 billion. Refinance activity comprised $532.71 million of loan volume for the year ended December 31, 2017, while purchases accounted for the remaining $3.04 billion in loan volume for the year. For the years ended December 31, 2016 and 2015, refinance volume was $727.09 million and $263.92 million, respectively, while purchase volume was $2.43 billion and $1.31 billion, respectively.

Insurance Segment: The Insurance segment comprises property and casualty and group benefits divisions. The Insurance segment represented 7.64%, or $6.70 million, of our total consolidated net income in 2017 compared to 7.93%, or $5.34 million, in 2016.

Earnings before taxes and noncontrolling interest for the Insurance segment were $12.51 million in 2017, as compared to $10.20 million in 2016. The primary factors affecting earnings were increases in contingent commission and bonus income in our property and casualty and benefits lines, combined with the W.A. Moore acquisition and growth in our travel insurance business. There was an increase in total commissions and fees of $3.35 million, or 6.66%, over 2016. Also contributing to the increase was higher contingency and bonus revenue of $2.31 million. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other things.

Earnings before taxes and noncontrolling interest for the Insurance segment were $10.20 million in 2016, as compared to $7.96 million in 2015. The primary factors affecting earnings were increases in income related to a full year of operations for insurance agencies acquired in 2015 and growth in our travel insurance business.

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

	Year Ended December 31,			Increase/(Decrease)			
				2017 over 2016		2016 over 2015	
	2017	2016	2015	Amount	Percent	Amount	Percent
Commission and fee income							
Property and casualty	$ 35,694	$ 33,544	$ 29,978	$ 2,150	6.41 %	$ 3,566	11.90 %
Employee benefits	12,551	11,683	10,279	868	7.43 %	1,404	13.66 %
Travel insurance	4,668	4,374	3,297	294	6.72 %	1,077	32.67 %
Specialized benefit services	657	623	557	34	5.46 %	66	11.85 %
Total commissions and fees	53,570	50,224	44,111	3,346	6.66 %	6,113	13.86 %
Contingency and bonus revenue	6,322	4,008	3,223	2,314	57.73 %	785	24.36 %
Other income	308	280	206	28	10.00 %	74	35.92 %
Total revenue	60,200	54,512	47,540	5,688	10.43 %	6,972	14.67 %
Employee commission expense	9,646	9,124	8,711	522	5.72 %	413	4.74 %
Revenue, net of commission expense	$ 50,554	$ 45,388	$ 38,829	$ 5,166	11.38 %	$ 6,559	16.89 %
Salaries and employee benefits	25,209	23,231	19,974	1,978	8.51 %	3,257	16.31 %
Occupancy expense	2,319	2,117	1,954	202	9.54 %	163	8.34 %
Furniture and equipment	801	758	904	43	5.67 %	(146)	(16.15)%
Amortization of intangible assets	2,803	2,784	2,285	19	0.68 %	499	21.84 %
Other expenses	6,298	5,665	5,048	633	11.17 %	617	12.22 %
Total expenses	37,430	34,555	30,165	2,875	8.32 %	4,390	14.55 %
Income before income tax, corporate allocation, and noncontrolling interest	13,124	10,833	8,664	2,291	21.15 %	2,169	25.03 %
Corporate allocation	(618)	(638)	(702)	20	(3.13)%	64	(9.12)%
Income before income tax provision and noncontrolling interest	12,506	10,195	7,962	2,311	22.67 %	2,233	28.05 %
Provision for income tax expense	(4,438)	(3,591)	(2,816)	(847)	23.59 %	(775)	27.52 %
Net income	8,068	6,604	5,146	1,464	22.17 %	1,458	28.33 %
Noncontrolling interest	(1,371)	(1,268)	(1,033)	(103)	8.12 %	(235)	22.75 %
Net income attributable to TowneBank	$ 6,697	$ 5,336	$ 4,113	$ 1,361	25.51 %	$ 1,223	29.73 %

Total revenue for the year ended December 31, 2017, increased $5.69 million, or 10.43%. The increase from the prior period was driven by an increase in contingent commission and bonus revenue of $2.31 million and was positively impacted by the 2017 insurance agency acquisition. The acquired insurance agency contributed additional revenue, net of commission expense of $0.81 million. Also contributing to the increase was improvement in commercial lines commissions due to organic growth and an increase in employee benefits commissions of $0.87 million.

Salaries and employee benefits expense increased $1.98 million, or 8.51%, when comparing 2017 to 2016, and increased $3.26 million, or 16.31%, when comparing 2016 to 2015. The increases were mainly driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $0.59 million and $2.03 million for 2017 and 2016, respectively.

Occupancy expense increased $0.20 million, or 9.54%, when comparing 2017 to 2016, and increased $0.16 million, or 8.34%, when comparing 2016 to 2015, largely as a result of the insurance agency acquisitions.

Amortization of intangible assets increased slightly by $0.02 million, or 0.68%, during the year ended December 31, 2017, compared to 2016, and increased $0.50 million, or 21.84%, when comparing 2016 to 2015, which was also a result of the acquisitions.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $0.55 billion, or 6.88%, to $8.52 billion at December 31, 2017, from $7.97 billion at December 31, 2016. Our loan portfolio grew by 2.41%, or $0.14 billion, to $5.95 billion at December 31, 2017, from $5.81 billion at December 31, 2016.

Our total average assets were $8.33 billion for 2017, reflecting an increase of $1.13 billion, or 15.68%, compared to the 2016 average of $7.21 billion. Total average assets for 2016 increased $1.17 billion, or 19.30%, compared to the 2015 average of $6.04 billion. Average earning assets were $7.52 billion in 2017, reflecting an increase of $1.08 billion, or 16.69%, compared to 2016.

Our average total deposits were $6.34 billion in 2017, reflecting growth of $771.13 million, or 13.84%, compared to 2016. Growth continued in average noninterest-bearing deposits, which increased $374.66 million, or 21.78%.

Securities: Our securities consist of available-for-sale securities and held-to-maturity securities. Our available-for-sale securities portfolio, which is held primarily for earnings, liquidity, and asset/liability management purposes, is reported at fair value based on market prices for similar instruments. Our held-to-maturity securities portfolio, which is held primarily for yield and pledging purposes, is valued at amortized cost. Our investment portfolio totaled $958.55 million as of December 31, 2017, with a balance of $867.65 million in available-for-sale, $61.30 million in held-to-maturity, and $29.59 million in FHLB stock. Average yield on available-for-sale securities was 1.61% at December 31, 2017, compared with 1.27% at December 31, 2016, and 1.49% at December 31, 2015. Average yield on held-to-maturity securities was 3.26% at December 31, 2017, compared to 3.19% at December 31, 2016, and 3.25% at December 31, 2015.

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

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

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

	Year Ended December 31,								
	2017			2016			2015		
	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Securities Available for Sale:									
U.S. agency securities	$ 277,062	$ 274,468	1.40%	$ 293,663	$ 292,470	1.20%	$ 540,984	$ 537,812	1.20%
U.S. Treasury notes	301,472	301,497	1.03%	251,994	252,001	0.32%	1,004	997	0.67%
Municipal securities	17,495	17,487	2.59%	23,502	23,552	2.81%	21,445	21,849	2.89%
Trust preferred corporate securities	22,799	23,364	4.97%	1,978	2,533	8.09%	3,974	4,593	4.55%
Other corporate securities	1,516	1,516	1.09%	1,515	1,515	1.09%	1,435	1,435	1.08%
Mortgage-backed securities	253,737	249,322	2.16%	245,106	240,903	2.13%	157,425	156,803	2.24%
Total securities available for sale	874,081	867,654	1.61%	817,758	812,974	1.27%	726,267	723,489	1.49%
Securities Held to Maturity:									
Trust preferred corporate securities	500	731	8.75%	500	704	8.75%	500	714	8.75%
Municipal securities	40,825	42,572	3.80%	40,922	42,746	3.86%	44,377	47,488	3.89%
Mortgage-backed securities	19,979	19,582	2.01%	25,068	24,746	1.99%	24,168	24,165	1.96%
Total securities held to maturity	61,304	62,885	3.26%	66,490	68,196	3.19%	69,045	72,367	3.25%
Total Portfolio	$ 935,385	$ 930,539	1.72%	$ 884,248	$ 881,170	1.41%	$ 795,312	$ 795,856	1.65%

The following table indicates the maturities of securities at December 31, 2017 (dollars in thousands):

	Available for Sale			Held to Maturity		
	Amortized Cost	Fair Market Value	Weighted Average Yield	Amortized Cost	Fair Market Value	Weighted Average Yield
U.S. Treasury & U.S. agency securities						
Due in one year or less	$ 371,978	$ 371,660	1.05%	$ —	$ —	—
After one year through five years	206,556	204,305	1.50%	—	—	—
After five years through ten years	—	—	—	—	—	—
After ten years	—	—	—	—	—	—
Municipal securities						
Due in one year or less	1,558	1,558	2.05%	2,017	2,025	4.54%
After one year through five years	10,678	10,603	2.38%	2,327	2,368	3.71%
After five years through ten years	3,099	3,081	2.63%	23,235	23,988	3.55%
After ten years	2,160	2,245	3.92%	13,246	14,191	4.13%
Mortgage-backed securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	3,011	2,998	1.88%	2,322	2,280	1.26%
After five years through ten years	20,831	20,689	2.42%	16,591	16,155	1.81%
After ten years	229,895	225,635	2.14%	1,066	1,147	6.79%
Trust preferred corporate securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	—	—	—	—	—	—
After five years through ten years	20,820	20,740	4.68%	—	—	—
After ten years	1,979	2,624	8.09%	500	731	8.75%
Other securities						
Due in one year or less	1,066	1,066	1.25%	—	—	—
After one year through five years	250	250	1.30%	—	—	—
After five years through ten years	200	200	—	—	—	—
After ten years	—	—	—	—	—	—
No stated maturity	—	—	—	—	—	—
Total Portfolio	$ 874,081	$ 867,654	1.61%	$ 61,304	$ 62,885	3.26%

Loans Held for Sale: At December 31, 2017, we held $313.26 million in mortgage loans originated and intended for sale in the secondary market, compared with $314.05 million at December 31, 2016. Average loans held for sale were 3.61% and 4.11% of average earning assets for the years ended December 31, 2017 and 2016, respectively. The majority of loans held for sale have been pre-committed to investors, minimizing our interest rate risk.

Our mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate 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" 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: Our loan portfolio, net of unearned income and deferred costs, totaled $5.95 billion on December 31, 2017. As a percentage of total average earning assets, average loans were 78.51% in 2017, compared with 79.63% in 2016 and 78.80% in 2015. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were continued improvements in our local economy and the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers. The following tables provide the balance and composition of the loan portfolio by major classification for the periods indicated (dollars in thousands):

Year Ended December 31,	**2017**	**2016**	**2015**	**2014**	**2013**
Real estate loans					
1-4 family residential	$ 1,217,349	$ 1,215,823	$ 973,331	$ 837,370	$ 797,723
Commercial	2,283,541	2,251,312	1,784,393	1,447,078	1,365,572
Construction and land development	930,426	826,027	598,875	452,481	469,679
Multifamily	198,720	222,791	167,371	51,472	53,562
Total real estate loans	4,630,036	4,515,953	3,523,970	2,788,401	2,686,536
Commercial and industrial loans	1,087,157	1,089,539	857,036	700,623	645,960
Consumer loans and other	229,772	201,729	138,387	75,365	48,698
Loans, net of unearned income and deferred costs	$ 5,946,965	$ 5,807,221	$ 4,519,393	$ 3,564,389	$ 3,381,194

Year Ended December 31,	**2017**	**2016**	**2015**	**2014**	**2013**
Real estate loans					
1-4 family residential	20.47%	20.94%	21.54%	23.49%	23.59%
Commercial	38.40%	38.77%	39.48%	40.60%	40.39%
Construction and land development	15.65%	14.22%	13.25%	12.70%	13.89%
Multifamily	3.34%	3.84%	3.70%	1.44%	1.58%
Total real estate loans	77.86%	77.77%	77.97%	78.23%	79.45%
Commercial and industrial loans	18.28%	18.76%	18.97%	19.66%	19.11%
Consumer loans and other	3.86%	3.47%	3.06%	2.11%	1.44%
Loans, net of unearned income and deferred costs	100.00%	100.00%	100.00%	100.00%	100.00%

The table below provides the maturity and sensitivity of the loan portfolio at December 31, 2017 (in thousands):

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Totals	Due After One Year: Fixed Rates	Due After One Year: Adjustable Rates
Real estate loans						
1-4 family residential	$ 100,831	$ 144,687	$ 971,831	$ 1,217,349	$ 449,555	$ 666,963
Commercial	190,027	306,001	1,787,513	2,283,541	1,823,473	270,041
Construction and land development	561,891	277,824	90,711	930,426	106,909	261,626
Multifamily	18,572	39,270	140,878	198,720	179,279	869
Total real estate loans	871,321	767,782	2,990,933	4,630,036	2,559,216	1,199,499
Commercial and industrial loans	431,930	316,775	338,452	1,087,157	510,342	144,885
Consumer loans and other	35,343	116,622	77,807	229,772	190,938	3,491
Loans, net of unearned income and deferred costs	$ 1,338,594	$ 1,201,179	$ 3,407,192	$ 5,946,965	$ 3,260,496	$ 1,347,875

At December 31, 2017, approximately 99.71% of our floating rate loans are tied to LIBOR interest rates or Wall Street Journal Prime interest rates. The following table is a summary of our floating rate loan portfolio and contractual interest rate indices at December 31, 2017 (in thousands):

Contractual Interest Rate Index	Floating Rate (at floor rate)	Floating Rate (not at floor or ceiling rate)	Floating Rate (at ceiling rate)	Total Floating Rate
Wall Street Journal Prime	$ 273,757	$ 1,693,916	$ 1,688	$ 1,969,361
LIBOR	8,954	331,014	—	339,968
Other contractual interest rate indices	3,496	3,117	132	6,745
	$ 286,207	$ 2,028,047	$ 1,820	$ 2,316,074

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

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

Our policy is to establish 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. Historical loss ratios are updated quarterly based on actual charge-off experience. An historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. Our pools of similar loans include groups of construction and land development loans, commercial real estate loans, commercial and industrial business loans, 1-4 family residential real estate loans, multifamily real estate loans, and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to TowneBank. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability, and effectiveness of the Company's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures, and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis to determine an appropriate general valuation allowance.

