FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D. C. 20429

FORM 10-Q

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

For the quarterly period ended **September 30, 2012**

FDIC Insurance Cert. Number: 35095

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

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

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

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

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

The number of shares of the Company's common stock outstanding as of October 31, 2012 was 31,371,219 shares.

TOWNEBANK

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

(Dollars in thousands, except share data)	September 30, 2012	September 30, 2011	December 31, 2011
	(unaudited)	(unaudited)	(audited)
ASSETS			
Cash and due from banks	$ 274,481	$ 485,289	$ 312,149
Interest bearing deposits in financial institutions	1,574	3,007	1,995
Total Cash and Cash Equivalents	276,055	488,296	314,144
Securities available-for-sale, at fair value	335,500	220,116	330,073
Securities held-to-maturity, at amortized cost	155,912	158,643	153,912
Trading account securities	12,298	10,193	10,854
Federal Home Loan Bank stock, at amortized cost	23,223	21,659	20,445
Total Securities	526,933	410,611	515,284
Mortgage loans held for sale	124,785	62,935	109,453
Loans, net of unearned income and deferred costs:			
Real estate-residential 1-4 family	758,461	696,101	709,129
Real estate-commercial	1,216,859	1,019,245	1,072,187
Real estate-construction and development	585,760	600,173	557,630
Real estate-multi-family	57,327	43,523	48,321
Commercial	368,063	327,206	362,830
Consumer and other loans	43,671	40,690	43,096
Loans, net of unearned income and deferred costs	3,030,141	2,726,938	2,793,193
Less: Allowance for loan losses	(39,336)	(40,941)	(39,740)
Net Loans	2,990,805	2,685,997	2,753,453
Premises and equipment, net	140,744	127,656	134,047
Goodwill	98,129	96,686	98,127
Other intangible assets, net	15,068	16,370	16,811
Bank-owned life insurance policies	54,680	53,084	53,315
Other assets	91,110	86,609	87,136
TOTAL ASSETS	$ 4,318,309	$ 4,028,244	$ 4,081,770
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 955,656	$ 856,634	$ 839,211
Interest-bearing:			
Demand and money market accounts	1,075,953	917,912	991,084
Savings	193,638	178,679	192,133
Certificates of deposit	1,079,878	1,194,120	1,168,359
Total Deposits	3,305,125	3,147,345	3,190,787
Advances from the Federal Home Loan Bank	380,000	280,000	280,000
Convertible subordinated capital debentures	-	13,740	13,740
Repurchase agreements and other borrowings	10,131	13,253	11,790
Total Borrowings	390,131	306,993	305,530
Other liabilities	69,447	58,751	64,964
TOTAL LIABILITIES	3,764,703	3,513,089	3,561,281
Shareholders' Equity			
Preferred stock, $5.00 par: 2,000,000 shares authorized 658,311 issued and outstanding at September 30, 2012, 660,355 issued and outstanding at September 30, 2011 and 659,945 issued and outstanding at December 31, 2011	134,344	134,548	134,507
Common stock, $1.667 par: 45,000,000 shares authorized 31,370,388 issued and outstanding at September 30, 2012, 29,054,080 issued and outstanding at September 30, 2011 and 29,145,226 issued and outstanding at December 31, 2011	52,294	48,433	48,585
Capital surplus	259,720	232,679	233,895
Retained earnings	98,440	89,971	94,453
Accumulated other comprehensive income	1,743	3,163	2,754
TOTAL SHAREHOLDERS' EQUITY	546,541	508,794	514,194
Noncontrolling interest	7,065	6,361	6,295
TOTAL EQUITY	553,606	515,155	520,489
TOTAL LIABILITIES AND EQUITY	$ 4,318,309	$ 4,028,244	$ 4,081,770

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

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

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
INTEREST INCOME:				
Loans, including fees	$ 39,590	$ 38,796	$ 116,874	$ 115,666
Investment securities	3,206	3,453	9,189	12,484
Interest bearing deposits in financial institutions and federal funds sold	189	273	543	533
Mortgage loans held for sale	1,231	505	3,249	1,466
Total Interest Income	44,216	43,027	129,855	130,149
INTEREST EXPENSE:				
Deposits	4,203	5,556	12,908	17,443
Advances from the Federal Home Loan Bank	3,010	3,070	8,980	9,813
Convertible subordinated capital debentures	-	292	237	878
Repurchase agreements and other borrowings	19	23	57	69
Total Interest Expense	7,232	8,941	22,182	28,203
Net Interest Income	36,984	34,086	107,673	101,946
PROVISION FOR LOAN LOSSES	4,977	1,400	13,196	12,540
Net Interest Income after Provision for Loan Losses	32,007	32,686	94,477	89,406
NONINTEREST INCOME:				
Residential mortgage brokerage income, net	7,329	3,396	19,573	8,371
Real estate brokerage and property management income, net	3,115	3,311	9,781	9,723
Insurance commissions and other title fees and income, net	5,978	5,619	18,385	17,409
Service charges on deposit accounts	2,047	1,883	5,755	5,414
Credit card merchant fees, net	931	694	2,834	1,983
Other income	2,274	1,920	5,861	5,181
Net gain (loss) on investment securities	508	(3)	3,038	3,679
Total Noninterest Income	22,182	16,820	65,227	51,760
NONINTEREST EXPENSE:				
Salaries and employee benefits	23,249	20,901	66,934	59,458
Occupancy expense	3,636	3,493	10,552	10,205
Furniture and equipment	1,621	1,459	4,778	4,315
Other expenses	11,725	11,236	36,139	33,738
Total Noninterest Expense	40,231	37,089	118,403	107,716
Income before income tax expense and noncontrolling interest	13,958	12,417	41,301	33,450
Provision for income tax expense	4,063	3,610	11,518	9,621
Net income	9,895	8,807	29,783	23,829
Net (income) loss attributable to noncontrolling interest	(545)	(282)	(1,468)	505
Net income attributable to TowneBank	$ 9,350	$ 8,525	$ 28,315	$ 24,334
Preferred stock dividends and accretion	1,355	3,627	4,872	8,294
Net income applicable to common shareholders	$ 7,995	$ 4,898	$ 23,443	$ 16,040
Per common share information				
Basic earnings	$ 0.26	$ 0.16	$ 0.76	$ 0.54
Diluted earnings	$ 0.26	$ 0.16	$ 0.76	$ 0.53
Cash dividends declared	$ 0.08	$ 0.08	$ 0.24	$ 0.23

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

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

(Dollars in thousands)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$ 9,895	$ 8,807	$ 29,783	$ 23,829
Other comprehensive income (loss)				
Unrealized gains on available-for-sale securities:				
Unrealized holding gains arising during the period	1,252	1,923	1,253	8,102
Realized (gains) losses reclassified into earnings	(6)	3	(1,968)	(3,679)
Net unrealized gains (losses)	1,246	1,926	(715)	4,423
Defined benefit retirement plan				
Actuarial loss	(553)	-	(841)	-
Other comprehensive income (loss), before tax	693	1,926	(1,556)	4,423
Income tax (expense) benefit related to items of other comprehensive income	(242)	(674)	545	(1,548)
Other comprehensive income (loss), net of tax	451	1,252	(1,011)	2,875
Comprehensive income	$ 10,346	$ 10,059	$ 28,772	$ 26,704

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

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

(Dollars in thousands)	Nine Months Ended September 30, 2012	2011
OPERATING ACTIVITIES:		
Net income	$ 29,783	$ 23,829
Adjustments to reconcile net income to net cash from operating activities:		
Net accretion of securities	1,540	2,952
Investment securities gains	(3,038)	(3,679)
Depreciation, amortization, and other intangible amortization	8,602	8,132
Provision for loan losses	13,196	12,540
Bank-owned life insurance income	(1,365)	(1,548)
Deferred income tax expense (benefit)	1,144	(2,313)
Share-based compensation expense	1,169	1,005
Purchases of trading account securities	(417)	-
Loss on sale and write-down of foreclosed assets	1,443	3,567
Changes in:		
Loans held for sale	(15,332)	2,093
Interest receivable	223	1,591
Other assets	(11,884)	(14,634)
Interest payable	(966)	(1,532)
Other liabilities	5,199	2,953
Net cash from operating activities	29,297	34,956
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(387,049)	(86,125)
Purchase of held-to-maturity securities	(19,656)	(365,249)
Sale of available-for-sale securities	44,777	230,536
Proceeds from maturities, calls, and prepayments of available-for-sale securities	333,351	64,825
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	18,138	355,991
Net increase in loans	(250,548)	(5,805)
Purchase of premises and equipment	(13,860)	(18,570)
Proceeds from sales of premises and equipment	304	-
Distribution of interest in joint ventures	(698)	(315)
Proceeds from sales of foreclosed assets	5,641	3,371
Acquisition of business, net of cash acquired	-	(3,209)
Net cash from (used for) investing activities	(269,600)	175,450
FINANCING ACTIVITIES:		
Net increase in deposit accounts	114,338	192,832
Net change in borrowings	98,361	(51,581)
Proceeds from issuance of common stock	2,537	-
Proceeds from issuance of preferred stock	-	76,458
Redemption of preferred stock	-	(76,458)
Payments for issuance of common stock and share-based activity	-	(14)
Cash dividends paid	(13,022)	(13,823)
Net cash from financing activities	202,214	127,414
Change in cash and cash equivalents	(38,089)	337,820
Cash and cash equivalents at beginning of year	314,144	150,476
Cash and cash equivalents at end of period	$ 276,055	$ 488,296
Supplemental cash flow information:		
Cash paid for interest	$ 23,148	$ 29,734
Cash paid for income taxes	$ 8,690	$ 11,305
Noncash financing and investing activities:		
Net unrealized gain (loss) on available-for-sale securities	$ (465)	$ 2,875
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 13,760	$ 145

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

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED STATEMENT OF EQUITY

(Dollars in thousands)	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interest	Total
Balance, January 1, 2012	**29,145,226**	**$ 134,507**	**$ 48,585**	**$ 233,895**	**$ 94,453**	**$ 2,754**	**$ 6,295**	**$ 520,489**
Net income	-	-	-	-	28,315	-	1,468	29,783
Other comprehensive loss, net of taxes	-	-	-	-	-	(1,011)	-	(1,011)
Cash dividends declared on common stock	-	-	-	-	(7,551)	-	-	(7,551)
Cash dividends declared on preferred stock	-	-	-	-	(4,872)	-	-	(4,872)
Stock dividend on common stock	919,923	-	1,536	10,351	(11,905)	-	-	(18)
Director's deferred compensation	(58,232)	-	(97)	97	-	-	-	-
Distribution of interests in joint ventures	-	-	-	-	-	-	(698)	(698)
Conversion of preferred stock into common stock	8,819	(163)	24	148	-	-	-	9
Conversion of convertible debt into common stock	1,028,058	-	1,718	12,042	-	-	-	13,760
Issuance of common stock - stock compensation plans	326,594	-	528	3,187	-	-	-	3,715
Balance, September 30, 2012	**31,370,388**	**$ 134,344**	**$ 52,294**	**$ 259,720**	**$ 98,440**	**$ 1,743**	**$ 7,065**	**$ 553,606**

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

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

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of TowneBank (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes required by accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments, which are of a normal, recurring nature, that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01 of the Securities and Exchange Commission (the "SEC"). These statements should be read in conjunction with the Company's 2011 audited Consolidated Financial Statements and the 2011 Annual Report on Form 10-K. Results of operations for the periods ended September 30, 2012 are not necessarily indicative of the results of operations for the full year or any other interim periods.

Reclassifications and Corrections

During the second quarter of 2011, the Company discovered certain overstatements in income attributable to noncontrolling interests as reported in prior periods, which resulted in a corresponding understatement of net income attributable to TowneBank for those periods. The overstatement of income attributable to noncontrolling interests was $251,000, $697,000, and $34,000 before taxes, for the years ended December 31, 2009 and 2010 and the first quarter of 2011, respectively. The Company recorded the correction to the prior period overstatements in the quarter ended June 30, 2011. The correction of the overstatement of net income attributable to noncontrolling interests has no effect on net income or total equity for any previously reported period.

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. On April 25, 2012, TowneBank's Board of Directors declared a special shareholder stock dividend of 3% per common share payable on June 12, 2012 to shareholders of record on May 25, 2012. All share and per share amounts included in the accompanying consolidated financial statements and footnotes have been restated for all periods presented to reflect the stock dividend.

Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*. ASU No. 2011-03 modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. The provisions of ASU No. 2011-03 removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. ASU No. 2011-03 does not change the other existing criteria used in the assessment of effective control. The provisions of ASU No. 2011-03 were effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. The adoption of this ASU did not have a material impact on the Company's financial statements.

PART I. FINANCIAL INFORMATION
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* ASU No. 2011-04 results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and International Financial Reporting Standards ("IFRS"). The changes to GAAP as a result of ASU No. 2011-04 are as follows: (1) The concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities); (2) GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices in active markets. ASU No. 2011-04 extends that prohibition to all fair value measurements; (3) An exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity's net exposure to either of those risks. This exception allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities; and (5) Disclosure requirements have been enhanced for Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to describe the sensitivity of fair value measurements to changes in unobservable inputs and interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The provisions of ASU No. 2011-04 were effective for the Company's interim reporting period beginning on or after December 15, 2011. The adoption of this ASU resulted in additional disclosures, but did not have a material impact on the Company's financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income.* The provisions of ASU No. 2011-05 allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 were effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The Company adopted the standard beginning with its 2011 year-end reporting, presenting other comprehensive income in a separate statement following the Consolidated Statements of Income.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles – Goodwill and Other (Topic 350) Testing Goodwill for Impairment.* ASU No. 2011-08 modifies the manner in which the two-step impairment test of goodwill is applied. Under the updated guidance, an entity may assess qualitative factors (such as changes in management, key personnel, strategy, key technology, or customers) that may impact a reporting unit's fair value and lead to the determination that it is more likely than not that the fair value of a reporting unit is less than its carrying value, including goodwill. If an entity determines that it is more likely than not, it must perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). If an entity determines that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The updated guidance is effective for the quarter ending

March 31, 2012. The adoption of this guidance did not have a material impact on the Company's financial statements.

In December 2011, the FASB issued ASU No. 2011-10, *Property, Plant, and Equipment (Topic 360): Derecognition of In-Substance Real Estate*. ASU No. 2011-10 amends Topic 360 to clarify that when a reporting entity ceases to have a controlling financial interest (as described in Accounting Standards Codification Topic ("ASC") 810 "Consolidation") in a subsidiary that is in-substance real estate as a result of default on the subsidiary's nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in-substance real estate. The clarification is meant to eliminate diversity in practice. The amendments are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. The adoption of this ASU is not expected to have a material impact on the Company's financial statements.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. ASU No. 2011-11 amends Topic 210 by requiring additional improved information to be disclosed regarding financial instruments and derivatives instruments that are offset in accordance with the conditions under ASC 210-20-45 or ASC 810-10-45 or subject to an enforceable master netting arrangement or similar agreement. The amendments are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The disclosures required by the amendments should be applied retrospectively for all comparative periods presented. The adoption of this ASU is not expected to have a material impact on the Company's financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU No. 2011-12 defers the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, until FASB is able to redeliberate the matter. The deferral is not expected to have a material impact on the Company's financial statements.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles – Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment*. ASU No. 2012-02 permits an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform a quantitative impairment test. An entity would continue to calculate the fair value of an indefinite-lived intangible asset if the asset fails the qualitative assessment, while no further analysis would be required if it passes. The provisions of the new guidance are effective as of the beginning of our 2013 fiscal year. The adoption of this ASU is not expected to have a material impact on the Company's financial statements.

