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, 2016

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, 2016 was 62,387,911 shares.

TOWNEBANK

TABLE OF CONTENTS

Part I. Financial Information

Item 1.	**Financial Statements**	
	Consolidated Balance Sheets	3
	September 30, 2016 (unaudited)	
	September 30, 2015 (unaudited)	
	December 31, 2015 (audited)	
	Consolidated Statements of Income	4
	Three and Nine Months Ended September 30, 2016 (unaudited)	
	Three and Nine Months Ended September 30, 2015 (unaudited)	
	Consolidated Statements of Comprehensive Income	5
	Three and Nine Months Ended September 30, 2016 (unaudited)	
	Three and Nine Months Ended September 30, 2015 (unaudited)	
	Consolidated Statements of Cash Flow	6
	Nine Months Ended September 30, 2016 (unaudited)	
	Nine Months Ended September 30, 2015 (unaudited)	
	Consolidated Statement of Equity	7
	Nine Months Ended September 30, 2016 (unaudited)	
	Notes to Consolidated Financial Statements	8
Item 2.	**Management's Discussion and Analysis of Financial Condition and Results of Operations**	45
Item 3.	**Quantitative and Qualitative Disclosures About Market Risk**	79
Item 4.	**Controls and Procedures**	81

Part II. Other Information

Item 1.	**Legal Proceedings**	82
Item 1A.	**Risk Factors**	82
Item 2.	**Unregistered Sales of Equity Securities and Use of Proceeds**	82
Item 3.	**Defaults Upon Senior Securities**	82
Item 4.	**Mine Safety Disclosures**	82
Item 5.	**Other Information**	82
Item 6.	**Exhibits**	82

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

(In thousands, except share data)	September 30, 2016	September 30, 2015	December 31, 2015
	(unaudited)	(unaudited)	(audited)
ASSETS			
Cash and due from banks	$ 147,887	$ 284,625	$ 250,836
Interest-bearing deposits in financial institutions	6,891	1,000	1,001
Total Cash and Cash Equivalents	154,778	285,625	251,837
Securities available for sale, at fair value	704,418	542,634	723,489
Securities held to maturity, at amortized cost	70,304	75,154	69,045
Federal Home Loan Bank stock, at amortized cost	24,888	24,058	23,691
Total Securities	799,610	641,846	816,225
Mortgage loans held for sale	439,608	99,330	102,346
Loans, net of unearned income and deferred costs:			
Real estate - residential 1-4 family	1,208,001	965,559	973,331
Real estate - commercial	2,189,489	1,796,150	1,784,393
Real estate - construction and land development	820,453	554,753	598,875
Real estate - multifamily	206,623	138,954	167,371
Commercial and industrial business	1,033,797	790,614	857,036
Consumer and other loans	193,279	121,009	138,387
Loans, net of unearned income and deferred costs	5,651,642	4,367,039	4,519,393
Less: Allowance for loan losses	(40,655)	(37,351)	(38,359)
Net Loans	5,610,987	4,329,688	4,481,034
Premises and equipment, net	202,955	172,940	173,695
Goodwill	264,578	152,438	154,842
Other intangible assets, net	39,747	23,080	26,153
Bank-owned life insurance policies	163,385	147,949	149,452
Other assets	154,494	320,995	140,990
TOTAL ASSETS	$ 7,830,142	$ 6,173,891	$ 6,296,574
LIABILITIES AND EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 1,974,395	$ 1,445,978	$ 1,393,264
Interest-bearing:			
Demand and money market accounts	2,207,962	1,676,623	1,824,226
Savings	315,477	295,952	300,408
Certificates of deposit	1,649,113	1,369,325	1,396,129
Total Deposits	6,146,947	4,787,878	4,914,027
Advances from the Federal Home Loan Bank	427,655	437,282	429,080
Repurchase agreements and other borrowings	31,927	33,784	37,434
Total Borrowings	459,582	471,066	466,514
Other liabilities	144,735	98,878	95,839
TOTAL LIABILITIES	6,751,264	5,357,822	5,476,380
Shareholders' Equity			
Preferred stock:			
Authorized and unissued shares - 2,000,000	—	—	—
Common stock, $1.667 par: 90,000,000 shares authorized 62,387,564; 51,580,762; and 51,605,521 shares issued at September 30, 2016 and 2015 and December 31, 2015, respectively	104,000	85,985	86,026
Capital surplus	743,223	533,609	535,094
Retained earnings	218,631	186,522	192,795
Common stock issued to deferred compensation trust, at cost 683,833; 651,362; and 648,350 shares at September 30, 2016 and 2015 and December 31, 2015, respectively	(10,969)	(10,151)	(10,172)
Deferred compensation trust	10,969	10,151	10,172
Accumulated other comprehensive income (loss)	1,339	1,036	(2,994)
TOTAL SHAREHOLDERS' EQUITY	1,067,193	807,152	810,921
Noncontrolling interests	11,685	8,917	9,273
TOTAL EQUITY	1,078,878	816,069	820,194
TOTAL LIABILITIES AND EQUITY	$ 7,830,142	$ 6,173,891	$ 6,296,574

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

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

(Dollars in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
INTEREST INCOME:				
Loans, including fees	$ 64,623	$ 48,906	$ 166,313	$ 144,418
Investment securities	3,099	3,728	9,703	10,386
Interest-bearing deposits in financial institutions and federal funds sold	(36)	107	658	287
Mortgage loans held for sale	4,137	1,246	6,124	2,971
Total Interest Income	71,823	53,987	182,798	158,062
INTEREST EXPENSE:				
Deposits	5,909	4,881	16,389	13,747
Advances from the Federal Home Loan Bank	3,276	3,422	9,606	10,160
Repurchase agreements and other borrowings	33	14	79	44
Total Interest Expense	9,218	8,317	26,074	23,951
Net Interest Income	62,605	45,670	156,724	134,111
PROVISION FOR LOAN LOSSES	1,686	130	3,526	2,176
Net Interest Income after Provision for Loan Losses	60,919	45,540	153,198	131,935
NONINTEREST INCOME:				
Residential mortgage banking income, net	21,430	8,262	40,696	26,956
Insurance commissions and other title fees and income, net	11,258	9,710	36,918	30,644
Real estate brokerage and property management income, net	6,647	5,349	17,591	13,888
Service charges on deposit accounts	2,552	2,388	7,012	6,911
Credit card merchant fees, net	1,365	823	3,373	1,821
Other income	3,569	3,036	10,114	11,081
Net gain on investment securities	—	736	—	904
Total Noninterest Income	46,821	30,304	115,704	92,205
NONINTEREST EXPENSE:				
Salaries and employee benefits	40,497	28,910	100,776	83,133
Occupancy expense	6,656	4,703	16,831	14,489
Furniture and equipment	3,199	2,211	7,937	6,949
Other expenses	20,581	14,082	69,448	44,843
Total Noninterest Expense	70,933	49,906	194,992	149,414
Income before income tax expense and noncontrolling interest	36,807	25,938	73,910	74,726
Provision for income tax expense	10,974	7,444	21,538	22,030
Net income	25,833	18,494	52,372	52,696
Net income attributable to noncontrolling interest	(1,657)	(928)	(4,118)	(2,780)
Net income attributable to TowneBank	$ 24,176	$ 17,566	$ 48,254	$ 49,916
Preferred stock dividends	—	—	—	13
Net income available to common shareholders	$ 24,176	$ 17,566	$ 48,254	$ 49,903
Per common share information				
Basic earnings	$ 0.39	$ 0.34	$ 0.88	$ 0.98
Diluted earnings	$ 0.39	$ 0.34	$ 0.87	$ 0.98
Cash dividends declared	$ 0.13	$ 0.12	$ 0.38	$ 0.35

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,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$ 25,833	$ 18,494	$ 52,372	$ 52,696
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	(516)	1,822	6,294	1,536
Deferred tax benefit (expense)	180	(638)	(2,203)	(538)
Realized gains reclassified into earnings	—	(736)	—	(785)
Deferred tax benefit	—	258	—	275
Net unrealized gains (losses)	(336)	706	4,091	488
Pension and postretirement benefit plans				
Actuarial gains	—	—	109	—
Deferred tax expense	—	—	(38)	—
Amortization of prior service costs	110	—	263	—
Deferred tax expense	(38)	—	(91)	—
Amortization of net actuarial (gain) loss	(2)	60	(2)	138
Deferred tax benefit (expense)	1	(21)	1	(48)
Change in defined benefit retirement plan, net of tax	71	39	242	90
Other comprehensive income (loss), net of tax	(265)	745	4,333	578
Comprehensive income	$ 25,568	$ 19,239	$ 56,705	$ 53,274

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, 2016	Nine Months Ended September 30, 2015
OPERATING ACTIVITIES:		
Net income	$ 52,372	$ 52,696
Adjustments to reconcile net income to net cash from (used for) operating activities:		
Net amortization of securities	1,934	2,479
Investment securities gains	—	(904)
Depreciation, amortization, and other intangible amortization	14,573	11,981
Provision for loan losses	3,526	2,176
Bank-owned life insurance income	(3,616)	(3,688)
Deferred income tax expense (benefit)	2,058	(2,056)
Share-based compensation expense	1,495	1,658
Originations of mortgage loans held for sale	(1,964,447)	(1,126,580)
Proceeds from sales of mortgage loans held for sale	1,978,432	1,138,103
Gain on sales of mortgage loans held for sale	(67,719)	(39,463)
(Gain) loss on sale and write-down of foreclosed assets	105	844
Changes in:		
Interest receivable	(6,178)	(1,774)
Other assets	29,266	(38,651)
Interest payable	910	586
Other liabilities	27,206	(300)
Net cash from (used for) operating activities	69,917	(2,893)
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(608,877)	(278,400)
Purchase of held-to-maturity securities	(6,062)	—
Sale of available-for-sale securities	—	234,909
Sale of held-to-maturity securities	—	2,272
Sale of FHLB stock	3,121	8,113
Proceeds from maturities, calls, and prepayments of available-for-sale securities	648,967	149,120
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	4,646	7,767
Net increase in loans	(327,790)	(311,026)
Purchase of premises and equipment	(16,855)	(19,327)
Proceeds from sales of premises and equipment	1,476	3,641
Proceeds from sales of foreclosed assets	12,093	17,614
Cash acquired in acquisitions of business, net of cash consideration paid	61,930	247,881
Net cash from (used for) investing activities	(227,351)	62,564
FINANCING ACTIVITIES:		
Net change in deposit accounts	171,300	258,330
Net change in borrowings	(88,972)	(150,480)
Redemption of preferred stock	—	(76,458)
Distribution of interest in joint ventures	(1,706)	(3,195)
Proceeds from issuance of common stock	2,171	1,801
Cash dividends paid	(22,418)	(18,049)
Net cash from (used for) financing activities	60,375	11,949
Change in cash and cash equivalents	(97,059)	71,620
Cash and cash equivalents at beginning of year	251,837	214,005
Cash and cash equivalents at end of period	$ 154,778	$ 285,625
Supplemental cash flow information:		
Cash paid for interest	$ 25,662	$ 23,365
Cash paid for income taxes	$ 14,592	$ 10,720
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	$ 2,449	$ 6,316
Sales of foreclosed assets financed by the Company	$ 4,117	$ 9,791
Net unrealized gains on available-for-sale securities, net of tax	$ 4,091	$ 488
Shares issued for business acquisitions	$ 222,431	$ 238,755
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 6	$ 7

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

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

(Dollars in thousands)	Common Shares	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total
Balance, January 1, 2016	**51,605,521**	**$ 86,026**	**$ 535,094**	**$ 192,795**	**$ 10,172**	**$ (10,172)**	**$ (2,994)**	**$ 9,273**	**$ 820,194**
Net income	—	—	—	48,254	—	—	—	4,118	52,372
Other comprehensive income, net of taxes	—	—	—	—	—	—	4,333	—	4,333
Cash dividends declared on common stock	—	—	—	(22,418)	—	—	—	—	(22,418)
Director's deferred compensation	—	—	—	—	797	(797)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,706)	(1,706)
Conversion of convertible debt into common stock	486	1	5	—	—	—	—	—	6
Issuance of common stock - contingent consideration earned on acquisitions	81,353	136	1,539	—	—	—	—	—	1,675
Issuance of common stock - acquisitions	10,487,069	17,482	204,949	—	—	—	—	—	222,431
Issuance of common stock - stock compensation plans	213,135	355	1,636	—	—	—	—	—	1,991
Balance, September 30, 2016	**62,387,564**	**$ 104,000**	**$ 743,223**	**$ 218,631**	**$ 10,969**	**$ (10,969)**	**$ 1,339**	**$ 11,685**	**$ 1,078,878**

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

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

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of TowneBank (the "Company") have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes necessary for a complete presentation of financial position, results of operations, and cash flow activity required in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments, which are of a normal, recurring nature that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01 of the Securities and Exchange Commission (the "SEC"). These statements should be read in conjunction with the Company's 2015 audited Consolidated Financial Statements and the 2015 Annual Report on Form 10-K. Results of operations for the three- and nine-month periods ended September 30, 2016, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Recent accounting pronouncements

In February 2015, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis.* The ASU changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments include: (1) modifying the evaluation of limited partnerships and similar legal entities, (2) amending when fees paid to a decision maker should be included in the variable interest entity analysis, (3) amending the related party relationship guidance, and (4) providing a scope exception from the consolidation guidance for reporting entities with interests in certain investment funds. The ASU is effective for interim and annual reporting periods beginning after December 15, 2015. The adoption of this guidance did not have a material impact on the Company's Consolidated Financial Statements.