The allowance for loan losses at December 31, 2017, 2016, and 2015, was $45.13 million, $42.0 million, and $38.36 million, respectively. The allowance was equal to 0.76% of total loans outstanding at December 31, 2017, compared with 0.72% at December 31, 2016, and 0.85% at December 31, 2015. Excluding purchased loans, the allowance was equal to 0.86% of total loans outstanding at December 31, 2017, compared with 0.87% at December 31, 2016, and 0.94% at December 31, 2015. We believe the consistency in the ratio, excluding purchased loans, is appropriate given the 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 0.68% of total loans at December 31, 2017, down from 1.31% at December 31, 2016. Additionally, loans 30 to 89 days past due were $5.96 million, or 0.10% of total loans, including purchased impaired loans of $0.15 million, at December 31, 2017, down significantly from $10.46 million, or 0.18% of total loans, at December 31, 2016, and total past due and nonaccruing loans were $11.37 million, or 0.19% of total loans, including purchased impaired past-due loans of $0.64 million, at December 31, 2017, compared to $25.21 million, or 0.43% of total loans, at December 31, 2016. Also reflecting the credit quality of our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 9.39x of nonperforming loans at December 31, 2017, compared with 3.21x at December 31, 2016. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at December 31, 2017.

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

Year Ended December 31,	2017	2016	2015	2014	2013
Balance beginning of period	$ 42,001	$ 38,359	$ 35,917	$ 38,380	$ 40,427
Loans charged off:					
1-4 family residential real estate	(2,291)	(1,448)	(1,443)	(1,473)	(4,402)
Multifamily	—	—	—	(493)	(14)
Commercial real estate	(139)	(399)	(279)	(1,165)	(396)
Construction and land development	—	(107)	(208)	(561)	(1,734)
Commercial and industrial	(345)	(481)	(122)	(432)	(1,040)
Consumer and other	(644)	(459)	(109)	(415)	(397)
Total	(3,419)	(2,894)	(2,161)	(4,539)	(7,983)
Loans recovered:					
Residential 1-4 family	286	716	636	661	465
Multifamily	2	2	1	47	—
Commercial real estate	339	59	244	452	335
Construction and land development	34	110	80	134	367
Commercial and industrial	82	121	493	130	466
Consumer and other	380	171	122	160	55
Total	1,123	1,179	1,576	1,584	1,688
Net loans charged off	(2,296)	(1,715)	(585)	(2,955)	(6,295)
Provision for loan losses	5,426	5,357	3,027	492	4,248
Balance end of period	$ 45,131	$ 42,001	$ 38,359	$ 35,917	$ 38,380
Nonperforming assets:					
Nonperforming loans	$ 4,807	$ 13,099	$ 8,670	$ 6,741	$ 12,753
Former bank premises	3,469	3,494	—	—	—
Foreclosed property	19,818	21,011	34,420	35,115	39,534
Total nonperforming assets	$ 28,094	$ 37,604	$ 43,090	$ 41,856	$ 52,287
Loans past due 90 days accruing interest	$ 103	$ 76	$ 424	$ 12	$ —
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	9.39x	3.21x	4.42x	5.33x	3.01x
Allowance to nonperforming assets	1.61x	1.12x	.89x	.86x	.73x
Allowance for loan losses to period end loans	0.76%	0.72%	0.85%	1.01%	1.14%
Allowance for loan losses to period end loans excluding purchased loans	0.86%	0.87%	0.94%	1.02%	1.15%
Nonperforming loans to period end loans	0.08%	0.23%	0.19%	0.19%	0.38%
Nonperforming assets to period end assets	0.33%	0.47%	0.68%	0.84%	1.12%
Net charge-offs to average loans	0.04%	0.03%	0.01%	0.09%	0.19%

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

At December 31, 2017, we had $28.09 million in nonperforming assets, which amounted to 0.33% of total assets. Nonperforming assets consist of $4.81 million in nonperforming loans, $3.47 million in former bank premises related to the Monarch merger, as well as $19.82 million in foreclosed property. Nonperforming loans decreased by $8.29 million from December 31, 2016, as additions to nonaccrual loans during 2017 were more than offset by transfers to OREO, charge-offs, and payments received. Nonperforming 1-4 family residential real estate loans decreased by $3.93 million with paydowns of $2.71 million, charge-offs of $2.29 million, and transfers to OREO of $2.60 million. Nonperforming construction and development loans decreased by $0.42 million with paydowns of $0.11 million and transfers to OREO of $0.31 million. Additionally, nonperforming commercial real estate loans decreased by $3.92 million with paydowns of $4.32 million, charge-offs of $0.14 million, and transfers to OREO of $1.34 million, which outpaced new nonperforming loans of $1.88 million. At December 31, 2017, foreclosed property totaled $19.82 million, a decrease from $21.01 million at December 31, 2016. Foreclosed property consists of 23 residential properties, 10 construction and development properties, and one commercial property. The six largest foreclosed property developments represented 86.14% of total foreclosed property at December 31, 2017.

At December 31, 2017, loans 60 to 89 days delinquent, excluding nonperforming loans, totaled $1.73 million. Additionally, there are other performing loans, totaling $18.12 million, that are current but have certain documentation deficiencies or other potential weaknesses that management considers warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At December 31, 2017, nonaccruing TDRs, which are included in nonperforming loans, totaled $1.38 million, and accruing TDRs totaled $24.83 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

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

	December 31, 2017	December 31, 2016
Construction and land development	$ 273	$ 696
Commercial real estate	1,191	5,110
Multifamily real estate	—	690
1-4 family residential real estate	2,184	6,113
Commercial and industrial loans	673	362
Consumer loans and other	486	128
Total nonperforming loans	$ 4,807	$ 13,099

Allocation of the Allowance for Loan Losses: At December 31, 2017, all of the allowance for loan losses was allocated to specific loan categories. Management monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Company experiences over time. This allocation of the allowance for loan losses is calculated on an approximate basis and is not intended as an indication of the specific amounts, by loan classification, to be charged to the allowance. The entire amount of the allowance is available to absorb losses occurring in any category of loans. The following table provides a breakdown of the allowance for loan losses among the various loan types for the periods indicated (in thousands):

Year Ended December 31,	**2017**	**2016**	**2015**	**2014**	**2013**
Real estate loans:					
1-4 family residential	$ 9,345	$ 9,050	$ 8,990	$ 9,121	$ 10,730
Commercial	16,864	16,248	14,687	14,226	13,621
Construction	5,753	4,280	4,984	5,661	7,925
Multifamily	1,075	1,370	945	667	699
Total real estate loans	33,037	30,948	29,606	29,675	32,975
Commercial and industrial loans	6,596	6,410	5,774	4,963	4,711
Consumer loans and other	5,498	4,643	2,979	1,279	694
Total	$ 45,131	$ 42,001	$ 38,359	$ 35,917	$ 38,380

In the opinion of management, the allowance was adequate at December 31, 2017, based on known conditions. However, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, changes in the value of collateral, and changes in general economic conditions and other risk factors.

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

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

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

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

Deposit accounts held as of December 31, 2017, totaled $6.45 billion. This represented an increase of $0.41 billion, or 6.84%, over 2016, which was $1.12 billion, or 22.82%, over 2015. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina. The deposits consist of demand deposits, interest-bearing checking accounts, money market deposit accounts, and time deposits. Some of our interest-bearing deposits were obtained through brokered transactions and our participation in CDARS. We had brokered time deposits of $183.4 million and CDARS deposits of $48.99 million at December 31, 2017.

The following tables provide the average balance and cost rate of interest-bearing deposits for the periods indicated (dollars in thousands). The aggregate amount of time deposits of $250,000 or more was $617.51 million and $367.81 million at December 31, 2017 and 2016, respectively. See Note 9 in the Notes to Consolidated Financial Statements for additional information on deposits.

	Average Balance			Average Cost Rate		
For the Year Ended December 31,	**2017**	**2016**	**2015**	**2017**	**2016**	**2015**
Noninterest-bearing demand deposits	$ 2,094,753	$ 1,720,093	$ 1,343,360	—	—	—
Demand and money markets	2,260,378	2,012,061	1,689,185	0.35%	0.30%	0.28%
Savings	319,940	309,049	300,620	1.03%	0.93%	0.92%
Certificates of deposit:						
Less than $250,000	1,143,687	1,188,072	1,059,192	1.03%	0.88%	0.87%
$250,000 or more	524,566	342,918	275,536	1.09%	0.86%	0.81%
Total interest-bearing deposits	4,248,571	3,852,100	3,324,533	0.68%	0.58%	0.57%
Total deposits	$ 6,343,324	$ 5,572,193	$ 4,667,893	0.45%	0.40%	0.40%

Average noninterest-bearing demand deposits were 33.02% of average total deposits during the year ended December 31, 2017, and 30.87% and 28.78% during 2016 and 2015, respectively. The variance from the prior year is primarily attributable to a change in the deposit mix related to the Monarch merger. The average cost of interest-bearing deposits was 0.68% for the year ended December 31, 2017, compared with 0.58% for 2016, and 0.57% for 2015.

Advances from the Federal Home Loan Bank: Our ability to borrow funds through nondeposit sources provides additional flexibility in meeting the liquidity needs of customers while enhancing our cost of funds structure. Average funds borrowed from the FHLB were $587.28 million and $483.74 million for the years ended December 31, 2017 and 2016, respectively. The balance at December 31, 2017, of $526.92 million, decreased $160.59 million from the balance at December 31, 2016, of $687.51 million. Refer to Note 10 in the Notes to Consolidated Financial Statements for additional disclosures related to borrowing arrangements.

Subordinated Debt: 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 December 31, 2017, the carrying value of the notes totaled $247.20 million and average subordinated debt during 2017 was $113.75 million, while the average cost of the debentures was 4.61%.

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

We maintained an average of $680.03 million outstanding in overnight interest-bearing deposits during 2017, compared with $300.13 million for 2016. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2017, we primarily funded our growth in total assets with deposit growth.

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

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

Contractual Obligations, Contingent Liabilities, and Commitments: The following table summarizes our significant contractual obligations, contingent liabilities, and certain other commitments outstanding as of December 31, 2017 (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1 - 3 years**	**3 - 5 years**	**More Than 5 Years**
Operating lease obligations	$ 46,045	$ 9,678	$ 12,468	$ 6,451	$ 17,448
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	526,923	13,000	506,000	—	7,923
Other commitments					
Standby letters of credit	83,620	83,620	—	—	—
Commitments to extend credit	2,282,303	1,936,469	345,834	—	—
Total contractual obligations	$ 2,938,891	$ 2,042,767	$ 864,302	$ 6,451	$ 25,371

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

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

Year Ended December 31,	**2017**	**2016**	**2015**
Return on average assets	1.05%	0.93%	1.03%
Return on average equity	7.80%	6.98%	7.75%
Return on average tangible equity	11.35%	9.93%	10.34%
Average equity to average assets	13.48%	13.38%	13.32%

Interest Sensitivity: Prudent balance sheet management requires processes that monitor and protect us against unanticipated or significant changes in the level of market interest rates. Net interest income stability should be maintained in changing rate environments by ensuring that interest rate risk is kept to an acceptable level. The ability to reprice our interest-sensitive assets and liabilities over various time intervals is of critical importance.

We use a variety of traditional and on-balance-sheet tools to manage our interest rate risk. Gap analysis, which monitors the "gap" between interest-sensitive assets and liabilities, is one such tool. In addition, we use simulation modeling to forecast future balance sheet and income statement behavior. By studying the effects on net interest income of rising, stable, and falling interest rate scenarios, we can position ourselves to take advantage of anticipated interest rate movement, and protect ourselves from unanticipated rate movements, by understanding the dynamic nature of our balance sheet components.

An asset-sensitive balance sheet structure implies that assets, such as loans and securities, will reprice faster than liabilities; consequently, net interest income should be positively affected in an increasing interest rate environment. Conversely, a liability-sensitive balance sheet structure implies that liabilities, such as deposits, will reprice faster than assets; consequently, net interest income should be positively affected in a decreasing interest rate environment. At December 31, 2017, we had $185.79 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position.

Market Risk Management: The effective management of market risk is essential to achieving our strategic objectives. As a financial institution, our most significant market risk exposure is interest rate risk. The primary objective of the management of interest rate risk is to minimize the effect that changes in interest rates have on net interest income. This is accomplished through active management of asset and liability portfolios, with a focus on the strategic pricing of asset and liability accounts and management of appropriate maturity mixes of assets and liabilities. The goal of these activities is the development of appropriate maturity and repricing opportunities in our portfolios of assets and liabilities that will produce consistent net interest income during periods of changing interest rates. Our ALCO monitors loan, investment, and liability portfolios to ensure comprehensive management of interest rate risk. These portfolios are analyzed for proper fixed-rate and variable-rate mixes under various interest rate scenarios.

The asset and liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities, and/or repricing opportunities of earning assets, deposits, and borrowed funds. It is the responsibility of the ALCO to determine and achieve the most appropriate volume and mix of earning assets and interest-bearing liabilities, as well as ensure an adequate level of liquidity and capital within the context of corporate performance goals. The ALCO also sets policy guidelines and establishes long-term strategies with respect to interest rate risk exposure and liquidity. The ALCO meets regularly to review our interest rate risk and liquidity positions in relation to present and prospective market and business conditions. In addition, funding and balance sheet management strategies are adopted with the intent to ensure that the potential impact on earnings and liquidity due to fluctuations in interest rates are within acceptable standards. We currently do not use off-balance-sheet financial instruments to manage interest rate sensitivity and net interest income.

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

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

Change in Prime Rate	% Change in Net Interest Income
+ 300 basis points	13.26 %
+ 200 basis points	9.04 %
+ 100 basis points	4.84 %
- 100 basis points	(8.22)%
- 200 basis points	(9.13)%

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	$ (67,611)
+ 200 basis points	$ (39,840)
+ 100 basis points	$ (16,543)
- 100 basis points	$ (89,517)
- 200 basis points	$ (240,128)

Credit Risk Elements: We place commercial loans in nonaccrual status when management believes, after considering economic and business conditions and collections efforts, that the borrower's financial condition is such that full collection of principal and interest is doubtful or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection. Residential mortgage loans and other consumer loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful or when the loan is past due for 120 days or more, unless the debt is both well-secured and in the process of collection.

FORWARD-LOOKING STATEMENTS

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

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

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

- our competitors may have greater financial resources and develop products that enable them to compete more successfully;
- changes in business conditions;
- changes in the securities market; and
- changes in our local economy with regard to our market area and its heavy concentration of U.S. military bases and related personnel.

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

NON-GAAP FINANCIAL MEASURES

The Company presents return on average assets, return on average tangible assets, return on average equity, and return on average tangible equity. The Company excludes the balance of average goodwill and other intangible assets from our calculation of return on average tangible assets and return on average tangible equity. This adjustment allows management to review the Company's core operating results and core capital position and facilitates comparisons with other banks.