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

Note 2. Earnings per Share and Shareholders' Equity

Earnings per Share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share are determined by dividing net income available to common shareholders by the weighted average shares outstanding, assuming all securities that could be converted to common stock have been converted or exercised. The following table summarizes the basic and diluted earnings per share calculations (dollars in thousands, except share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic				
Net income, as reported	$ 9,350	$ 8,525	$ 28,315	$ 24,334
Preferred stock dividends and accretion of discount	1,355	3,627	4,872	8,294
Net income available to common shareholders	$ 7,995	$ 4,898	$ 23,443	$ 16,040
Average common shares outstanding	31,118,698	29,708,215	30,657,440	29,750,615
Basic earnings per share amount	$ 0.26	$ 0.16	$ 0.76	$ 0.54
Diluted				
Net income available to common shareholders	$ 7,995	$ 4,898	$ 23,443	$ 16,040
Add: interest applicable to 8% subordinated debt, net of tax (1)	-	180	154	356
Net income available to common shareholders, for diluted EPS	$ 7,995	$ 5,078	$ 23,597	$ 16,396
Average common shares outstanding	31,118,698	29,708,215	30,657,440	29,750,615
Add shares if converted:				
Stock compensation plans, net of tax benefit (2)	56,652	44,906	60,932	79,944
Convertible subordinated debentures (3)	-	1,057,736	293,154	1,057,736
Average diluted shares outstanding	31,175,350	30,810,857	31,011,526	30,888,295
Diluted earning per share amount	$ 0.26	$ 0.16	$ 0.76	$ 0.53

(1) Interest on 8% convertible subordinated capital debentures (net of tax) is added to net income since this interest would not be paid subsequent to the conversion of the debentures into common stock.
(2) Stock options and restricted stock shares totaling 1,909 and 54,743 were excluded from the computation of diluted earnings per share during the third quarter of 2012 and 2011, respectively, and 28,967 and 31,965 were excluded from the computation of diluted earnings per share during the nine months ended September 30, 2012 and 2011, respectively, because their inclusion would be anti-dilutive.
(3) Shares assumed to have been converted since the beginning of the period through the date of actual conversion.

At September 30, 2012, the terms of the TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A entitled the holders to convert their shares into 3,229,284 shares of common stock at a conversion price of $18.02 per share. These shares were not included in the computation of diluted earnings per share as the effect was anti-dilutive for the periods presented in the table above.

In conjunction with the Company's issuance of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B to the U.S. Treasury, the Company issued a ten-year warrant to purchase 554,330 common shares at an exercise price of $20.69 per share. These shares were not included in the computation of diluted earnings per share as the effect was anti-dilutive for the periods presented in the table above.

On March 19, 2012, there was a mandatory conversion of TowneBank's $13.60 million of outstanding Series III notes into shares of TowneBank common stock. See Note 12 for additional discussion regarding the conversion of the Series III notes.

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

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).

September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 26,660	$ 128	$ -	$ 26,788
U.S. Treasury notes	150,000	-	-	150,000
Municipal securities	40,737	1,298	(45)	41,990
Trust preferred and other corporate securities	5,072	276	-	5,348
Mortgage-backed securities issued by GSE	109,510	1,864	-	111,374
Total available-for-sale securities	$ 331,979	$ 3,566	$ (45)	$ 335,500

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 65,489	$ 1,646	$ -	$ 67,135
U.S. Treasury notes	120,001	-	(1)	120,000
Municipal securities	34,817	1,092	-	35,909
Trust preferred and other corporate securities	7,563	156	-	7,719
Mortgage-backed securities issued by GSE	97,977	1,346	(13)	99,310
Total available-for-sale securities	$ 325,847	$ 4,240	$ (14)	$ 330,073

Held-to-maturity securities

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

September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 185	$ -	$ 685
Municipal securities	62,742	5,476	-	68,218
Industrial revenue bonds	92,670	5,029	(23)	97,676
Total held-to-maturity securities	$ 155,912	$ 10,690	$ (23)	$ 166,579

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 15,701	$ 865	$ (21)	$ 16,545
Municipal securities	63,272	3,603	-	66,875
Industrial revenue bonds	74,939	1,941	(1,847)	75,033
Total held-to-maturity securities	$ 153,912	$ 6,409	$ (1,868)	$ 158,453

Trading securities

Trading securities represent mutual fund investments in a self-directed employee deferred compensation plan, which is structured as a rabbi trust. These investments are bought and sold as employees defer compensation, receive distributions, or make changes in the funds underlying their accounts.

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).

September 30, 2012	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 151,008	$ 151,014	$ 7,013	$ 7,065
Due after one year through five years	35,292	35,631	18,290	19,459
Due after five years through 10 years	28,061	28,637	30,174	31,656
Due after 10 years	117,043	119,643	100,435	108,399
	331,404	334,925	155,912	166,579
Other equity securities	575	575	-	-
	$ 331,979	$ 335,500	$ 155,912	$ 166,579

December 31, 2011	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 127,001	$ 127,000	$ 4,235	$ 4,237
Due after one year through five years	61,316	62,989	20,459	20,994
Due after five years through 10 years	25,632	26,185	16,186	17,068
Due after 10 years	111,316	113,317	113,032	116,154
	325,265	329,491	153,912	158,453
Other equity securities	582	582	-	-
	$ 325,847	$ 330,073	$ 153,912	$ 158,453

Unrealized losses

The following table shows the Company's gross unrealized losses and fair values, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position (in thousands).

September 30, 2012	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal securities	$ 3,597	$ 45	$ -	$ -	$ 3,597	$ 45
Industrial revenue bonds	2,478	23	-	-	2,478	23
Total temporarily impaired securities	$ 6,075	$ 68	$ -	$ -	$ 6,075	$ 68

December 31, 2011	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	$ 127,000	$ 1	$ -	$ -	$ 127,000	$ 1
Industrial revenue bonds	31,209	1,847	-	-	31,209	1,847
Mortgage-backed securities issued by GSE	6,047	13	-	-	6,047	13
Trust preferred corporate securities	6,559	21	-	-	6,559	21
Total temporarily impaired securities	$ 170,815	$ 1,882	$ -	$ -	$ 170,815	$ 1,882

U.S. Treasury obligations

The Company had no unrealized losses on U. S. Treasury obligations at September 30, 2012.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At September 30, 2012, four securities had unrealized losses of $45,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

The Company had no unrealized losses on investments in federal agency mortgage-backed securities at September 30, 2012.

Trust preferred corporate securities

The Company had no unrealized losses on trust preferred corporate securities at September 30, 2012.

Federal Home Loan Bank of Atlanta ("FHLB") stock

The Company is required to maintain an investment in the capital stock of the FHLB. The FHLB stock is stated at cost, as this is a restricted security without a readily determinable fair value. The Company had $23.22 million and $20.44 million of FHLB stock at September 30, 2012 and December 31, 2011, 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.

Industrial revenue bonds

The Company's unrealized losses on industrial revenue bonds were caused by interest rate fluctuations. At September 30, 2012, two bond issuances had a total unrealized loss of $23,000. Based on the credit quality of the issuers, and because it is the Company's intent to hold these bonds until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the bonds before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at September 30, 2012.

Note 4. Loans and Allowance for Loan Losses

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

Allowance for Loan Losses

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company considers the allowance for loan losses of $39.34 million adequate to cover loan losses inherent in the loan portfolio at September 30, 2012.

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The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three and nine-month periods ended September 30, 2012 (in thousands).

Three Months Ended September 30, 2012	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 13,091	$ 12,152	$ 404	$ 10,455	$ 3,854	$ 414	$ 40,370
Provision charged to expense	196	1,171	594	1,626	1,192	198	4,977
Losses charged off	(2,568)	(1,086)	(345)	(958)	(1,083)	(101)	(6,141)
Recoveries	-	8	-	99	18	5	130
Balance, end of quarter	$ 10,719	$ 12,245	$ 653	$ 11,222	$ 3,981	$ 516	$ 39,336
Nine Months Ended September 30, 2012							
Allowance for loan losses:							
Balance, beginning of year	$ 13,623	$ 10,578	$ 395	$ 10,837	$ 3,842	$ 465	$ 39,740
Provision charged to expense	2,736	4,818	603	2,842	1,889	308	13,196
Losses charged off	(5,691)	(3,198)	(345)	(3,231)	(1,791)	(310)	(14,566)
Recoveries	51	47	-	774	41	53	966
Balance, end of quarter	$ 10,719	$ 12,245	$ 653	$ 11,222	$ 3,981	$ 516	$ 39,336

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three and nine-month periods ended September 30, 2011 (in thousands).

Three Months Ended September 30, 2011	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 15,765	$ 10,151	$ 282	$ 11,141	$ 3,960	$ 488	$ 41,787
Provision charged to expense	(891)	252	28	1,471	473	67	1,400
Losses charged off	(1,261)	(52)	-	(1,193)	(66)	(117)	(2,689)
Recoveries	336	-	2	87	13	5	443
Balance, end of quarter	$ 13,949	$ 10,351	$ 312	$ 11,506	$ 4,380	$ 443	$ 40,941
Nine Months Ended September 30, 2011							
Allowance for loan losses:							
Balance, beginning of year	$ 10,984	$ 12,827	$ 557	$ 9,543	$ 4,008	$ 741	$ 38,660
Provision charged to expense	8,648	(1,905)	(248)	5,545	792	(292)	12,540
Losses charged off	(6,417)	(583)	-	(3,909)	(497)	(297)	(11,703)
Recoveries	734	12	3	327	77	291	1,444
Balance, end of quarter	$ 13,949	$ 10,351	$ 312	$ 11,506	$ 4,380	$ 443	$ 40,941

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The following table provides a summary of the allowance for loan losses classified by portfolio segment (in thousands).

September 30, 2012	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	$ 1,364	$ 786	$ 71	$ 2,098	$ -	$ 156	$ 4,475
Loans collectively evaluated for impairment	9,355	11,459	582	9,124	3,981	360	34,861
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-
Balance, end of quarter	$ 10,719	$ 12,245	$ 653	$ 11,222	$ 3,981	$ 516	$ 39,336
December 31, 2011							
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 4,583	$ 776	$ -	$ 1,302	$ 282	$ 165	$ 7,108
Loans collectively evaluated for impairment	9,040	9,802	395	9,535	3,560	300	32,632
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-
Balance, end of year	$ 13,623	$ 10,578	$ 395	$ 10,837	$ 3,842	$ 465	$ 39,740

The following table presents, by portfolio segment, the Company's investment in loans (in thousands).

September 30, 2012	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	$ 42,328	$ 22,015	$ 721	$ 22,053	$ 2,206	$ 416	$ 89,739
Ending balance: collectively evaluated for impairment	541,958	1,191,190	56,426	731,815	365,857	43,255	2,930,501
Ending balance: loans acquired with deteriorated credit quality	1,474	3,654	180	4,593	-	-	9,901
Ending Balance	$ 585,760	$ 1,216,859	$ 57,327	$ 758,461	$ 368,063	$ 43,671	$ 3,030,141

December 31, 2011	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	$ 46,899	$ 17,500	$ -	$ 15,456	$ 2,864	$ 518	$ 83,237
Ending balance: collectively evaluated for impairment	508,982	1,048,549	48,126	688,746	359,966	42,578	2,696,947
Ending balance: loans acquired with deteriorated credit quality	1,749	6,138	195	4,927	-	-	13,009
Ending Balance	$ 557,630	$ 1,072,187	$ 48,321	$ 709,129	$ 362,830	$ 43,096	$ 2,793,193

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.

Changes in the carrying amount and accretable yield for purchased impaired and nonimpaired loans were as follows for the nine months ended September 30, 2012 and 2011 (in thousands).

	September 30, 2012				September 30, 2011			
	Purchased Impaired		Purchased Nonimpaired		Purchased Impaired		Purchased Nonimpaired	
	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans	Accretable Yield	Carrying Amount of Loans
Balance at beginning of period	$ 2,134	$ 13,009	$ 7,408	$ 45,440	$ 1,046	$ 16,816	$ 11,756	$ 58,049
Additions	-	-	-	-	-	-	-	-
Accretion	(909)	909	(2,451)	2,451	(641)	641	(2,816)	2,816
Reclassifications from nonaccretable balance, net	-	-	-	-	-	-	-	-
Payments received, net	-	(4,017)	-	(10,606)	-	(4,047)	-	(12,446)
Balance at end of period	$ 1,225	$ 9,901	$ 4,957	$ 37,285	$ 405	$ 13,410	$ 8,940	$ 48,419

At September 30, 2012, none of the purchased loans were classified as nonperforming assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased loans. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses. The outstanding unpaid principal balance for all purchased impaired loans and purchased nonimpaired loans as of September 30, 2012 was $13.06 million and $37.49 million, respectively.

Portfolio Quality Indicators

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

The Company’s internally assigned grades are as follows:

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

- Special Mention – Loans in this category are considered to have potential weaknesses that deserve management’s close 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 periods ended September 30, 2012 and December 31, 2011 (in thousands).

September 30, 2012	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	$ 521,686	$ 1,165,892	$ 52,851	$ 731,105	$ 362,076	$ 42,633	$ 2,876,243
Special Mention	15,957	26,267	3,500	4,840	1,438	-	52,002
Substandard	48,057	24,700	976	22,093	4,549	1,037	101,412
Doubtful	60	-	-	423	-	1	484
Total	$ 585,760	$ 1,216,859	$ 57,327	$ 758,461	$ 368,063	$ 43,671	$ 3,030,141

December 31, 2011	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	$ 473,419	$ 1,024,259	$ 46,986	$ 683,854	$ 355,885	$ 41,875	$ 2,626,278
Special Mention	24,173	22,866	1,072	8,160	771	121	57,163
Substandard	60,038	25,062	263	16,073	6,174	1,077	108,687
Doubtful	-	-	-	1,042	-	23	1,065
Total	$ 557,630	$ 1,072,187	$ 48,321	$ 709,129	$ 362,830	$ 43,096	$ 2,793,193

Age Analysis of Past-Due Financing Receivables by Class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of September 30, 2012 and December 31, 2011. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Purchased impaired loans are included in the aging schedule, but are excluded from the disclosure of accruing loans more than 90 days past due as they are considered to be accruing due to the existence of the accretable yield and not based on consideration given to contractual interest payments (in thousands).

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
September 30, 2012								
Construction and land development	$ 1,202	$ -	$ 571	$ 27,699	$ 29,472	$ 556,288	$ 585,760	$ -
Commercial real estate	2,639	1,882	-	8,108	12,629	1,204,230	1,216,859	-
Multifamily real estate	348	-	255	-	603	56,724	57,327	-
1-4 family residential real estate	3,557	441	136	13,336	17,470	740,991	758,461	-
Commercial and industrial business loans	14	-	1	1,985	2,000	366,063	368,063	-
Consumer loans and other	51	64	-	391	506	43,165	43,671	-
Total	$ 7,811	$ 2,387	$ 963	$ 51,519	$ 62,680	$ 2,967,461	$ 3,030,141	$ -

	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, 2011								
Construction and land development	$ 718	$ 94	$ -	$ 36,712	$ 37,524	$ 520,106	$ 557,630	$ -
Commercial real estate	1,486	4,756	705	5,561	12,508	1,059,679	1,072,187	-
Multifamily real estate	-	-	263	-	263	48,058	48,321	-
1-4 family residential real estate	7,954	876	172	10,394	19,396	689,733	709,129	-
Commercial and industrial business loans	362	9	-	2,644	3,015	359,815	362,830	-
Consumer loans and other	148	23	1	490	662	42,434	43,096	1
Total	$ 10,668	$ 5,758	$ 1,141	$ 55,801	$ 73,368	$ 2,719,825	$ 2,793,193	$ 1

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 through an allowance estimate or a charge-off to the allowance. When the Company determines an impaired loan is a confirmed loss, the estimated impairment is directly charged-off to the loan rather than creating a specific reserve for inclusion in the allowance for loan losses.

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

Unearned loan income was $2.26 million in excess of deferred loan costs at September 30, 2012, $1.73 million at September 30, 2011, and $2.02 million at December 31, 2011. There were $51.52 million, $62.57 million, and $55.80 million in nonaccrual loans at September 30, 2012, September 30, 2011, and December 31, 2011. The Company would have earned $416,000 in the third quarter of 2012 if interest on the loans had been accrued.