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

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The ASU amends the Financial Instruments topic of the ASC to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for interim and annual reporting periods beginning after December 15, 2017. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company is

currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements, but does not expect the adoption of this guidance to have a material impact.

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

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The ASU amends ASC Topic 718, *Compensation – Stock Compensation*. The ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The ASU is effective for interim and annual periods beginning after December 15, 2016, and early adoption is permitted. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements, but does not expect the adoption of this guidance to have a material impact.

In June 2016, the FASB issued ASU 2016-13*, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU was issued to change the accounting for credit losses and modify the impairment model for certain debt securities. The ASU is effective for the Company for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the effect that implementation of the new standard will have on its Consolidated Financial Statements.

Note 2. Earnings per Share and Shareholders' Equity

Earnings per share

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic				
Net income, as reported	$ 24,176	$ 17,566	$ 48,254	$ 49,916
Preferred stock dividends	—	—	—	13
Net income available to common shareholders	$ 24,176	$ 17,566	$ 48,254	$ 49,903
Weighted-average common shares outstanding	61,908,316	51,153,205	55,113,221	50,976,963
Basic earnings per common share	$ 0.39	$ 0.34	$ 0.88	$ 0.98
Diluted				
Net income available to common shareholders, for diluted EPS	$ 24,176	$ 17,566	$ 48,254	$ 49,903
Weighted-average common shares outstanding	61,908,316	51,153,205	55,113,221	50,976,963
Effect of dilutive securities:				
Stock compensation plans, net of tax benefit (1)	159,516	110,177	124,918	69,936
Weighted-average diluted shares outstanding	62,067,832	51,263,382	55,238,139	51,046,899
Diluted earnings per common share	$ 0.39	$ 0.34	$ 0.87	$ 0.98

(1) There were no shares with respect to stock options or restricted stock excluded from the computation of diluted earnings per share during the third quarter of 2016 or 2015; 91,720 and 22,234 shares with respect to stock options and restricted stock were excluded from the computation of diluted earnings per share during the nine months ended September 30, 2016 and 2015, respectively, because their inclusion would be anti-dilutive.

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

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

Note 3. Investment Securities

Available-for-sale securities

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

September 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 368,928	$ 811	$ (46)	$ 369,693
U.S. Treasury notes	127,004	1	—	127,005
Municipal securities	23,119	413	(2)	23,530
Trust preferred and other corporate securities	3,490	583	—	4,073
Mortgage-backed securities issued by GSE	178,361	1,878	(122)	180,117
Total available-for-sale securities	$ 700,902	$ 3,686	$ (170)	$ 704,418

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 540,984	$ 91	$ (3,263)	$ 537,812
U.S. Treasury notes	1,004	—	(7)	997
Municipal securities	21,445	449	(45)	21,849
Trust preferred and other corporate securities	5,409	620	(1)	6,028
Mortgage-backed securities issued by GSE	157,425	585	(1,207)	156,803
Total available-for-sale securities	$ 726,267	$ 1,745	$ (4,523)	$ 723,489

Held-to-maturity securities

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

September 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 223	$ —	$ 723
Municipal securities	43,470	3,241	—	46,711
Mortgage-backed securities issued by GSE	26,334	329	—	26,663
Total held-to-maturity securities	$ 70,304	$ 3,793	$ —	$ 74,097

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 214	$ —	$ 714
Municipal securities	44,377	3,111	—	47,488
Mortgage-backed securities issued by GSE	24,168	94	(97)	24,165
Total held-to-maturity securities	$ 69,045	$ 3,419	$ (97)	$ 72,367

Maturities of investment securities

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and estimated fair value of investment securities are shown by contractual maturity (including mortgage-backed securities) as of September 30, 2016, and December 31, 2015, in the following table (in thousands):

September 30, 2016	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 246,008	$ 246,132	$ —	$ —
Due after one year through five years	263,937	264,717	2,891	3,020
Due after five years through 10 years	35,127	35,311	38,784	40,169
Due after 10 years	154,318	156,746	28,629	30,908
	699,390	702,906	70,304	74,097
Other equity securities	1,512	1,512	—	—
	$ 700,902	$ 704,418	$ 70,304	$ 74,097

December 31, 2015	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 138,796	$ 138,749	$ —	$ —
Due after one year through five years	391,267	388,376	2,074	2,191
Due after five years through 10 years	63,766	63,681	40,803	41,662
Due after 10 years	131,003	131,248	26,168	28,514
	724,832	722,054	69,045	72,367
Other equity securities	1,435	1,435	—	—
	$ 726,267	$ 723,489	$ 69,045	$ 72,367

Unrealized losses

The following table shows the Company's gross unrealized losses and fair values of available-for-sale and held-to-maturity securities, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 108,998	$ (46)	$ —	$ —	$ 108,998	$ (46)
Municipal securities	2,273	(2)	—	—	2,273	(2)
Mortgage-backed securities issued by GSE	9,691	(43)	5,514	(79)	15,205	(122)
Total temporarily impaired securities	$ 120,962	$ (91)	$ 5,514	$ (79)	$ 126,476	$ (170)

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

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

The Company's unrealized losses on obligations of U.S. government agencies were caused by interest rate fluctuations. At September 30, 2016, 13 securities had an aggregate unrealized loss of $0.05 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on investments in municipal securities were caused by interest rate fluctuations. At September 30, 2016, four securities had an aggregate unrealized loss of $2,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At September 30, 2016, 11 securities had an aggregate unrealized loss of $0.12 million. The severity and duration of the unrealized loss will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider this investment other than temporarily impaired.

Trust preferred and other corporate securities

The Company had no unrealized losses on corporate securities at September 30, 2016.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at September 30, 2016.

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

The Company is required to maintain an investment in the capital stock of the FHLB. The FHLB stock is stated at cost, since this is a restricted security without a readily determinable fair value. The Company had $24.89 million and $23.69 million of FHLB stock at September 30, 2016, and December 31, 2015, respectively. Based on the Company's review of the credit quality of the institution, the institution's ability to repurchase shares, and the Company's carrying value in the shares, the Company does not consider this investment other than temporarily impaired.

Note 4. Loans and Allowance for Loan Losses

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

Allowance for loan losses

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. While portions of the allowance are attributed to specific portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio. The Company considers the allowance for loan losses of $40.66 million adequate to cover estimated loan losses inherent in the loan portfolio at September 30, 2016.

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

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the three- and nine-month periods ended September 30, 2016, and 2015 (in thousands):

Three Months Ended September 30, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 4,630	$ 15,596	$ 870	$ 8,775	$ 5,846	$ 3,901	$ 39,618
Provision for loan losses	(105)	(25)	339	316	500	661	1,686
Losses charged off	(26)	—	—	(245)	(390)	(226)	(887)
Recoveries	5	14	—	146	3	70	238
Balance, end of period	$ 4,504	$ 15,585	$ 1,209	$ 8,992	$ 5,959	$ 4,406	$ 40,655

Nine Months Ended September 30, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359
Provision charged to expense	(494)	912	263	733	567	1,545	3,526
Losses charged off	(92)	(66)	—	(1,140)	(462)	(250)	(2,010)
Recoveries	106	52	1	409	80	132	780
Balance, end of period	$ 4,504	$ 15,585	$ 1,209	$ 8,992	$ 5,959	$ 4,406	$ 40,655

Three Months Ended September 30, 2015	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of period	$ 5,509	$ 14,639	$ 752	$ 8,962	$ 5,454	$ 1,974	$ 37,290
Provision charged to expense	(827)	216	(94)	399	(201)	637	130
Losses charged off	(32)	—	—	(401)	—	(55)	(488)
Recoveries	21	14	—	100	243	41	419
Balance, end of period	$ 4,671	$ 14,869	$ 658	$ 9,060	$ 5,496	$ 2,597	$ 37,351

Nine Months Ended September 30, 2015	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Allowance for loan losses:							
Balance, beginning of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
Provision charged to expense	(867)	838	(9)	661	236	1,317	2,176
Losses charged off	(198)	(278)	—	(1,090)	(118)	(91)	(1,775)
Recoveries	75	83	—	368	415	92	1,033
Balance, end of period	$ 4,671	$ 14,869	$ 658	$ 9,060	$ 5,496	$ 2,597	$ 37,351

The following table presents, by portfolio segment, the allocation of the allowance for loan losses at September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 306	$ 836	$ —	$ 1,386	$ 35	$ 3	$ 2,566
Loans collectively evaluated for impairment	4,184	14,681	1,209	7,588	5,924	4,403	37,989
Loans acquired with deteriorated credit quality	14	68	—	18	—	—	100
Balance, end of period	$ 4,504	$ 15,585	$ 1,209	$ 8,992	$ 5,959	$ 4,406	$ 40,655
December 31, 2015							
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 411	$ 819	$ —	$ 1,255	$ 26	$ 13	$ 2,524
Loans collectively evaluated for impairment	4,573	13,868	945	7,708	5,748	2,966	35,808
Loans acquired with deteriorated credit quality	—	—	—	27	—	—	27
Balance, end of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359

The following table presents, by portfolio segment, the Company’s investment in loans at September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 6,009	$ 17,601	$ 694	$ 14,685	$ 552	$ 140	$ 39,681
Ending balance: collectively evaluated for impairment	805,436	2,137,752	190,020	1,161,882	1,031,263	193,139	5,519,492
Ending balance: loans acquired with deteriorated credit quality	9,008	34,136	15,909	31,434	1,982	—	92,469
Ending Balance	$ 820,453	$2,189,489	$ 206,623	$1,208,001	$ 1,033,797	$ 193,279	$5,651,642

December 31, 2015	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 9,566	$ 13,627	$ 731	$ 13,286	$ 496	$ 78	$ 37,784
Ending balance: collectively evaluated for impairment	582,901	1,740,467	150,282	930,185	856,540	138,309	4,398,684
Ending balance: loans acquired with deteriorated credit quality	6,408	30,299	16,358	29,860	—	—	82,925
Ending Balance	$ 598,875	$1,784,393	$ 167,371	$ 973,331	$ 857,036	$ 138,387	$4,519,393

Loans acquired in a transfer, including business combinations, where there is evidence of credit deterioration since origination and it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments, are accounted for as purchased impaired loans. Purchased impaired loans are initially recorded at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, the historical allowance for credit losses related to these loans is not carried over.

Accounting for purchased impaired loans involves estimating fair value, at acquisition, using the principal and interest cash flows expected to be collected, discounted at the prevailing market rate of interest. The excess of cash flows expected to be collected over the estimated fair value at acquisition date is referred to as the accretable yield and is recognized in interest income using an effective yield method over the remaining life of the loans. The difference between contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions) will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses.