Year Ended December 31,	**2017**	**2016**
Return on average assets (GAAP basis)	1.05%	0.93%
Impact of excluding average goodwill and other intangibles	0.10%	0.09%
Return on average tangible assets (non-GAAP)	1.15%	1.02%
Return on average equity (GAAP basis)	7.80%	6.98%
Impact of excluding average goodwill and other intangibles	3.55%	2.95%
Return on average tangible equity (non-GAAP)	11.35%	9.93%

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

	Per share	
Year Ended December 31,	**2017**	**2016**
Book value (GAAP basis)	$ 18.06	$ 17.20
Impact of excluding average goodwill and other intangibles	4.93	4.84
Tangible book value (non-GAAP)	$ 13.13	$ 12.36

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

Year Ended December 31,	**2017**	**2016**
Efficiency ratio (GAAP basis)	65.94%	71.59%
Impact of excluding securities gains	—%	—%
Efficiency ratio, as reported (non-GAAP)	65.94%	71.59%

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of ***TowneBank***

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of TowneBank and subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2017 and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

Basis for Opinion

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on the Company's consolidated financial statements, and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/ Dixon Hughes Goodman LLP

We have served as the Company’s auditor since 1999.

Norfolk, Virginia
March 1, 2018

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2017, including controls over regulatory financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013). Based on our assessment we believe that, as of December 31, 2017, our internal control over financial reporting is effective based on those criteria.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2017, and for the year then ended. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts, some of which are based on management’s judgments and estimates.

Compliance with Designated Laws and Regulations

Our management is also responsible for compliance with federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations. Management assessed our compliance with the designated laws and regulations. Based on this assessment, our management believes that we complied, in all significant respects, with the designated laws and regulations relating to safety and soundness for the year ended December 31, 2017.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income, as of December 31, 2017, has been audited by Dixon Hughes Goodman LLP, the independent registered public accounting firm, as stated in their report dated March 1, 2018. A copy of this report, which is combined with the report expressing an opinion on the consolidated financial statements, precedes.

March 1, 2018

/s/ G. Robert Aston, Jr.

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

/s/ Clyde E. McFarland, Jr.

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

TOWNEBANK
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)
December 31, 2017 and 2016

	2017	2016
ASSETS		
Cash and due from banks	$ 500,408	$ 130,967
Interest-bearing deposits in financial institutions	4,471	5,581
Total Cash and Cash Equivalents	504,879	136,548
Securities available for sale, at fair value	867,654	812,974
Securities held to maturity, at amortized cost	61,304	66,490
Federal Home Loan Bank stock, at amortized cost	29,595	35,937
Total Securities	958,553	915,401
Mortgage loans held for sale	313,256	314,046
Loans, net of unearned income and deferred costs:	5,946,965	5,807,221
Less: allowance for loan losses	(45,131)	(42,001)
Net Loans	5,901,834	5,765,220
Premises and equipment, net	194,900	198,568
Goodwill	270,250	264,910
Other intangible assets, net	38,568	37,856
Bank-owned life insurance policies	195,775	189,499
Other assets	144,161	151,867
TOTAL ASSETS	$ 8,522,176	$ 7,973,915
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 2,157,338	$ 1,947,312
Interest-bearing:		
Demand and money market accounts	2,225,211	2,263,894
Savings	315,889	319,611
Certificates of deposit	1,749,782	1,504,380
Total Deposits	6,448,220	6,035,197
Advances from the Federal Home Loan Bank	526,923	687,511
Subordinated debt, net	247,196	—
Repurchase agreements and other borrowings	24,850	32,540
Total Borrowings	798,969	720,051
Other liabilities	132,482	132,109
TOTAL LIABILITIES	7,379,671	6,887,357
Preferred stock		
Authorized and unissued shares - 2,000,000	—	—
Common stock, $1.667 par value		
Authorized shares - 90,000,000		
Issued and outstanding shares 62,629,001 in 2017 and 64,492,168 in 2016	104,403	104,174
Capital surplus	749,800	745,411
Retained earnings	282,729	229,503
Common stock issued to deferred compensation trust, at cost 729,919 shares in 2017 and 692,431 shares in 2016	(12,524)	(11,168)
Deferred compensation trust	12,524	11,168
Accumulated other comprehensive loss	(5,692)	(3,986)
TOTAL SHAREHOLDERS' EQUITY	1,131,240	1,075,102
Noncontrolling interest	11,265	11,456
TOTAL EQUITY	1,142,505	1,086,558
TOTAL LIABILITIES AND EQUITY	$ 8,522,176	$ 7,973,915

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)
For the Years Ended December 31, 2017, 2016, and 2015

	2017	2016	2015
INTEREST INCOME:			
Loans, including fees	$ 273,999	$ 231,464	$ 194,737
Investment securities	13,064	12,855	13,801
Interest-bearing deposits in financial institutions and federal funds sold	7,480	1,145	499
Mortgage loans held for sale	10,561	9,152	3,836
Total interest income	305,104	254,616	212,873
INTEREST EXPENSE:			
Deposits	28,792	22,316	18,866
Advances from the Federal Home Loan Bank	9,837	13,320	13,486
Subordinated debt	5,249	—	—
Repurchase agreements and other borrowings	105	104	79
Total interest expense	43,983	35,740	32,431
Net interest income	261,121	218,876	180,442
PROVISION FOR LOAN LOSSES	5,426	5,357	3,027
Net interest income after provision for loan losses	255,695	213,519	177,415
NONINTEREST INCOME:			
Residential mortgage banking income, net	75,851	58,792	34,211
Insurance commissions and other title fees and income, net	51,933	46,741	39,641
Real estate brokerage and property management income, net	27,487	20,515	16,326
Service charges on deposit accounts	10,594	9,547	9,165
Credit card merchant fees, net	5,008	4,508	2,588
Bank owned life insurance	6,262	5,992	5,190
Other income	10,987	9,121	9,258
Gain (loss) on investment securities	(1)	6	904
Total noninterest income	188,121	155,222	117,283
NONINTEREST EXPENSE:			
Salaries and employee benefits	170,989	143,847	113,959
Occupancy	26,855	23,717	19,645
Furniture and equipment	14,072	11,315	9,339
Other expenses	84,298	88,949	59,214
Total noninterest expense	296,214	267,828	202,157
Income before income tax expense & noncontrolling interest	147,602	100,913	92,541
Provision for income tax expense	54,813	28,698	26,876
Net income	$ 92,789	$ 72,215	$ 65,665
Net income attributable to noncontrolling interest	(5,126)	(4,965)	(3,283)
Net income attributable to TowneBank	$ 87,663	$ 67,250	$ 62,382
Preferred stock dividends and accretion	—	—	13
Net income available to common shareholders	$ 87,663	$ 67,250	$ 62,369
Per common share information			
Basic earnings	$ 1.41	$ 1.18	$ 1.22
Diluted earnings	$ 1.41	$ 1.18	$ 1.22
Cash dividends declared	$ 0.55	$ 0.51	$ 0.47

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
For the Years Ended December 31, 2017, 2016, and 2015

	2017	2016	2015
Net income	$ 92,789	$ 72,215	$ 65,665
Other comprehensive income (loss)			
Unrealized losses on securities			
Unrealized holding losses arising during the period	(1,644)	(2,000)	(4,031)
Deferred tax benefit	575	700	1,411
Realized (gains) losses reclassified into earnings	1	(6)	(785)
Deferred tax benefit	—	2	275
Net unrealized losses	(1,068)	(1,304)	(3,130)
Pension and postretirement benefit plans			
Prior service costs	(1,027)	—	(1,405)
Deferred tax benefit	359	—	492
Actuarial gain (loss)	(400)	323	694
Deferred tax benefit (expense)	142	(113)	(243)
Amortization of prior service costs	288	151	—
Deferred tax expense	(100)	(53)	—
Amortization of net actuarial loss	156	7	215
Deferred tax expense	(56)	(3)	(75)
Change in retirement plans, net of tax	(638)	312	(322)
Other comprehensive loss, net of tax	(1,706)	(992)	(3,452)
Comprehensive income	$ 91,083	$ 71,223	$ 62,213
Comprehensive income attributable to noncontrolling interest	(5,126)	(4,965)	(3,283)
Comprehensive income attributable to TowneBank	$ 85,957	$ 66,258	$ 58,930

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF EQUITY
(dollars in thousands, except share data)
For the Years Ended December 31, 2017, 2016, and 2015

	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total
Balance, December 31, 2014	**35,785,679**	**$ 76,458**	**$ 59,655**	**$ 317,718**	**$ 154,655**	**$ 9,674**	**$ (9,674)**	**$ 458**	**$ 9,332**	**$ 618,276**
Net income	—	—	—	—	62,382	—	—	—	3,283	65,665
Other comprehensive income, net of taxes	—	—	—	—	—	—	—	(3,452)	—	(3,452)
Cash dividends declared on common stock	—	—	—	—	(24,229)	—	—	—	—	(24,229)
Cash dividends declared on preferred stock	—	—	—	—	(13)	—	—	—	—	(13)
Directors' deferred compensation	—	—	—	—	—	498	(498)	—	—	—
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	—	(3,342)	(3,342)
Issuance of common stock - acquisitions	15,633,024	—	26,058	214,210	—	—	—	—	—	240,268
Redemption of preferred stock	—	(76,458)	—	—	—	—	—	—	—	(76,458)
Conversion of convertible debt into common stock	1,674	—	4	22	—	—	—	—	—	26
Issuance of common stock - stock compensation plans	138,599	—	233	2,003	—	—	—	—	—	2,236
Issuance of common stock - net contingent consideration earned on acquisitions	46,545	—	76	1,141	—	—	—	—	—	1,217
Balance, December 31, 2015	**51,605,521**	**$ —**	**$ 86,026**	**$ 535,094**	**$ 192,795**	**$ 10,172**	**$ (10,172)**	**$ (2,994)**	**$ 9,273**	**$ 820,194**
Net income	—	—	—	—	67,250	—	—	—	4,965	72,215
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(992)	—	(992)
Cash dividends declared on common stock	—	—	—	—	(30,542)	—	—	—	—	(30,542)
Directors' deferred compensation	—	—	—	—	—	996	(996)	—	—	—
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	—	(2,782)	(2,782)
Conversion of convertible debt into common stock	833	—	2	9	—	—	—	—	—	11
Issuance of common stock - acquisitions	10,487,069	—	17,482	204,949	—	—	—	—	—	222,431
Issuance of common stock - stock compensation plans	297,774	—	496	3,263	—	—	—	—	—	3,759
Issuance of common stock - net contingent consideration earned on acquisitions	100,971	—	168	2,096	—	—	—	—	—	2,264
Balance, December 31, 2016	**62,492,168**	**$ —**	**$ 104,174**	**$ 745,411**	**$ 229,503**	**$ 11,168**	**$ (11,168)**	**$ (3,986)**	**$ 11,456**	**$ 1,086,558**
Net income	—	—	—	—	87,663	—	—	—	5,126	92,789
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(1,706)	—	(1,706)
Cash dividends declared on common stock	—	—	—	—	(34,437)	—	—	—	—	(34,437)
Directors' deferred compensation	—	—	—	—	—	1,356	(1,356)	—	—	—
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	—	1,029	1,029
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	—	(6,346)	(6,346)
Conversion of convertible debt into common stock	1,528	—	2	20	—	—	—	—	—	22
Issuance of common stock - stock compensation plans	65,459	—	110	2,314	—	—	—	—	—	2,424
Issuance of common stock - net contingent consideration earned on acquisitions	69,846	—	117	2,055	—	—	—	—	—	2,172
Balance, December 31, 2017	**62,629,001**	**$ —**	**$ 104,403**	**$ 749,800**	**$ 282,729**	**$ 12,524**	**$ (12,524)**	**$ (5,692)**	**$ 11,265**	**$ 1,142,505**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2017, 2016, and 2015

OPERATING ACTIVITIES:	2017	2016	2015
Net income	$ 92,789	$ 72,215	$ 65,665
Adjustments to reconcile net income to net cash from operating activities:			
Net amortization of securities	2,359	2,688	3,238
Investment securities loss (gains)	1	(6)	(904)
Depreciation, amortization, and other intangible amortization	24,500	20,552	16,147
Amortization of debt issuance costs	124	—	—
Provision for loan losses	5,426	5,357	3,027
Bank-owned life insurance income	(6,262)	(5,993)	(5,190)
Deferred income tax expense	570	3,154	3,671
Share-based compensation expense	2,706	2,162	1,917
Loss on sale and write-down of foreclosed assets	1,087	520	310
Originations of mortgage loans held for sale	(3,329,859)	(2,860,710)	(1,448,009)
Proceeds from sales of mortgage loans held for sale	3,443,801	3,031,817	1,467,932
Gain on sales of mortgage loans held for sale	(113,152)	(99,350)	(50,879)
Changes in:			
Interest receivable	(2,213)	(3,766)	(4,247)
Other assets	11,027	366	(37,119)
Interest payable	5,720	646	499
Other liabilities	(13,856)	15,387	65,029
Net cash from operating activities	124,768	185,039	81,087
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(1,139,306)	(974,031)	(515,713)
Purchase of held-to-maturity securities	—	(6,062)	—
Sale of available-for-sale securities	306	—	414,141
Sale of held-to-maturity securities	—	—	2,272
Sale of Federal Home Loan Bank stock	6,816	3,121	8,113
Proceeds from maturities, calls, and prepayments of available-for-sale securities	1,080,040	885,519	196,160
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	4,988	8,408	13,821
Net increase in loans	(146,610)	(485,411)	(463,224)
Purchases of premises and equipment	(13,445)	(18,055)	(23,315)
Proceeds from sales of premises and equipment	674	2,981	3,713
Proceeds from sales of foreclosed assets	7,595	20,477	24,227
Investment from noncontrolling interest in consolidated joint ventures	1,029	—	—
Acquisition of business, net of cash acquired	(11,469)	61,930	241,332
Net cash used for investing activities	(209,382)	(501,123)	(98,473)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	413,022	59,550	384,479
Net change in borrowings	(168,256)	170,708	(229,013)
Proceeds from issuance of subordinated debt, net of issuance costs	247,072	—	—
Proceeds (payments) from share-based compensation activity	(282)	1,597	322
Proceeds from issuance of common stock	2,172	2,264	1,215
Distribution of interest in joint ventures, net	(6,346)	(2,782)	(3,342)
Redemption of preferred stock	—	—	(76,458)
Cash dividends paid	(34,437)	(30,542)	(21,985)
Net cash from financing activities	452,945	200,795	55,218
Change in cash and cash equivalents	368,331	(115,289)	37,832
Cash and cash equivalents at beginning of year	136,548	251,837	214,005
Cash and cash equivalents at end of year	$ 504,879	$ 136,548	$ 251,837
Supplemental cash flow information:			
Cash paid for interest	$ 38,262	$ 35,095	$ 31,933
Cash paid for income taxes	$ 35,972	$ 23,459	$ 15,129
Noncash financing and investing activities:			
Transfer from loans to foreclosed property	$ 4,570	$ 4,006	$ 6,516
Sales of foreclosed assets financed by the Company	$ 1,012	$ 5,583	$ 9,890
Transfers to foreclosed property from premises and equipment	$ 843	$ 3,659	$ 277
Net unrealized loss on available-for-sale securities	$ (1,068)	$ (1,304)	$ (3,130)
Dividends declared but not paid	$ 8,769	$ 8,124	$ 6,193
Common stock issued in connection with business acquisitions	$ —	$ 222,431	$ 240,268

See accompanying Notes to Consolidated Financial Statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

In order to better reflect the Company's view of the business and credit characteristics of the instruments, a reclassification of industrial revenue bonds ("IRB") from investment securities to loans held for investment was made during 2015. At December 31, 2015, the Company had $240.64 million in IRBs classified as loans held for investment and recorded $5.71 million in interest income from loans related to IRBs for the year then ended. Because there was no allowance for loan loss previously associated with the IRBs, the Company recorded a provision for loan loss related to the IRBs attributable to prior periods of $0.80 million in second quarter 2015 and recorded a total provision for loan loss related to the IRBs of $1.10 million in 2015.