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

September 30, 2012	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	QTD Interest Income Recognized	YTD Interest Income Recognized
Loans without a specific valuation allowance						
Construction and land development	$ 25,167	$ 21,777	$ -	$ 26,736	$ 164	$ 527
Commercial real estate	17,014	16,691	-	17,087	275	738
Multi-family real estate	-	-	-	-	-	-
1-4 family residential real estate	14,400	13,859	-	14,646	223	557
Commercial and industrial business loans	2,506	2,206	-	2,499	6	24
Consumer loans and other	190	112	-	210	2	8
Total	$ 59,277	$ 54,645	$ -	$ 61,178	$ 670	$ 1,854
Loans with a specific valuation allowance						
Construction and land development	$ 22,608	$ 20,551	$ 1,364	$ 22,811	$ 11	$ 35
Commercial real estate	5,921	5,324	786	5,955	72	221
Multi-family real estate	721	721	71	724	12	36
1-4 family residential real estate	8,646	8,194	2,098	8,679	72	197
Commercial and industrial business loans	-	-	-	-	-	-
Consumer loans and other	349	304	156	353	7	7
Total	$ 38,245	$ 35,094	$ 4,475	$ 38,522	$ 174	$ 496
Total impaired loans						
Construction and land development	$ 47,775	$ 42,328	$ 1,364	$ 49,547	$ 175	$ 562
Commercial real estate	22,935	22,015	786	23,042	347	959
Multi-family real estate	721	721	71	724	12	36
1-4 family residential real estate	23,046	22,053	2,098	23,325	295	754
Commercial and industrial business loans	2,506	2,206	-	2,499	6	24
Consumer loans and other	539	416	156	563	9	15
Total	$ 97,522	$ 89,739	$ 4,475	$ 99,700	$ 844	$ 2,350

(1) Included in the table above are accruing TDRs of $37.01 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $23.64 million.

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December 31, 2011	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 27,373	$ 16,650	$ -	$ 30,880	$ 293
Commercial real estate	14,826	14,033	-	16,846	685
1-4 family residential real estate	16,800	12,418	-	16,772	193
Commercial and industrial business loans	2,823	2,333	-	2,968	2
Consumer loans and other	345	193	-	354	2
Total	$ 62,167	$ 45,627	$ -	$ 67,820	$ 1,175
Loans with a specific valuation allowance					
Construction and land development	$ 31,770	$ 30,249	$ 4,583	$ 32,570	$ 103
Commercial real estate	3,667	3,467	776	4,305	95
1-4 family residential real estate	3,252	3,038	1,302	3,255	32
Commercial and industrial business loans	534	531	282	554	12
Consumer loans and other	363	325	165	370	1
Total	$ 39,586	$ 37,610	$ 7,108	$ 41,054	$ 243
Total impaired loans					
Construction and land development	$ 59,143	$ 46,899	$ 4,583	$ 63,450	$ 396
Commercial real estate	18,493	17,500	776	21,151	780
1-4 family residential real estate	20,052	15,456	1,302	20,027	225
Commercial and industrial business loans	3,357	2,864	282	3,522	14
Consumer loans and other	708	518	165	724	3
Total	$ 101,753	$ 83,237	$ 7,108	$ 108,874	$ 1,418

(1) Included in the table above are accruing TDRs of $24.06 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $21.39 million.

Troubled Debt Restructurings

In order to maximize the collection of loan balances, the Company evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: (1) a creditor has granted a concession to the debtor, and, (2) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current 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. The following table shows the loans modified in TDRs for the three and nine-months ended September 30, 2012 and 2011 (in thousands, except number of loans).

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	4	$ 2,309	$ 2,309	17	$ 7,970	$ 7,970
Commercial real estate	9	3,173	3,010	18	8,143	7,972
Multi-family real estate	-	-	-	1	345	345
1-4 family residential real estate	2	1,630	1,630	15	5,523	5,417
Commercial and industrial	1	453	170	3	696	413
Consumer loans and other	-	-	-	1	17	17
Total	16	$ 7,565	$ 7,119	55	$ 22,694	$ 22,134

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	15	$ 21,754	$ 21,739	15	$ 21,754	$ 21,739
Commercial real estate	-	-	-	6	7,384	7,384
Multi-family real estate	-	-	-	-	-	-
1-4 family residential real estate	-	-	-	3	199	198
Commercial and industrial	-	-	-	-	-	-
Consumer loans and other	-	-	-	1	8	8
Total	15	$ 21,754	$ 21,739	25	$ 29,345	$ 29,329

In accordance with the Company’s adoption of the provisions of ASU No. 2011-02, the Company reassessed all loan modifications occurring since January 1, 2011 for identification as troubled debt restructurings. There were no additional TDRs identified in this reassessment. The restructured loans generally include terms to reduce the interest rate and extend payment terms. We have not forgiven any principal on the above loans. There were no loans that were restructured within the last 12 months that subsequently defaulted.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At September 30, 2012, all significant impaired loans have been determined to be collateral dependent.

Nonaccrual Loans

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Beginning balance	$ 29,775	$ 26,177	$ 29,819	$ 20,452
Additions	5,474	5,329	16,094	16,355
Sales	(4,266)	(3,315)	(13,560)	(6,399)
Valuation allowance	-	-	-	(288)
Gain (loss) on sale and write-downs	(73)	(1,638)	(1,443)	(3,567)
Ending balance	$ 30,910	$ 26,553	$ 30,910	$ 26,553

Note 6. Segment Reporting

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Hampton Roads and northeastern North Carolina and includes the operations of TowneBank Commercial Mortgage and Towne Investment Group. The Realty segment combines the operations of Prudential Towne Realty with TowneBank Mortgage, Virginia Home Title and Settlements, NewTowne Mortgage, LLC, and Corolla Classic Vacations, LLC, to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance and TFA Benefits.

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

Segment profit and loss is measured by net income after income tax. Inter-segment transactions are recorded at cost and eliminated as part of the consolidation process. Because of the interrelationships of the various segments, the information presented is not indicative of how the segments would perform if they operated as independent entities. The following tables provide information about reportable segments and reconciliation of such information to the consolidated financial statements (dollars in thousands).

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Three Months Ended September 30, 2012	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 36,172	$ 812	$ -	$ 36,984
Provision for loan losses	4,977	-	-	4,977
Net interest income after provision for loan losses	31,195	812	-	32,007
Residential mortgage brokerage income, net	(119)	7,448	-	7,329
Real estate brokerage and property management income, net	-	3,115	-	3,115
Insurance commissions and other title fees and income, net	-	498	5,480	5,978
Other noninterest income	5,228	336	196	5,760
Noninterest expense	27,414	8,449	4,368	40,231
Income before income tax, corporate allocation and noncontrolling interest	8,890	3,760	1,308	13,958
Corporate allocation	139	(100)	(39)	-
Income before income tax provision and noncontrolling interest	9,029	3,660	1,269	13,958
Provision for income tax expense	2,404	1,160	499	4,063
Net income	6,625	2,500	770	9,895
Noncontrolling interest	-	(521)	(24)	(545)
Net income attributable to TowneBank	$ 6,625	$ 1,979	$ 746	$ 9,350
Net income as percentage of total	70.85%	21.17%	7.98%	100.00%

Three Months Ended September 30, 2011	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 33,760	$ 319	$ 7	$ 34,086
Provision for loan losses	1,400	-	-	1,400
Net interest income after provision for loan losses	32,360	319	7	32,686
Residential mortgage brokerage income, net	(16)	3,412	-	3,396
Real estate brokerage and property management income, net	-	3,311	-	3,311
Insurance commissions and other title fees and income, net	-	418	5,201	5,619
Other noninterest income	3,946	383	165	4,494
Noninterest expense	27,018	6,115	3,956	37,089
Income before income tax, corporate allocation and noncontrolling interest	9,272	1,728	1,417	12,417
Corporate allocation	118	(76)	(42)	-
Income before income tax provision and noncontrolling interest	9,390	1,652	1,375	12,417
Provision for income tax expense	2,520	570	520	3,610
Net income	6,870	1,082	855	8,807
Noncontrolling interest	-	(207)	(75)	(282)
Net income attributable to TowneBank	$ 6,870	$ 875	$ 780	$ 8,525
Net income as percentage of total	80.59%	10.26%	9.15%	100.00%

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Nine Months Ended September 30, 2012	**Banking**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 105,487	$ 2,173	$ 13	$ 107,673
Provision for loan losses	13,196	-	-	13,196
Net interest income after provision for loan losses	92,291	2,173	13	94,477
Residential mortgage brokerage income, net	(454)	20,027	-	19,573
Real estate brokerage and property management income, net	-	9,781	-	9,781
Insurance commissions and other title fees and income, net	-	1,384	17,001	18,385
Other noninterest income	16,016	932	540	17,488
Noninterest expense	81,768	23,460	13,175	118,403
Income before income tax, corporate allocation and noncontrolling interest	26,085	10,837	4,379	41,301
Corporate allocation	417	(299)	(118)	-
Income before income tax provision and noncontrolling interest	26,502	10,538	4,261	41,301
Provision for income tax expense	6,387	3,530	1,601	11,518
Net income	20,115	7,008	2,660	29,783
Noncontrolling interest	-	(1,183)	(285)	(1,468)
Net income attributable to TowneBank	$ 20,115	$ 5,825	$ 2,375	$ 28,315
Net income as percentage of total	71.04%	20.57%	8.39%	100.00%

Nine Months Ended September 30, 2011	**Banking**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 100,968	$ 958	$ 20	$ 101,946
Provision for loan losses	12,540	-	-	12,540
Net interest income after provision for loan losses	88,428	958	20	89,406
Residential mortgage brokerage income, net	(74)	8,445	-	8,371
Real estate brokerage and property management income, net	-	9,723	-	9,723
Insurance commissions and other title fees and income, net	-	1,216	16,193	17,409
Other noninterest income	14,710	1,051	496	16,257
Noninterest expense	77,752	17,835	12,129	107,716
Income before income tax, corporate allocation and noncontrolling interest	25,312	3,558	4,580	33,450
Corporate allocation	359	(211)	(148)	-
Income before income tax provision and noncontrolling interest	25,671	3,347	4,432	33,450
Provision for income tax expense	6,324	1,639	1,658	9,621
Net income	19,347	1,708	2,774	23,829
Noncontrolling interest	-	820	(315)	505
Net income attributable to TowneBank	$ 19,347	$ 2,528	$ 2,459	$ 24,334
Net income as percentage of total	79.51%	10.39%	10.11%	100.00%

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Note 7. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case by case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, the total commitment amounts may not necessarily represent future cash requirements. At September 30, 2012, the amounts of off-balance sheet commitments to extend credit were $912.53 million.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At September 30, 2012, standby letters of credit and financial guarantees were $35.11 million.

Additionally, the Company had $390.20 million in mortgage loans sold to investors with various recourse and warranty provisions. The Company provided an allowance for estimated losses from such provisions that management considered adequate at September 30, 2012.

Rate lock commitments, which are designed to mitigate the Company's exposure to fluctuations in interest rates associated with rate lock commitments and loans held for sale, are related to the origination of mortgage loans held for sale and the corresponding loan sale commitments and are considered derivative instruments. Outstanding loan balances under these rate lock commitments totaled $85.0 million at September 30, 2012. The Company recognized gains associated with the rate lock commitments on the aforementioned loans of $30,000 and $1.21 million, which were recorded as noninterest income in the Company's financials for the three- and nine-month periods ended September 30, 2012, respectively.

Note 8. Mergers and Acquisitions

Stanton Taylor Agency, Inc.: Effective October 3, 2011, the Company acquired the Stanton Taylor Agency, Inc. insurance agency, that is affiliated with Towne Insurance Agency ("Towne Insurance"), a wholly-owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting 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 October 3, 2011. The purchase price was $2.70 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $364,000, goodwill of $1.50 million, other intangible assets, including customer lists of $1.13 million, and assumed liabilities of $293,000.

W. T. Chapin Inc.: Effective January 14, 2011, TowneBank acquired W. T. Chapin Inc. insurance agency, an independent insurance agency that is affiliated with Towne Insurance. 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, 2011. The purchase price was $4.21 million in cash and stock. The allocation of the purchase price resulted in tangible assets of $25,000, goodwill of $2.85 million, and other intangible assets, including customer lists of $1.34 million.

Benchmark Mortgage, Inc.: Effective November 1, 2011, TowneBank acquired Benchmark Mortgage, Inc., an independent mortgage business that was merged with the operations of TowneBank Mortgage, 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 November 1, 2011. The purchase price was $385,000 in cash. The allocation of the purchase price resulted in tangible assets of $308,000 and a loan pipeline of $77,000. There was no goodwill ascribed to the transaction.

The Bank of Currituck: Effective December 3, 2010, TowneBank acquired all the deposit accounts of The Bank of Currituck ("Currituck") and its six banking offices in northeastern North Carolina, including three banking offices on the Outer Banks. Under the terms of the purchase agreement, TowneBank also purchased a substantial portion of the Moyock-headquartered bank's loan portfolio and all of its other banking assets. 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. In accordance with the purchase agreement, TowneBank also was required to purchase and sell back certain loans in the amount of $21.15 million. However, because the transfer of the loans did not meet sale treatment under the accounting provisions of ASC 860, *Transfers and Servicing*, the transfer was treated as a secured borrowing, which was repaid at the time of the business combination. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income after the acquisition date of December 3, 2010. The purchase price was $7.84 million in cash. Acquisition-related costs were $548,000 and were included in noninterest expense in the consolidated statement of income for the year ended December 31, 2010. Following the closing of the transaction, Currituck ceased operation as a commercial bank and is operating as Currituck Resolution Properties, Inc. (the "Resolution Company") in order to manage the assets it retained in this transaction, including certain loans and other real estate owned. Also in accordance with the purchase agreement, TowneBank entered into a secured credit facility with the Resolution Company, which consists of three components, (i) a revolving line of credit in the principal amount of $1.0 million to be used for working capital purposes; (ii) a second revolving line of credit in the principal amount of $1.0 million to be used as an interest reserve to support the interest owed on the loan; and (iii) a term loan, in the amount of $14.07 million, which was used to fund and support the Resolution Company's asset base and operations.

Note 9. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 6 – Goodwill and Intangible Assets* of the 2011 Annual Report to the Stockholders for more information on the Company's goodwill and other intangibles.

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

	September 30, 2012		September 30, 2011		December 31, 2011	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	$ 417	$ 94	$ 4,094	$ 3,400	$ 4,094	$ 3,524
Non-compete agreements	1,456	1,204	1,456	1,065	1,456	1,144
Customer lists	17,920	6,910	16,790	5,128	17,920	5,579
Total intangible assets subject to amortization	19,793	8,208	22,340	9,593	23,470	10,247
Trade name	252	-	392	-	357	-
Contractual agreements	3,231	-	3,231	-	3,231	-
Total intangible assets not subject to amortization	3,483	-	3,623	-	3,588	-
Total intangible assets	$ 23,276	$ 8,208	$ 25,963	$ 9,593	$ 27,058	$ 10,247

Amortization expense for intangible assets was $507,000 and $654,000 for the three-month periods and $1.74 million and $1.96 million for the nine-month periods ended September 30, 2012 and 2011, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2011 are as follows (in thousands).

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2011	$ 58,885	$ 15,822	$ 23,420	$ 98,127
Additions to goodwill	-	-	-	-
Other adjustments	-	2	-	2
Balance, September 30, 2012	$ 58,885	$ 15,824	$ 23,420	$ 98,129

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of September 30, 2012 was $54.68 million. The Company had $53.32 million and $53.08 million of BOLI at December 31, 2011 and September 30, 2011, respectively. The Company recognized BOLI income, included in other noninterest income, of $467,000 and $488,000 for the three-month periods and $1.36 million and $1.60 million for the nine-month periods ended September 30, 2012 and 2011, respectively. The Company has a related retirement plan, implemented in the fourth quarter of 2008, which provides retirement benefits to the executives covered under the plan.

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Note 11. Postretirement Benefits

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011
Service cost	$ 723	$ 1,208
Interest cost	93	111
Net periodic postretirement benefit cost	$ 816	$ 1,319

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Service cost	$ 1,831	$ 3,038
Interest cost	372	305
Net periodic postretirement benefit cost	$ 2,203	$ 3,343

Note 12. Subordinated Capital Notes

During the first quarter of 2012, TowneBank announced the mandatory conversion of its outstanding Series III notes, which totaled $13.60 million as of that date. At the close of business on March 19, 2012, all outstanding Series III notes were converted into shares of TowneBank common stock at the conversion price of $13.38 per share (equal to a conversion rate of 149.48 shares per $2,000 principal amount of notes).

Note 13. Other Expenses

The following table shows a summary of other expenses (in thousands).