The following table presents the changes in the accretable yield for purchased impaired loans for the nine months ended September 30, 2016, and 2015 (in thousands):

	September 30,	
	2016	2015
Balance at beginning of period	$ 43,959	$ 2,107
Additions	2,207	42,648
Accretion	(4,845)	(5,481)
Reclassifications from nonaccretable balance, net	3,685	3,182
Other changes, net	(2,027)	292
Balance at end of period	$ 42,979	$ 42,748

Portfolio quality indicators

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

The Company’s internally assigned grades are as follows:

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

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

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

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

The following table represents credit exposures by internally assigned grades as of September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Pass	$ 799,271	$ 2,138,293	$ 205,098	$ 1,182,573	$ 1,028,599	$ 192,961	$ 5,546,795
Special Mention	3,423	20,243	—	2,761	1,818	—	28,245
Substandard	17,759	30,953	1,525	22,667	3,301	318	76,523
Doubtful	—	—	—	—	79	—	79
Total	$ 820,453	$ 2,189,489	$ 206,623	$ 1,208,001	$ 1,033,797	$ 193,279	$ 5,651,642

December 31, 2015	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Pass	$ 578,737	$ 1,740,028	$ 162,934	$ 953,790	$ 851,775	$ 138,219	$ 4,425,483
Special Mention	956	18,886	3,429	2,275	1,851	59	27,456
Substandard	19,182	25,479	1,008	17,266	3,410	109	66,454
Doubtful	—	—	—	—	—	—	—
Total	$ 598,875	$ 1,784,393	$ 167,371	$ 973,331	$ 857,036	$ 138,387	$ 4,519,393

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

Age analysis of past-due financing receivables by class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of September 30, 2016, and December 31, 2015. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Purchased impaired loans are included in the aging schedule, but are excluded from the disclosure of accruing loans more than 90 days past due because they are considered to be accruing due to the existence of the accretable yield and not based on consideration given to contractual interest payments (in thousands):

September 30, 2016	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 112	$ —	$ 379	$ 768	$ 1,259	$ 819,194	$ 820,453	$ —
Commercial real estate	2,058	147	69	3,422	5,696	2,183,793	2,189,489	—
Multifamily real estate	—	—	—	695	695	205,928	206,623	—
1-4 family residential real estate	1,965	1,276	804	5,979	10,024	1,197,977	1,208,001	—
Commercial and industrial business loans	589	—	—	359	948	1,032,849	1,033,797	—
Consumer loans and other	494	66	—	114	674	192,605	193,279	—
Total	$ 5,218	$ 1,489	$ 1,252	$ 11,337	$ 19,296	$5,632,346	$ 5,651,642	$ —

December 31, 2015	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
Construction and land development	$ 239	$ —	$ 810	$ 1,243	$ 2,292	$ 596,583	$ 598,875	$ 424
Commercial real estate	1,689	1,220	—	2,093	5,002	1,779,391	1,784,393	—
Multifamily real estate	—	—	—	731	731	166,640	167,371	—
1-4 family residential real estate	2,586	834	895	4,267	8,582	964,749	973,331	—
Commercial and industrial business loans	633	—	—	282	915	856,121	857,036	—
Consumer loans and other	276	—	—	54	330	138,057	138,387	—
Total	$ 5,423	$ 2,054	$ 1,705	$ 8,670	$ 17,852	$4,501,541	$ 4,519,393	$ 424

The following table includes an aging analysis of the recorded investment of purchased impaired loans as of September 30, 2016, included in the table above (in thousands):

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
September 30, 2016						
Construction and land development	$ 112	$ —	$ 378	$ 490	$ 8,518	$ 9,008
Commercial real estate	—	16	69	85	34,051	34,136
Multifamily real estate	—	—	—	—	15,909	15,909
1-4 family residential real estate	275	436	804	1,515	29,919	31,434
Commercial and industrial business loans	—	—	—	—	1,982	1,982
Consumer loans and other	—	—	—	—	—	—
Total	$ 387	$ 452	$ 1,251	$ 2,090	$ 90,379	$ 92,469

Impaired loans

Management considers a loan to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan’s effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), impairment is recognized as a specific component to be provided for in the allowance for loan losses, or the impaired balance on collateral-dependent loans is charged off if it is determined that such amount represents a confirmed loss. Smaller balance loans (under $500,000) are generally not individually assessed for impairment, but are evaluated collectively.

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

Unearned loan income was $3.78 million in excess of deferred loan costs at September 30, 2016, $2.97 million at September 30, 2015, and $2.86 million at December 31, 2015. There were $11.34 million, $8.48 million, and $8.67 million in nonaccrual loans at September 30, 2016, September 30, 2015, and December 31, 2015, respectively. The Company would have earned $0.48 million in third quarter 2016 if interest on the loans had been accrued.

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

The following tables include the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable, as of September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 4,648	$ 4,623	$ —	$ 4,920	$ 160
Commercial real estate	8,742	8,732	—	8,774	315
Multifamily real estate	740	694	—	745	24
1-4 family residential real estate	3,252	2,822	—	3,201	72
Commercial and industrial business loans	318	180	—	306	11
Consumer loans and other	—	—	—	—	—
Total	$ 17,700	$ 17,051	$ —	$ 17,946	$ 582
Loans with a specific valuation allowance					
Construction and land development	$ 1,780	$ 1,386	$ 306	$ 1,838	$ 36
Commercial real estate	9,044	8,869	836	9,135	350
Multifamily real estate	—	—	—	—	—
1-4 family residential real estate	12,320	11,863	1,386	12,401	418
Commercial and industrial business loans	451	372	35	470	16
Consumer loans and other	143	140	3	155	6
Total	$ 23,738	$ 22,630	$ 2,566	$ 23,999	$ 826
Total impaired loans					
Construction and land development	$ 6,428	$ 6,009	$ 306	$ 6,758	$ 196
Commercial real estate	17,786	17,601	836	17,909	665
Multifamily real estate	740	694	—	745	24
1-4 family residential real estate	15,572	14,685	1,386	15,602	490
Commercial and industrial business loans	769	552	35	776	27
Consumer loans and other	143	140	3	155	6
Total	$ 41,438	$ 39,681	$ 2,566	$ 41,945	$ 1,408

Note: Included in the table above are accruing TDRs of $28.34 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $6.14 million.

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

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

Troubled debt restructurings

In order to maximize the collection of loan balances, the Company evaluates troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. A loan is a troubled debt restructuring ("TDR") if both of the following exist: (1) a creditor has granted a concession to the debtor, and (2) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we

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

The following table shows the loans modified in TDRs for the three and nine months ended September 30, 2016 and 2015 (in thousands, except number of loans):

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

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

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. One loan that was restructured within the last 12 months subsequently defaulted; a commercial loan in the amount $22,000.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At September 30, 2016, all significant impaired loans have been determined to be collateral-dependent.

Nonaccrual loans

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

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

The table below presents a summary of the activity related to OREO for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Beginning balance	$ 25,707	$ 46,154	$ 34,420	$ 35,115
Additions	1,600	6,460	5,012	16,578
Franklin merger	—	1,110	(234)	16,065
Sales	(4,113)	(14,015)	(16,209)	(27,405)
Valuation allowance	—	—	(90)	(152)
Loss on sale and write-downs, net	(310)	(200)	(15)	(692)
Ending balance	$ 22,884	$ 39,509	$ 22,884	$ 39,509

As of September 30, 2016, the Company's recorded investment in OREO collateralized by residential real estate was $4.77 million. As of September 30, 2016, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $1.36 million.

Note 6. Segment Reporting

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina, and includes the operations of TowneBank Commercial Mortgage, LLC, and Towne Investment Group. The Realty segment

combines the operations of Berkshire Hathaway HomeServices Towne Realty with TowneBank Mortgage: Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements; SimonTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; NewTowne Mortgage, LLC; Homesale Mortgage, LLC; Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head; and Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations, to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance Agency, LLC, and Towne Benefits.

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

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

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

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

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

Three Months Ended September 30, 2015	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 44,747	$ 923	$ —	$ 45,670
Provision for loan losses	130	—	—	130
Net interest income after provision for loan losses	44,617	923	—	45,540
Residential mortgage banking income, net	(273)	8,535	—	8,262
Insurance commissions and other title fees and income, net	—	451	9,259	9,710
Real estate brokerage and property management income, net	—	5,349	—	5,349
Other noninterest income	6,428	357	198	6,983
Noninterest expense	31,749	10,858	7,299	49,906
Income before income tax, corporate allocation and noncontrolling interest	19,023	4,757	2,158	25,938
Corporate allocation	293	(135)	(158)	—
Income before income tax provision and noncontrolling interest	19,316	4,622	2,000	25,938
Provision for income tax expense	5,168	1,518	758	7,444
Net income	14,148	3,104	1,242	18,494
Noncontrolling interest	—	(759)	(169)	(928)
Net income attributable to TowneBank	$ 14,148	$ 2,345	$ 1,073	$ 17,566
Net income as percentage of total	80.54%	13.35%	6.11%	100.00%
Total assets	$ 5,883,863	$ 173,498	$ 116,530	$ 6,173,891

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

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

Nine Months Ended September 30, 2015	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 132,006	$ 2,105	$ —	$ 134,111
Provision for loan losses	2,176	—	—	2,176
Net interest income after provision for loan losses	129,830	2,105	—	131,935
Residential mortgage banking income, net	(550)	27,506	—	26,956
Insurance commissions and other title fees and income, net	—	1,211	29,433	30,644
Real estate brokerage and property management income, net	—	13,888	—	13,888
Other noninterest income	17,736	2,420	561	20,717
Noninterest expense	95,169	32,283	21,962	149,414
Income before income tax, corporate allocation and noncontrolling interest	51,847	14,847	8,032	74,726
Corporate allocation	901	(400)	(501)	—
Income before income tax provision and noncontrolling interest	52,748	14,447	7,531	74,726
Provision for income tax expense	14,425	4,856	2,749	22,030
Net income	38,323	9,591	4,782	52,696
Noncontrolling interest	—	(1,870)	(910)	(2,780)
Net income attributable to TowneBank	$ 38,323	$ 7,721	$ 3,872	$ 49,916
Net income as percentage of total	76.77%	15.47%	7.76%	100.00%
Total assets	$ 5,883,863	$ 173,498	$ 116,530	$ 6,173,891

Note 7. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2016, the amounts of off-balance sheet commitments to extend credit were $2.09 billion.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At September 30, 2016, standby letters of credit and financial guarantees were $79.98 million.

Additionally, the Company had $155.44 million in mortgage loans sold to investors with various recourse and warranty provisions as of September 30, 2016.

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

Note 8. Mergers and Acquisitions

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

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

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

The Monarch merger has been accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the June 24, 2016, merger date. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The application of the acquisition method of accounting resulted in goodwill of approximately $107.71 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

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

Fair value of assets acquired:		
Cash and cash equivalents	$	67,457
Securities available for sale		20,818
Loans held for sale		283,528
Loans held for investment		808,137
Bank premise and equipment		23,998
Intangible assets		13,210
Other assets		62,401
Total assets	$	1,279,549
Fair value of liabilities assumed:		
Deposits	$	1,061,620
Total borrowings		82,046
Other liabilities		21,148
Total liabilities	$	1,164,814
Net identifiable assets acquired		114,735
Goodwill		107,709
Net assets acquired	$	222,444
Purchase price:		
Company common shares issued		10,487,069
Purchase price per share of Company’s common stock	$	21.21
Common stock issued	$	222,431
Cash exchanged for fractional shares		13
Fair value of total consideration transferred	$	222,444

During the quarter ended September 30, 2016, adjustments were made to the purchase price allocations that resulted in a decrease to the initial fair value estimate of loans of $9.98 million, an increase in deferred tax assets of $3.37 million, and a decrease to acquired net assets of $0.49 million resulting from adjustments to other assets and liabilities. The revised fair value estimates resulted in an increase to goodwill of $7.10 million.

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

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

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

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

	Pro Forma for the Three Months Ended September 30,		Pro Forma for the Nine Months Ended September 30,	
(in thousands)	2016	2015	2016	2015
Revenues (net interest income plus noninterest income)	$ 107,685	$ 108,931	$ 339,741	$ 329,212
Net income	$ 23,751	$ 20,294	$ 63,185	$ 47,738

Oak Island Accommodations, Inc.: Effective January 14, 2016, the Company acquired Oak Island Accommodations, Inc., an independent resort property management company that was merged with the operations of Towne Vacations Oak Island, LLC, a division of TowneBank's Realty segment. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of

operations of the acquired business are included in the Company's Consolidated Statements of Income commencing January 14, 2016. The purchase price for the transaction was $5.52 million in cash. The allocation of the purchase price resulted in tangible assets of $0.36 million, goodwill of $1.58 million, and other intangible assets of $3.58 million.

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

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

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

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

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

The Franklin merger has been accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the January 2, 2015, merger date.