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 Securities and Exchange Commission Staff Accounting Bulletin 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 year ended December 31, 2017.

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

Cash and cash equivalents: For purposes of reporting cash flows, the Company considers cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold as cash and cash equivalents.

Generally, federal funds and securities purchased under agreements to resell are purchased and sold for one-day periods. The Company is required to maintain average reserve balances in cash with the Federal Reserve Bank of Richmond; required reserves were $53.88 million and $40.61 million at December 31, 2017 and 2016, respectively.

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

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

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

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

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

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

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

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

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

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

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

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability, and effectiveness of the Company's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures, and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis to determine an appropriate general valuation allowance. Management considers the current level of allowance for loan losses adequate to absorb losses inherent in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses, which is based on the factors and risk identification procedures previously discussed, requires the use of judgments and estimations that may change in the future. Changes in the factors used by management to determine the adequacy of the allowance or the availability of new information could cause the allowance for loan losses to be adjusted in future periods.

Loans acquired: Loans acquired through the completion of a transfer, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable, are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance. Loans are evaluated individually to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans, if the loans being aggregated have common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. The difference between the contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. A subsequent decrease in the estimate of cash flows expected to be received on purchased credit-impaired loans generally results in the recognition of an allowance for loan losses. Increases in cash flows result in reversal of any nonaccretable difference (or allowance for loan losses to the extent any has been recorded) with a positive impact on interest income subsequently recognized. The measurement of cash flows involves assumptions and judgments for interest rates, prepayments, default rates, loss severity, and collateral values. All of these factors are inherently subjective and significant changes in the cash flow estimates over the life of the loan can result.

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

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

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

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

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

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

Goodwill is tested for impairment at the reporting unit level on an annual basis as of August 31, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step (step 1) compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. For our annual impairment testing conducted during 2017, we identified six reporting units with goodwill: Berkshire Hathaway HomeServices Towne Realty; property and casualty insurance division; benefits insurance division; mortgage division; resort property management division; and Banking. For purposes of performing step 1 of the goodwill impairment test, the Company primarily uses the income approach to value its reporting units. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the respective reporting units. The significant inputs to the income approach include expected future cash flows, the long-term target tangible equity to tangible assets ratio, and the discount rate. Discount rates are unique to each reporting unit and are based upon the cost of capital specific to the industry in which the reporting unit operates. Management evaluated the sensitivity of the significant assumptions in its impairment analysis, including consideration of the effect of changes in estimated future cash flows or the discount rate for each reporting unit. Based on our analysis, we determined there is no goodwill impairment, since the fair value for all reporting units was in excess of the respective reporting unit's carrying value as of August 31, 2017.

The second step (step 2) of impairment testing is necessary only if the reporting unit does not pass step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination. Significant judgment and estimates are involved in estimating the fair value of the assets and liabilities of the reporting unit. Since none of the reporting units failed step 1, step 2 was not applicable during 2017 testing. The Company monitored events and circumstances during the fourth quarter of 2017, and it determined that there were no triggering events requiring an updated impairment test as of December 31, 2017.

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

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

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

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

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

Interest rate lock commitments and forward sales contracts: The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (“rate lock commitments”). The commitments are generally for periods of 60 days and are at market rates. In order to mitigate risk from interest rate fluctuations, the Company enters into forward loan sale commitments on a “best efforts” basis while the loan is in the pipeline. Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Changes in the estimated fair value of the derivatives during the commitment period are recorded in current earnings.

We may 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 “to be announced” (“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 prior to the close of such loans. This differs from a “best efforts” delivery, which sets the sale price with the investor on a loan-by-loan basis when each loan is locked with the respective borrower. The Company has not formally designated these derivatives as a qualifying hedge relationship, accordingly, changes to fair value are recorded to earnings each period.

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

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

Insurance commission income is recorded as of the effective date of insurance coverage or the billing date, whichever is later. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known. We currently recognize contingent commissions when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts. Upon adoption of Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers*, on January 1, 2018, the Company must use judgment to estimate the amount of consideration that will be received such that a significant reversal of revenue is not probable. Contingent commissions represent a form of variable consideration associated with the same performance obligation, which is in the form of placement of coverage, for which we earn core commissions. In connection with the new standard, contingent commissions will be estimated and accrued throughout the year as the underlying business is placed with the insurance carriers rather than our historical recognition where the majority of these were recognized in the first quarter, typically when we received cash or the related policy detail or other carrier specific information from the insurance carrier.

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

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

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

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

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

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

Advertising costs: Advertising costs are expensed as incurred.

Segment information: Operating segments as defined by ASC 280, *Segment Reporting*, are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The accounting policies of operating segments are the same as those described elsewhere in this footnote. Revenue for all segments is derived from external sources. See Note 25 for further discussion of the Company's operating segments.

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

Income taxes: Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities that result in future taxable or deductible amounts. The effect on deferred taxes of a change in tax rates is recognized in the year of enactment and is measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized in the near term. Note 20 provides additional information on the Company's income taxes.

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

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

Earnings per share: Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the year, less the average number of nonvested restricted stock awards. Diluted earnings per share reflect the potential dilution from the issuance of additional shares of common stock caused by the exercise of stock options and restricted stock awards. See Note 26 for further discussion on the Company's earnings per share.

Recent accounting pronouncements

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The ASU will supersede most of the existing revenue recognition requirements in GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. 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. Approximately 60% of the Company's revenue comes from net interest income and is explicitly out of scope of the guidance. Additionally, residential mortgage banking income accounts for approximately 15% of revenue and is also out of scope of the guidance. The Company has concluded the adoption of the accounting standard will not have a material impact on the Company's revenue recognition patterns or financial presentation and disclosures. The new standard is largely consistent with the existing guidance and current practices applied by our businesses with the primary impact related to a change in the timing of recognition of contingent insurance commissions and resort property management fees. We will adopt this guidance using the modified retrospective approach in first quarter of 2018.

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 Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments are 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 adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

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 was effective for interim and annual periods beginning after December 15, 2016. 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 ASU No. 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.

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The* ASU was issued to address the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the prohibition of backward tracing due to an income tax rate change that was initially recorded in other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act of 2017 ("Tax Reform Act") on December 22, 2017 that changed the Company's income tax rate from 35% to 21%. The ASU changed current accounting whereby an entity may elect to reclassify the stranded tax effect from accumulated other comprehensive income to retained earnings. The ASU is effective for fiscal years, and interim periods within those years, beginning after December 31, 2018; however, public business entities are allowed to early adopt in any interim period for which the financial statements have not yet been issued. The amendments of the ASU may be applied either at the beginning of the period (annual or interim) of adoption or retrospectively to each of the period(s) in which the effect of the change in the U.S. federal corporate tax rate in the Tax Reform Act is recognized. As a result of the re-measurement of the Company's deferred tax assets following the enactment of the Tax Reform Act, accumulated other comprehensive loss included $1.18 million of standard tax effects at December 31, 2017. The Company intends to early adopt the new standard during the first quarter of 2018 and plans to make an election to reclassify the stranded tax effects from accumulated other comprehensive loss to retaining earnings at the beginning of the period of adoption.

NOTE 2: MERGERS AND ACQUISITIONS

W.A. Moore & Company: Effective August 1, 2017, the Company acquired W.A. Moore & Company ("W.A. Moore"), an independent insurance agency, which was merged with the operations of Towne Insurance Agency, LLC ("Towne Insurance"), a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. 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 ("Railey Mountain"), 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 $2.69 million, and other intangible assets of $5.67 million.

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. The application of the acquisition method of accounting resulted in goodwill of approximately $108.05 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

The following table presents the final purchase price allocation of the fair values of the assets acquired and liabilities assumed for Monarch, acquired 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 to 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 (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)
Preliminary 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 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 amortization of intangibles with definite lives and 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 $18.47 million of acquisition-related expenses for the year ended December 31, 2016. The pro forma earnings for the year ended December 31, 2015, were adjusted to include these expenses. 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 Year Ended December 31, 2016		Pro Forma for the Year Ended December 31, 2015
Revenues (net interest income plus noninterest income)	$	439,240	$	431,455
Net income	$	79,956	$	62,512

Oak Island Accommodations, Inc.: Effective January 14, 2016, the Company acquired Oak Island Accommodations, Inc. ("Oak Island"), 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.

Insurance Agencies: Effective October 1, 2015, the Company acquired two insurance agencies, SIFA Corporation d/b/a B.H. Baird Insurance Agency and Invincia Corporation, which were merged with the operations of Towne Insurance. The acquisitions were accounted for as business combinations under the acquisition method of accounting, and, as such, the assets acquired and liabilities assumed in the transactions were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses are included in the Company's Consolidated Statements of Income commencing October 1, 2015. The total purchase price for the transactions was $10.69 million in cash, common stock, and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of $0.57 million, goodwill of $6.54 million, other intangible assets of $3.88 million, and assumed liabilities of $0.30 million.

Total Insurance Planning, LLC: Effective September 1, 2015, the Company acquired Total Insurance Planning, LLC, which is affiliated with Towne Insurance. The acquisition was accounted for as a business combination under the acquisition method of accounting, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing September 1, 2015. The total purchase price for the transaction was $1.45 million in cash, common stock, and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of $0.06 million, goodwill of $1.0 million, and other intangible assets of $0.39 million.

Insurance Agencies: Effective February 1, 2015, the Company acquired two insurance agencies, Lackey-Saunders Co., Inc. and Gloucester-Southside Insurance Agency, Inc., which were merged with the operations of Towne Insurance. The acquisitions were accounted for as business combinations under the acquisition method of accounting, and, as such, the assets acquired and liabilities assumed in the transactions were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses are included in the Company's Consolidated Statements of Income commencing February 1, 2015. The total purchase price for the transactions was $2.89 million in cash and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of $0.30 million, goodwill of $2.0 million, other intangible assets, including customer lists of $0.78 million, and assumed liabilities of $0.19 million.

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

In the merger with Franklin, each outstanding share of common stock of Franklin was converted into 1.40 shares of TowneBank common stock. TowneBank issued an aggregate of 15.55 million shares of TowneBank common stock to Franklin stockholders and cash of $9.90 million to holders of equity awards. Based on the closing price of TowneBank's common stock on January 2, 2015, of $15.35 per share, the aggregate consideration paid to Franklin common stockholders and holders of equity awards to acquire Franklin common stock was approximately $248.56 million.

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

The Franklin merger has been accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the January 2, 2015 merger date. Such fair values 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 was considered final, whichever was earlier. The application of the acquisition method of accounting resulted in goodwill of approximately $35.90 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

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

Fair value of assets acquired:		
Cash and cash equivalents	$	260,559
Securities available for sale		222,539
Net loans		496,297
Bank premise and equipment		10,890
OREO, net of valuation allowance		15,693
Core deposit intangible		1,501
Other assets		89,290
Total assets	$	1,096,769
Fair value of liabilities assumed:		
Deposits	$	682,947
Long-term borrowings		191,478
Other liabilities		9,687
Total liabilities	$	884,112
Net identifiable assets acquired	$	212,657
Goodwill		35,899
Net assets acquired	$	248,556
Purchase Price:		
Company common shares issued		15,547,627
Purchase price per share of Company's common stock	$	15.35
Common stock issued and cash exchanged for fractional shares	$	238,656
Cash consideration for stock options paid		9,900
Fair value of total consideration transferred	$	248,556

During the year ended December 31, 2015, adjustments were made to the purchase price allocations that resulted in increases as of the acquisition date to the initial fair value estimate of loans of $3.93 million, OREO of $0.85 million, core deposit intangible of $1.48 million, and a decrease to acquired net assets of $0.18 million resulting from adjustments to other assets and liabilities. The revised fair value estimates resulted in a decrease to goodwill of $6.08 million.

The Company assumed long-term borrowings of $191.48 million in the form of Federal Home Loan Bank of Atlanta ("FHLB") advances. On January 7, 2015, the Company repaid the advances in full.

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

The Company's operating results for the year ended December 31, 2015 include the results from the operations acquired in the Franklin transaction since January 2, 2015. Franklin's operations contributed approximately $31.73 million in total revenue (net interest income plus noninterest income) and an estimated $13.26 million in net income for the period from the acquisition date.

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

Contractual principal and interest at acquisition	$ 177,615
Nonaccretable difference	(26,401)
Expected cash flows at acquisition	151,214
Accretable yield	(45,755)
Preliminary estimated fair value of loans acquired with a deterioration of credit quality	$ 105,459

NOTE 3: INVESTMENT SECURITIES

Available-for-sale securities

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

December 31, 2017

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 277,062	$ 6	$ (2,600)	$ 274,468
U.S. Treasury notes	301,472	25	—	301,497
Municipal securities	17,495	100	(108)	17,487
Trust preferred and other corporate securities	24,315	645	(80)	24,880
Mortgage-backed securities issued by GSE	253,737	229	(4,644)	249,322
Total available-for-sale securities	$ 874,081	$ 1,005	$ (7,432)	$ 867,654

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

For the year ended December 31, 2017, the Company had proceeds from sales of securities available for sale in the amount of $0.31 million, resulting in gross realized losses of $1,000. For the year ended December 31, 2016, there were no proceeds from sales of securities available for sale. For the year ended December 31, 2015, the Company had proceeds from sales of securities available for sale in the amount of $414.14 million, resulting in gross realized gains of $0.91 million and gross realized losses of $2,000.

Held-to-maturity securities

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

December 31, 2017

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 231	$ —	$ 731
Municipal securities	40,825	1,747	—	42,572
Mortgage-backed securities issued by GSE	19,979	82	(479)	19,582
Total held-to-maturity securities	$ 61,304	$ 2,060	$ (479)	$ 62,885

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) in the following tables (in thousands):

December 31, 2017	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 373,536	$ 373,218	$ 2,017	$ 2,025
Due after one year through five years	220,246	217,906	4,649	4,648
Due after five years through 10 years	44,750	44,510	39,826	40,143
Due after 10 years	234,033	230,504	14,812	16,069
	872,565	866,138	61,304	62,885
Other equity securities	1,516	1,516	—	—
	$ 874,081	$ 867,654	$ 61,304	$ 62,885

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

Pledged securities

At December 31, 2017 and 2016, the Company had investment securities with market values of $208.30 million and $226.13 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the Federal Reserve Bank of Richmond ("FRB") at December 31, 2017 or 2016. The Company also had $36.48 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2017, compared to $42.01 million at December 31, 2016.