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Advertising and marketing	$ 1,165	$ 1,116	$ 3,574	$ 3,189
Other	2,372	1,195	5,740	3,844
Charitable contributions	789	738	2,836	2,289
Outside processing	787	721	2,205	2,138
Professional fees	1,153	939	3,561	2,872
Stationery and supplies	459	407	1,555	1,328
FDIC and other insurance	915	823	2,715	3,318
Foreclosed property expenses	664	1,904	3,364	4,707
Software expense	1,040	872	3,197	2,501
Telephone and postage	880	795	2,654	2,306
Amortization exp-intangibles	507	654	1,743	1,961
Bank franchise tax/SCC fees	475	488	1,396	1,470
Directors fees and expenses	282	405	886	1,255
Travel/meals/entertainment	237	179	713	560
Total other expenses	$ 11,725	$ 11,236	$ 36,139	$ 33,738

Note 14. Variable Interest Entities

In the normal course of business, the Company is involved with various entities that are considered to be Variable Interest Entities ("VIE"). A VIE is an entity that has either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support or whose equity investors lack the characteristics of a controlling financial interest. In accordance with existing accounting guidance, 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 multi-family 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 $46.68 million, $34.84 million, and $40.46 million in these partnerships were not included in the Consolidated Balance Sheets at September 30, 2012, September 30, 2011, and December 31, 2011, respectively. These limited partner interests had carrying values of $15.07 million, $9.71 million, and $11.68 million at September 30, 2012, September 30, 2011, and December 31, 2011, 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 $15.07 million, $9.71 million, and $11.68 million at September 30, 2012, September 30, 2011, and December 31, 2011, respectively.

Currituck Resolution Properties, Inc.

Following the Company's acquisition of the banking offices of The Bank of Currituck, the remaining entity ceased operation as a commercial bank and is operating as a North Carolina corporation under the name Currituck Resolution Properties, Inc. The sole purpose of the Resolution Company is to liquidate its remaining assets, pay its remaining liabilities, and wind down its business affairs. The Resolution Company continues to be managed by its existing board of directors and operates with minimal employees. At the closing of the purchase transaction, the Company entered into a secured credit facility with the Resolution Company, consisting of three components: (i) a revolving line of credit in the principal amount of $1.0 million to be used for working capital purposes; (ii) a second revolving line of credit in the principal amount of $1.0 million to be used as an interest reserve to support the interest owed on the loan; and (iii) a term loan, of approximately $14 million, which was to be used to fund and support the Resolution Company's asset base and operations.

The Company concluded that the Resolution Company is a VIE because the equity investors do not have sufficient equity at risk for the entity to independently finance its activities as evidenced by the amount of subordinated support provided by the Company. However, the Company determined that it is not the primary beneficiary of the Resolution Company as it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company does not have any contractual obligation to provide additional support to this entity, and its maximum exposure to loss at September 30, 2012, was limited to (i) the current outstanding balance of the term loan, which was $4.08 million, and (ii) the commitments on the two revolving lines of credit, which were $530,000 as of September 30, 2012 and $387,000 as of December 31, 2011. The total unconsolidated assets of the Resolution Company as of September 30, 2012 and December 31, 2011, were $14.67 million and $20.71 million, respectively.

Note 15. Fair Value Disclosures

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

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

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. This category generally includes U.S. Government and agency mortgage-backed debt securities, corporate debt securities, and residential mortgage loans held for sale.

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. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, interest rate lock commitments, asset-backed securities, and highly structured or long-term derivative contracts.

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.

Trading securities: Fair values are based on published market prices or dealer quotes.

Interest Rate Lock Commitments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the closing ratio, is derived from the Company’s internal data and is adjusted using significant management judgment. The closing ratio is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three- and six-month periods ending September 30, 2012, the Company used a weighted average closing ratio of 80%. The Company recognized a gain associated with the rate lock commitments of $30,000 and $1.21 million for the three- and nine-month periods ended September 30, 2012, respectively. Because the amounts associated with the rate lock commitments were determined to be immaterial, the Company did not record the value of the rate locks in any period prior to January 1, 2012. The carrying value of the interest rate lock commitments was $1.21 million at September 30, 2012.

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

	September 30, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ -	$ 176,788	$ -	$ 176,788
Municipal securities	-	41,990	-	41,990
Federal agency mortgage-backed securities	-	111,374	-	111,374
Corporate securities and other	3	5,345	-	5,348
Equity securities	12,298	-	-	12,298
Interest rate lock commitments	-	-	1,213	1,213

	December 31, 2011			
	Level 1	**Level 2**	**Level 3**	**Total**
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ -	$ 187,135	$ -	$ 187,135
Municipal securities	-	35,909	-	35,909
Federal agency mortgage-backed securities	-	99,310	-	99,310
Corporate securities and other	4	7,715	-	7,719
Equity securities	10,854	-	-	10,854

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at September 30, 2012 (in thousands):

September 30, 2012	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ -	$ 26,234	$ 17,509	$ 43,743
Other real estate owned	$ -	$ 25,440	$ 5,470	$ 30,910
December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ -	$ 26,033	$ 16,891	$ 42,924
Other real estate owned	$ -	$ 25,959	$ 3,860	$ 29,819

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 Level 2 inputs based on observable market data or Level 3 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.

Loans held for sale: Loans held for sale are carried at the lower of cost or estimated fair value. Fair values of loans held for sale are based on commitments on hand from investors or, if commitments have not yet been obtained, prevailing market rates.

Foreclosed Property: The fair value of foreclosed property is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on upon assumptions specific to the individual property. Level 3 inputs typically include unobservable inputs such as management applied discounts used to further reduce values to a net realizable value or in situations where our appraisal date predates a likely change in market conditions. These deductions ranged from 8% to 14%.

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

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

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

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

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

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

Convertible subordinated capital debentures: The fair values of the convertible subordinated capital debentures are estimated using discounted contractual cash flows based on the Company's incremental rate of borrowing that would be currently available for similar types of borrowing arrangements.

Repurchase agreements: The carrying amount approximates fair value.

Federal funds purchased: The carrying amount approximates fair value.

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

The estimated fair values of our financial instruments required to be disclosed under ASC 825 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):

September 30, 2012	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 274,481	$ 274,481	$ 274,481	$ -	$ -
Interest-bearing deposits in financial institutions	1,574	1,574	1,574	-	-
Securities available for sale	335,500	335,500	3	335,497	-
Securities held to maturity	155,912	166,579	-	68,903	97,676
Trading securities	12,298	12,298	12,298	-	-
Mortgage loans held for sale	124,785	124,785	-	124,785	-
Net Loans	2,990,805	3,118,667	-	-	3,118,667
Interest receivable	11,262	11,262	-	11,262	-
Interest rate lock commitments	1,213	1,213	-	-	1,213
Deposits	3,305,125	3,105,926	-	3,105,926	-
Advances from the Federal Home Loan Bank of Atlanta	380,000	424,199	-	424,199	-
Repurchase agreements and other borrowings	10,131	10,131	-	10,131	-
Interest payable	2,506	2,506	-	2,506	-

December 31, 2011	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 312,149	$ 312,149	$ 312,149	$ -	$ -
Interest-bearing deposits in financial institutions	1,995	1,995	1,995	-	-
Securities available for sale	330,073	330,073	4	330,069	-
Securities held to maturity	153,912	158,453	-	83,420	75,033
Trading securities	10,854	10,854	10,854	-	-
Mortgage loans held for sale	109,453	109,453	-	109,453	-
Net Loans	2,753,453	2,841,709	-	-	2,841,709
Interest receivable	11,485	11,485	-	11,485	-
Deposits	3,190,787	3,012,276	-	3,012,276	-
Advances from the Federal Home Loan Bank of Atlanta	280,000	322,925	-	322,925	-
Convertible subordinated capital debentures	13,740	14,142	-	-	14,142
Repurchase agreements and other borrowings	11,790	11,790	-	11,790	-
Interest payable	3,472	3,472	-	3,472	-

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

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2012	Second Quarter 2012	First Quarter 2012	Fourth Quarter 2011	Third Quarter 2011
Results of Operations:					
Interest income	$ 44,216	$ 43,210	$ 42,428	$ 42,325	$ 43,027
Interest expense	7,232	7,306	7,643	8,048	8,941
Net interest income	36,984	35,904	34,785	34,277	34,086
Provision for loan losses	4,977	4,122	4,097	1,062	1,400
Net interest income after provision for loan losses	32,007	31,782	30,688	33,215	32,686
Noninterest income:					
Residential mortgage brokerage income, net	7,329	6,527	5,718	4,272	3,396
Real estate brokerage and property management income, net	3,115	3,293	3,373	1,773	3,311
Insurance commissions and other title fees and income, net	5,978	6,019	6,387	5,137	5,619
Service charges on deposit accounts	2,047	2,010	1,698	1,798	1,883
Credit card merchant fees, net	931	1,035	868	845	694
Other income	2,274	1,860	1,727	2,145	1,920
Gain (loss) on investment securities	508	1,753	778	3	(3)
Total noninterest income	22,182	22,497	20,549	15,973	16,820
Noninterest expense:					
Salaries and benefits	23,249	22,194	21,491	20,100	20,901
Occupancy expense	3,636	3,540	3,376	3,674	3,493
Furniture and equipment	1,621	1,577	1,580	1,490	1,459
Other expenses	11,725	13,329	11,085	11,840	11,236
Total noninterest expense	40,231	40,640	37,532	37,104	37,089
Income before noncontrolling interest and income tax	13,958	13,639	13,705	12,084	12,417
Provision for income tax expense	4,063	3,401	4,054	3,105	3,610
Net income	9,895	10,238	9,651	8,979	8,807
Net (income) loss from noncontrolling interest	(545)	(709)	(214)	8	(282)
Net income attributable to TowneBank	$ 9,350	$ 9,529	$ 9,437	$ 8,987	$ 8,525
Net income available to common shareholders	$ 7,995	$ 7,929	$ 7,521	$ 6,846	$ 4,898
Per Share Data:					
Net income:					
Basic (1)	$ 0.26	$ 0.26	$ 0.25	$ 0.23	$ 0.16
Diluted (1)	0.26	0.26	0.25	0.23	0.16
Book value at period end (1)	13.14	12.93	12.79	12.65	12.51
Tangible book value at period end (1)	9.53	9.31	9.13	8.82	8.73
Cash dividends paid (1)	0.08	0.08	0.078	0.078	0.078
Cash dividends declared (1)	0.08	0.08	0.078	0.078	0.078
Common Stock Closing Price:					
High	$ 15.86	$ 14.04	$ 14.52	$ 13.47	$ 14.32
Low	13.76	11.83	12.34	10.82	10.52
Close	15.33	14.00	13.49	12.24	11.37
Selected Financial Ratios:					
Return on average assets	0.88%	0.93%	0.93%	0.88%	0.84%
Return on average tangible assets	0.90%	0.95%	0.96%	0.91%	0.87%
Return on average equity	6.73%	7.04%	7.21%	6.87%	6.59%
Return on average tangible equity	8.47%	8.90%	9.21%	8.83%	8.46%
Net interest margin (tax-equivalent basis) (2)	3.95%	3.99%	3.93%	3.94%	3.87%
Daily Averages:					
Total assets	$ 4,239,838	$ 4,128,116	$ 4,073,157	$ 4,049,883	$ 4,012,377
Total tangible assets	4,126,309	4,014,039	3,958,456	3,934,515	3,898,997
Loans, net of unearned income, excluding nonaccrual loans	2,958,789	2,879,798	2,780,762	2,692,055	2,663,562
Total earning assets (2)	3,850,305	3,735,432	3,682,952	3,660,185	3,618,334
Total deposits	3,332,845	3,235,597	3,182,941	3,163,755	3,129,411
FHLB advances	283,261	280,000	280,000	280,000	287,609
Total equity	552,541	544,561	526,681	519,288	513,257
Tangible equity	439,012	430,484	411,980	403,920	399,877
Basic weighted average shares outstanding (1)	31,118,698	30,916,123	29,905,057	29,789,006	29,708,215
Diluted weighted average shares outstanding (1)	31,175,350	30,971,917	30,893,197	30,915,694	30,810,857

(1) Prior periods were restated to reflect 3% common stock dividend paid June 12, 2012.

(2) Includes bank-owned life insurance.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2011 audited Consolidated Financial Statements and the 2011 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by Dixon Hughes Goodman LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements with respect to our financial condition, results of operations, and business. These forward-looking statements involve certain risks and uncertainties and are based on the beliefs and assumptions of our management. When used in this quarterly report or future regulatory filings, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We wish to caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, competitive and legislative or regulatory factors, and other factors described in our 2011 Annual Report on Form 10-K could affect our financial performance and could cause actual results for future periods to differ materially from those anticipated or projected.*

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

Overview

TowneBank ("Company," "we," "us") is a retail and commercial banking business serving the Greater Hampton Roads area and northeastern North Carolina. We place special emphasis on serving the financial needs of small- and medium-size businesses, professionals, and individuals in our geographic footprint. We offer a full range of banking and related financial services through our controlled divisions and subsidiaries.

Since our inception, we have expanded our financial services to include banking, real estate, mortgage, title, insurance, employee benefit services, and investments. We have three reportable segments: Banking, Realty, and Insurance. Our Banking segment provides loan and deposit services to retail and commercial customers. The Realty segment offers residential real estate services, mortgage loans, and residential and commercial title insurance. Commercial and retail insurance and employee benefit services are provided through our Insurance segment.

The following is a summary of the Company's financial performance in the quarter ended September 30, 2012:

- Net income for the three months ended September 30, 2012 was $9.35 million, or $0.26 per common diluted share, compared with $8.53 million, or $0.16 per diluted share, in the same period in 2011. Net income for the nine months ended September 30, 2012 was $28.32 million, or $0.76 per common diluted share, compared with $24.33 million, or $0.53 per diluted share, in the nine months ended September 30, 2011. Net income available to common shareholders for the third quarter of 2012 was $7.99 million after accretion and preferred dividend payments compared with $4.90 million in the same period of 2011. The increase in earnings was primarily driven by the growth in noninterest income combined with an increase in net interest income related to the growth in earning assets. Net income available to common shareholders was positively affected by a decrease in preferred stock dividends and accretion from the comparable prior year period.

- Net interest income increased $2.90 million, or 8.50%, in the third quarter of 2012 from the comparable period in 2011. The increase was primarily due to the growth in earning assets and the positive effect from the repricing of interest-bearing liabilities.

- The provision for loan losses increased $3.58 million, or 255.50%, from the comparative three-month period of 2011, and increased $656,000, or 5.23% from the comparative nine-month period of 2011. The loan loss reserve decreased to 1.30% of loans at September 30, 2012 from 1.50% at September 30, 2011 and 1.42% at December 31, 2011. The increases in the provision for loan losses in the current year periods were primarily attributable to higher charge-offs during the current quarter combined with growth in the loan portfolio. These factors were partially offset by improvements in certain credit quality metrics and a large percentage of charge-offs related to loans with specific reserves.

- Excluding gains on investment securities, noninterest income for the three- and nine-month periods ended September 30, 2012 increased by $4.85 million, or 28.84%, and $14.11 million, or 29.34%, respectively, compared to the comparative periods in 2011. The increases in both comparative periods were driven by improved performance in our Realty segment, primarily due to increases in residential mortgage banking income.

- For the three- and nine-month periods ended September 30, 2012, noninterest expense increased $3.14 million, or 8.47%, and $10.69 million, or 9.92%, respectively, compared to the same periods in 2011. The increase was driven by acquisitions and expansions during late 2011 in our Insurance and Realty segments, which led to higher personnel costs and occupancy expenses.

- Our effective tax rate increased to 30.29% for the third quarter of 2012 from 29.75% in the comparative period of 2011. For the first nine months of 2012, the effective tax rate increased to 28.92% compared to 28.33% for the same period in 2011. The increases were primarily a result of higher taxable income, partially offset by increased federal tax credits from community reinvestment activity.

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, deferred income taxes, and estimates of fair value to be critical accounting policies. Refer to our 2011 Annual Report to the Stockholders for further discussion of these policies.

PART I. FINANCIAL INFORMATION
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ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 0.88% for the third quarter of 2012 compared to 0.84% for the third quarter of 2011, and 0.93% for the second quarter of 2012. The annualized return on average tangible assets was 0.90%, 0.87%, and 0.95% for the same respective periods. ROA for the nine months ended September 30, 2012 was 0.91% compared to 0.82% for the nine months ended September 30, 2011. ROA was positively affected by the increase in noninterest income, as the growth in average assets was outpaced by the increase in net income.