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

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

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

Note 9. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually, or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 7 – Goodwill and Intangible Assets* of the 2015 Annual Report to the Stockholders for more information on the Company's goodwill and other intangibles. The following table presents the gross carrying amount and accumulated amortization for the Company's intangible assets as of the dates indicated (in thousands):

	September 30,					
	2016		2015		December 31, 2015	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	$ 9,818	$ 1,196	$ 1,918	$ 376	$ 1,918	$ 431
Non-compete agreements	2,201	1,325	1,481	1,164	1,531	1,190
Customer lists	43,291	16,326	30,162	12,267	34,158	13,148
Trade name	211	158	211	116	211	127
Total intangible assets subject to amortization	55,521	19,005	33,772	13,923	37,818	14,896
Contractual agreements	3,231	—	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—	3,231	—
Total intangible assets	$ 58,752	$ 19,005	$ 37,003	$ 13,923	$ 41,049	$ 14,896

Amortization expense for intangible assets was $1.92 million and $0.92 million for the three-month periods and $4.11 million and $2.57 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

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

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2015	$ 94,319	$ 13,999	$ 46,524	$ 154,842
Additions to goodwill	99,790	10,263	—	110,053
Other adjustments	465	(760)	(22)	(317)
Balance, September 30, 2016	$ 194,574	$ 23,502	$ 46,502	$ 264,578

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

Note 10. Bank-Owned Life Insurance Policies

The total carrying amount of bank-owned life insurance policies ("BOLI") as of September 30, 2016, was $163.39 million. The Company had $147.95 million and $149.45 million of BOLI as of September 30, 2015, and December 31, 2015, respectively. The Company recognized BOLI income, included in other noninterest income, of $1.26 million and $1.22 million for the three-month periods and $3.62 million and $3.69 million for the nine-month periods ended September 30, 2016 and 2015, respectively. The Company has a related retirement plan, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits.

Note 11. Postretirement Benefits

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

	SERP		Other Postretirement Benefits	
	Three Months Ended		Three Months Ended	
September 30,	**2016**	**2015**	**2016**	**2015**
Service cost	$ 689	$ 366	$ (11)	$ 21
Interest cost	292	211	(4)	8
Amortization of prior service costs	38	—	—	—
Amortization of actuarial (gain) loss	14	60	(15)	—
Net periodic postretirement benefit cost	$ 1,033	$ 637	$ (30)	$ 29

	SERP		Other Postretirement Benefits	
	Nine Months Ended		Nine Months Ended	
September 30,	**2016**	**2015**	**2016**	**2015**
Service cost	$ 1,579	$ 1,140	$ 19	$ 42
Interest cost	799	633	12	16
Amortization of prior service costs	114	—	—	—
Amortization of actuarial (gain) loss	52	138	(45)	—
Net periodic postretirement benefit cost	$ 2,544	$ 1,911	$ (14)	$ 58

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2016 and 2015 (in thousands), and changes in the nine months then ended. The amounts reclassified from accumulated other comprehensive income ("AOCI") for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the pension and postretirement plans are a component of salaries and employee benefits expense on the consolidated statements of income.

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2015	$ (1,805)	$ (1,189)	$ (2,994)
Other comprehensive income before reclassifications	4,091	71	4,162
Amounts reclassified from AOCI	—	171	171
Net change	4,091	242	4,333
Balance, September 30, 2016	$ 2,286	$ (947)	$ 1,339

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2014	$ 1,325	$ (867)	$ 458
Other comprehensive income before reclassifications	998	—	998
Amounts reclassified from AOCI	(510)	90	(420)
Net change	488	90	578
Balance, September 30, 2015	$ 1,813	$ (777)	$ 1,036

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

Note 13. Other Expenses

The following table shows a summary of other expenses for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Advertising and marketing	$ 2,327	$ 1,704	$ 6,207	$ 5,550
Acquisition-related expenses	969	243	19,817	1,027
Other	3,040	1,264	6,258	4,493
Charitable contributions	1,045	1,121	3,466	4,109
Outside processing	1,931	1,182	4,723	3,745
Professional fees	1,220	1,314	3,830	4,263
Stationery and supplies	890	601	2,030	1,794
FDIC and other insurance	1,352	1,242	3,624	3,679
Foreclosed property expenses	157	573	727	1,972
Software expense	1,904	1,537	5,064	4,324
Telephone and postage	1,758	1,142	4,171	3,524
Amortization-intangibles	1,920	918	4,112	2,565
Bank franchise tax/SCC fees	1,151	596	3,032	1,895
Directors fees and expenses	385	294	985	918
Travel/meals/entertainment	532	351	1,402	985
Total other expenses	$ 20,581	$ 14,082	$ 69,448	$ 44,843

Note 14. Variable Interest Entities

A Variable Interest Entity (“VIE”) is an entity that either (i) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (ii) has a group of equity owners that are unable to make significant decisions about its activities, or (iii) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns as generated by its operations. If any of these characteristics are present, the entity is subject to a variable interest consolidation model, and consolidation is based on variable interests, not on ownership of the entity's outstanding voting stock. Variable interests are defined as contractual, ownership, or other monetary interests in an entity that change with fluctuations in the entity's net asset value. The primary beneficiary consolidates the VIE. The primary beneficiary is the entity that has (i) the power to direct the activities of a VIE that most significantly impact the entity’s economic performance, and (ii) the obligation to absorb losses of the entity that could potentially be significant to the VIE, or the right to receive benefits from the entity that could potentially be significant to the VIE. The Company reviews all significant interests in the VIEs it is involved with, including the amounts and types of financial and other support, including equity investments, debt financing, and guarantees. The Company also considers the activities of the VIEs that most significantly impact the VIEs’ economic performance and whether it has control over those activities.

Low income housing tax credit partnerships

As part of its community reinvestment initiatives, the Company invests within its footprint in multifamily affordable housing developments as a limited partner. The Company receives tax credits for its partnership investments. The Company has determined that these partnerships meet the definition of a VIE and are evaluated for the purpose of determining whether the Company is the primary beneficiary.

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because the general partner of each limited partnership has both the power to direct the activities which most significantly affect the performance of each partnership and the obligation to absorb losses or the right to receive benefits that could be significant to the entities. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $84.76 million, $61.87 million, and $61.71 million were not included in the Consolidated Balance Sheets at September 30, 2016, September 30, 2015, and December 31, 2015, respectively. These limited partner interests had carrying values of $14.95 million, $16.12 million, and $16.16 million at September 30, 2016, September 30, 2015, and December 31, 2015, respectively, and are recorded in other assets on the Company's Consolidated Balance Sheets. The Company's maximum exposure to loss for these limited partner investments totaled $21.04 million, $16.12 million, and $16.16 million at September 30, 2016, September 30, 2015, and December 31, 2015, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments, along with $5.92 million of loans to the entities at September 30, 2016. As of September 30, 2016, the Company had $21.44 million in funding commitments that are dependent on certain contractual milestones and $12.0 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the three- and nine-month periods ended September 30, 2016, tax benefits totaling $0.35 million and $1.02 million, net of amortization expenses of $0.69 million and $2.10 million, respectively, were recognized as a component of income tax expense.

Note 15. Fair Value Disclosures

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

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

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

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

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

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

Derivative Financial Instruments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three-month periods ended September 30, 2016 and 2015, and the year ended December 31, 2015, the Company used weighted average fall-out rates of 18.80%, 20.0%, and 16.80%, respectively.

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

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2016, and December 31, 2015 (in thousands):

	September 30, 2016			
	Level 1	**Level 2**	**Level 3**	**Total**
U.S. agency securities	$ —	$ 369,693	$ —	$ 369,693
U.S. Treasury notes	—	127,005	—	127,005
Municipal securities	—	23,530	—	23,530
Mortgage-backed securities issued by GSEs	—	180,116	—	180,116
Trust preferred and other corporate securities	—	4,074	—	4,074
Derivative assets	—	481	4,873	5,354
Derivative liabilities	—	2,076	54	2,130

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

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at September 30, 2016, and December 31, 2015 (in thousands):

September 30, 2016	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ —	$ —	$ 14,654	$ 14,654
Other real estate owned	—	21,800	1,084	22,884

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

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

Loans: Impaired loans for which repayment of the loan is expected to be provided solely by the value of the underlying collateral are considered collateral-dependent and are valued based on the fair value of such collateral. Collateral values are estimated using inputs based on observable market data or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically, discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 3% to 68%, with a weighted average of 15.59%.

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

Foreclosed property: The fair value of foreclosed property is estimated using Level 2 inputs based on observable market data, or Level 3 inputs based on assumptions specific to the individual property. Level 3 inputs typically include unobservable inputs such as management-applied discounts used to further reduce values to a net realizable value, or in situations where our appraisal date predates a likely change in market conditions. These deductions ranged from 10% to 57%, with a weighted average of 25.12%.

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

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

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

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

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

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

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

Repurchase agreements: The carrying amount approximates fair value.

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

The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of September 30, 2016, and December 31, 2015, are as follows (in thousands):

September 30, 2016	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 147,887	$ 147,887	$ 147,887	$ —	$ —
Interest-bearing deposits in financial institutions	6,891	6,891	6,891	—	—
Securities available for sale	704,418	704,418	—	704,418	—
Securities held to maturity	70,304	74,097	—	74,097	—
Mortgage loans held for sale	439,608	440,028	—	440,028	—
Net loans	5,651,642	5,737,006	—	—	5,737,006
Interest receivable	18,453	18,453	—	18,453	—
Deposits	6,146,947	5,769,810	—	5,769,810	—
Advances from the Federal Home Loan Bank of Atlanta	427,655	433,595	—	433,595	—
Repurchase agreements and other borrowings	31,927	31,136	—	31,136	—
Interest payable	3,320	3,320	—	3,320	—

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

Note 16. Derivative Instruments and Hedging Activities

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

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

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

	September 30, 2016		December 31, 2015	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 57,723	$ 481	$ —	$ —
Interest rate lock commitments	537,068	4,873	76,815	1,239
Total included in other assets		$ 5,354		$ 1,239
Included in other liabilities:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 423,355	$ 1,836	$ —	$ —
Interest rate lock commitments	15,297	54	—	—
TBA mortgage-backed securities	50,750	240	—	—
Total included in other liabilities		$ 2,130		$ —

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest rate lock commitments	$ (1,249)	$ (465)	$ (509)	$ 786
Forward sales contracts	116	—	443	—
	$ (1,133)	(465)	(66)	786

Note 17. Borrowings

The Company has short-term borrowings for terms under one year consisting of retail repurchase agreements ("REPOs") and FHLB advances. FHLB advances are for various terms and are secured by a blanket lien on residential mortgages and other real estate secured loans. All REPOs are overnight short-term investments and are not insured by the Federal Deposit Insurance Corporation. Securities pledged as collateral under

these REPO financing arrangements cannot be sold or repledged by the secured party and are therefore accounted for as a secured borrowing. Mortgage-backed securities and U.S. government agency securities with a total carrying value of $42.40 million at September 30, 2016, and $50.34 million at December 31, 2015, were pledged as collateral for these secured transactions. The pledged securities are held in safekeeping at the FHLB. Due to the overnight, short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily.