Unrealized losses

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

December 31, 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	$ 57,411	$ (529)	$ 218,189	$ (2,072)	$ 275,600	$ (2,601)
Municipal securities	11,510	(89)	1,211	(19)	12,721	(108)
Mortgage-backed securities issued by GSE	87,001	(842)	167,273	(4,280)	254,274	(5,122)
Trust preferred and other corporate securities	20,740	(80)	—	—	20,740	(80)
Total temporarily impaired securities	$ 176,662	$ (1,540)	$ 386,673	$ (6,371)	$ 563,335	$ (7,911)

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 agency securities

At December 31, 2017, 23 securities had unrealized losses of $2.60 million. The Company's unrealized losses on U.S. government agency securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

At December 31, 2017, 15 securities had unrealized losses of $0.11 million. The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

At December 31, 2017, 39 securities experienced a total unrealized loss of $5.12 million. The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Trust preferred and other corporate securities

At December 31, 2017, one security had unrealized losses of $0.08 million. The unrealized losses were caused by interest rate fluctuations. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Other investments, including common stock

At December 31, 2017, the Company had no unrealized losses on other investments or common stocks.

FHLB stock

The Company is required to maintain an investment in the capital stock of the FHLB. The FHLB stock is stated at cost, as this is a restricted security without a readily determinable fair value. The Company had $29.59 million and $35.94 million of FHLB stock at December 31, 2017 and 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.

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

December 31,	2017	2016
Real estate loans		
1-4 family residential	$ 1,217,349	$ 1,215,823
Commercial	2,283,541	2,251,312
Construction and land development	930,426	826,027
Multifamily	198,720	222,791
Total real estate loans	4,630,036	4,515,953
Commercial and industrial business	1,087,157	1,089,539
Consumer loans and other	229,772	201,729
Loans, net of unearned income and deferred costs	$ 5,946,965	$ 5,807,221

Unearned loan income was $4.83 million in excess of deferred loan costs at December 31, 2017, $4.02 million at December 31, 2016, and $2.86 million at December 31, 2015. There were $4.81 million, $13.10 million, and $8.67 million in nonaccrual loans at December 31, 2017, 2016, and 2015, respectively. The Company would have earned $0.14 million in 2017, $0.18 million in 2016, and $0.13 million in 2015 if interest on the loans had been accrued. Of total loans, $1.00 billion were pledged as collateral to secure overnight borrowings with the FHLB, and $42.70 million was pledged to secure borrowings from the discount window at the FRB at December 31, 2017.

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 $45.13 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2017.

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the years ended December 31, 2017, 2016, and 2015 (in thousands):

December 31, 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 year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
Provision charged to expense	1,439	416	(297)	2,300	449	1,119	5,426
Losses charged off	—	(139)	—	(2,291)	(345)	(644)	(3,419)
Recoveries	34	339	2	286	82	380	1,123
Balance, end of year	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131
December 31, 2016							
Allowance for loan losses:							
Balance, beginning of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359
Provision charged to expense	(707)	1,901	423	792	996	1,952	5,357
Losses charged off	(107)	(399)	—	(1,448)	(481)	(459)	(2,894)
Recoveries	110	59	2	716	121	171	1,179
Balance, end of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
December 31, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
Provision charged to expense	(549)	496	277	676	440	1,687	3,027
Losses charged off	(208)	(279)	—	(1,443)	(122)	(109)	(2,161)
Recoveries	80	244	1	636	493	122	1,576
Balance, end of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359

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

December 31, 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	$ 34	$ 789	$ 30	$ 938	$ 47	$ 7	$ 1,845
Loans collectively evaluated for impairment	5,719	16,075	1,045	8,345	6,549	5,491	43,224
Loans acquired with deteriorated credit quality	—	—	—	62	—	—	62
Balance, end of year	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131
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 (in thousands):

December 31, 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	$ 2,552	$ 22,183	$ 1,218	$ 14,460	$ 4,253	$ 766	$ 45,432
Ending balance: collectively evaluated for impairment	916,333	2,232,057	182,354	1,175,215	1,082,904	229,006	5,817,869
Ending balance: loans acquired with deteriorated credit quality	11,541	29,301	15,148	27,674	—	—	83,664
Ending Balance	$ 930,426	$ 2,283,541	$198,720	$ 1,217,349	$ 1,087,157	$ 229,772	$ 5,946,965
December 31, 2016							
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 years ended December 31, 2017 and 2016 (in thousands):

	December 31, 2017	December 31, 2016
Balance at beginning of period	$ 40,467	$ 43,959
Additions	—	2,207
Accretion	(9,300)	(6,595)
Reclassifications from nonaccretable balance, net	4,512	3,761
Other changes, net	2,863	(2,865)
Balance at end of period	$ 38,542	$ 40,467

At December 31, 2017, none of the purchased impaired loans were classified as nonperforming assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and expected cash flows, is being recognized on all purchased loans. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses.

Portfolio Quality Indicators

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

The Company's internally assigned grades are as follows:

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

- Special Mention – Loans in this category are considered to have potential weaknesses that deserve management's attention. The borrower's ability to repay from the primary (intended) sources is currently adequate, but threatened by potential weaknesses which may, if not corrected, result in the deterioration of the repayment prospects for the asset or in the Company's credit position loss at some future date.

- Substandard – Loans in this category are considered to have increased credit risk and servicing needs and generally require that the Company follow their performance very closely. The borrower's ability to repay is threatened by a clearly defined weakness which jeopardizes ultimate repayment of the loan.

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

The following tables represent consumer credit exposures by internally assigned grades for the years ended December 31, 2017 and 2016 (in thousands):

December 31, 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	$ 923,501	$ 2,246,128	$ 197,502	$ 1,198,462	$ 1,074,176	$ 229,005	$5,868,774
Special Mention	3,786	19,991	717	4,675	8,737	—	37,906
Substandard	3,139	17,422	501	14,212	4,244	767	40,285
Doubtful	—	—	—	—	—	—	—
Total	$ 930,426	$ 2,283,541	$ 198,720	$ 1,217,349	$ 1,087,157	$ 229,772	$5,946,965

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 December 31, 2017. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (i) well-secured and in the process of collection, or (ii) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Purchased impaired loans are included in the aging schedule, but are excluded from the disclosure of accruing loans more than 90 days past due as they are considered to be accruing due to the existence of the accretable yield and not based on consideration given to contractual interest payments (in thousands).

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
December 31, 2017								
Construction and land development	$ —	$ 36	$ —	$ 273	$ 309	$ 930,117	$ 930,426	$ —
Commercial real estate	1,049	873	—	1,191	3,113	2,280,428	2,283,541	—
Multifamily real estate	—	—	—	—	—	198,720	198,720	—
1-4 family residential real estate	2,074	429	573	2,184	5,260	1,212,089	1,217,349	79
Commercial and industrial business loans	356	143	—	673	1,172	1,085,985	1,087,157	—
Consumer loans and other	750	252	24	486	1,512	228,260	229,772	24
Total	$ 4,229	$ 1,733	$ 597	$ 4,807	$ 11,366	$5,935,599	$ 5,946,965	$ 103

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
December 31, 2016								
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 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
December 31, 2017						
Construction and land development	$ —	$ —	$ —	$ —	$ 11,541	$ 11,541
Commercial real estate	—	—	—	—	29,301	29,301
Multifamily real estate	—	—	—	—	15,148	15,148
1-4 family residential real estate	106	44	494	644	27,030	27,674
Commercial and industrial business loans	—	—	—	—	—	—
Consumer loans and other	—	—	—	—	—	—
Total	$ 106	$ 44	$ 494	$ 644	$ 83,020	$ 83,664

	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. In the fourth quarter of 2016, the Company adopted a policy to classify all loans identified as substandard as impaired. Previously, these loans were reviewed on a case-by-case basis. The adoption of this policy resulted in an increase in impaired loans of $32.29 million at December 31, 2016.

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

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

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 151	$ 151	$ —	$ 162	$ 13
Commercial real estate	11,959	11,886	—	12,667	689
Multifamily real estate	—	—	—	—	—
1-4 family residential real estate	2,432	2,282	—	2,603	102
Commercial and industrial business loans	2,825	2,641	—	3,017	158
Total	$ 17,367	$ 16,960	$ —	$ 18,449	$ 962
Loans with a specific valuation allowance					
Construction and land development	$ 2,773	$ 2,401	$ 34	$ 2,799	$ 124
Commercial real estate	10,384	10,296	789	10,840	524
Multifamily real estate	1,218	1,218	30	1,252	80
1-4 family residential real estate	12,353	12,177	938	13,893	667
Commercial and industrial business loans	1,726	1,612	47	1,847	105
Consumer loans and other	779	767	7	868	34
Total	$ 29,233	$ 28,471	$ 1,845	$ 31,499	$ 1,534
Total impaired loans					
Construction and land development	$ 2,924	$ 2,552	$ 34	$ 2,961	$ 137
Commercial real estate	22,343	22,182	789	23,507	1,213
Multifamily real estate	1,218	1,218	30	1,252	80
1-4 family residential real estate	14,785	14,459	938	16,496	769
Commercial and industrial business loans	4,551	4,253	47	4,864	263
Consumer loans and other	779	767	7	868	34
Total	$ 46,600	$ 45,431	$ 1,845	$ 49,948	$ 2,496

Included in the table above are accruing TDRs of $24.83 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $1.38 million.

December 31, 2016	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	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

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.

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

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

Troubled Debt Restructurings

In order to maximize the collection of loan balances, the Company evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: (i) a creditor has granted a concession to the debtor, and (ii) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.   All restructured loans are considered impaired in the calendar year of restructuring. Effective January 1, 2015, the Company adopted a policy stating that in subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

The following table shows the loans modified in TDRs for the years ended December 31, 2017 and 2016 (in thousands, except number of loans):

	Year Ended December 31, 2017		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
1-4 family residential real estate	1	$ 20	$ 20
Commercial and industrial	2	275	274
Total	3	$ 295	$ 294

	Year Ended December 31, 2016		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	3	$ 2,288	$ 2,286
Commercial real estate	7	5,639	5,636
1-4 family residential real estate	4	879	874
Commercial and industrial	1	206	206
Consumer loans and other	1	25	25
Total	16	$ 9,037	$ 9,027

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. No loans 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 December 31, 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

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

	Year Ended December 31,	
	2017	**2016**
Beginning balance	$ 24,505	$ 34,420
Additions and capital improvements	7,635	7,657
Franklin merger	—	(234)
Sales	(8,608)	(20,477)
Valuation allowance	42	(301)
Loss on sale and write-downs	(1,129)	(219)
Transfers (to) from premises and equipment	843	3,659
Ending balance	$ 23,288	$ 24,505

As of December 31, 2017, the Company's recorded investment in OREO collateralized by residential real estate was $5.29 million. As of December 31, 2017, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $0.61 million.

NOTE 6: PREMISES, EQUIPMENT, AND LEASES

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

	Useful Life	December 31,	
		2017	**2016**
Land and improvements	—	$ 35,001	$ 34,040
Buildings and improvements	10 to 45 years	136,243	133,362
Autos	3 to 5 years	6,160	5,768
Computer equipment	2 to 5 years	13,405	16,175
Equipment	5 to 10 years	24,305	22,950
Furniture and fixtures	5 to 20 years	49,269	49,071
Leasehold improvements	Lesser of lease term or 15 years	29,028	29,466
Construction in progress	—	416	102
		293,827	290,934
Less accumulated depreciation		(98,927)	(92,366)
Net premises and equipment		$ 194,900	$ 198,568

Depreciation and leasehold amortization expense for the years ended December 31, 2017, 2016, and 2015, was $15.90 million, $13.70 million, and $11.72 million, respectively.

Various facilities and equipment are leased under noncancellable operating leases with initial remaining terms in excess of one year and an option for renewal. In addition to minimum rentals, certain leases have escalation clauses and include provisions for additional payments to cover taxes, insurance, and maintenance. The effects of scheduled rent increases, which are included in the minimum lease payments, are recognized on a straight-line basis over the lease term. Rental expense was $11.21 million for 2017, compared to $9.37 million for 2016, and $7.57 million for 2015.

Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2017, are listed in the following chart (in thousands):

2018	$ 9,678
2019	7,199
2020	5,269
2021	3,355
2022	3,096
Thereafter	17,448
	$ 46,045

Rental income for the year ended December 31, 2017, was $0.93 million, compared to $0.96 million for 2016, and $0.64 million for 2015. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2017 (in thousands):

2018	$ 723
2019	709
2020	620
2021	532
2022	249
Thereafter	91
	$ 2,924

NOTE 7: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2017		2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 9,819	$ 4,115	$ 9,818	$ 1,827
Non-compete agreements	1,368	838	2,201	1,407
Customer lists	48,307	20,584	43,291	17,493
Trade names	1,591	211	211	169
Total intangible assets subject to amortization	61,085	25,748	55,521	20,896
Intangible assets not subject to amortization				
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—
Total intangible assets	$ 64,316	$ 25,748	$ 58,752	$ 20,896

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2017, was $7.66 million, compared to $6.01 million for 2016, and $3.54 million for 2015. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2017, is as follows: 2018, $7.37 million; 2019, $6.53 million; 2020, $5.88 million; 2021, $4.92 million; and 2022, $3.84 million.

During 2017, the Company recorded $5.34 million in net increases to goodwill and $0.71 million in intangible assets. This represents the acquisitions of W.A. Moore, Railey Mountain Lake, and an insurance-related book of business. During 2016, the Company recorded $110.07 million in net increases to goodwill and $11.70 million in intangible assets. This represents the acquisitions of Monarch, Oak Island, and an insurance-related book of business. The intangible assets acquired are finite-lived, consisting primarily of book-of-business purchases.

No impairment charges were recorded in any year reported. Impairment testing indicated that goodwill was not impaired in 2017, 2016, or 2015. Changes in the carrying amount of goodwill related to each of the Company's segments are as follows (in thousands):

	Bank	Realty	Insurance	Consolidated Totals
Balance, December 31, 2015	$ 94,319	$ 13,999	$ 46,524	$ 154,842
Additions to goodwill	100,129	10,263	—	110,392
Other adjustments	465	(767)	(22)	(324)
Balance, December 31, 2016	$ 194,913	$ 23,495	$ 46,502	$ 264,910
Additions to goodwill	—	3,336	2,655	5,991
Other adjustments	—	(651)	—	(651)
Balance, December 31, 2017	$ 194,913	$ 26,180	$ 49,157	$ 270,250

NOTE 8: BANK-OWNED LIFE INSURANCE POLICIES

The total carrying amount of bank-owned life insurance ("BOLI") as of December 31, 2017, was $195.77 million. The Company had $189.50 million of BOLI at December 31, 2016, and $149.45 million at December 31, 2015. The Company recognized BOLI income, included in other noninterest income, of $6.26 million, $5.99 million, and $5.19 million for the years ended December 31, 2017, 2016, and 2015, respectively. The Company has a related retirement plan, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits. Refer to Note 12 for additional discussions regarding retirement plans.