The annualized return on average equity ("ROE") was 6.73% for the third quarter of 2012, 6.59% for the third quarter of 2011, and 7.04% for the second quarter of 2012, while the annualized return on average tangible equity was 8.47%, 8.46%, and 8.90% for the same respective periods. ROE for the nine months ended September 30, 2012 was 6.99%, compared to 6.39% for the nine months ended September 30, 2011.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $58.66 million for the quarter ended September 30, 2012, which increased $7.75 million, or 15.22%, compared to the quarter ended September 30, 2011. Operating income was $56.65 million for the quarter ended June 30, 2012. For the nine months ended September 30, 2012, operating income was $169.86 million, reflecting an increase of $19.84 million, or 13.22% over comparative 2011.

Basic earnings per share were $0.26 for the three months ended September 30, 2012 from $0.16 in comparative 2011, while basic earnings per share for the nine months ended September 30, 2012 also increased to $0.76 from $0.54 in comparative 2011. Diluted earnings per share increased to $0.26 for the three months ended September 30, 2012 from $0.16 in comparative 2011, while diluted earnings per share for the nine months ended September 30, 2012 increased to $0.76 from $0.53 in comparative 2011. Earnings per share were positively affected, as compared to the prior periods, by the reduction of preferred dividends and accretion due to the Company's participation in the Small Business Lending Fund program. Due to the Company's loan growth, the blended dividend rate for the period from closing through December 31, 2011 was 4.63%, with the rate reduced to 2.28% and 1.00% for the second and third quarters of 2012, respectively. Net income available to common shareholders in the comparative prior year periods was impacted by the $1.86 million acceleration of the discount on the repurchased Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B ("Series B Preferred Stock").

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 the 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.

We reported net interest income, on a tax-equivalent basis, of $38.22 million for the quarter ended September 30, 2012, which was $2.89 million, or 8.17%, above the year ago amount of $35.33 million. On a linked quarter basis, tax-equivalent net interest income increased by $1.15 million, or 3.11%, from the $37.07 million reported for the second quarter of 2012. The growth in earning assets drove the improvement from both prior periods, while lower funding costs contributed to a wider margin as compared to the third quarter of the prior year.

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Interest income, on a tax-equivalent basis, was $45.45 million for the quarter ended September 30, 2012, which was $1.18 million, or 2.66%, higher than the $44.27 million reported for the quarterly period ended September 30, 2011. On a linked quarter basis, tax-equivalent interest income increased $1.08 million, or 2.43%, from $44.37 million in the second quarter of 2012. Average earning assets grew to $3.85 billion in the quarter ended September 30, 2012, from $3.63 billion in the comparative prior year quarter, an increase of $220.99 million, or 6.09%. In the linked quarter comparison, average earning assets grew by $114.87 million, or 3.08%, from $3.74 billion in the quarter ended June 30, 2012. The yield on earning assets was 4.70% in the quarter ended September 30, 2012, which compared to 4.85% in the comparative prior year period and 4.78% in the linked period. Average loan balances, excluding nonaccrual loans, of $2.96 billion were $295.23 million, or 11.08%, higher in the third quarter of 2012 than in the same period a year ago, while loan yields declined by 45 basis points. In the linked quarter, loans grew $78.99 million or 2.74% and loan yields were 11 basis points lower. The increase in interest income from the comparative prior year period was driven by higher balances on loans and loans held for sale, which was partially offset by lower yields on tax-exempt investments, loans, and loans held for sale. In the linked quarter comparison, the increase in interest income was primarily due to the increase in loan balances and higher yields on taxable investments, which was partially offset by the decrease in loan yields. Interest income in the current quarter was positively impacted by the accretion recognized due to the call of several of the Company's trust preferred corporate securities, with total recorded balances of $17.17 million, by their various issuers. The called securities had yields ranging from 6.90% to 9.75%. Trust preferred corporate securities generally have a higher yield than other security types, which may put downward pressure in future periods on net interest income and the net interest margin if lower yielding assets are acquired in the place of the called securities.

Interest expense, for the quarter ended September 30, 2012, was $7.23 million, which was $1.71 million or 19.11% below the $8.94 million amount in the year ago quarter. The average balance of interest-bearing liabilities increased to $2.69 billion in the third quarter of 2012 from $2.64 billion in the comparative prior year quarter, an increase of 1.76%. On a linked quarter basis, interest expense declined by $73,000, or 1.0%, from $7.31 million in the second quarter of 2012. In the linked quarter, average interest bearing liabilities increased by $37.93 million, or 1.43%, from $2.65 billion in the quarter ended June 30, 2012. The decline in interest expense was driven by repricing opportunities in certificates of deposit in the linked quarter comparison and the redemption of the subordinated debentures in the year-over-year comparison.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.95% in the quarter ended September 30, 2012, which was 8 basis points higher than the 3.87% margin of the September 30, 2011 quarter and 4 basis point lower than the 3.99% margin of the June 30, 2012 quarter. The year-over-year improvement was primarily driven by lower funding costs, while the linked quarter compression resulted from falling asset yields.

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

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	Three Months Ended September 30, 2012			Three Months Ended June 30, 2012			Three Months Ended September 30, 2011		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 2,958,789	$ 39,623	5.33%	$ 2,879,798	$ 38,966	5.44%	$ 2,663,562	$ 38,817	5.78%
Taxable investment securities	232,796	1,784	3.07%	277,980	1,555	2.24%	288,990	2,080	2.99%
Tax-exempt investment securities	168,064	1,904	4.53%	151,773	1,794	4.73%	148,798	1,847	4.97%
Interest bearing deposits	297,355	189	0.25%	244,816	155	0.25%	428,444	273	0.25%
Loans held for sale	138,930	1,231	3.54%	127,148	1,211	3.81%	46,579	505	4.34%
Bank-owned life insurance	54,371	720	5.26%	53,917	691	5.16%	52,937	751	5.63%
Total earning assets	3,850,305	45,451	4.70%	3,735,432	44,372	4.78%	3,629,310	44,273	4.85%
Less: allowance for loan losses	(40,463)			(40,428)			(43,319)		
Total nonearning assets	429,996			433,112			426,386		
Total Assets	$ 4,239,838			$ 4,128,116			$ 4,012,377		
Liabilities and Equity:									
Interest bearing deposits									
Demand and money market	$ 1,084,821	$ 1,108	0.41%	$ 1,060,116	$ 1,083	0.41%	$ 910,629	$ 1,344	0.59%
Savings	194,180	246	0.50%	194,517	244	0.51%	169,912	310	0.72%
Certificates of deposit	1,112,558	2,849	1.02%	1,102,850	2,991	1.09%	1,244,072	3,902	1.24%
Total interest bearing deposits	2,391,559	4,203	0.70%	2,357,483	4,318	0.74%	2,324,613	5,556	0.95%
Borrowings	295,620	3,029	4.01%	291,763	2,988	4.05%	302,313	3,093	4.00%
Subordinated debentures	-	-	-	-	-	0.00%	13,756	292	8.49%
Total interest bearing liabilities	2,687,179	7,232	1.07%	2,649,246	7,306	1.11%	2,640,682	8,941	1.34%
Demand deposits	941,286			878,114			804,798		
Other noninterest bearing liabilities	58,832			56,195			53,640		
Total liabilities	3,687,297			3,583,555			3,499,120		
Shareholders' equity	552,541			544,561			513,257		
Total liabilities and equity	$ 4,239,838			$ 4,128,116			$ 4,012,377		
Net interest income (tax-equivalent basis)		$ 38,219			$ 37,066			$ 35,332	
Reconcilement of Non-GAAP Financial Measures									
Bank-Owned Life Insurance		(720)			(691)			(751)	
Tax-equivalent basis adjustment		(515)			(471)			(495)	
Net interest income (GAAP)		$ 36,984			$ 35,904			$ 34,086	
Interest rate spread (1)			3.63%			3.67%			3.51%
Interest expense as a percent of average earning assets			0.75%			0.79%			0.98%
Net interest margin (tax equivalent basis) (2)			3.95%			3.99%			3.87%
Total cost of deposits			0.50%			0.54%			0.70%

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

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

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(Dollars in thousands)	Increase/(Decrease) Three Months Ended September 30, 2012 Compared to Three Months Ended June 30, 2012			Increase/(Decrease) Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 1,310	$ (653)	$ 657	$ 4,023	$ (3,217)	$ 806
Taxable investment securities	(281)	510	229	(359)	63	(296)
Tax-exempt investment securities	187	(77)	110	228	(171)	57
Interest bearing deposits	35	(1)	34	(87)	3	(84)
Loans held for sale	108	(87)	21	835	(108)	727
Bank-owned life insurance	8	21	29	19	(50)	(31)
Total earning assets	1,367	(287)	1,080	4,659	(3,480)	1,179
Liabilities and Equity:						
Interest bearing deposits						
Demand and money market	33	(8)	25	230	(466)	(236)
Savings	1	1	2	39	(103)	(64)
Certificates of deposit	30	(172)	(142)	(392)	(661)	(1,053)
Total interest bearing deposits	64	(179)	(115)	(123)	(1,230)	(1,353)
Borrowings	58	(16)	42	(71)	8	(63)
Subordinated debentures	-	-	-	(292)	-	(292)
Total interest bearing liabilities	122	(195)	(73)	(486)	(1,222)	(1,708)
Net interest income	$ 1,245	$ (92)	$ 1,153	$ 5,145	$ (2,258)	$ 2,887

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

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	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011			Nine Months Ended September 30, 2012 Compared with September 30, 2011		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change due to Rate	Change due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding	$ 2,873,429	$ 116,968	5.44%	$ 2,673,268	$ 115,761	5.79%	$ 1,207	$ (7,284)	$ 8,491
Taxable investment securities	268,143	5,099	2.54%	393,993	8,469	2.95%	(3,370)	(1,030)	(2,340)
Tax-exempt investment securities	155,887	5,484	4.69%	145,957	5,397	4.93%	87	(270)	357
Interest bearing deposits	286,433	543	0.25%	277,598	533	0.26%	10	(12)	22
Loans held for sale	118,760	3,249	3.65%	42,062	1,466	4.65%	1,783	(376)	2,159
Bank-owned life insurance	53,921	2,100	5.20%	53,044	2,381	6.00%	(281)	(320)	39
Total earning assets	3,756,573	133,443	4.74%	3,585,922	134,007	5.01%	(564)	(9,292)	8,728
Less: allowance for loan losses	(40,251)			(40,918)					
Total nonearning assets	431,054			425,862					
Total Assets	$ 4,147,376			$ 3,970,866					
Liabilities and Equity:									
Interest bearing deposits									
Demand and money market	$ 1,052,437	$ 3,316	0.42%	$ 855,151	$ 3,630	0.57%	$ (314)	$ (1,062)	$ 748
Savings	194,397	768	0.53%	156,412	862	0.74%	(94)	(282)	188
Certificates of deposit	1,120,374	8,824	1.05%	1,293,169	12,951	1.34%	(4,127)	(2,545)	(1,582)
Total interest bearing deposits	2,367,208	12,908	0.73%	2,304,732	17,443	1.01%	(4,535)	(3,889)	(646)
Borrowings	292,958	9,037	4.05%	330,570	9,882	3.94%	(845)	284	(1,129)
Subordinated debentures	3,941	237	8.02%	13,809	878	8.48%	(641)	(45)	(596)
Total interest bearing liabilities	2,664,107	22,182	1.11%	2,649,111	28,203	1.42%	(6,021)	(3,650)	(2,371)
Demand deposits	883,553			760,534					
Other noninterest bearing liabilities	58,414			52,046					
Total liabilities	3,606,074			3,461,691					
Shareholders' equity	541,302			509,175					
Total liabilities and equity	$ 4,147,376			$ 3,970,866					
Net interest income (tax-equivalent basis)		$ 111,261			$ 105,804		$ 5,457	$ (5,642)	$ 11,099
Reconcilement of Non-GAAP Financial Measures									
Bank-Owned Life Insurance		(2,100)			(2,381)		281		
Tax-equivalent basis adjustment		(1,488)			(1,477)		(11)		
Net interest income (GAAP)		$ 107,673			$ 101,946		$ 5,727		
Interest rate spread (1)			3.63%			3.59%			
Interest expense as a percent of average earning assets			0.79%			1.05%			
Net interest margin (tax equivalent basis) (2)			3.96%			3.96%			
Total cost of deposits			0.53%			0.76%			

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

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

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Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended September 30, 2012 was $21.67 million, an increase of $4.85 million, or 28.84%, compared to the same period in 2011 and an increase of $931,000, or 4.49%, compared to the second quarter of 2012. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for the third quarter of 2012 was 36.95%, compared with 33.04% for comparative 2011 and 36.62% for the second quarter of 2012.

Our noninterest income primarily consists of fee income produced by our three reportable segments, less applicable commission expenses. The following tables provide an analysis of noninterest income (dollars in thousands).

	Three Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Residential mortgage brokerage income, net	$ 7,329	$ 3,396	$ 3,933	115.81%
Real estate brokerage and property management, net	3,115	3,311	(196)	(5.92%)
Insurance commissions and other title fees and income, net	5,978	5,619	359	6.39%
Service charges on deposit accounts	2,047	1,883	164	8.71%
Credit card merchant fees, net	931	694	237	34.15%
Other income	2,274	1,920	354	18.44%
Subtotal before gain on investment securities	21,674	16,823	4,851	28.84%
Net gain on investment securities	508	(3)	511	N/M
Total noninterest income	$ 22,182	$ 16,820	$ 5,362	31.88%

	Three Months Ended		Increase/(Decrease) Second Quarter 2012 over First Quarter 2012	
	September 30, 2012	June 30, 2012	Amount	Percent
Residential mortgage brokerage income, net	$ 7,329	$ 6,527	$ 802	12.29%
Real estate brokerage and property management, net	3,115	3,293	(178)	(5.41%)
Insurance commissions and other title fees and income, net	5,978	6,019	(41)	(0.68%)
Service charges on deposit accounts	2,047	2,010	37	1.84%
Credit card merchant fees, net	931	1,035	(104)	(10.05%)
Other income	2,274	1,859	415	22.32%
Subtotal before gain on investment securities	21,674	20,743	930	4.49%
Net gain on investment securities	508	1,753	(1,245)	(71.02%)
Total noninterest income	$ 22,182	$ 22,496	$ (314)	(1.40%)

	Nine Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Residential mortgage brokerage income, net	$ 19,573	$ 8,371	$ 11,202	133.82%
Real estate brokerage and property management, net	9,781	9,723	58	0.60%
Insurance commissions and other title fees and income, net	18,385	17,409	976	5.61%
Service charges on deposit accounts	5,755	5,414	341	6.30%
Credit card merchant fees, net	2,834	1,983	851	42.92%
Other income	5,861	5,181	680	13.12%
Subtotal before gain on sale of investment securities	62,189	48,081	14,108	29.34%
Net gain on investment securities	3,038	3,679	(641)	(17.42%)
Total noninterest income	$ 65,227	$ 51,760	$ 13,467	26.02%

For the third quarter of 2012, residential mortgage brokerage income, net of commission expense was $7.33 million, reflecting an increase of $3.93 million, or 115.81%, compared to the third quarter of 2011 and an increase of $802,000, or 12.29%, compared to the second quarter of 2012. For the nine-month period ended September 30, 2012, residential mortgage brokerage income, net of commission expense was $19.57 million, reflecting an increase of $11.20 million, or 133.82%, compared to the same period in 2011. Mortgage brokerage income is highly correlated to the housing market, which saw some improvement in the first three quarters of 2012, and mortgage interest rates, which were affected by a general decrease in long-term interest rates during the period. These factors contributed to a significantly higher volume in purchase and refinancing transactions and the corresponding increase in net mortgage brokerage income from the comparative prior year period and modest increases from the linked quarter. Additionally, the Company recognized gains on rate lock commitments of $30,000 and $1.21 million for the three- and nine-month periods ended September 30, 2012, respectively. Also, the November 1, 2011, acquisition of Benchmark Mortgage, Inc. ("Benchmark"), a mortgage company affiliated with TowneBank Mortgage, and other expansions of our mortgage operations resulted in additional net brokerage income of $3.35 million and $8.06 million in the three- and nine-month periods ended September 30, 2012 as compared to the same periods of 2011.