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2016	Second Quarter 2016	First Quarter 2016	Fourth Quarter 2015	Third Quarter 2015
Results of Operations:					
Interest income	$ 71,823	$ 56,241	$ 54,734	$ 54,811	$ 53,987
Interest expense	9,218	8,457	8,398	8,480	8,317
Net interest income	62,605	47,784	46,336	46,331	45,670
Provision for loan losses	$ 1,686	2,099	(259)	852	130
Net interest income after provision for loan losses	60,919	45,684	46,595	45,479	45,540
Noninterest income:					
Residential mortgage banking income, net	21,430	12,148	7,118	7,255	8,262
Insurance commissions and other title fees and income, net	11,258	11,627	14,033	8,997	9,710
Real estate brokerage and property management income, net	6,647	6,116	4,827	2,438	5,349
Service charges on deposit accounts	2,552	2,284	2,176	2,254	2,388
Credit card merchant fees, net	1,365	1,113	895	767	823
Other income	3,569	3,180	3,366	3,368	3,036
Gain on investment securities	—	—	—	—	736
Total noninterest income	46,821	36,468	32,415	25,079	30,304
Noninterest expense:					
Salaries and benefits	40,497	30,093	30,187	30,826	28,910
Occupancy expense	6,656	5,157	5,017	5,156	4,703
Furniture and equipment	3,199	2,381	2,357	2,390	2,211
Other expenses	20,581	34,268	14,600	14,371	14,082
Total noninterest expense	70,933	71,899	52,161	52,743	49,906
Income before noncontrolling interest and income tax	36,807	10,254	26,849	17,815	25,938
Provision for income tax expense	10,974	2,375	8,188	4,846	7,444
Net income	25,833	7,879	18,661	12,969	18,494
Net income attributable to noncontrolling interest	(1,657)	(1,620)	(842)	(503)	(928)
Net income attributable to TowneBank	$ 24,176	$ 6,259	$ 17,819	$ 12,466	$ 17,566
Net income available to common shareholders	$ 24,176	$ 6,259	$ 17,819	$ 12,466	$ 17,566

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2016	Second Quarter 2016	First Quarter 2016	Fourth Quarter 2015	Third Quarter 2015
Per Share Data:					
Net income:					
Basic	$ 0.39	$ 0.12	$ 0.35	$ 0.24	$ 0.34
Diluted	0.39	0.12	0.35	0.24	0.34
Book value at period end	17.11	16.84	16.00	15.71	15.65
Tangible book value at period end	12.23	12.05	12.38	12.21	12.25
Cash dividends declared	0.13	0.13	0.12	0.12	0.12
Common Stock Closing Price:					
High	24.03	22.64	20.88	22.51	19.23
Low	21.66	19.10	16.65	18.57	16.05
Close	24.03	21.65	19.19	20.87	18.85
Selected Financial Ratios (annualized):					
Return on average assets	1.20%	0.39%	1.14%	0.78%	1.14%
Return on average tangible assets	1.29%	0.44%	1.21%	0.85%	1.21%
Return on average equity	8.95%	2.93%	8.63%	6.00%	8.58%
Return on average tangible equity	12.87%	4.19%	11.56%	8.11%	11.25%
Net interest margin (tax-equivalent basis) (1)	3.57%	3.36%	3.37%	3.36%	3.40%
Daily Averages:					
Total assets	$ 7,991,213	$ 6,534,063	$ 6,313,238	$ 6,305,571	$ 6,115,681
Total tangible assets	7,689,122	6,339,815	6,126,524	6,120,799	5,940,258
Loans, net of unearned income, excluding nonaccrual loans	5,583,711	4,702,825	4,516,277	4,426,387	4,300,751
Total earning assets (1)	7,255,956	6,025,033	5,815,383	5,800,907	5,604,472
Total deposits	6,178,341	5,082,863	4,915,400	4,878,644	4,734,876
FHLB advances	479,660	433,626	429,020	431,421	437,431
Total equity	1,075,023	859,938	830,178	823,627	812,602
Tangible equity	772,932	665,690	643,464	638,855	637,179
Basic weighted average shares outstanding	61,908,316	51,994,473	51,290,010	51,267,447	51,153,205
Diluted weighted average shares outstanding	62,067,832	52,116,772	51,392,857	51,440,440	51,263,382

(1) Includes bank-owned life insurance.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2015 audited Consolidated Financial Statements included in our 2015 Annual Report to Stockholders and our 2015 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by Dixon Hughes Goodman LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements with respect to our financial condition, results of operations, and business. These forward-looking statements involve certain risks and uncertainties and are based on the beliefs and assumptions of our management. When used in this quarterly report or future regulatory filings, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We wish to caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, mergers and acquisitions, competitive and legislative or regulatory factors, and other factors described in our 2015 Annual Report on Form 10-K could affect our financial performance and could cause actual results for future periods to differ materially from those anticipated or projected.*

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

Overview

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

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

On June 24, 2016, TowneBank completed the acquisition of Monarch Financial Holdings, Inc. ("Monarch"), and its wholly-owned bank subsidiary, Monarch Bank, headquartered in Chesapeake, Virginia. The Company acquired approximately $808.14 million of loans and assumed approximately $1.06 billion of deposits. The purchase price was $222.44 million in cash and common stock.

PART I. FINANCIAL INFORMATION

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

The following is a summary of the Company's financial performance in the quarter ended September 30, 2016:

- Net income for the three months ended September 30, 2016, was $24.18 million, or $0.39 per common diluted share, compared with $17.57 million, or $0.34 per common diluted share, in the same period in 2015. Net income for the nine months ended September 30, 2016, was $48.25 million, or $0.87 per common diluted share, compared with $49.92 million, or $0.98 per common diluted share, in the nine months ended September 30, 2015.

- Net interest income increased $16.94 million, or 37.08%, in third quarter 2016 from the comparable period in 2015. The increase was primarily due to an increase in average earning assets as a result of the acquisition of Monarch in the second quarter of 2016.

- The provision for loan losses increased $1.56 million from the provision of $0.13 million in the comparative three-month period of 2015, and increased $1.35 million from the comparative nine-month period of 2015. The loan loss reserve was 0.72% of total loans at September 30, 2016, as compared to 0.71% at June 30, 2016, and 0.86% at September 30, 2015. The increase in the provision for loan losses in comparison to prior year and linked quarters was primarily a result of loan growth, partially offset by a reduction in historical loss ratios. Loan loss reserve as a percentage of total loans, excluding purchased loans, remained steady at 0.91% at September 30, 2016, as compared to 0.90% at June 30, 2016, which is consistent with continued stability in credit quality.

- Excluding gains on investment securities, noninterest income for the three- and nine-month periods ended September 30, 2016, increased by $17.25 million, or 58.35%, and increased by $24.40 million, or 26.73%, respectively, from the comparative periods in 2015. The increase from the comparable prior year periods was primarily due to an increase in residential mortgage banking income related to the Monarch acquisition, combined with increases resulting from our 2015 insurance agency acquisitions and our January 2016 acquisition of a North Carolina resort property management company. The increase from the linked quarter was primarily related to an increase in residential mortgage banking income combined with increases in real estate brokerage and property management income, partially offset by a slight seasonal decrease in insurance contingency commission income.

- For the three- and nine-month periods ended September 30, 2016, noninterest expense increased $21.03 million, or 42.13%, and $45.58 million, or 30.50%, respectively, compared to the same periods in 2015. The increase from the prior year periods was driven by increased operating expenses related to the second quarter acquisition of Monarch. Also contributing to the increase were increased operating expenses related to insurance agency and resort property management company acquisitions.

- Our effective tax rate was 31.22% for the third quarter of 2016, an increase from 29.76% in the comparative period of 2015. For the first nine months of 2016, the effective tax rate increased to 30.86% compared to 30.62% for the same period in 2015. The increase from the prior year third quarter was primarily a result of the increase in taxable income subject to the federal statutory rate of 35%, while the variance from the prior year nine-month period was primarily due to a slight decrease in federal tax credits.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the consolidated financial statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, other real estate owned, deferred income taxes, estimates of fair value of financial instruments, mergers and acquisitions, and goodwill and other intangibles to be critical accounting policies. Refer to our 2015 Annual Report to Stockholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 1.20% for third quarter 2016 compared to 1.14% for third quarter 2015, and 0.39% for second quarter 2016. The annualized return on average tangible assets was 1.29%, 1.21%, and 0.44% for the same respective periods. ROA for the nine months ended September 30, 2016, was 0.93%, compared to 1.12% for the nine months ended September 30, 2015. In comparison to the prior year third quarter, ROA was positively affected by the increase in net income, which outpaced the growth in average assets. In comparison to prior year nine-month period, ROA was negatively affected by after-tax acquisition-related expenses of $13.34 million for the nine months ended September 30, 2016.

The annualized return on average equity ("ROE") was 8.95% for third quarter 2016, 8.58% for third quarter 2015, and 2.93% for second quarter 2016, while the annualized return on average tangible equity was 12.87%, 11.25%, and 4.19% for the same respective periods. ROE for the nine months ended September 30, 2016, was 6.99%, compared to 8.36% for the nine months ended September 30, 2015.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $109.43 million for the quarter ended September 30, 2016, which increased $34.19 million, or 45.44%, compared to the quarter ended September 30, 2015. Operating income was $84.25 million for the quarter ended June 30, 2016. For the nine months ended September 30, 2016, operating income was $272.43 million, an increase of $47.02 million, or 20.86%, over comparative 2015.

Basic earnings per share were $0.39 for the three months ended September 30, 2016, compared to $0.34 in comparative 2015, while basic earnings per share for the nine months ended September 30, 2016 was $0.88, compared to $0.98 in comparative 2015. Diluted earnings per share were $0.39 for the three months ended September 30, 2016, compared to $0.34 in comparative 2015, while diluted earnings per share for the nine months ended September 30, 2016, was $0.87, compared to $0.98 in the same period of 2015.

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

TowneBank reported net interest income, on a tax-equivalent basis, of $65.17 million for the quarter ended September 30, 2016, which was $17.13 million, or 35.66%, higher than the year-ago amount of $48.04 million. On a linked quarter basis, tax-equivalent net interest income increased by $14.78 million, or 29.34%, from the $50.39 million reported for second quarter 2016. In comparison to both prior comparative periods, net interest income rose primarily due to increased balances of earning assets. Accretion of purchase accounting marks added $2.63 million, or 17 basis points, to margin in the current quarter, $0.68 million, or six basis points, in third quarter 2015, and $0.61 million, or five basis points, in the linked quarter.

Interest income, on a tax-equivalent basis, was $74.39 million for the quarter ended September 30, 2016, which was $18.03 million, or 32.00%, higher than the $56.36 million reported for the quarter ended September 30, 2015. On a linked quarter basis, tax-equivalent interest income increased $15.54 million, or 26.41%, from $58.85 million in second quarter 2016. Average earning assets grew to $7.26 billion in the quarter ended September 30, 2016, from $5.60 billion in the comparative prior year quarter, an increase of $1.65 billion, or 29.47%. In the linked quarter comparison, average earning assets increased by $1.23 billion, or 20.43%, from $6.03 billion in second quarter 2016. The yield on earning assets was 4.08% in the quarter ended September 30, 2016, which compared to 3.99% in the comparative prior year and 3.93% in the linked period. Average loan balances, excluding nonaccrual loans, of $5.58 billion were $1.28 billion, or 29.83%, higher in third quarter 2016 than in the same period a year ago, while loan yields grew by 9 basis points. In the linked quarter, average loans grew $880.89 million, or 18.73%, and loan yields increased by 18 basis points. The increase in interest income from comparative prior periods was primarily driven by growth in loans and loans held for sale resulting from the Monarch acquisition, combined with the increase in yields.

Interest expense for the quarter ended September 30, 2016, was $9.22 million, which was $0.90 million, or 10.85%, higher than the $8.32 million amount in the year-ago quarter. The average balance of interest-bearing liabilities increased to $4.73 billion in third quarter 2016 from $3.82 billion in the comparative prior year quarter, an increase of 23.89%. On a linked quarter basis, interest expense increased by 9.00% to $9.22 million from $8.46 million in second quarter 2016. In the linked quarter, average interest-bearing liabilities increased by $716.91 million, or 17.86%, from $4.01 billion in the quarter ended June 30, 2016. The increase in interest expense as compared to prior periods was primarily due to the merger-driven increase in interest-bearing deposits, partially offset by lower rates in borrowings and time deposits. During fourth quarter 2016, the Company pre-funded $260 million of FHLB advances with maturities in 2017. The existing cost on these funds was an average of 4.28% and is being replaced at a cost of 1.26%. The resulting annualized pre-tax savings is expected to be approximately $7.9 million.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.57% in the quarter ended September 30, 2016, which was 17 basis points higher than the 3.40% margin of the September 30, 2015, quarter and 21 basis points higher than the 3.36% margin from the June 30, 2016, quarter. The increase in margin from the prior periods was driven by an increase in loan yields combined with an increase in the accretion of purchase accounting marks and rate decreases in borrowing and time deposits. As the positive effect of the Monarch acquisition on net interest margin diminishes, the company expects compression in the net interest margin to resume in the coming quarters. The rate of compression will reflect the impacts of the merger, including acquisition accounting impacts. The company sees the current quarter net interest margin of 3.57% compressing by approximately 10 basis points over the next four quarters.