NOTE 9: DEPOSITS

A summary of time deposits by maturity at December 31, 2017, is shown in the following chart (dollars in thousands):

Maturity	Total
2018	$ 1,191,070
2019	338,637
2020	110,400
2021	76,873
2022 and thereafter	32,802
	$ 1,749,782

At year-end 2017, TowneBank had a total of $407.03 million in no-penalty time deposits as compared to $407.94 million at December 31, 2016. The aggregate amount of time deposits of $250,000 or more was $617.51 million and $367.81 million at December 31, 2017 and 2016, respectively.

Some of the Company's officers and directors, and the respective companies in which the officers and directors have a financial interest, have deposit relationships with the Company. Related party deposits amounted to approximately $96.83 million and $82.29 million at December 31, 2017 and 2016, respectively.

NOTE 10: BORROWINGS

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

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

	2017	2016
Balance outstanding at end of year	$ 526,923	$ 687,511
Average balance outstanding	$ 587,281	$ 483,739
Maximum outstanding at any month-end	$ 687,511	$ 687,572
Average interest rate during the year	1.68%	2.75%
Average interest rate at end of year	1.40%	2.32%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2017, are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Call Date	Outstanding Amount
01/29/2018	3.05%	—	$ 13,000
11/15/2028	3.43%	—	4,617
12/01/2028	2.83%	—	3,306
12/07/2020	1.38%	01/08/2018	74,000
08/29/2019	1.43%	01/29/2018	72,000
11/04/2019	1.26%	—	260,000
03/06/2020	1.42%	01/08/2018	100,000
			$ 526,923

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

	2017	2016
Balance outstanding at end of year	$ 24,094	$ 31,747
Average balance outstanding	$ 29,676	$ 36,088
Maximum outstanding at any month-end	$ 34,562	$ 39,442
Average interest rate during the year	0.36%	0.25%
Average interest rate at end of year	0.42%	0.27%

Retail repurchase agreements (“REPOs”) totaled $24.09 million at December 31, 2017. All REPOs are overnight short-term investments and are not insured by the Federal Deposit Insurance Corporation (“FDIC”). Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and are therefore accounted for as a secured borrowing. 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. In addition, federal funds lines with other financial institutions of $140.00 million were available at December 31, 2017, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2017 and 2016, the Company had an unused line of credit with the FHLB totaling $1.85 billion and $1.60 billion, respectively. The FHLB advances are secured by a blanket floating lien on certain 1-4 family residential, multifamily, HELOCs, second mortgages, and commercial mortgages with carrying values of $1.00 billion at December 31, 2017.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2017, which provide potential additional funding.

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 December 31, 2017, the carrying value of the notes totaled $247.20 million.

NOTE 11: COMMITMENTS

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

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

Our contractual amounts are as follows (in thousands):

December 31,	**2017**	**2016**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 2,282,303	$ 2,084,992
Standby letters of credit	83,620	84,307
	$ 2,365,923	$ 2,169,299

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

Standby letters of credit are conditional commitments issued to guarantee performance of a customer to a third party. The letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral supporting those commitments is generally held, if deemed necessary. The Company provides an allowance for estimated losses from such provisions that management considered adequate at December 31, 2017. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

NOTE 12: RETIREMENT PLANS

Defined Contribution Plans

The Company has a defined contribution 401(k) plan. All employees who are at least 18 years of age and have completed one quarter of a year of service are eligible to participate. Under the plan, employees may contribute a percentage of their annual salary, subject to statutory limitations, and the Company will make a discretionary match of the employees' contributions up to 6% of their salary. The Company matched employee contributions up to 3.0% in 2017, 3.0% in 2016, and 4.2% in 2015. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2017, 2016, or 2015. The Company made matching contributions of $4.35 million, $3.46 million, and $1.19 for the years ended December 31, 2017, 2016, and 2015, respectively.

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

The funds for the non-qualified deferred compensation plan are held in a rabbi trust and invested in certificates of deposit, which are included in other assets on the balance sheet. Changes in the obligation are recorded in compensation expense, which resulted in an increase in expenses of $0.41 million, $0.68 million, and $0.46 million for the years ended December 31, 2017, 2016, and 2015, respectively. The Company did not make matching contributions to the plan for the years ended December 31, 2017, 2016, or 2015.

Retirement Plans

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

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

	SERP		Other Postretirement Benefits	
December 31,	**2017**	**2016**	**2017**	**2016**
Change in benefit obligation				
Benefit obligation, beginning of year	$ 30,290	$ 23,970	$ 918	$ 843
Service cost	3,336	2,270	39	111
Interest cost	1,146	1,092	(41)	32
Net amortization	436	217	8	(59)
Benefits paid	(654)	(469)	(9)	(17)
Benefit obligation assumed through acquisition	—	3,699	—	—
Prior service cost	1,027	—	—	—
Net actuarial (gain) loss	(476)	(489)	430	8
Benefit obligation, end of year	$ 35,105	$ 30,290	$ 1,345	$ 918
Change in plan assets				
Fair value of plan assets, beginning of year	—	—	—	—
Employer contributions	654	469	9	17
Benefits paid	(654)	(469)	(9)	(17)
Fair value of plan assets, end of year	$ —	$ —	$ —	$ —
Funded status, end of year	$ (35,105)	$ (30,290)	$ (1,345)	$ (918)
Accumulated benefit obligation, end of year	$ 31,927	$ 28,433	$ 1,345	$ 918
Amounts recognized in other comprehensive income, pretax				
Prior service cost	$ 1,027	$ —	$ —	$ —
Net actuarial (gain) loss	$ (476)	$ (489)	$ 430	$ 8

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

	SERP			Other Postretirement Benefits		
	2017	**2016**	**2015**	**2017**	**2016**	**2015**
Service cost	$ 3,336	$ 2,270	$ 1,497	$ 39	$ 111	$ 3
Interest cost	1,146	1,092	874	(41)	32	1
Prior service cost	288	151	—	—	—	—
Net amortization	148	66	146	8	(59)	69
Net periodic benefit cost	$ 4,918	$ 3,579	$ 2,517	$ 6	$ 84	$ 73

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

	SERP		Other Postretirement Benefits	
December 31,	**2017**	**2016**	**2017**	**2016**
Prior service cost	$ 2,114	$ 1,254	$ —	$ —
Net actuarial (gain) loss	25	334	191	(239)
Deferred tax benefit (expense)	(749)	(556)	(67)	83
Amounts included in accumulated other comprehensive income, net of tax	$ 1,390	$ 1,032	$ 124	$ (156)

Pre-tax amounts recorded in accumulated other comprehensive income as of December 31, 2017 that are expected to be recognized as a component of our net periodic benefit cost in 2018 consist of the following (in thousands):

	SERP	Other Postretirement Benefits
Net actuarial loss	$ 33	$ 49
Prior service cost	$ 279	$ —

The Company used certain weighted average assumptions to determine benefit obligations and net benefit costs, including discount rate and rate of increase in future compensation levels. The discount rate used to determine net periodic benefit cost and benefit obligation of the SERP was 3.78% in 2017, 4.32% in 2016, and 4.32% 2015. The rate of increase in future compensation levels used was 4.0% in 2017, 2016, and 2015. The discount rate used to determine net periodic benefit cost and benefit obligation of other postretirement benefits was 3.78% in 2017, 4.32% in 2016, and 4.32% 2015. When estimating the discount rate, we review yields available on high-quality, fixed-income debt instruments and use a yield curve model from which the discount rate is derived by applying the projected benefit payments under the plan to points on a published yield curve.

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

Year	SERP	Other Postretirement Benefits
2018	$ 1,702	$ —
2019	1,936	47
2020	2,528	71
2021	2,744	75
2022	2,824	79
2023-2027	16,148	455

NOTE 13: SHARE-BASED COMPENSATION

The Company maintains a share-based compensation plan ("Plan") that provides for the granting of incentive and non-statutory stock options and restricted common stock. The Plan is administered by the Compensation Committee of the Board of Directors (the "Compensation Committee"). The maximum aggregate number of shares that may be issued under the Plan may not exceed 2.50 million. The Company has a policy of using authorized and unissued common shares to satisfy share option exercises and vesting of restricted stock awards. At December 31, 2017, approximately 2.49 million common shares were available for issuance under the Plan.

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

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

For the Year Ended December 31,	2017		2016		2015	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Options outstanding, beginning balance	97,590	$ 16.24	277,287	$ 17.69	414,005	$ 18.44
Granted	—	—	—	—	—	—
Exercised	(50,066)	17.36	(125,622)	17.59	(28,690)	17.50
Expired	(824)	18.81	(51,500)	20.87	(105,453)	20.68
Forfeited	(309)	17.96	(2,575)	14.18	(2,575)	17.96
Options outstanding, ending balance	46,391	$ 14.97	97,590	$ 16.24	277,287	$ 17.69
Options exercisable at December 31,	30,171	$ 14.90	66,799	$ 16.51	226,973	$ 18.07

	Number of Shares	Weighted-Average Exercise Price
Unvested stock options, December 31, 2016	30,791	$ 15.64
Granted	—	—
Vested	(14,262)	16.19
Forfeited	(309)	17.96
Unvested stock options, December 31, 2017	16,220	$ 15.11

For the years ended December 31, 2017, 2016, and 2015, there were no stock options granted. In 2017, the total intrinsic value of options exercised was $0.73 million. In 2016, the total intrinsic value of options exercised was $1.27 million. In 2015, the total intrinsic value of options exercised was $0.09 million. Additional information pertaining to options outstanding at December 31, 2017, is as follows:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	46,391	$ 14.97	$ 731,939	1.80
Options vested or expected to vest	45,825	$ 14.97	$ 722,965	1.79
Options exercisable	30,171	$ 14.90	$ 478,199	1.44

The grant-date fair value of each option grant is estimated using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs.

Expected volatility was calculated based on the historical volatility of the Company's stock over the most recent period of time equal to the expected term of the option. The average expected life was based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior based on historical patterns. The risk-free interest rate is based on the U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. Forfeitures are estimated based on historical voluntary termination behavior.

For the years ended December 31, 2017, 2016, and 2015, the tax benefit on cash paid for stock options exercised was \$0.25 million, \$0.45 million, and \$0.30 million, respectively. Compensation expense related to stock options for the years ended December 31, 2017, 2016, and 2015, was \$0.06 million, \$0.07 million, and \$0.11 million, respectively. As of December 31, 2017, there was \$0.06 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 2.38 years.

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

The following chart shows a summary of restricted stock award activity and related information, assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2017:

	Number of Shares	Weighted-Average Price
Unvested RSAs, beginning balance	456,385	$ 17.84
Granted	73,824	32.12
Vested	(140,010)	16.59
Forfeited	(14,418)	20.45
Unvested RSAs, ending balance	375,781	$ 21.01

Compensation expense related to awards for the years ended December 31, 2017, 2016, and 2015, was \$2.53 million, \$2.09 million, and \$1.81 million, respectively. The total fair value of awards vested during 2017, 2016, and 2015 was \$2.32 million, \$1.76 million, and \$1.51 million, respectively. As of December 31, 2017, there was \$6.10 million of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 2.98 years.

The Company has a directors' deferred compensation plan whereby the directors may elect to defer up to 100% of their directors' fees. All deferred compensation is invested in the Company's common stock and is held in a rabbi trust. The stock is held in the nominee name of the trustee, and the principal and earnings of the trust are held separate and apart from other funds of the Company, and are used exclusively for the uses and purposes of the deferred compensation agreement. The accounts of the trust have been consolidated in the financial statements of the Company with common stock reported separately in a manner similar to treasury stock (that is, changes in fair value are not recognized) and a corresponding deferred compensation obligation reflected in additional paid-in capital of \$12.52 million and \$11.17 million at December 31, 2017 and 2016, respectively.

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

The Board of Directors approved and adopted the Member Stock Purchase and Dividend Reinvestment Plan to raise additional capital by providing a convenient and cost-effective way for shareholders, customers, and employees to purchase shares of TowneBank common stock. In connection with the member stock purchase component of the plan for the year ended December 31, 2017, the Company entered the open market and acquired 78,215 shares at an average price of $31.75 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2017, the Company entered the open market and acquired 153,894 shares at an average price of $32.05 per share.

In connection with the member stock purchase component of the plan for the year ended December 31, 2016, the Company entered the open market and acquired 101,867 shares at an average price of $22.28 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2016, the Company entered the open market and acquired 216,312 shares at an average price of $21.81 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In February 2017, the Company declared a quarterly cash dividend of $0.13 per common share. In May, August, and November 2017, the Company declared quarterly cash dividends of $0.14 per common share. In February 2016, the Company declared a quarterly cash dividend of $0.12 per common share. In May, August, and November 2016, the Company declared quarterly cash dividends of $0.13 per common share. In February 2015, the Company declared a quarterly cash dividend of $0.11 per common share. In May, August, and November 2015, the Company declared quarterly cash dividends of $0.12 per common share. The quarterly dividends were paid on April 10, 2015; July 10, 2015; October 9, 2015; January 12, 2016; April 12, 2016; July 12, 2016; October 12, 2016; January 12, 2017; April 12, 2017; July 12, 2017; October 12, 2017; and January 12, 2018.

Declaration of future cash dividends will depend on our earnings, our capital position, and other factors. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

NOTE 15: OTHER EXPENSES

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

Year Ended December 31,	**2017**	**2016**	**2015**
Advertising and marketing	$ 9,867	$ 8,443	$ 7,515
Acquisition-related expenses	2,268	19,111	1,312
Charitable contributions	5,550	4,582	5,193
Telephone and postage	6,907	5,996	4,701
Outside processing	6,975	6,420	4,844
Professional fees	7,144	5,329	5,764
Other	11,796	9,417	6,019
Stationery and office supplies	2,730	2,978	2,479
Amortization of intangible assets	7,656	6,010	3,537
Foreclosed property expenses	782	1,335	1,785
FDIC and other insurance	4,249	4,613	4,954
Software expense	8,517	7,116	5,916
Travel/Meals/Entertainment	2,820	2,044	1,452
Directors' expense	1,734	1,371	1,244
Bank franchise tax/SCC fees	5,303	4,184	2,499
	$ 84,298	$ 88,949	$ 59,214

NOTE 16: REGULATORY CAPITAL REQUIREMENTS

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

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. To be categorized as "well-capitalized," the Company must maintain minimum total common equity Tier I, Tier 1 capital, total capital, and leverage capital ratios as set forth in the table below. Under the FDIC rules, we are considered "well capitalized" as of December 31, 2017.