Real estate brokerage and property management income, net of commission expense, for the third quarter of 2012 was $3.12 million, which was $196,000 or 5.92%, lower than comparative 2011, and $178,000, or 5.41%, less than the second quarter of 2012. The increase for the nine-month period was $58,000, or 0.60%, from the comparative prior year period. The decrease from the comparative prior year quarter was primarily due to a decrease in property management fees and was also affected by an decrease in real estate brokerage income resulting from a decrease in the total volume of units sold of $9.76 million, or 4.27%, despite a 4.11% increase in the number of units sold. The decrease from the linked quarter was driven by an expected seasonal decrease in the number and volume of units sold, as the volume decreased by $58.15 million, or 21.0%. The decrease in real estate brokerage income in the linked quarter was partially offset by an increase in property management fees of $147,000. The increase in the nine-month period was due to slight increases in both net property management fee income real estate brokerage income.

For the third quarter of 2012, insurance commissions and other title income, net of commission expense was $5.98 million, which was $359,000, or 6.39%, higher than comparative 2011, and $41,000, or 0.68%, less than the second quarter 2012. For the nine-month period, insurance commissions and other title income, net of commission expense was $976,000, or 5.61%, higher than comparative 2011. The increase from both of the comparative prior year periods was largely due to the acquisition of the Stanton Taylor Agency, Inc.

("Stan Taylor") insurance agency in the fourth quarter of 2011. The decrease in the linked quarter comparison is largely due to a decrease in travel insurance commission income combined with a decrease in employee benefits insurance bonus income, which is mostly received during the first half of each year.

For the third quarter of 2012, credit card merchant fees totaled $931,000, which was $237,000, or 34.15%, higher than comparative 2011 and $104,000, or 10.05%, less than the second quarter of 2012. For the nine months ended September 30, 2012, credit card merchant fees totaled $2.83 million, which was $851,000, or 42.92%, higher than comparative 2011. For both comparative prior year periods, the increase was due to a higher volume of transactions.

Other noninterest income for the three and nine-months ended September 30, 2012 was $2.27 million and $5.86 million, respectively, and included income generated by Towne Investment Group, net of commission expense. For the three months ended September 30, 2012, net commission income totaled $460,000 as compared to $469,000 for the comparative period of 2011 and $453,000 for Towne Investment Group for the second quarter of 2012.

During the third quarter of 2012, we had sales, maturities, prepayments, and calls totaling $165.21 million of investment securities from our available-for-sale securities portfolio. The securities were comprised of callable agencies securities and mortgage-backed securities. As a result of the sales, we recognized security gains of $6,000 during the period.

Noninterest Expense. For the quarter ended September 30, 2012, total noninterest expense was $40.23 million, which was $3.14 million, or 8.47%, higher than comparative 2011 and $409,000, or 1.01%, lower than the quarter ended June 30, 2012. For the nine months ended September 30, 2012, total noninterest expense increased $10.69 million, or 9.92%, from comparative 2011 to $118.40 million.

As a percentage of operating income, noninterest expense was 68.59% for the third quarter of 2012, 72.85% for comparative 2011, and 71.74% for the quarter ended June 30, 2012. The primary components of noninterest expense in the third quarter of 2012 were salaries and employee benefits of $23.25 million, occupancy expenses of $3.64 million, furniture and equipment expenses of $1.62 million, advertising and marketing expenses of $1.17 million, and professional fees of $1.15 million. In comparison to the third quarter of 2011, a significant portion of the increase in total noninterest expense is due to the October 3, 2011, acquisition of the Stan Taylor insurance agency, which resulted in additional expenses of $286,000, primarily in salaries and benefits, and the November 1, 2011, acquisition of Benchmark, and other expansions of our mortgage operations, which resulted in additional expenses of $2.18 million, primarily in salaries and benefits. Excluding the costs associated with the acquisitions and expansions, noninterest expense increased $677,000, or 1.83%, from the comparative quarter in 2011.

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The following table provides an analysis of quarterly total noninterest expense by line item (dollars in thousands).

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2012 over September 30, 2011		September 30, 2012 over June 30, 2012	
	2012	2011	2012	Amount	Percent	Amount	Percent
Salaries and benefits	$ 23,249	$ 20,901	$ 22,194	$ 2,348	11.23%	$ 1,055	4.75%
Occupancy expense	3,636	3,493	3,540	143	4.09%	96	2.71%
Furniture and equipment	1,621	1,459	1,577	162	11.10%	44	2.79%
Other							
Advertising and marketing	1,165	1,116	1,332	49	4.39%	(167)	(12.54%)
Other	2,372	1,116	2,013	1,256	112.54%	359	17.83%
Charitable contributions	789	738	1,163	51	6.91%	(374)	(32.16%)
Outside processing	787	721	775	66	9.15%	12	1.55%
Professional fees	1,153	939	1,290	214	22.79%	(137)	(10.62%)
Stationery and supplies	459	407	630	52	12.78%	(171)	(27.14%)
FDIC and other insurance	915	823	1,019	92	11.18%	(104)	(10.21%)
Foreclosed property expenses	664	1,904	1,512	(1,240)	(65.13%)	(848)	(56.08%)
Software expense	1,040	872	1,117	168	19.27%	(77)	(6.89%)
Telephone and postage	880	795	871	85	10.69%	9	1.03%
Amortization exp-intangibles	507	733	607	(226)	(30.83%)	(100)	(16.47%)
Bank franchise tax/SCC fees	475	488	453	(13)	(2.66%)	22	4.86%
Directors fees and expenses	282	405	293	(123)	(30.37%)	(11)	(3.75%)
Travel/meals/entertainment	237	179	254	58	32.40%	(17)	(6.69%)
Total other expenses	11,725	11,236	13,329	489	4.35%	(1,604)	(12.03%)
Total noninterest expense	$ 40,231	$ 37,089	$ 40,640	$ 3,142	8.47%	$ (409)	(1.01%)

	Nine Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Salaries and benefits	$ 66,934	$ 59,458	$ 7,476	12.57%
Occupancy expense	10,552	10,205	347	3.40%
Furniture and equipment	4,778	4,315	463	10.73%
Other				
Advertising and marketing	3,574	3,189	385	12.07%
Other	5,740	3,844	1,896	49.32%
Charitable contributions	2,836	2,289	547	23.90%
Outside processing	2,205	2,138	67	3.13%
Professional fees	3,561	2,872	689	23.99%
Stationery and supplies	1,555	1,328	227	17.09%
FDIC and other insurance	2,715	3,318	(603)	(18.17%)
Foreclosed property expenses	3,364	4,707	(1,343)	(28.53%)
Software expense	3,197	2,501	696	27.83%
Telephone and postage	2,654	2,306	348	15.09%
Amortization exp-intangibles	1,743	1,961	(218)	(11.12%)
Bank franchise tax/SCC fees	1,396	1,470	(74)	(5.03%)
Directors fees and expenses	886	1,255	(369)	(29.40%)
Travel/meals/entertainment	713	560	153	27.32%
Total other expenses	36,139	33,738	2,401	7.12%
Total noninterest expense	$ 118,403	$ 107,716	$ 10,687	9.92%

Salary and benefits expense, the largest portion of noninterest expense, was $23.25 million, representing 57.79% of total noninterest expense for the quarter ended September 30, 2012 and 56.53% for the nine months ended September 30, 2012. Salary and benefits expense increased $2.35 million, or 11.23%, and $7.48 million, or 12.57%, over the comparative three- and nine-month periods in 2011 and $1.06 million, or 4.75%, over the second quarter of 2012. The increase from both comparative periods of the prior year is primarily due to the addition of staff resulting from the insurance and mortgage expansion and an increase in profit sharing and incentive expenses. The increase from the linked quarter is primarily due to an increase in expense related to the management deferred compensation plan, partially offset by decreases in profit sharing and incentive expenses.

In our Banking segment we had a total of 632 full-time equivalent employees ("FTE") at September 30, 2012, which was up from 607 at September 30, 2011 and down from 656 at June 30, 2012. In our non-Banking segments at September 30, 2012, we had a total of 583 FTEs, excluding real estate sales agents, which was up from 464 at September 30, 2011 and down from 616 at June 30, 2012. Real estate sales agents are independent contractors, and therefore, not included as our employees. Total operating income per FTE was $48,000 for the quarter ended September 30, 2012, unchanged from $48,000 for the three-month period ended September 30, 2011 and an increase from $45,000 for the three-month period ended June 30, 2012.

Occupancy expense for the third quarter of 2012 experienced a 4.09% increase from comparative 2011 and a 2.71% increase from second quarter 2012. Occupancy expense for the first nine months of 2012 increased $347,000, or 3.40%, from comparative 2011. The increase from the comparative periods in the prior year was primarily driven by the expansion of mortgage operations during 2011. The increase from the sequential quarter was primarily a result of increases in utilities, real estate taxes, cleaning and other occupancy costs.

For the three- and nine-month periods ended September 30, 2012, furniture and equipment expense increased by $162,000 and $463,000, respectively, over 2011 and increased by $44,000 compared with the second quarter of 2012.

Other noninterest expenses for the third quarter of 2012 saw an increase of $489,000 , or 4.35%, compared to the same period in 2011, an increase for the first nine months of 2012 of $2.40 million, or 7.12%, compared to the same period in 2011, and a decrease of $1.60 million, or 12.03%, when compared to second quarter 2012. The primary drivers of the increase from the comparative prior year periods were increases in professional fees, higher software expenses, and a one-time impairment charge on a building that was razed on a bank-owned property intended to be the site of a future branch. The increases were partially offset by a decrease in expenses related to foreclosed properties, and Federal Deposit Insurance Corporation ("FDIC") fees, which was related to a change in assessment methodology, effective April 1, 2011. The linked quarter decrease was driven by lower expenses related to foreclosed properties, merger and acquisition costs, advertising and marketing expenses, and charitable contributions. The decrease was partially offset by the building impairment charge.

Provision for Income Taxes. Our effective tax rate increased to 30.29% in the third quarter of 2012 from 29.75% in the comparative period of 2011. For the first nine months of 2012, the effective tax rate increased to 28.92% compared to 28.33% for the same period in 2011.

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.

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For further financial details, see *Note 6 – Segment Reporting* of the Notes to Consolidated Financial Statements in this report.

Banking Segment. For the three months ended September 30, 2012, the Banking segment represented 70.85%, or $6.63 million, of our total consolidated net income compared to 80.59%, or $6.87 million, for comparative 2011. For the nine months ended September 30, 2012, the Banking segment represented 71.04%, or $20.12 million, of our total consolidated net income compared to 79.51%, or $19.35 million, for comparative 2011.

Pre-tax earnings for the three months ended September 30, 2012 for the Banking segment were $9.03 million, decreasing $361,000, or 3.84%, from comparative 2011. The decrease in earnings from comparative 2011 was primarily driven by increases in the provision for loan losses of $3.58 million and in noninterest expenses of $396,000, which were partially offset by an increase in increase in net interest income of $2.41 million, or 7.14%, and an increase in the net gain on investment securities.

Noninterest expenses increased by $396,000, or 1.47%, in the third quarter of 2012 compared to the comparative quarter of 2011. The primary factors in the increase were increases in salaries and employee benefits expense of $635,000, or 4.32%, primarily due to an increase in management deferred compensation expense, an impairment charge, included in other expense, taken on a building that was torn down in preparation for construction of a new bank branch on a bank-owned property, and an increase in furniture and equipment expense of $187,000. Partially offsetting the increases was a decrease of $1.24 million in foreclosed property expenses.

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

	Quarter Ended			Increase/(Decrease)			
	September 30,		June 30,	2012 over 2011		September over June	
	2012	2011	2012	Amount	Percent	Amount	Percent
Net interest income	$ 36,172	$ 33,760	$ 35,067	$ 2,412	7.14%	$ 1,105	3.15%
Service charges on deposit accounts	2,047	1,883	2,010	164	8.71%	37	1.84%
Credit card merchant fees	931	694	1,035	237	34.15%	(104)	(10.05%)
Other income	1,623	1,356	1,161	267	19.69%	462	39.79%
Net gain on investment securities	508	(3)	1,753	511	N/M	(1,245)	(71.02%)
Total noninterest income	5,109	3,930	5,959	1,179	30.00%	(850)	(14.26%)
Total revenue	41,281	37,690	41,026	3,591	9.53%	255	0.62%
Provision for loan losses	4,977	1,400	4,122	3,577	255.50%	855	20.74%
Salaries and employee benefits	15,348	14,713	14,928	635	4.32%	420	2.81%
Occupancy expense	2,720	2,705	2,688	15	0.55%	32	1.19%
Furniture and equipment	1,297	1,110	1,251	187	16.85%	46	3.68%
Other expenses	8,049	8,490	9,152	(441)	(5.19%)	(1,103)	(12.05%)
Total noninterest expenses	27,414	27,018	28,019	396	1.47%	(605)	(2.16%)
Income before income tax and corporate allocation	8,890	9,272	8,885	(382)	(4.12%)	5	0.06%
Corporate allocation	139	118	133	21	17.80%	6	4.51%
Income before income tax provision	9,029	9,390	9,018	(361)	(3.84%)	11	0.12%
Provision for income tax expense	2,404	2,520	1,920	(116)	(4.60%)	484	25.21%
Net income	$ 6,625	$ 6,870	$ 7,098	$ (245)	(3.57%)	$ (473)	(6.66%)

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	Nine Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Net interest income	$ 105,487	$ 100,968	$ 4,519	4.48%
Service charges on deposit accounts	5,755	5,414	341	6.30%
Credit card merchant fees	2,834	1,983	851	42.91%
Other income	3,935	3,560	375	10.53%
Gain on available-for-sale	3,038	3,679	(641)	(17.42%)
Total noninterest income	15,562	14,636	926	6.33%
Total revenue	121,049	115,604	5,445	4.71%
Provision for loan losses	13,196	12,540	656	5.23%
Salaries and employee benefits	44,621	41,200	3,421	8.30%
Occupancy expense	7,969	7,797	172	2.21%
Furniture and equipment	3,803	3,297	506	15.35%
Other expenses	25,375	25,458	(83)	(0.33%)
Total expenses	81,768	77,752	4,016	5.17%
corporate allocation	26,085	25,312	773	3.05%
Corporate allocation	417	359	58	16.16%
Income before income tax provision	26,502	25,671	831	3.24%
Provision for income tax expense	6,387	6,324	63	1.00%
Net income	$ 20,115	$ 19,347	$ 768	3.97%

Realty Segment. For the three months ended September 30, 2012, the Realty segment had income before income tax provision and noncontrolling interest of $3.66 million as compared to $1.65 million for the comparative 2011 period. Total revenue increased to $12.21 million in 2012 from $7.84 million in the third quarter of 2011. The increase in revenue is largely due to an improvement in net mortgage brokerage income as a result of increased volume in purchase and refinancing transactions. As discussed previously, mortgage volumes were positively affected by a degree of stabilization in the housing market and a decrease in mortgage interest rates. Additionally, the Company recognized a gain on rate lock commitments of $30,000 for the quarter ended September 30, 2012 and the expansions of our mortgage operations resulted in additional net brokerage income of $3.35 million as compared to the third quarter of 2011. The linked quarter comparison was affected by a seasonal decrease in resort property management fees for Corolla Classic Vacations.

Expenses for the Realty segment increased 38.17%, or $2.33 million, when compared to the same period in 2011, and increased by 5.38%, or $431,000, when compared to the quarter ended June 30, 2012. The increase from the comparative period in 2011 is primarily due to additional noninterest expenses of $2.18 million related to the expansion of our mortgage operations, while the increase from the linked quarter was primarily due to increases in salary expense in our mortgage operations and increased wages for part-time housekeeping employees at our resort property management operation.