The following table sets forth an estimate of the expected effects of the estimated aggregate acquisition accounting adjustments on the pre-tax net interest income for the periods shown *(in thousands)*:

	Discount Accretion (Premium Amortization)			
	For the three months ended			
	December 31, 2016	March 31, 2017	June 30, 2017	September 30, 2017
Assets:				
Investment Securities	$ (40)	$ (31)	$ (21)	$ (12)
Loans	1,397	932	904	800
Liabilities:				
Deposits	(351)	(305)	(232)	(171)
Total estimated effect on net interest income	$ 1,708	$ 1,206	$ 1,115	$ 959

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

PART I. FINANCIAL INFORMATION

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

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

	Three Months Ended September 30, 2016			Three Months Ended June 30, 2016			Three Months Ended September 30, 2015		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 5,583,711	$ 65,245	4.65 %	$ 4,702,825	$ 52,232	4.47%	$ 4,300,751	$ 49,398	4.56%
Taxable investment securities	687,480	2,703	1.57 %	671,792	2,734	1.63%	796,062	3,235	1.63%
Tax-exempt investment securities	53,180	396	2.98 %	52,398	405	3.09%	61,048	493	3.23%
Interest-bearing deposits	287,672	(36)	(0.05)%	289,698	364	0.51%	167,247	107	0.25%
Loans held for sale	481,358	4,137	3.44 %	156,425	1,294	3.31%	132,214	1,246	3.77%
Bank-owned life insurance	162,555	1,945	4.76 %	151,895	1,817	4.81%	147,150	1,877	5.06%
Total earning assets	7,255,956	74,390	4.08 %	6,025,033	58,846	3.93%	5,604,472	56,356	3.99%
Less: allowance for loan losses	(40,004)			(38,419)			(37,926)		
Total nonearning assets	775,261			547,449			549,135		
Total assets	$ 7,991,213			$ 6,534,063			$ 6,115,681		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 2,216,987	$ 1,674	0.30 %	$ 1,813,502	$ 1,298	0.29%	$ 1,693,424	$ 1,201	0.28%
Savings	318,193	723	0.90 %	301,542	709	0.95%	297,041	695	0.93%
Certificates of deposit	1,684,136	3,512	0.83 %	1,429,449	3,260	0.92%	1,356,409	2,985	0.87%
Total interest-bearing deposits	4,219,316	5,909	0.56 %	3,544,493	5,267	0.60%	3,346,874	4,881	0.58%
Borrowings	512,027	3,309	2.53 %	469,939	3,190	2.69%	472,120	3,435	2.85%
Total interest-bearing liabilities	4,731,343	9,218	0.78 %	4,014,432	8,457	0.85%	3,818,994	8,316	0.86%
Demand deposits	1,959,025			1,538,370			1,388,002		
Other noninterest-bearing liabilities	225,822			121,323			96,083		
Total liabilities	6,916,190			5,674,125			5,303,079		
Shareholders' equity	1,075,023			859,938			812,602		
Total liabilities and equity	$ 7,991,213			$ 6,534,063			$ 6,115,681		
Net interest income (tax-equivalent basis)		$ 65,172			$ 50,389			$ 48,040	
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(1,945)			(1,817)			(1,877)	
Tax-equivalent basis adjustment		(622)			(788)			(493)	
Net interest income (GAAP)		$ 62,605			$ 47,784			$ 45,670	
Interest rate spread (1)			3.30 %			3.08%			3.13%
Interest expense as a percent of average earning assets			0.51 %			0.56%			0.59%
Net interest margin (tax equivalent basis) (2)			3.57 %			3.36%			3.40%
Total cost of deposits			0.38 %			0.42%			0.41%

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

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

	Increase/(Decrease) Three Months Ended September 30, 2016 Compared to Three Months Ended June 30, 2016			Increase/(Decrease) Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 10,693	$ 2,320	$ 13,013	$ 14,847	$ 1,000	$ 15,847
Taxable investment securities	63	(95)	(32)	(429)	(103)	(532)
Tax-exempt investment securities	6	(15)	(9)	(61)	(36)	(97)
Interest-bearing deposits	(3)	(397)	(400)	40	(183)	(143)
Loans held for sale	2,791	52	2,843	3,010	(119)	2,891
Bank-owned life insurance	145	(17)	128	184	(116)	68
Total earning assets	13,695	1,848	15,543	17,591	443	18,034
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	314	63	377	388	85	473
Savings	43	(29)	14	47	(19)	28
Certificates of deposit	570	(318)	252	680	(153)	527
Total interest-bearing deposits	927	(284)	643	1,115	(87)	1,028
Borrowings	297	(179)	118	273	(399)	(126)
Total interest-bearing liabilities	1,224	(463)	761	1,388	(486)	902
Net interest income	$ 12,471	$ 2,311	$ 14,782	$ 16,203	$ 929	$ 17,132

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

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

	Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015			Nine Months Ended September 30, 2016 Compared with September 30, 2015		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change due to Rate	Change due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$4,936,641	$ 168,257	4.55%	$4,177,038	$ 146,020	4.67%	$ 22,237	(3,850)	26,087
Taxable investment securities	704,532	8,492	1.61%	787,996	8,862	1.50%	(370)	609	(979)
Tax-exempt investment securities	52,854	1,211	3.05%	63,684	1,524	3.19%	(313)	(63)	(250)
Interest-bearing deposits	280,900	658	0.31%	152,472	287	0.25%	371	83	288
Loans held for sale	238,983	6,124	3.42%	109,592	2,971	3.62%	3,153	(172)	3,325
Bank-owned life insurance	154,796	5,564	4.80%	144,551	5,674	5.25%	(110)	(853)	743
Total earning assets	6,368,706	190,306	3.99%	5,435,333	165,338	4.07%	24,968	(4,246)	29,214
Less: allowance for loan losses	(38,996)			(36,950)					
Total nonearning assets	$ 620,275			$ 551,342					
Total assets	$6,949,985			$5,949,725					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$1,938,818	$ 4,300	0.30%	$1,658,531	$ 3,456	0.28%	$ 844	$ 230	$ 614
Savings	306,644	2,132	0.93%	300,996	2,071	0.92%	61	21	40
Certificates of deposit	1,510,707	9,957	0.88%	1,319,827	8,220	0.83%	1,737	492	1,245
Total interest-bearing deposits	3,756,169	16,389	0.58%	3,279,354	13,747	0.56%	2,642	743	1,899
Borrowings	483,692	9,685	2.63%	460,195	10,205	2.92%	(520)	(1,018)	498
Total interest-bearing liabilities	4,239,861	26,074	0.82%	3,739,549	23,952	0.86%	2,122	(275)	2,397
Demand deposits	1,638,902			1,317,517					
Other noninterest-bearing liabilities	148,950			94,278					
Total liabilities	6,027,713			5,151,344					
Shareholders' equity	922,272			798,381					
Total liabilities and equity	$6,949,985			$5,949,725					
Net interest income (tax-equivalent basis)		$ 164,232			$ 141,386		$ 22,846	$ (3,971)	$ 26,817
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(5,564)			(5,674)		110		
Tax-equivalent basis adjustment		(1,944)			(1,601)		$ (342)		
Net interest income (GAAP)		$ 156,724			$ 134,111		$ 22,614		
Interest rate spread (1)			3.17%			3.21%			
Interest expense as a percent of average earning assets			0.55%			0.59%			
Net interest margin (tax equivalent basis) (2)			3.45%			3.48%			
Total cost of deposits			0.41%			0.40%			

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

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

Noninterest Income. Total noninterest income, excluding securities gains or losses, for the quarter ended September 30, 2016, was $46.82 million, an increase of $17.25 million, or 58.35%, compared to the same period in 2015 and an increase of $10.35 million, or 28.39%, compared to second quarter 2016. As a percentage of total operating income, noninterest income, excluding securities gains or losses, for third quarter 2016 was 42.79%, compared with 39.30% for comparative 2015 and 43.28% for second quarter 2016.

Our noninterest income primarily consists of fee income produced by our three reportable segments, less applicable commission expenses. The following table provides an analysis of noninterest income for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Residential mortgage banking income, net	$ 21,430	$ 8,262	$ 13,168	159.38 %
Insurance commissions and other title fees and income, net	11,258	9,710	1,548	15.94 %
Real estate brokerage and property management, net	6,647	5,349	1,298	24.27 %
Service charges on deposit accounts	2,552	2,388	164	6.87 %
Credit card merchant fees, net	1,365	823	542	65.86 %
Other income	3,569	3,036	533	17.56 %
Subtotal before gain on investment securities	46,821	29,568	17,253	58.35 %
Net gain on investment securities	—	736	(736)	(100.00)%
Total noninterest income	$ 46,821	$ 30,304	$ 16,517	54.50 %

	Three Months Ended		Increase/(Decrease) Third Quarter 2016 over Second Quarter 2016	
	September 30, 2016	June 30, 2016	Amount	Percent
Residential mortgage banking income, net	$ 21,430	$ 12,148	$ 9,282	76.41 %
Insurance commissions and other title fees and income, net	11,258	11,627	(369)	(3.17)%
Real estate brokerage and property management, net	6,647	6,116	531	8.68 %
Service charges on deposit accounts	2,552	2,284	268	11.73 %
Credit card merchant fees, net	1,365	1,113	252	22.64 %
Other income	3,569	3,180	389	12.23 %
Subtotal before gain on investment securities	46,821	36,468	10,353	28.39 %
Net gain on investment securities	—	—	—	—
Total noninterest income	$ 46,821	$ 36,468	$ 10,353	28.39 %

	Nine Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Residential mortgage banking income, net	$ 40,696	$ 26,956	$ 13,740	50.97 %
Insurance commissions and other title fees and income, net	36,918	30,644	6,274	20.47 %
Real estate brokerage and property management, net	17,591	13,888	3,703	26.66 %
Service charges on deposit accounts	7,012	6,911	101	1.46 %
Credit card merchant fees, net	3,373	1,821	1,552	85.23 %
Other income	10,114	11,081	(967)	(8.73)%
Subtotal before gain on investment securities	115,704	91,301	24,403	26.73 %
Net gain on investment securities	—	904	(904)	(100.00)%
Total noninterest income	$ 115,704	$ 92,205	$ 23,499	25.49 %

For the third quarter of 2016, residential mortgage banking income, net of commission expense, was $21.43 million, an increase of $13.17 million, or 159.38%, compared to third quarter 2015, and an increase of $9.28 million, or 76.41%, compared to second quarter 2016. For the nine-month period ended September 30, 2016, residential mortgage banking income, net of commission expense, was $40.70 million, reflecting an increase of $13.74 million, or 50.97%, compared to the same period in 2015. The increase from prior comparative periods was primarily due to higher production volumes resulting from the Monarch merger in June 2016. Also factoring in the variance from the prior periods was a seasonal decrease in mortgage banking income of $1.25 million associated with a decrease in the value of rate lock commitments recorded as of September 30, 2016, as compared to an increase of $0.36 million and a decrease of $0.46 million recognized for the quarters ended June 30, 2016, and September 30, 2015, respectively.

For the third quarter of 2016, insurance commissions and other title income, net of commission expense, was $11.26 million, which was $1.55 million, or 15.94%, higher than comparative 2015, and $0.37 million, or 3.17%, lower than second quarter 2016. The increase for the 2016 nine-month period was $6.27 million, or 20.47%, from the comparative period in 2015. The increase from the comparative prior year quarter was largely due to the acquisition of three insurance agencies in the second half of 2015, which contributed additional commission and fee income of $0.97 million and $3.55 million in the three- and nine-month periods ended September 30, 2016. Also contributing was an increase in commercial lines commissions due to organic growth and an increase in commissions from travel insurance.

Real estate brokerage and property management income, net of commission expense, for third quarter 2016 was $6.65 million, which was $1.30 million, or 24.27%, higher than comparative 2015, and $0.53 million, or 8.68%, higher than second quarter 2016. For the nine-month period, real estate brokerage and property management income, net of commission expense, was $3.70 million, or 26.66%, higher than comparative 2015. The increase from the prior year periods was primarily a result of an increase in property management fees associated with our purchase of Oak Island Accommodations, Inc. ("Oak Island") on January 14, 2016. The increase from the comparative prior year nine-month period was partially offset by the second quarter 2015 sale of our Corolla, North Carolina-based property management business ("Corolla"), which generated management fee revenue of $1.80 million in 2015 prior to the sale. The increase from the linked quarter was primarily due to the seasonal increase in resort property management fees.

Service charges on deposit accounts were $2.55 million for third quarter 2016, compared with $2.39 million for the comparative 2015 period, and $2.28 million for second quarter 2016. For the nine months ended September 30, 2016, service charges on deposit accounts were $7.01 million, which was $0.10 million, or 1.46%, higher than comparative 2015. The increase from prior periods was primarily due to the addition of accounts related to the Monarch merger.

For the third quarter of 2016, credit card merchant fees totaled $1.36 million, which was $0.54 million, or 65.86%, higher than comparative 2015, and $0.25 million, or 22.64%, higher than the second quarter of 2016. For the nine months ended September 30, 2016, credit card merchant fees totaled $3.37 million, which was $1.55 million, or 85.23%, higher than comparative 2015. The increases from the prior periods were primarily related to the effects of the Monarch merger, combined with a decrease in prior year merchant fees related to structural changes in vendor contractual terms and nonrecurring expenses related to a platform change and equipment purchases associated with Europay, MasterCard, and Visa (EMV) compliance. The Company believes the contractual changes will be beneficial in the long term, which is reflected in the increase from the prior periods.