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

As of December 31, 2017	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Common equity Tier 1						
(to risk-weighted assets)	$ 839,287	12.19%	$ 309,797	4.50%	$ 447,484	6.50%
Tier 1 capital						
(to risk-weighted assets)	$ 842,168	12.23%	$ 413,062	6.00%	$ 550,750	8.00%
Total risk-based capital						
(to risk-weighted assets)	$ 1,134,495	16.48%	$ 550,750	8.00%	$ 688,437	10.00%
Tier 1 leverage ratios						
(to average assets)	$ 842,168	10.17%	$ 331,282	4.00%	$ 414,103	5.00%

As of December 31, 2016	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Common equity Tier 1						
(to risk-weighted assets)	$ 797,205	11.75%	$ 305,365	4.50%	$ 441,083	6.50%
Tier 1 capital						
(to risk-weighted assets)	$ 802,066	11.82%	$ 407,154	6.00%	$ 542,872	8.00%
Total risk-based capital						
(to risk-weighted assets)	$ 844,067	12.44%	$ 542,872	8.00%	$ 678,590	10.00%
Tier 1 leverage ratios						
(to average assets)	$ 802,066	10.44%	$ 307,342	4.00%	$ 384,178	5.00%

NOTE 17: FAIR VALUE DISCLOSURES

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

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

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

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

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

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

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 years ended December 31, 2017 and 2016, the Company used weighted average fall-out rates of 17.14%, 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 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.

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

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 274,468	$ —	$ 274,468
U.S. Treasury notes	$ —	$ 301,497	$ —	$ 301,497
Municipal securities	$ —	$ 17,487	$ —	$ 17,487
Mortgage-backed securities issued by GSE	$ —	$ 249,322	$ —	$ 249,322
Trust preferred and other corporate securities	$ —	$ 24,880	$ —	$ 24,880
Derivative assets	$ —	$ 499	$ 2,000	$ 2,499
Derivative liabilities	$ —	$ 297	$ —	$ 297

	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 GSE	$ —	$ 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 (in thousands):

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 9,852	$ 9,852
Foreclosed property	$ —	$ —	$ 23,288	$ 23,288
December 31, 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 12,097	$ 12,097
Foreclosed property	$ —	$ —	$ 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, where available, or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 0.22% to 21.40%, with a weighted average of 12.60%.

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 December 31, 2017, one property included in foreclosed assets was valued using a management-applied discount to the appraisal of 6.17%.

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 loan receivables with short-term and/or variable characteristics, the total receivable outstanding approximates fair value. The fair value of other loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Interest receivable and interest payable: The carrying amount approximates fair value.

Deposits: The fair value of noninterest-bearing deposits and deposits with no defined maturity is estimated by discounting anticipated future cash flows using current borrowing rates. The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits would be made.

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

Repurchase agreements: The carrying amount approximates fair value.

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

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

December 31, 2017	**Carrying Value**	**Estimated Fair Value**	**Level 1**	**Level 2**	**Level 3**
Cash and due from banks	$ 500,408	$ 500,408	$ 500,408	$ —	$ —
Interest-bearing deposits in financial institutions	$ 4,471	$ 4,471	$ 4,471	$ —	$ —
Securities available for sale	$ 867,654	$ 867,654	$ —	$ 867,654	$ —
Securities held to maturity	$ 61,304	$ 62,885	$ —	$ 62,885	$ —
Mortgage loans held for sale	$ 313,256	$ 313,453	$ —	$ 313,453	$ —
Loans, net	$ 5,946,965	$ 5,910,115	$ —	$ —	$ 5,910,115
Interest receivable	$ 22,501	$ 22,501	$ —	$ 22,501	$ —
Deposits	$ 6,448,220	$ 6,431,467	$ —	$ 6,431,467	$ —
Advances from the Federal Home Loan Bank of Atlanta	$ 526,923	$ 522,720	$ —	$ 522,720	$ —
Subordinated debentures	$ 247,196	$ 256,305	$ —	$ 256,305	$ —
Repurchase agreements and other borrowings	$ 24,850	$ 24,853	$ —	$ 24,853	$ —
Interest payable	$ 9,274	$ 9,274	$ —	$ 9,274	$ —

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	$ —
Loans, net	$ 5,807,221	$ 5,828,335	$ —	$ —	$ 5,828,335
Interest receivable	$ 20,288	$ 20,288	$ —	$ 20,288	$ —
Deposits	$ 6,035,197	$ 5,468,657	$ —	$ 5,468,657	$ —
Advances from the Federal Home Loan Bank of Atlanta	$ 687,511	$ 687,100	$ —	$ 687,100	$ —
Subordinated debentures	$ —	$ —	$ —	$ —	$ —
Repurchase agreements and other borrowings	$ 32,540	$ 32,543	$ —	$ 32,543	$ —
Interest payable	$ 3,320	$ 3,320	$ —	$ 3,320	$ —

Note 18. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company enters into interest 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 as of the period end (in thousands):

	December 31, 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	$ 125,092	$ 410	$ 14,923	$ 78
Interest rate lock commitments	199,837	2,000	215,166	2,282
TBA mortgage-backed securities	67,500	89	73,500	1,469
Total included in other assets		$ 2,499		$ 3,829
Included in other liabilities:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 32,326	$ 126	$ 29,881	$ 647
TBA mortgage-backed securities	127,000	171	—	—
Total included in other liabilities		$ 297		$ 647

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

	December 31,	
	2017	2016
Interest rate lock commitments	$ (282)	$ (2,407)
Forward sales contracts	613	908
	$ 331	$ (1,499)

NOTE 19: VARIABLE INTEREST ENTITIES

In the normal course of business, the Company is involved with various entities that are considered to be Variable Interest Entities ("VIE"). A VIE is an entity that has either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support, or whose equity investors lack the characteristics of a controlling financial interest. In accordance with existing accounting guidance, we are required to consolidate any VIE of which we are determined to be the primary beneficiary. The primary beneficiary is the entity that has (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and (ii) the obligation to absorb losses of the entity that could potentially be significant to the VIE, or the right to receive benefits from the entity that could potentially be significant to the VIE. We review all significant interests in the VIEs we are involved with, including the amounts and types of financial and other support, including equity investments, debt financing, and guarantees. We also consider the activities of the VIEs that most significantly impact the VIEs' economic performance and whether we have control over those activities. We assess whether or not we are the primary beneficiary of a VIE on an ongoing basis. To provide the necessary disclosures, we aggregate similar VIEs based on the nature and purpose of the entities.

Low Income Housing Tax Credit Partnerships

As part of its community reinvestment initiatives, the Company invests within its footprint in multifamily affordable housing developments as a limited partner. The Company receives tax credits for its partnership investments. The Company has determined that these partnerships are VIEs when it does not own 100% of the entity, because the holders of the equity investment at risk do not have the power through voting rights or similar rights to direct the activities of the entity that most significantly impact the entity's economic performance. Accordingly, the Company's limited partner interests are variable interests that the Company evaluates for purposes of determining whether the Company is the primary beneficiary.

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $112.66 million and $92.44 million in these partnerships were not included in the Consolidated Balance Sheets at December 31, 2017 and 2016, respectively. These limited partner interests had carrying values of $22.79 million and $14.94 million at December 31, 2017 and 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 $30.15 million and $21.02 million at December 31, 2017 and 2016, respectively. As of December 31, 2017, the Company has $37.26 million in funding commitments that are dependent on certain contractual milestones and $7.50 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the year ended December 31, 2017, a tax benefit totaling $1.75 million, net of amortization of $4.36 million, was recognized as a component of income tax expense.

NOTE 20: INCOME TAXES

Current income tax expense represents the amounts expected to be reported on the Company's income tax returns, and deferred tax expense or benefit represents the change in net deferred tax assets and liabilities. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Valuation allowances are recorded as appropriate to reduce deferred tax assets to the amount considered likely to be realized.

On December 22, 2017, the President of the United States signed into law the Tax Cut and Jobs Act of 2017 ("Tax Reform Act"). The legislation made key changes to U.S. tax law, including the reduction of the U.S. federal corporate tax rate from 35% to 21%, effective January 1, 2018.

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. As a result of the reduction in the U.S. corporate income tax rate from 35% to 21% under the Tax Reform Act, the Company revalued its ending net deferred tax assets at December 31, 2017, and recognized a provisional $10.11 million tax expense in the Company's consolidated statement of income for the year ended December 31, 2017. We are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018.

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

For the Year Ended December 31,	2017	2016	2015
Current income tax expense			
Federal	$ (51,925)	$ (24,520)	$ (22,163)
State	(2,318)	(1,024)	(1,042)
Total current tax expense	(54,243)	(25,544)	(23,205)
Deferred income tax (expense) benefit			
Federal	9,210	(3,154)	(3,671)
State	332	—	—
Revaluation of deferred taxes	(10,112)	—	—
Total deferred income tax expense	(570)	(3,154)	(3,671)
Income tax expense	$ (54,813)	$ (28,698)	$ (26,876)

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

	2017		2016		2015	
For the Year Ended December 31,	**$**	**Rate**	**$**	**Rate**	**$**	**Rate**
Federal income tax expense at statutory rate	$ (49,867)	(35.00)%	$ (33,582)	(35.00)%	$ (31,240)	(35.00)%
Federal income tax expense - tax reform	(10,112)	(7.10)%	—	— %	—	— %
State income tax expense, net of federal benefit	(1,507)	(1.06)%	(666)	(0.69)%	(677)	(0.76)%
Tax advantaged income	4,950	3.47 %	4,981	5.19 %	3,850	4.31 %
Tax credits		— %	—	— %	204	0.23 %
LIHTC, net of amortization	1,750	1.23 %	1,378	1.44 %	1,291	1.45 %
Franklin Federal capital loss carryforward utilized	—	— %	—	— %	452	0.51 %
Section 162(m) disallowance	(169)	(0.11)%	—	— %	(615)	(0.69)%
Merger and acquisition expense, non-deductible	(412)	(0.29)%	(476)	(0.50)%	(212)	(0.24)%
Share based compensation	930	0.65 %	—	— %	—	— %
Other	(376)	(0.26)%	(333)	(0.35)%	71	0.08 %
Income tax expense	$ (54,813)	(38.47)%	$ (28,698)	(29.91)%	$ (26,876)	(30.11)%

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

Year Ended December 31,	**2017**	**2016**
Deferred tax assets:		
Allowance for loan losses	$ 9,819	$ 14,700
Stock-based compensation	465	754
Basis differences due to tax credits and partnerships	—	2,576
Other	940	3,590
Accrued expenses	1,322	3,009
Retirement plan	8,485	11,348
Unrealized loss on securities available for sale	1,398	1,674
Deferred compensation	3,908	7,103
Assets acquired in acquisitions	7,936	20,189
Total deferred tax assets	34,273	64,943
Deferred tax liabilities:		
Depreciation	8,387	12,270
Noncompete and intangibles	3,920	6,580
Basis differences due to tax credits and partnerships	80	—
Other	5,273	3,028
Total deferred tax liabilities	17,660	21,878
Net deferred tax assets	$ 16,613	$ 43,065

As of December 31, 2017 and December 31, 2016, the Company did not have any unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next 12 months. The Company recognizes interest and penalties related to unrecognized tax benefits as "Interest Expense" and "Other Expense," respectively, and not as part of the tax provision. The Company did not recognize any interest expense or penalties for the years ended December 31, 2017, 2016, and 2015. Additionally, there were no interest or penalties accrued at December 31, 2017 or 2016. The Company is no longer subject to examination for federal and state purposes for tax years prior to 2014.

NOTE 21: ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the components of accumulated other comprehensive income (loss) at December 31, 2017, 2016, and 2015, and changes during the years then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the defined benefit retirement plan are a component of salaries and employee benefits expense on the consolidated statements of income.

(in thousands)	**Unrealized Gains (Losses) on Securities (a)**	**Pension and Postretirement Plans (b)**	**Accumulated Other Comprehensive Income (Loss), Net of Tax**
Balance, December 31, 2014	$ 1,325	$ (867)	$ 458
Other comprehensive income (loss) before reclassifications, net of tax	(2,620)	(462)	(3,082)
Amounts reclassified from AOCI, net of tax	(510)	140	(370)
Net change	(3,130)	(322)	(3,452)
Balance, December 31, 2015	(1,805)	(1,189)	(2,994)
Other comprehensive loss before reclassifications, net of tax	(1,300)	210	(1,090)
Amounts reclassified from AOCI, net of tax	(4)	102	98
Net change	(1,304)	312	(992)
Balance, December 31, 2016	(3,109)	(877)	(3,986)
Other comprehensive loss before reclassifications, net of tax	(1,069)	(926)	(1,995)
Amounts reclassified from AOCI, net of tax	1	288	289
Net change	(1,068)	(638)	(1,706)
Balance, December 31, 2017	$ (4,177)	$ (1,515)	$ (5,692)

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

NOTE 22: LEGAL CONTINGENCIES

Various legal actions arise from time to time in the normal course of our business. There were no significant asserted claims or assessments at December 31, 2017. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2017.

NOTE 23: OTHER RELATED PARTY TRANSACTIONS

Loans are made to the Company's executive officers and directors and their associates during the ordinary course of business. The aggregate amount of loans to such related parties totaled $363.08 million, $364.33 million, and $258.01 million as of December 31, 2017, 2016, and 2015, respectively. During 2017, new advances on all commitments to such parties totaled $50.04 million, additions to loans associated with related parties totaled $5.32 million, and repayments amounted to $460.87 million. Included in the loans to related parties, at December 31, 2017, we had $130.05 million in unfunded commitments to extend credit to such related parties.

The Company rents space for various financial centers from companies associated with its directors. Rent expense related to these leases was $2.92 million, $2.76 million, and $2.44 million for the years ended December 31, 2017, 2016, and 2015, respectively.

In the ordinary course of business, the Company acquired certain goods and services from companies associated with its directors and employees, including purchases of automobiles, construction of Company-owned facilities, and maintenance and furnishing of Company facilities. Amounts paid to these companies during the years ended December 31, 2017, 2016, and 2015, approximated $1.28 million, $1.67 million, and $1.09 million, respectively.