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

	Three Months Ended			Increase/(Decrease)			
				September 30, 2012 September 30, 2011		September 30, 2012 June 30, 2012	
	September 30,		June 30,				
	2012	2011	2012	Amount	Percent	Amount	Percent
Residential mortgage brokerage income, net	$ 7,448	$ 3,412	$ 6,732	$ 4,036	118.29%	$ 716	10.64%
Real estate brokerage income, net	1,408	1,429	1,734	(21)	(1.47%)	(326)	(18.80%)
Title insurance and settlement fees	498	418	482	80	19.14%	16	3.32%
Property management fees, net	1,706	1,882	1,559	(176)	(9.35%)	147	9.43%
Income from unconsolidated subsidiary	175	186	123	(11)	(5.91%)	52	42.28%
Net interest and other income	974	516	1,038	458	88.76%	(64)	(6.17%)
Total revenue	12,209	7,843	11,668	4,366	55.67%	541	4.64%
Salaries and employee benefits	4,942	3,430	4,450	1,512	44.08%	492	11.06%
Occupancy expense	668	565	619	103	18.23%	49	7.92%
Furniture and equipment	190	212	201	(22)	(10.38%)	(11)	(5.47%)
Amortization of intangible assets	162	227	165	(65)	(28.63%)	(3)	(1.82%)
Other expenses	2,487	1,681	2,583	806	47.95%	(96)	(3.72%)
Total expenses	8,449	6,115	8,018	2,334	38.17%	431	5.38%
Income before income tax, corporate allocation and noncontrolling interest	3,760	1,728	3,650	2,032	117.59%	110	3.01%
Corporate allocation	(100)	(76)	(95)	(24)	(31.58%)	(5)	(5.26%)
Income before income tax provision and noncontrolling interest	3,660	1,652	3,555	2,008	121.55%	105	2.95%
Provision for income tax benefit	1,160	570	1,098	590	103.51%	62	5.65%
Net income	2,500	1,082	2,457	1,418	131.05%	43	1.75%
Noncontolling interest	(521)	(207)	(566)	(314)	151.69%	45	(7.95%)
Net income attributable to TowneBank	$ 1,979	$ 875	$ 1,891	$ 1,104	126.17%	$ 88	4.65%
Key data:							
Number of units sold	861	827	959	34	4.11%	(98)	(10.22%)
Volume of units sold	$ 218,762	$ 228,518	$ 276,913	$ (9,756)	(4.27%)	$ (58,151)	(21.00%)
Number of real estate agents	362	419	382	(57)	(13.60%)	(20)	(5.24%)
Loans originated, mortgage	$ 176,039	$ 63,521	$ 165,439	$ 112,518	177.14%	$ 10,600	6.41%
Loans originated, joint venture	191,055	125,023	184,447	66,032	52.82%	6,608	3.58%
Total loans originated	$ 367,094	$ 188,544	$ 349,886	$ 178,550	94.70%	$ 17,208	4.92%
Number of loans, mortgage	806	270	745	536	198.52%	61	8.19%
Number of loans, joint venture	884	583	867	301	51.63%	17	1.96%
Total number of loans	1,690	853	1,612	837	98.12%	78	4.84%
Average loan amount, mortgage	$ 218	$ 235	$ 222	$ (17)	(7.23%)	$ (4)	(1.80%)
Average loan amount, joint venture	216	214	213	2	0.94%	3	1.41%
Average loan amount	$ 217	$ 221	$ 217	$ (4)	(1.81%)	$ 0	0.08%
Average number of originators, mortgage	55	22	48	33	150.00%	7	14.58%
Average number of originators, joint venture	35	38	38	(3)	(7.89%)	(3)	(7.89%)
Average number of originators	90	60	86	30	50.00%	4	4.65%

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	Nine Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Residential mortgage brokerage income, net	$ 20,027	$ 8,445	$ 11,582	137.15%
Real estate brokerage income, net	4,144	4,121	23	0.56%
Title insurance and settlement fees	1,384	1,216	168	13.82%
Property management fees, net	5,637	5,602	35	0.62%
Income from unconsolidated subsidiary	428	460	(32)	(6.96%)
Net interest and other income	2,677	1,549	1,128	72.82%
Total revenue	34,297	21,393	12,904	60.32%
Salaries and employee benefits	13,629	9,834	3,795	38.59%
Occupancy expense	1,871	1,756	115	6.55%
Furniture and equipment	580	618	(38)	(6.15%)
Amortization of intangible assets	501	680	(179)	(26.32%)
Other expenses	6,879	4,947	1,932	39.05%
Total expenses	23,460	17,835	5,625	31.54%
Income before income tax, corporate allocation and noncontrolling interest	10,837	3,558	7,279	204.58%
Corporate allocation	(299)	(211)	(88)	41.71%
Income before income tax provision and noncontrolling interest	10,538	3,347	7,191	214.85%
Provision for income tax expense	3,530	1,639	1,891	115.38%
Net income	7,008	1,708	5,300	310.30%
Noncontolling interest	(1,183)	820	(2,003)	(244.27%)
Net income attributable to TowneBank	$ 5,825	$ 2,528	$ 3,297	130.42%
Key data:				
Number of units sold	2,389	2,280	109	4.78%
Volume of units sold	$ 635,278	$ 610,629	$ 24,649	4.04%
Number of real estate agents	375	425	(50)	(11.76%)
Loans originated, mortgage	$ 482,032	$ 192,637	$ 289,395	150.23%
Loans originated, joint venture	502,177	326,542	175,635	53.79%
Total loans originated	$ 984,209	$ 519,179	$ 465,030	89.57%
Number of loans, mortgage	2,161	775	1,386	178.84%
Number of loans, joint venture	2,338	1,534	804	52.41%
Total number of loans	4,499	2,309	2,190	94.85%
Average loan amount, mortgage	$ 223	$ 249	$ (26)	(10.44%)
Average loan amount, joint venture	215	213	2	0.94%
Average loan amount	$ 219	$ 225	$ (6)	(2.67%)

Mortgage. The loan volume for the combined mortgage operations increased in the quarter ended September 30, 2012 as compared to the same period in 2011. Total loans originated in the third quarter of 2012 were $367.09 million, a 94.70% increase, or $178.55 million from $188.54 million in the comparative period of 2011. This was a $17.21 million, or 4.92%, increase compared to the volume for the quarter ended June 30, 2012. Refinance activity comprised $127.76 million of loan volume for the quarter ended September 30, 2012, while purchases accounted for the remaining $239.33 million in loan volume for the quarter. For the quarters ended September 30, 2011 and June 30, 2012, refinance volume was $43.53 million and $99.09 million, respectively, while purchase volume was $145.01 million and $250.80 million, respectively.

Insurance Segment. The Insurance segment is comprised of property and casualty and group benefit divisions. The Insurance segment represented 7.98%, or $746,000, of total consolidated net income at September 30, 2012 and 9.15%, or $780,000, at September 30, 2011.

Earnings before income taxes and noncontrolling interests for the three months ended September 30, 2012 for the Insurance segment were $1.27 million, decreasing $106,000, or 7.71%, from comparative 2011. Factors contributing to the decrease from the prior year comparative period were costs related to our newly formed premium finance entity, which had noninterest expenses of $56,000, but has not yet recognized revenues, and an increase in noninterest expenses of $104,000 at our travel insurance company due to salaries for new employees and increased professional fees. Also contributing to the variance from the prior year, were the effects of the Stan Taylor acquisition, which resulted in additional net commission income of $263,000 and additional noninterest expense of $286,000. The improvement in earnings from the linked quarter was largely due to a decrease in other operating expenses due to a one-time $500,000 charge, taken in the three-month period ended June 30, 2012, related to the final settlement of the 2009 Taylor Johnson Insurance Group purchase agreement. The decrease was partially offset by increased expenses in our premium finance and travel insurance companies.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2012 September 30, 2011		September 30, 2012 June 30, 2012	
	2012	2011	2012	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 4,102	$ 3,742	$ 3,861	$ 360	9.62%	$ 241	6.24%
Specialized benefit services	132	116	124	16	13.79%	8	6.45%
Employee benefits	1,304	1,329	1,353	(25)	(1.88%)	(49)	(3.62%)
Total net commissions and fees	5,538	5,187	5,338	351	6.77%	200	3.75%
Contingency and bonus revenue	74	130	323	(56)	(43.08%)	(249)	(77.09%)
Other income	64	56	45	8	14.29%	19	42.22%
Total revenues	$ 5,676	$ 5,373	$ 5,706	$ 303	5.64%	$ (30)	(0.53%)
Salaries and employee benefits	$ 2,959	$ 2,758	$ 2,816	$ 201	7.29%	$ 143	5.08%
Occupancy expense	247	223	233	24	10.76%	14	6.01%
Furniture and equipment	133	137	125	(4)	(2.92%)	8	6.40%
Amortization of intangible assets	311	282	311	29	10.28%	-	-
Other expenses	718	556	1,118	162	29.14%	(400)	(35.78%)
Total operating expenses	4,368	3,956	4,603	412	10.41%	(235)	(5.11%)
Income before income tax, corporate allocation and noncontrolling interest	1,308	1,417	1,103	(109)	(7.69%)	205	18.59%
Corporate allocation	(39)	(42)	(38)	3	(7.14%)	(1)	2.63%
Income before income tax provision and noncontrolling interest	1,269	1,375	1,065	(106)	(7.71%)	204	19.15%
Provision for income tax expense	499	520	383	(21)	(4.04%)	116	30.29%
Net income	770	855	682	(85)	(9.94%)	88	12.90%
Noncontrolling interest	(24)	(75)	(143)	51	(68.00%)	119	(83.22%)
Net income attributable to TowneBank	$ 746	$ 780	$ 539	$ (34)	(4.36%)	$ 207	38.40%

	Nine Months Ended September 30,		Increase/(Decrease) 2012 over 2011	
	2012	2011	Amount	Percent
Net commission and fee income				
Property and casualty	$ 11,315	$ 10,163	$ 1,152	11.34%
Specialized Benefit Services	382	323	$ 59	18.27%
Employee benefits	4,115	4,133	$ (18)	(0.44%)
Total net commissions and fees	15,812	14,619	1,193	8.16%
Contingency and bonus revenue	1,570	1,896	(326)	(17.19%)
Other income	172	194	(22)	(11.34%)
Total revenues	$ 17,554	$ 16,709	$ 845	5.06%
Salaries and employee benefits	$ 8,684	$ 8,424	$ 260	3.09%
Occupancy expense	712	652	60	9.20%
Furniture and equipment	395	400	(5)	(1.25%)
Amortization of intangible assets	934	846	88	10.40%
Other expenses	2,450	1,807	643	35.58%
Total operating expenses	13,175	12,129	1,046	8.62%
Income before income tax, corporate allocation and noncontrolling interest	4,379	4,580	(201)	(4.39%)
Corporate allocation	(118)	(148)	30	(20.27%)
Income before income tax provision and noncontrolling interest	4,261	4,432	(171)	(3.86%)
Provision for income tax expense	1,601	1,658	(57)	(3.44%)
Net income	2,660	2,774	(114)	(4.11%)
Noncontolling interest	(285)	(315)	30	(9.52%)
Net income attributable to TowneBank	$ 2,375	$ 2,459	$ (84)	(3.42%)

Salaries and employee benefits expense increased $201,000, or 7.29%, when comparing the three months ended September 30, 2012 to the same period for 2011. The increase was driven by the Stan Taylor business combination, which resulted in salaries and employee benefit expenses of $197,000, and the hiring of employees at our travel insurance company, which resulted in an increase of $73,000. The increase was partially offset by a decrease of $54,000 at our employee benefits company.

Occupancy expense increased $24,000, or 10.76%, when comparing the three months ended September 30, 2012 to the same period for 2011. The primary driver of the increase was the Stan Taylor business combination.

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2012, total assets were $4.32 billion, which is $290.07 million, or 7.20%, greater than the period end balance for comparative 2011 and $87.32 million, or 2.06%, greater than the balance at June 30, 2012. Our loan portfolio, less unearned income and deferred costs, made up 70.17% of our period end assets and totaled $3.03 billion at September 30, 2012. Average assets for the quarter ended September 30, 2012 were $4.24 billion, up $227.46 million, or 5.67%, from comparative September 30, 2011 and $111.72 million, or 2.71%, from the quarter ended June 30, 2012.

Average earning assets increased $220.99 million, or 6.09%, from $3.63 billion for the third quarter of 2011 to $3.85 billion for the third quarter of 2012. Compared to the second quarter of 2012, average earning assets increased $114.87 million.

Our average total deposits were $3.33 billion for third quarter 2012, reflecting growth of $203.43 million, or 6.50%, compared to third quarter 2011. Average noninterest bearing deposits, which increased $136.49 million, or 16.96%, grew at a significantly higher rate than interest bearing deposits over comparative 2011.

Interest Bearing Deposits in Financial Institutions. Interest bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest bearing deposit balances at September 30, 2012 were $234.69 million and consisted mainly of overnight deposits with the Federal Reserve Bank of Richmond.

The average balance of interest bearing deposits in other banks and federal funds sold during the third quarter of 2012 was $297.36 million, or 7.72%, of average total earning assets compared with $428.44 million, or 11.81%, of average total earning assets for comparative 2011. For the second quarter of 2012, the average balance of interest bearing deposits in other banks was $244.82 million, or 6.55%, of average total earning assets.

Securities Available for Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The securities available for sale portfolio was $335.50 million at September 30, 2012 compared with $220.12 million at September 30, 2011. The average balance during the third quarter of 2012 was $214.48 million compared to the 2011 period average of $222.88 million, or 5.57% and 6.14% of average earning assets, respectively. During the three months ended September 30, 2012, we had sales, maturities and calls totaling $165.21 million, in investment securities that were classified as available for sale.

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

Securities Held to Maturity. Held-to-maturity securities are valued at amortized cost. Securities held to maturity were $155.91 million at September 30, 2012 and $158.64 million at September 30, 2011. The average balance during the third quarter of 2012 was $155.44 million compared with $181.53 million in the 2011 period, representing 4.04% and 5.0% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At September 30, 2012, we held $124.78 million in mortgage loans originated and intended for sale in the secondary market, as compared with $62.94 million for comparative 2011 and $152.33 million for the quarter ended June 30, 2012.

Average loans held for sale were 3.61% and 1.28% of average earning assets for the quarters ended September 30, 2012 and 2011, respectively. Average loans held for sale were 3.40% of average earning assets for the quarter ended June 30, 2012. The majority of mortgage loans held for sale have been pre-committed to investors, which minimizes our interest rate risk.

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

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

Loan Portfolio. Loans, net of unearned income and deferred costs, were $3.03 billion at September 30, 2012, which was $303.20 million, or 11.12%, above the $2.73 billion reported at September 30, 2011 and $27.63 million, or 0.92%, above the $3.0 billion at June 30, 2012. Factors that contributed to the increase in our loan demand were the stabilization of our local economy, and the efforts of our experienced loan officers in developing new loan relationships, combined with the support of existing customers and directors. As a percentage of total average earning assets, average loans were 76.85% for the quarter ended September 30, 2012 compared with 73.39% for 2011 and 77.09% for the quarter ended June 30, 2012.

Allowance for Loan Losses and Asset Quality. The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on management's evaluation of the risk inherent in the loan portfolio at the balance sheet date and changes in the nature and volume of loan activity. This evaluation includes a review of loans for which collection may not be reasonably assured. It considers internal risk grades, the estimated fair value of the underlying collateral, current 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 Accounting Standards Codification ("ASC") Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 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 Topic 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 and the peer review committees may review the classification to ensure accuracy and consistency of classifications, which are then validated by the chief credit officer. Loan classifications are internally reviewed to determine if any changes in the circumstances of the loan require a different risk grade. To determine the most appropriate risk grade classification for each loan, the credit officers examine the borrower's liquidity level, asset quality, the amount of the borrower's other indebtedness, cash flow, earnings, sources of financing, and existing lending relationships. The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans.

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

During the current quarter, management updated the look-back period for calculating historical losses for all classes of loans from eight quarters to 12 quarters. In the current economic environment, we believe the extension of our look-back period was appropriate due to the risks inherent in our loan portfolio. Absent the extension of our look-back periods, early cycle losses during 2010 would be excluded from the determination of the historical loss rates. We believe this period remains a relevant indicator of the current credit cycle and in determining the risks in the loan portfolio. As we progress through this economic cycle, we will continue to evaluate the appropriateness of the look-back period utilized as we seek to capture the inherent risks in our portfolio. This refinement of our historical loss calculation period did not have a material impact on our allowance for loan losses or provision expense.

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

The allowance for loan losses at September 30, 2012, September 30, 2011, and June 30, 2012 was $39.34 million, $40.94 million, and $40.37 million, respectively. The allowance was equal to 1.30% of total loans outstanding at September 30, 2012, compared with 1.50% and 1.34% at September 30, 2011 and June 30, 2012, respectively. The most significant factor in the decline was a reduction in specific reserves due to improved valuations and charge-offs of loans with reserves, as general reserves as a percentage of total loans outstanding remained relatively unchanged from the prior quarter. We believe the decline in the ratio is appropriate given the continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Further, we believe that early and aggressive action plans for loans with identified changes in credit metrics, combined with originating high quality new loans will facilitate continued improvement in our key credit metrics. Reflective of improving metrics, classified loans, defined as loans in the substandard and doubtful categories, decreased to 3.36% of total loans at September 30, 2012 from 4.34% at September 31, 2011, and 3.61% at June 30, 2012, and loans 30 to 89 days past due fell to $11.16 million at September 30, 2012 from $18.13 million and $17.33 million at September 30, 2011 and June 30, 2012, respectively. Also reflecting improvement in our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 76% of nonperforming loans at September 30, 2012, compared with 65% and 79% at September 30, 2011 and June 30, 2012. However, although overall economic conditions have shown some recent improvement, the residential real estate market remained stressed and risks to a full recovery remain. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at September 30, 2012.