Other noninterest income for the three and nine months ended September 30, 2016, was $3.57 million and $10.11 million, respectively, and included income generated by Towne Investment Group, net of commission expense. For the three months ended September 30, 2016, net commission income for Towne Investment Group totaled $0.94 million as compared to $0.68 million for third quarter 2015 and $0.63 million for second quarter 2016. The decrease from the prior year nine-month period was due to gains recognized in second quarter 2015 of $1.36 million on the sale of our North Carolina-based property management business and $0.57 million on the sale of land in Virginia Beach.

Noninterest Expense. For the quarter ended September 30, 2016, total noninterest expense was $70.93 million, which was $21.03 million, or 42.13%, higher than comparative 2015, and $0.97 million, or 1.34%, lower than the quarter ended June 30, 2016. For the nine months ended September 30, 2016, total noninterest expense increased $45.58 million, or 30.50%, from comparative 2015 to $194.99 million.

As a percentage of operating income, noninterest expense was 64.82% for the third quarter of 2016, 66.33% for comparative 2015, and 85.34% for the quarter ended June 30, 2016. The primary components of noninterest expense in the third quarter of 2016 were salaries and employee benefits of $40.50 million, occupancy expenses of $6.66 million, furniture and equipment expenses of $3.20 million, advertising and marketing expenses of $2.33 million, acquisition-related expenses of $0.97 million, software expenses of $1.90 million, and outside processing expenses of $1.93 million. In comparison to the prior year comparative periods, the primary driver of the increase in total noninterest expense was due to additional operational expenses related to the Monarch acquisition, while the decrease from the linked quarter was due to a decrease of $17.47 million in acquisition-related expenses resulting from the Monarch merger. Also contributing to the increase from the prior year periods were insurance agency acquisitions in 2015 and the Oak Island acquisition in January 2016, which contributed combined additional operational expenses of $2.37 million and $6.72 million in the three- and nine-month periods ending September 30, 2016, respectively.

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

	Three Months Ended			Increase/(Decrease)			
				September 30, 2016 over September 30, 2015		September 30, 2016 over June 30, 2016	
	September 30,		June 30,				
	2016	2015	2016	Amount	Percent	Amount	Percent
Salaries and benefits	$ 40,497	$ 28,910	$ 30,093	$ 11,587	40.08 %	$ 10,404	34.57 %
Occupancy expense	6,656	4,703	5,157	1,953	41.53 %	1,499	29.07 %
Furniture and equipment	3,199	2,211	2,381	988	44.69 %	818	34.36 %
Other							
Advertising and marketing	2,327	1,704	1,978	623	36.56 %	349	17.64 %
Acquisition-related expenses	969	243	18,435	726	298.77 %	(17,466)	(94.74)%
Other	3,040	1,264	2,045	1,776	140.51 %	995	48.66 %
Charitable contributions	1,045	1,121	1,373	(76)	(6.78)%	(328)	(23.89)%
Outside processing	1,931	1,182	1,395	749	63.37 %	536	38.42 %
Professional fees	1,220	1,314	1,159	(94)	(7.15)%	61	5.26 %
Stationery and supplies	890	601	546	289	48.09 %	344	63.00 %
FDIC and other insurance	1,352	1,242	1,280	110	8.86 %	72	5.63 %
Foreclosed property expenses	157	573	458	(416)	(72.60)%	(301)	(65.72)%
Software expense	1,904	1,537	1,538	367	23.88 %	366	23.80 %
Telephone and postage	1,758	1,142	1,202	616	53.94 %	556	46.26 %
Amortization - intangibles	1,920	918	1,100	1,002	109.15 %	820	74.55 %
Bank franchise tax/SCC fees	1,151	596	941	555	93.12 %	210	22.32 %
Directors fees and expenses	385	294	329	91	30.95 %	56	17.02 %
Travel/meals/entertainment	532	351	489	181	51.57 %	43	8.79 %
Total other expenses	20,581	14,082	34,268	6,499	46.15 %	(13,687)	(39.94)%
Total noninterest expense	$ 70,933	$ 49,906	$ 71,899	$ 21,027	42.13 %	$ (966)	(1.34)%

	Nine Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Salaries and benefits	$100,776	$ 83,133	$ 17,643	21.22 %
Occupancy expense	16,831	14,489	2,342	16.16 %
Furniture and equipment	7,937	6,949	988	14.22 %
Other				
Advertising and marketing	6,207	5,550	657	11.84 %
Acquisition-related expenses	19,817	1,027	18,790	N/M
Other	6,258	4,493	1,765	39.28 %
Charitable contributions	3,466	4,109	(643)	(15.65)%
Outside processing	4,723	3,745	978	26.11 %
Professional fees	3,830	4,263	(433)	(10.16)%
Stationery and supplies	2,030	1,794	236	13.15 %
FDIC and other insurance	3,624	3,679	(55)	(1.49)%
Foreclosed property expenses	727	1,972	(1,245)	(63.13)%
Software expense	5,064	4,324	740	17.11 %
Telephone and postage	4,171	3,524	647	18.36 %
Amortization - intangibles	4,112	2,565	1,547	60.31 %
Bank franchise tax/SCC fees	3,032	1,895	1,137	60.00 %
Directors fees and expenses	985	918	67	7.30 %
Travel/meals/entertainment	1,402	985	417	42.34 %
Total other expenses	69,448	44,843	24,605	54.87 %
Total noninterest expense	$194,992	$149,414	$ 45,578	30.50 %

Salary and benefits expense, the largest portion of noninterest expense, was $40.50 million, representing 57.09% of total noninterest expense for the quarter ended September 30, 2016, and $100.78 million, or 51.68% of total noninterest expense for the nine months ended September 30, 2016. Salary and benefits expense increased $11.59 million, or 40.08%, and increased $17.64 million, or 21.22%, over the comparative three- and nine-month periods in 2016, and increased $10.40 million, or 34.57%, from second quarter 2016. The increase from prior periods was primarily due to the addition of staff resulting from the Monarch acquisition. Also contributing to the increase from the comparative 2015 periods was the addition of staff resulting from the acquisitions in our Insurance and Realty segment businesses, which resulted in increases of $1.47 million and $4.12 million from the three- and nine-month periods ended September 30, 2015, respectively.

In our Banking segment, we had a total of 810 full-time equivalent employees ("FTE") at September 30, 2016, as compared to 703 at September 30, 2015, and 841 at June 30, 2016. In our non-Banking segments at September 30, 2016, we had a total of 1,245 FTEs, excluding real estate sales agents, which was up from 748 at September 30, 2015, and remained unchanged from 1,245 at June 30, 2016. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE was $53,000 for the quarter ended September 30, 2016, increased from $52,000 and $40,000 for the three-month periods ended September 30, 2015, and June 30, 2016, respectively.

Occupancy expense for the third quarter of 2016 experienced a $1.95 million, or 41.53%, increase from the comparative quarter of 2015, and a $1.50 million, or 29.07%, increase from the second quarter of 2016. Occupancy expense for the first nine months of 2016 increased $2.34 million, or 16.16%, from comparative 2015. The increase from prior periods was primarily related to facilities acquired in the Monarch acquisition, combined with the opening of a new banking office in Richmond, Virginia, in August 2016. Also contributing to the increase from the comparative periods of the prior year were additional expenses related to the Insurance and Realty segment acquisitions.

For the three- and nine-month periods ended September 30, 2016, furniture and equipment expense increased by $0.99 million over both comparative 2015 periods, and increased $0.82 million over second quarter 2016. The increases from prior periods were primarily related to facilities acquired in the Monarch acquisition.

Other noninterest expenses for the third quarter of 2016 were $20.58 million, an increase of $6.50 million, or 46.15%, compared to the same period in 2015, and for the first nine months of 2016 increased $24.61 million, or 54.87%, compared to the same period in 2015, while there was a decrease of $13.69 million, or 39.94%, compared to second quarter 2016. The Monarch merger was the primary driver of the increase from the comparative prior year periods, while the decrease in acquisition-related expenses from the linked quarter was partially offset by increased outside processing taxes and amortization expenses.

Provision for Income Taxes. We reported a provision for income tax expense of $10.97 million, representing an effective tax rate of 31.22%, in the third quarter of 2016. The provision for income tax expense was $7.44 million for the third quarter of 2015, with an effective rate of 29.76%, and $2.38 million with an effective rate of 27.51%, in the second quarter of 2016. For the first nine months of 2016, the effective rate increased to 30.86% compared to 30.62% in the same period of 2015. The increase from the prior year third quarter was primarily a result of the increase in taxable income subject to the federal statutory rate of 35%, while the variance from the prior year nine-month period was primarily due to a slight decrease in federal tax credits.

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

Banking Segment. For the three months ended September 30, 2016, the Banking segment represented 75.60%, or $18.29 million, of our total consolidated net income, compared to 80.54%, or $14.15 million, for comparative 2015. For the nine months ended September 30, 2016, the Banking segment represented 69.83%, or $33.70 million, of our total consolidated income, compared to 76.77%, or $38.32 million, for comparative 2015.

Pre-tax earnings for the three months ended September 30, 2016, for the Banking segment were $25.62 million, increasing $6.30 million from comparative 2015. The increase in earnings from the comparative 2015 quarter was driven by an increase in net interest income of $14.17 million, which was primarily a result of additional interest income from earning assets related to the Monarch merger as average loan balances increased $1.28 billion to $5.58 billion. Partially offsetting the increase was an increase in noninterest expenses of $6.92 million, which included increased personnel costs of $2.52 million, higher occupancy costs of $0.92 million, additional amortization expenses of $0.52 million, and an increase in acquisition-related expenses of $0.80 million related to the Monarch merger. Also offsetting the increase in earnings from third quarter 2015 was an increase in the loan loss provision of $1.56 million.

Pre-tax earnings increased $25.01 million compared to the linked quarter ended June 30, 2016. The increase in earnings was a result of higher net interest income of $12.03 million, which was primarily due to the increase in earning assets related to the Monarch merger combined with the decrease in noninterest expenses of $11.31 million, which included a decrease in acquisition-related expenses of $17.16 million, partially offset by an increase in personnel costs of $3.39 million. Also contributing was a decrease in the provision for loan losses of $0.41 million.

Pre-tax earnings were down $6.66 million for the nine months ended September 30, 2016, compared to the comparative period in 2015. The leading factor in the decrease was the previously discussed acquisition-related expenses, which increased $18.72 million from the nine months ended September 30, 2015, combined with higher personnel and facilities costs associated with the Monarch merger. The increase in expenses was partially offset by an increase in net interest income of $19.62 million related to the merger-driven increase in average earning assets.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,			2016 over 2015		September over June	
	2016	2015	June 30, 2016	Amount	Percent	Amount	Percent
Net interest income	$ 58,919	$ 44,747	$ 46,888	$ 14,172	31.67 %	$ 12,031	25.66 %
Service charges on deposit accounts	2,552	2,388	2,284	164	6.87 %	268	11.73 %
Credit card merchant fees	1,365	823	1,113	542	65.86 %	252	22.64 %
Other income	2,701	2,208	2,148	493	22.33 %	553	25.74 %
Net gain on investment securities	—	736	—	(736)	(100.00)%	—	— %
Total noninterest income	6,618	6,155	5,545	463	7.52 %	1,073	19.35 %
Total revenue	65,537	50,902	52,433	14,635	28.75 %	13,104	24.99 %
Provision for loan losses	1,686	130	2,099	1,556	1,196.92 %	(413)	(19.68)%
Salaries and employee benefits	20,509	17,992	17,119	2,517	13.99 %	3,390	19.80 %
Occupancy expense	4,197	3,282	3,588	915	27.88 %	609	16.97 %
Furniture and equipment	2,358	1,777	1,847	581	32.70 %	511	27.67 %
Other expenses	11,607	8,698	27,423	2,909	33.44 %	(15,816)	(57.67)%
Total noninterest expenses	38,671	31,749	49,977	6,922	21.80 %	(11,306)	(22.62)%
Income before income tax and corporate allocation	25,180	19,023	357	6,157	32.37 %	24,823	6,953.22 %
Corporate allocation	439	293	255	146	49.83 %	184	72.16 %
Income before income tax provision	25,619	19,316	612	6,303	32.63 %	25,007	4,086.11 %
Provision for income tax expense	7,325	5,168	(678)	2,157	41.74 %	8,003	(1,180.38)%
Net income	$ 18,294	$ 14,148	$ 1,290	$ 4,146	29.30 %	$ 17,004	1,318.14 %
Efficiency ratio (1)	59.01%	63.29%	95.32%	(4.28)%	(6.76)%	(36.31)%	(38.09)%

(1) Excludes gain on investment securities.