NOTE 24: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2017 and 2016, is as follows (in thousands, except per share data):

2017	**Fourth**	**Third**	**Second**	**First**
Interest income	$ 78,465	$ 77,871	$ 78,681	$ 70,087
Interest expense	12,801	11,948	9,428	9,806
Provision for loan losses	869	696	1,320	2,541
Noninterest income	43,477	49,416	50,344	44,886
Net gain on investment securities	—	—	(1)	—
Noninterest expense	73,660	74,186	78,119	70,248
Income before income tax expense and noncontrolling interest	34,612	40,457	40,157	32,378
Income tax expense	21,325	11,862	12,240	9,386
Net income	13,287	28,595	27,917	22,992
Noncontrolling interest	(954)	(1,445)	(1,704)	(1,024)
Net income attributable to TowneBank	$ 12,333	$ 27,150	$ 26,213	$ 21,968
Net income per common share				
Basic	$ 0.20	$ 0.44	$ 0.42	$ 0.35
Diluted	$ 0.20	$ 0.44	$ 0.42	$ 0.35
Dividends	$ 0.14	$ 0.14	$ 0.14	$ 0.13

2016	**Fourth**	**Third**	**Second**	**First**
Interest income	$ 71,818	$ 71,823	$ 56,241	$ 54,734
Interest expense	9,667	9,218	8,457	8,398
Provision for loan losses	1,831	1,686	2,099	(259)
Noninterest income	39,512	46,821	36,468	32,415
Net gain on investment securities	6	—	—	—
Noninterest expense	72,834	70,933	71,899	52,161
Income before income tax expense and noncontrolling interest	27,004	36,807	10,254	26,849
Income tax expense	7,160	10,974	2,375	8,188
Net income	19,844	25,833	7,879	18,661
Noncontrolling interest	(848)	(1,657)	(1,620)	(842)
Net income attributable to TowneBank	$ 18,996	$ 24,176	$ 6,259	$ 17,819
Net income per common share				
Basic	$ 0.31	$ 0.39	$ 0.12	$ 0.35
Diluted	$ 0.31	$ 0.39	$ 0.12	$ 0.35
Dividends	$ 0.13	$ 0.13	$ 0.13	$ 0.12

NOTE 25: 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 Lake 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.

Information about reportable segments and reconciliation of such information to the Consolidated Financial Statements follows (dollars in thousands):

For the Year Ended December 31, 2017	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 251,003	$ 10,118	$ —	$ 261,121
Provision for loan losses	5,426	—	—	5,426
Net interest income after provision for loan losses	245,577	10,118	—	255,695
Residential mortgage banking income, net	(394)	76,245	—	75,851
Real estate brokerage and property management income, net	—	27,487	—	27,487
Insurance commissions and other title fees and income, net	468	1,877	49,588	51,933
Other noninterest income	29,574	2,310	966	32,850
Noninterest expense	143,395	94,482	33,837	271,714
Depreciation and amortization	15,460	5,447	3,593	24,500
Income before income tax, corporate allocation, and noncontrolling interest	116,370	18,108	13,124	147,602
Corporate allocation	(1,828)	1,210	618	—
Income before income tax provision and noncontrolling interest	118,198	16,898	12,506	147,602
Income tax provision	44,584	5,791	4,438	54,813
Net income	73,614	11,107	8,068	92,789
Noncontrolling interest	1	(3,756)	(1,371)	(5,126)
Net income attributable to TowneBank	$ 73,615	$ 7,351	$ 6,697	$ 87,663
Net income as percentage of total	83.97%	8.39%	7.64%	100.00%
Assets	$ 7,842,558	$ 504,516	$ 175,102	$ 8,522,176
Efficiency ratio	56.60%	84.66%	74.04%	65.94%

For the Year Ended December 31, 2016	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 211,112	$ 7,763	$ 1	$ 218,876
Provision for loan losses	5,326	31	—	5,357
Net interest income after provision for loan losses	205,786	7,732	1	213,519
Residential mortgage banking income, net	(1,078)	59,870	—	58,792
Real estate brokerage and property management income, net	—	20,515	—	20,515
Insurance commissions and other title fees and income, net	373	1,883	44,485	46,741
Other noninterest income	26,269	2,003	902	29,174
Noninterest expense	149,082	67,167	31,027	247,276
Depreciation and amortization	13,262	3,762	3,528	20,552
Income before income tax, corporate allocation, and noncontrolling interest	69,006	21,074	10,833	100,913
Corporate allocation	1,573	(935)	(638)	—
Income before income tax provision and noncontrolling interest	70,579	20,139	10,195	100,913
Income tax provision	18,923	6,184	3,591	28,698
Net income	51,656	13,955	6,604	72,215
Noncontrolling interest	(28)	(3,669)	(1,268)	(4,965)
Net income attributable to TowneBank	$ 51,628	$ 10,286	$ 5,336	$ 67,250
Net income as percentage of total	76.77%	15.30%	7.93%	100.00%
Assets	$ 7,332,713	$ 481,476	$ 159,726	$ 7,973,915
Efficiency ratio	68.59%	77.07%	76.13%	71.59%

For the Year Ended December 31, 2015	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 177,715	$ 2,727	$ —	$ 180,442
Provision for loan losses	3,027	—	—	3,027
Net interest income after provision for loan losses	174,688	2,727	—	177,415
Residential mortgage banking income, net	(741)	34,952	—	34,211
Real estate brokerage and property management income, net	—	16,326	—	16,326
Insurance commissions and other title fees and income, net	—	1,574	38,067	39,641
Other noninterest income	23,400	2,943	762	27,105
Noninterest expense	117,900	40,913	27,196	186,009
Depreciation and amortization	10,848	2,331	2,969	16,148
Income before income tax, corporate allocation, and noncontrolling interest	68,599	15,278	8,664	92,541
Corporate allocation	1,234	(532)	(702)	—
Income before income tax provision and noncontrolling interest	69,833	14,746	7,962	92,541
Income tax provision	19,290	4,770	2,816	26,876
Net income	50,543	9,976	5,146	65,665
Noncontrolling interest	—	(2,250)	(1,033)	(3,283)
Net income attributable to TowneBank	$ 50,543	$ 7,726	$ 4,113	$ 62,382
Net income as percentage of total	81.03%	12.38%	6.59%	100.00%
Assets	$ 5,991,165	$ 175,120	$ 130,289	$ 6,296,574
Efficiency ratio	64.25%	73.89%	77.69%	68.11%

The following table provides the change in net income and total assets for each segment, comparing the years ended December 31, 2017 and 2016 (dollars in thousands):

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 21,987	$ (2,935)	$ 1,361	$ 20,413
Net Income (%)	42.59%	(28.53)%	25.51%	30.35%
Total Assets ($)	$ 509,845	$ 23,040	$ 15,376	$ 548,261
Total Assets (%)	6.95%	4.79 %	9.63%	6.88%

NOTE 26: EARNINGS PER SHARE

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

Year Ended December 31,	2017	2016	2015
Basic			
Net income, as reported	$ 87,663	$ 67,250	$ 62,382
Preferred stock dividends and accretion of discount	—	—	(13)
Net income available to common shareholders	$ 87,663	$ 67,250	$ 62,369
Average common shares outstanding	62,168,455	56,837,018	51,064,719
Basic earnings per common share	$ 1.41	$ 1.18	$ 1.22
Diluted			
Net income available to common shareholders, for diluted EPS	$ 87,663	$ 67,250	$ 62,369
Average common shares outstanding	62,168,455	56,837,018	51,064,719
Effect of dilutive securities:			
Stock compensation plans, net of tax benefit (1)	225,827	146,287	96,522
Average diluted shares outstanding	62,394,282	56,983,305	51,161,241
Diluted earnings per common share	$ 1.41	$ 1.18	$ 1.22

(1) Stock options and restricted stock shares totaling 13,643; 80,045; and 12,814 were excluded from the computation of diluted earnings per share during 2017, 2016, and 2015, respectively, because their inclusion would be antidilutive.

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

aNOTE 27: SUBSEQUENT EVENTS

Paragon Merger

On January 26, 2018, TowneBank completed its acquisition of Paragon Commercial Corporation (“Paragon”) in an all-stock transaction. As part of the merger, Paragon and Paragon Commercial Bank (“Paragon Bank”), a wholly owned subsidiary of Paragon, merged with and into TB Acquisition, LLC, a wholly owned subsidiary of TowneBank.

In the merger with Paragon, each outstanding share Paragon common stock was converted into the right to receive 1.725 shares of TowneBank common stock. TowneBank issued an aggregate of 9.43 million shares of TowneBank common stock to Paragon stockholders. Based on the closing price of TowneBank's common stock on January 26, 2018, of $31.20 per share, the aggregate consideration paid to Paragon common stockholders and holders of equity awards to acquire Paragon common stock was approximately $294.07 million.

The integration of Paragon Bank's deposit system and the conversion of Paragon Bank's branches to TowneBank's operating platform were completed over the weekend of January 27-28, 2018. Paragon Bank had three branches, which all re-opened January 29, 2018 as Paragon Bank, a division of TowneBank.

The Paragon merger has been accounted for under the acquisition method of accounting. Under this guidance, an entity is required to recognize the assets acquired, liabilities assumed and the consideration given at their fair value on the acquisition date. Due to the recency and nature of the transaction, the Company is still in the process of evaluating the fair value adjustments necessary to adjust the acquired assets and assumed liabilities to estimated fair value, as well as the related intangible assets associated with the transaction. Therefore, it is impractical to estimate and disclose the provisional allocation amounts and the pro forma impact of the acquisition at this time.

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 23, 2018, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

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

	2017		2016	
Quarter	**High**	**Low**	**High**	**Low**
First	$ 33.50	$ 30.60	$ 20.88	$ 16.65
Second	34.35	29.00	22.64	19.10
Third	33.50	29.50	24.03	21.66
Fourth	34.90	30.75	34.10	23.83

INVESTOR RELATIONS

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

TowneBank
6001 Harbour View Boulevard
Suffolk, Virginia 23435
email: investor.relations@townebank.net

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

INDEPENDENT AUDITORS

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

TRANSFER AGENT

Computershare Shareholder Services
P.O. Box 30170
College Station, Texas 77842-3170
800-368-5948
www.computershare.com/investor

CORPORATE COUNSEL

Williams Mullen
200 South 10th Street, Suite 1600
Richmond, Virginia 23219

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

Exhibit (14)

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

Preface

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

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

Code of Ethical Conduct

General standards of ethical behavior

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

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

- Proactively promote ethical and honest behavior within the workplace.

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

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

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

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

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

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

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

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

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

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

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

ACKNOWLEDGMENT

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

____
OFFICER

____
DATE

Exhibit (21)

Subsidiaries of TowneBank

Subsidiary	State of Incorporation or Organization
TowneBank Investment Corporation	Virginia
Towne Investments, LLC	Virginia
TowneBank Woodview Investment Co., LLC	Virginia
TowneBank Woodview Investment Co. II, LLC	Virginia
TowneBank Heritage Forest, LLC	Virginia
TowneBank Cromwell House Affordable Housing, LLC	Virginia
TowneBank Pavilion Place Affordable Housing, LLC	Virginia
TowneBank Westbury Cottages Affordable Housing, LLC	Virginia
TB Affordable Housing Equity Fund XX, LLC	Virginia
TowneBank Catalina Crossing Affordable Housing, LLC	Virginia
Hamilton Place Towne I, LLC	Virginia
Hamilton Place Towne II, LLC	Virginia
TowneBank VCDC Fund 18, LLC	Virginia
TowneBank VCDC Fund 19, LLC	Virginia
TB Affordable Housing Equity Fund XXI, LLC	Virginia
TB Forrest Landing II Affordable Housing, LLC	Virginia
TB Dale II Affordable Housing, LLC	Virginia
TB York Senior Affordable Housing, LLC	Virginia
TB Suffolk Senior Affordable Housing, LLC	Virginia
TB Shoulders Hill Senior Affordable Housing, LLC	Virginia
Towne Financial Services Group, LLC	Virginia
GSH Residential Real Estate Corporation	Virginia
Towne Oak Island RE, LLC	Virginia
Towne Vacations Oak Island, LLC, t/a Oak Island Accommodations	Virginia
Towne Vacations, LLC, t/a Beach Properties of Hilton Head	Virginia
Towne Vacations Deep Creek, LLC t/a Railey Mountain Lake Vacations	Virginia
Towne Deep Creek RE, LLC	Virginia
GSH NC Realty, LLC	Virginia
Towne Realty LLC, t/a Berkshire Hathaway HomeServices Towne Realty	Virginia
Lawyers Escrow & Title Agency, LLC	Virginia
Eastern Title Company, Inc.	Virginia
PTR Referral, LLC	Virginia
Virginia Home Title and Settlements, LLC	Virginia
Towne Insurance Agency, LLC	Virginia
The Frieden Agency LLC, t/a Towne Benefits	Virginia
Benefit Design Group, LLC	Virginia
Beneflex Management, LLC	Virginia
Towne Insurance Agency of North Carolina, LLC	North Carolina
Out of Towne, LLC, t/a Red Sky Insurance	Virginia
TowneBank Commercial Mortgage, LLC	Virginia
Towne Hall, LLC	Virginia

Subsidiaries of TowneBank (continued)

Subsidiary	State of Incorporation or Organization
Towne 1031 Exchange, LLC	Virginia
Towne Security, LLC	Virginia
Towne Mortgage, LLC	Virginia
NewTowne Mortgage, LLC	Virginia
SimonTowne Mortgage, LLC	Virginia
Towne Center Mortgage, LLC	Virginia
Coastal Home Mortgage, LLC	Virginia
Advance Financial Group, LLC	Virginia
Towne First Mortgage, LLC	Virginia
Franklin Service Corporation	Virginia
Homesale Mortgage, LLC	Virginia
Reality Holdings, LLC	Virginia
Reality I, LLC	Virginia
Reality V, LLC	Virginia
Reality X, LLC	Virginia
Southeastern Virginia Investment Properties, LLC	Virginia
Southeastern Virginia Coastal Properties I, LLC	Virginia
Southeastern Virginia Properties, LLC	Virginia
Southeastern Virginia Properties at Uncles Neck, LLC	Virginia
Towne Mortgage of the Carolinas, LLC	North Carolina
Northeastern North Carolina Properties, LLC	North Carolina
Northeastern North Carolina Properties at Bermuda Bay, LLC	Virginia
Northeastern North Carolina Properties at Hamilton Cay, LLC	North Carolina
Northeastern North Carolina Properties Corolla Soundside, LLC	North Carolina
Northeastern North Carolina Properties Oceanside Villas, LLC	North Carolina
Virginia Hotel Properties, LLC	Virginia
Virginia Properties Apartment and Land, LLC	Virginia
CPF Partners, LLC	North Carolina
TBNCT, LLC	Virginia
TBVAT, LLC	Virginia
West Suffolk Properties, LLC	Virginia
TB Travel Services, LLC	Virginia
TB Acquisition, LLC	Virginia
Monarch Investment, LLC	Virginia
Real Estate Security Agency, LLC	Virginia

Exhibit (31.1)

TOWNEBANK

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

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

1. I have reviewed this annual report on Form 10-K of TowneBank;

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

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

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

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

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

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

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

TOWNEBANK

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

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

   (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.

March 1, 2018	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer

TOWNEBANK

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

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

1. I have reviewed this annual report on Form 10-K of TowneBank;

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

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

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

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

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

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

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

TOWNEBANK

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

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

(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.

March 1, 2018	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr.
	Senior Executive Vice President/CFO

Exhibit (32)

Certification Pursuant to 18 U.S.C. Section 1350,
As Adopted By
Section 906 of The Sarbanes-Oxley Act of 2002

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

1. Our Annual Report on Form 10-K for the year ended December 31, 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 presents fairly, in all material respects, our financial condition and results of operations as of and for the period covered by the Report.

March 1, 2018	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer
March 1, 2018	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

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