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

	Three Months Ended			Nine Months Ended	
	September 30,		June 30,	September 30,	September 30,
	2012	2011	2012	2012	2011
Allowance for loan losses					
Balance beginning of period	$ 40,370	$ 41,787	$ 40,034	$ 39,740	$ 38,660
Loans charged off:					
Residential 1-4 family	(958)	(1,193)	(470)	(3,231)	(3,909)
Multifamily	(345)	-	-	(345)	-
Commercial real estate	(1,086)	(52)	(1,826)	(3,198)	(583)
Construction	(2,568)	(1,261)	(1,371)	(5,691)	(6,417)
Commercial and industrial	(1,083)	(66)	(328)	(1,791)	(497)
Consumer and other	(101)	(117)	(99)	(310)	(297)
Total	(6,141)	(2,689)	(4,094)	(14,566)	(11,703)
Loans recovered:					
Residential 1-4 family	99	87	213	774	327
Multifamily	-	2	-	-	3
Commercial real estate	8	-	36	47	12
Construction	-	336	1	51	734
Commercial and industrial	18	13	13	41	77
Consumer and other	5	5	45	53	291
Total	130	443	308	966	1,444
Net loans charged off	(6,011)	(2,246)	(3,786)	(13,600)	(10,259)
Provision for loan losses	4,977	1,400	4,122	13,196	12,540
Balance end of period	$ 39,336	$ 40,941	$ 40,370	$ 39,336	$ 40,941
Nonperforming assets					
Nonperforming loans	$ 51,519	$ 62,574	$ 51,117	$ 51,519	$ 62,574
Foreclosed property	30,910	26,553	29,775	30,910	26,553
Total nonperforming assets	$ 82,429	$ 89,127	$ 80,892	$ 82,429	$ 89,127
Loans past due 90 days and still accruing interest	$ -	$ 1,469	$ 112	$ -	$ 1,469
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	0.76x	0.65x	0.79x	0.76x	0.65x
Allowance for loan losses to period end loans	1.30%	1.50%	1.34%	1.30%	1.50%
Nonperforming loans to period end loans	1.70%	2.29%	1.70%	1.70%	2.29%
Nonperforming assets to period end assets	1.91%	2.21%	1.91%	1.91%	2.21%
Net charge-offs to average loans (annualized)	0.79%	0.33%	0.52%	0.60%	0.50%

Nonperforming assets consist of nonaccrual loans, foreclosed real estate, and other repossessed collateral. It is our policy to place commercial loans on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 90 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. When loans are placed on nonaccrual status, interest receivable is reversed against interest income recognized in the current period, and any prior year unpaid interest is charged off against the allowance for loan losses. Interest payments received thereafter are applied as a reduction of the remaining principal balance so long as doubt exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when the collection of principal or interest is no longer doubtful. Similarly, 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. At September 30, 2012, we had $82.43 million in nonperforming assets, which amounted to 1.91% of total assets. Additionally, there were no loans past due 90 days or more that were accruing interest. Nonperforming assets consist of $51.52 million in nonperforming loans as well as $30.91 million in foreclosed property. Foreclosed property consists of 32 residential properties, 57 construction and development properties, and nine commercial properties.

At September 30, 2012, loans 60-89 days past due totaled $2.39 million. Additionally, there are other performing loans, totaling $52.76 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 the collection of loan balances, we evaluate troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. We may pursue loan modifications when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. Because some troubled debt restructurings ("TDRs") may not ultimately result in the complete collection of principal and interest (as modified by the terms of the restructuring), additional incremental losses could result. These potential incremental losses have been factored into our overall allowance for loan losses estimate. At September 30, 2012, nonaccruing TDRs, which are included in nonperforming loans, totaled $23.64 million and accruing TDRs totaled $37.01 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current 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.

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

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

	September 30, 2012	December 31, 2011
1-4 family residential real estate	$ 13,336	$ 10,394
Commercial real estate	8,108	5,561
Construction and land development	27,699	36,712
Commercial and industrial business loans	1,985	2,644
Consumer loans and other	391	490
Total nonperforming loans	$ 51,519	$ 55,801

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

	September 30,		June 30,
	2012	2011	2012
Real estate loans:			
Residential 1-4 family	$ 11,222	$ 11,506	$ 10,455
Commercial	12,245	10,351	12,152
Construction	10,719	13,949	13,091
Multi-family	653	312	404
Total real estate loans	34,839	36,118	36,102
Commercial and industrial loans	3,981	4,380	3,854
Consumer loans and other	516	443	414
Total	$ 39,336	$ 40,941	$ 40,370

Deposits. Total deposits at September 30, 2012 were $3.31 billion, representing an increase of 5.01%, or $157.78 million, over September 30, 2011, and a decrease of $24.51 million, or 0.74%, compared to June 30, 2012. Overall growth in deposits is primarily attributed to an increase in the Banking segment customer base and in the number of accounts. Total average deposits were $3.33 billion during the third quarter of 2012 compared to $3.13 billion during the third quarter of 2011 and 3.24 billion during the second quarter of 2012.

Average noninterest bearing demand deposits as a percentage of average total deposits were 28.24% during the third quarter of 2012 and 25.72% during the same period in 2011. Average noninterest bearing demand deposits were 27.14% of average total deposits for the second quarter of 2012. The cost of interest bearing deposits was 0.70% for the third quarter of 2012 compared with 0.95% for the third quarter of 2011 and 0.73% for the second quarter of 2012.

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

The following tables set forth a summary of our various deposit categories and their respective cost rates (dollars in thousands).

	Average Balance/Cost Rate Three Months Ended					
	September 30,				June 30,	
	2012		2011		2012	
Interest bearing demand and money market accounts	$ 1,084,821	0.41%	$ 910,629	0.59%	$ 1,060,116	0.41%
Regular savings	194,180	0.50%	169,912	0.72%	194,517	0.51%
Certificates of deposit	1,112,558	1.02%	1,244,072	1.24%	1,102,850	1.09%
Total interest bearing	2,391,559	0.70%	2,324,613	0.95%	2,357,483	0.74%
Noninterest bearing	941,286		804,798		878,114	
Total	$ 3,332,845	0.50%	$ 3,129,411	0.70%	$ 3,235,597	0.54%

	Average Balance/Cost Rate Nine Months Ended			
	September 30, 2012		September 30, 2011	
Interest bearing demand and money market accounts	$ 1,052,437	0.42%	$ 855,151	0.57%
Regular savings	194,397	0.53%	156,412	0.74%
Certificates of deposit	1,120,374	1.05%	1,293,169	1.34%
Total interest bearing	2,367,208	0.73%	$ 2,304,732	1.01%
Noninterest bearing	883,553		760,534	
Total	$ 3,250,761	0.53%	$ 3,065,266	0.76%

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

	Average Balance and Composition Three Months Ended					
	September 30,				June 30,	
	2012		2011		2012	
Interest bearing demand and money market accounts	$ 1,084,821	32.55%	$ 910,629	29.10%	$ 1,060,116	32.76%
Regular savings	194,180	5.83%	169,912	5.43%	194,517	6.01%
Certificates of deposit	1,112,558	33.38%	1,244,072	39.75%	1,102,850	34.08%
Total interest bearing	2,391,559	71.76%	2,324,613	74.28%	2,357,483	72.86%
Noninterest bearing	941,286	28.24%	804,798	25.72%	878,114	27.14%
Total	$ 3,332,845	100.00%	$ 3,129,411	100.00%	$ 3,235,597	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Borrowings of advances from the Federal Home Loan Bank of Atlanta ("FHLB") as of September 30, 2012 were $380.0 million, compared to $280.0 million at September 30, 2011 and $280.0 million at June 30, 2012. The average borrowing cost for the third quarter of 2012 was 3.35%, compared to 4.18% for the same period in 2011 and 4.20% for the second quarter of 2012. The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2012 are summarized as follows (dollars in thousands).

Maturity	Interest Rate	Call Date		Outstanding Amount
03/06/2017	4.08%	12/06/2012	$	100,000
05/18/2017	4.35%	11/19/2012		80,000
05/18/2017	4.48%	11/19/2012		80,000
01/29/2018	3.05%	-		13,000
01/29/2018	3.05%	-		7,000
09/28/2015	0.55%	-		33,000
09/28/2017	0.95%	-		34,000
09/30/2019	1.44%	-		33,000
		Total FHLB Loans	**$**	**380,000**

At September 30, 2012, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $776.48 million collateralized the advances from the FHLB. At September 30, 2011, certain loans with carrying values of $627.88 million collateralized the advances from the FHLB. At June 30, 2012, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $769.41 million collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of September 30, 2012, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the third quarter of 2012 were $295.62 million compared with $302.31 million for the third quarter of 2011 and $291.76 million for the second quarter of 2012, while the average cost of these funds was 4.01%, 4.00% and 4.05%, respectively.

Convertible Subordinated Capital Debentures. During the first quarter of 2012, TowneBank announced the mandatory conversion of its outstanding Series III notes. At the close of business on March 19, 2012, all $13.60 million of outstanding Series III notes were converted into shares of TowneBank common stock at the conversion price of $13.38 per share (equal to a conversion rate of 149.48 shares per $2,000 principal amount of notes). There were no convertible subordinated capital debentures at September 30, 2012. At September 30, 2011, the debentures totaled $13.74 million, and at December 31, 2011, they were $13.74 million.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* on page 38 in this report.

On February 22, 2012, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on April 12, 2012 to shareholders of record on March 30, 2012.

On April 25, 2012 we declared a special shareholder stock dividend of 3% per common share. The dividend was paid on June 12, 2012 to shareholders of record on May 25, 2012.

On May 30, 2012, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on July 12, 2012 to shareholders of record on June 29, 2012.

On August 22, 2012, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on October 12, 2012 to shareholders of record on September 28, 2012. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

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

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

An additional measure of capital adequacy is risk-based capital ratios. As indicated below, our risk-based capital ratios are 12.88% for Tier I and 14.03% for total capital, which are both well above the required minimums of 4.00% and 8.00%, respectively. Under the FDIC rules, we are considered "well capitalized" as of September 30, 2012.

During the second quarter of 2012, the Agencies jointly issued three notices of proposed rulemaking ("NPRs") that would significantly revise the current regulatory capital requirements, if implemented. The impact of these NPRs, if adopted, would result in higher risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision, referred to as Basel III. The majority of the provisions contained within the NPRs would be phased-in over periods ranging from three to 10 years. The proposed NPRs were in a comment period through October 22, 2012, and are subject to further modification by the Agencies. We are currently in the process of evaluating the impact of the proposed NPRs on our regulatory capital ratios; however, we anticipate that our capital ratios would continue to exceed the well-capitalized minimum requirements on a fully phased-in basis.

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

The following table provides information on our risk-based capital position (dollars in thousands).

	September 30, 2012	September 30, 2011	June 30, 2012
Tier I Capital:			
Shareholders' equity (1)(2)	$ 551,864	$ 511,992	$ 545,703
Less: goodwill and intangible assets, net of deferred tax	111,996	113,056	112,582
Total Tier I	439,868	398,936	433,121
Tier II Capital:			
Convertible subordinated debentures	-	13,740	-
Qualifying allowance for loan losses (3)	39,336	39,124	40,370
Total Tier II	39,336	52,864	40,370
Total Risk Based Capital	$ 479,204	$ 451,800	$ 473,491
Total Assets	$ 4,318,309	$ 4,028,244	$ 4,230,993
Total risk weighted assets	3,415,756	3,128,103	3,513,744
Average assets for leverage capital purposes	4,127,842	3,899,321	4,015,534
Risk Weighted Assets to Total Assets	79.10%	77.65%	83.05%
Risk Based Capital Ratios:			
Tier I (4% minimum requirement)	12.88%	12.75%	12.33%
Total (8% minimum requirement)	14.03%	14.44%	13.48%
Tier I Leverage Ratio (4% minimum requirement)	10.66%	10.23%	10.79%

(1) Excludes unrealized gains/losses on securities available for sale.

(2) Includes adjustments per regulatory guidelines.

(3) Limited to 1.25% of risk weighted assets.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Return on average assets (GAAP basis)	0.88%	0.84%	0.91%	0.82%
Impact of excluding average goodwill and other intangibles and amortization	0.02%	0.03%	0.03%	0.02%
Return on average tangible assets	0.90%	0.87%	0.94%	0.84%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Return on average equity (GAAP basis)	6.73%	6.59%	6.99%	6.39%
Impact of excluding average goodwill and other intangibles and amortization	1.74%	1.87%	1.86%	1.82%
Return on average tangible equity	8.47%	8.46%	8.85%	8.21%

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

	Three Months Ended September 30,	
	2012	2011
Book value (GAAP basis)	$ 13.14	$ 12.51
Impact of excluding goodwill and other intangibles and amortization	(3.61)	(3.78)
Tangible book value	$ 9.53	$ 8.73

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

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

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

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

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

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

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

At September 30, 2012, we had $107.39 million more liabilities than assets subject to repricing within one year, and therefore, were in a liability-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

PART I. FINANCIAL INFORMATION
Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2012, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2012. There were no changes that occurred during the period covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

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

Item 1A. Risk Factors.
For information regarding factors that could affect the Company's results of operations, financial condition or liquidity, see the risk factors discussed in Part I, Item 1A of TowneBank's 2011 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2 of this Quarterly Report on Form 10-Q. Other than as set forth below, there have been no material changes from the risk factors previously disclosed in TowneBank's 2011 Annual Report on Form 10-K.

Proposed rules may require higher capital levels, impacting our profitability, lending and ability to pay common stock dividends.

In June 2012, the Federal Reserve, Office of the Comptroller of the Currency, and FDIC issued three Notices of Proposed Rulemaking ("NPRs") that would revise and replace the current capital rules to align with the Basel III capital standards and meet certain requirements of the Dodd-Frank Act. Certain requirements of the proposed NPRs would establish more restrictive capital definitions, higher risk-weightings for certain asset classes, capital buffers and higher minimum capital ratios. The potential impact of Basel III includes, but is not limited to, reduced lending and negative pressure on profitability and return on equity due to the higher capital requirements. To the extent the Company is required to increase capital in the future to comply with Basel III, our ability to pay common stock dividends may be reduced. The proposed NPRs were in a comment period through October 22, 2012, and are subject to further modification.

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

Item 3. Defaults Upon Senior Securities.
None

Item 4. Mine Safety Disclosures.
Not applicable

Item 5. Other Information.
None

Item 6. Exhibits.

Exhibit No.	Description
(31.1)	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
(99)	Independent Accountants' Report by Dixon Hughes Goodman LLP, dated November 8, 2012

Signatures

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

TOWNEBANK

November 8, 2012	By:	/s/ G. Robert Aston, Jr.
Date		G. Robert Aston, Jr. Chairman/Chief Executive Officer
November 8, 2012	By:	/s/ Clyde E. McFarland, Jr.
Date		Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

Exhibit (31.1)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2012 of TowneBank;

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

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

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 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 our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

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

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

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

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

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

Exhibit (31.1)
continued

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

November 8, 2012	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer

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

Exhibit (31.2)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2012 of TowneBank;

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

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

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 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 our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

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

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

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

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

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

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

November 8, 2012	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

Exhibit (32)

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

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

1. Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

November 8, 2012	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer
November 8, 2012	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

DIXON HUGHES GOODMAN LLP
Certified Public Accountants and Advisors

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of *TowneBank*

We have reviewed the accompanying consolidated balance sheets of *TowneBank* and subsidiaries (the Company) as of September 30, 2012 and 2011, the related consolidated statements of income, comprehensive income, equity and cash flows for the three-month and nine-month periods then ended. This condensed financial information is the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated balance sheet of *TowneBank* and subsidiaries as of December 31, 2011, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated March 13, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Dixon Hughes Goodman LLP

Norfolk, Virginia
November 8, 2012