	Nine Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Net interest income	$ 151,630	$ 132,006	$ 19,624	14.87 %
Service charges on deposit accounts	7,012	6,911	101	1.46 %
Credit card merchant fees	3,373	1,821	1,552	85.23 %
Other income	7,377	7,550	(173)	(2.29)%
Gain on investment securities	—	904	(904)	(100.00)%
Total noninterest income	17,762	17,186	576	3.35 %
Total revenue	169,392	149,192	20,200	13.54 %
Provision for loan losses	3,526	2,176	1,350	62.04 %
Salaries and employee benefits	55,140	50,607	4,533	8.96 %
Occupancy expense	11,261	10,117	1,144	11.31 %
Furniture and equipment	6,070	5,517	553	10.02 %
Other expenses	48,357	28,928	19,429	67.16 %
Total expenses	120,828	95,169	25,659	26.96 %
Income before income tax and corporate allocation	45,038	51,847	(6,809)	(13.13)%
Corporate allocation	1,054	901	153	16.98 %
Income before income tax provision	46,092	52,748	(6,656)	(12.62)%
Provision for income tax expense	12,377	14,425	(2,048)	(14.20)%
Net income	$ 33,715	$ 38,323	$ (4,608)	(12.02)%
Efficiency ratio (1)	71.33%	64.18%	7.15%	11.14 %

Realty Segment. For the three months ended September 30, 2016, the Realty segment had income before income tax provision and noncontrolling interest of $9.11 million, as compared to $4.62 million for the comparative 2015 period, and $7.27 million for the linked quarter ended June 30, 2016. Total revenue increased to $33.15 million in third quarter 2016 from $15.62 million in third quarter 2015. The $13.16 million, or 154.15%, increase in residential mortgage banking income resulted from higher production volumes related to the Monarch merger. Residential mortgage banking income included a decrease in the value of rate lock commitments of $1.25 million for the quarter ended September 30, 2016, compared to a decrease of $0.46 million in the same period of 2015. The increase in property management fees from 2015 was primarily due to increased revenue from our purchase of Oak Island on January 14, 2016. The increase in net interest and other income was a result additional net interest income resulting from a higher balance of average mortgage loans held for sale.

Expenses for the Realty segment increased 118.88%, or $12.91 million, when compared to the same period in 2015, and increased by 80.80%, or $10.62 million, when compared to the quarter ended June 30, 2016. The increase from third quarter 2015 and second quarter 2016 was primarily due to an increase in mortgage operation expenses related to the Monarch merger. Also contributing to the increase in expenses over the comparative prior year quarter were additional operating expenses of $1.42 million related to Oak Island operations.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2016 September 30, 2015		September 30, 2016 June 30, 2016	
	2016	2015	2016	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	$ 21,692	$ 8,535	$ 12,490	$ 13,157	154.15 %	$ 9,202	73.67 %
Real estate brokerage income, net	2,267	1,989	2,393	278	13.98 %	(126)	(5.27)%
Title insurance and settlement fees	562	451	550	111	24.61 %	12	2.18 %
Property management fees, net	4,381	3,360	3,723	1,021	30.39 %	658	17.67 %
Income from unconsolidated subsidiary	283	132	216	151	114.39 %	67	31.02 %
Net interest and other income	3,964	1,148	1,167	2,816	245.30 %	2,797	239.67 %
Total revenue	33,149	15,615	20,539	17,534	112.29 %	12,610	61.40 %
Salaries and employee benefits	14,198	6,335	7,250	7,863	124.12 %	6,948	95.83 %
Occupancy expense	1,922	940	1,053	982	104.47 %	869	82.53 %
Furniture and equipment	762	231	275	531	229.87 %	487	177.09 %
Amortization of intangible assets	559	236	353	323	136.86 %	206	58.36 %
Other expenses	6,325	3,116	4,214	3,209	102.98 %	2,111	50.09 %
Total expenses	23,766	10,858	13,145	12,908	118.88 %	10,621	80.80 %
Income before income tax, corporate allocation and noncontrolling interest	9,383	4,757	7,394	4,626	97.25 %	1,989	26.90 %
Corporate allocation	(278)	(135)	(123)	(143)	(105.93)%	(155)	(126.02)%
Income before income tax provision and noncontrolling interest	9,105	4,622	7,271	4,483	96.99 %	1,834	25.22 %
Provision for income tax	2,921	1,518	2,249	1,403	92.42 %	672	29.88 %
Net income	6,184	3,104	5,022	3,080	99.23 %	1,162	23.14 %
Noncontrolling interest	(1,369)	(759)	(1,257)	(610)	(80.37)%	(112)	(8.91)%
Net income attributable to TowneBank	$ 4,815	$ 2,345	$ 3,765	$ 2,470	105.33 %	$ 1,050	(27.89)%
Key data:							
Efficiency ratio	71.69%	69.54%	64.00%	2.15%	3.09 %	7.69%	12.02 %
Number of units sold	1,220	1,122	1,256	98	8.73 %	(36)	(2.87)%
Volume of units sold	$ 363,927	$ 318,171	$ 372,124	$ 45,756	14.38 %	$ (8,197)	(2.20)%
Number of real estate agents	398	405	416	(7)	(1.73)%	(18)	(4.33)%
Loans originated, mortgage	$ 974,975	$ 221,772	$ 326,840	$ 753,203	339.63 %	$ 648,135	198.30 %
Loans originated, joint venture	271,702	213,049	264,945	58,653	27.53 %	6,757	2.55 %
Total loans originated	$ 1,246,677	$ 434,821	$ 591,785	$ 811,856	186.71 %	$ 654,892	110.66 %
Number of loans, mortgage	3,729	993	1,313	2,736	275.53 %	2,416	184.01 %
Number of loans, joint venture	1,193	936	1,232	257	27.46 %	(39)	(3.17)%
Total number of loans	4,922	1,929	2,545	2,993	155.16 %	2,377	93.40 %
Average loan amount, mortgage	$ 261	$ 223	$ 249	$ 38	17.04 %	$ 12	4.82 %
Average loan amount, joint venture	228	228	215	—	— %	13	6.05 %
Average loan amount	$ 253	$ 225	$ 233	$ 28	12.44 %	$ 20	8.58 %
Average number of originators, mortgage	250	72	66	178	247.22 %	184	278.79 %
Average number of originators, joint venture	56	52	55	4	7.69 %	1	1.82 %
Average number of originators	306	124	121	182	146.77 %	185	152.89 %

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

	Nine Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Residential mortgage banking income, net	$ 41,492	$ 27,506	$ 13,986	50.85 %
Real estate brokerage income, net	6,072	5,220	852	16.32 %
Title insurance and settlement fees	1,461	1,211	250	20.64 %
Property management fees, net	11,519	8,668	2,851	32.89 %
Income from unconsolidated subsidiary	663	447	216	48.32 %
Net interest and other income	5,895	4,078	1,817	44.56 %
Total revenue	67,102	47,130	19,972	42.38 %
Salaries and employee benefits	28,155	18,415	9,740	52.89 %
Occupancy expense	3,988	2,956	1,032	34.91 %
Furniture and equipment	1,306	763	543	71.17 %
Amortization of intangible assets	1,264	786	478	60.81 %
Other expenses	13,382	9,363	4,019	42.92 %
Total expenses	48,095	32,283	15,812	48.98 %
Income before income tax, corporate allocation and noncontrolling interest	19,007	14,847	4,160	28.02 %
Corporate allocation	(570)	(400)	(170)	42.50 %
Income before income tax provision and noncontrolling interest	18,437	14,447	3,990	27.62 %
Provision for income tax expense	5,829	4,856	973	20.04 %
Net income	12,608	9,591	3,017	31.46 %
Noncontrolling interest	(2,994)	(1,870)	(1,124)	60.11 %
Net income attributable to TowneBank	$ 9,614	$ 7,721	1,893	24.52 %
Key data:				
Efficiency ratio	71.67%	68.50%	3.17%	4.63 %
Number of units sold	3,280	2,953	327	11.07 %
Volume of units sold	$ 960,751	$ 806,159	$ 154,592	19.18 %
Number of real estate agents	398	405	(7)	(1.73)%
Loans originated, mortgage	$ 1,464,806	$ 616,188	$ 848,618	137.72 %
Loans originated, joint venture	686,795	603,288	83,507	13.84 %
Total loans originated	$ 2,151,601	$ 1,219,476	$ 932,125	76.44 %
Number of loans, mortgage	5,723	2,651	3,072	115.88 %
Number of loans, joint venture	3,161	2,827	334	11.81 %
Total number of loans	8,884	5,478	3,406	62.18 %
Average loan amount, mortgage	$ 256	$ 232	$ 24	10.34 %
Average loan amount, joint venture	217	213	4	1.88 %
Average loan amount	$ 242	$ 223	$ 19	8.52 %

Mortgage. Loan volume for the combined mortgage operations increased in the quarter ended September 30, 2016, as compared to the same period in 2015. Total loans originated in the third quarter of 2016 were $1.25 billion, a 186.71% increase, or $811.86 million, from $434.82 million in the comparative period of 2015. This was a $654.89 million, or 110.66%, increase compared to the volume for the quarter ended June 30, 2016. Refinance activity comprised $325.18 million of loan volume for the quarter ended September 30, 2016, while purchases accounted for the remaining $921.50 million in loan volume for the quarter. For the quarters ended September 30, 2015, and June 30, 2016, refinance volume was $58.07 million and $80.68 million, respectively, while purchase volume was $376.75 million and $511.11 million, respectively.

Insurance Segment. The Insurance segment comprises property and casualty and group benefit divisions. The Insurance segment represented 4.48%, or $1.09 million, of total consolidated net income at September 30, 2016, and 6.11%, or $1.07 million, at September 30, 2015.

Earnings before income taxes and noncontrolling interests for the three months ended September 30, 2016, were $2.08 million, increasing $0.08 million, or 4.15%, from comparative 2015, and down $0.29 million from the linked quarter ended June 30, 2016. Earnings before income taxes and noncontrolling interests for the first nine months of 2016 were $9.38 million, increasing $1.85 million, or 24.57%, from the same period in 2015. The primary factors affecting earnings in comparison to the prior year periods were income related to insurance agencies acquired in 2015, an increase in contingency revenue, and growth in our travel insurance business.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2016 September 30, 2015		September 30, 2016 June 30, 2016	
	2016	2015	2016	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 9,068	$ 8,156	$ 8,815	$ 912	11.18 %	$ 253	2.87 %
Employee benefits	2,947	2,578	2,907	369	14.31 %	40	1.38 %
Travel insurance	926	626	1,163	300	47.92 %	(237)	(20.38)%
Specialized benefit services	154	145	152	9	6.21 %	2	1.32 %
Total net commissions and fees	13,095	11,505	13,037	1,590	13.82 %	58	0.44 %
Contingency and bonus revenue	45	260	445	(215)	(82.69)%	(400)	(89.89)%
Other income	82	53	52	29	54.72 %	30	57.69 %
Total revenues	13,222	11,818	13,534	1,404	11.88 %	(312)	(2.31)%
Employee commission expense	2,482	2,361	2,254	121	5.12 %	228	10.12 %
Revenue, net of commission expense	$ 10,740	$ 9,457	$ 11,280	1,283	13.57 %	(540)	(4.79)%
Salaries and employee benefits	5,790	4,583	5,723	1,207	26.34 %	67	1.17 %
Occupancy expense	537	480	517	57	11.88 %	20	3.87 %
Furniture and equipment	78	202	259	(124)	(61.39)%	(181)	(69.88)%
Amortization of intangible assets	706	543	692	163	30.02 %	14	2.02 %
Other expenses	1,385	1,491	1,586	(106)	(7.11)%	(201)	(12.67)%
Total operating expenses	8,496	7,299	8,777	1,197	16.40 %	(281)	(3.20)%
Income before income tax, corporate allocation and noncontrolling interest	2,244	2,158	2,503	86	3.99 %	(259)	(10.35)%
Corporate allocation	(161)	(158)	(132)	(3)	1.90 %	(29)	21.97 %
Income before income tax provision and noncontrolling interest	2,083	2,000	2,371	83	4.15 %	(288)	(12.15)%
Provision for income tax	728	758	804	(30)	(3.96)%	(76)	(9.45)%
Net income	1,355	1,242	1,567	113	9.10 %	(212)	(13.53)%
Noncontrolling interest	(270)	(169)	(363)	(101)	59.76 %	93	(25.62)%
Net income attributable to TowneBank	$ 1,085	$ 1,073	$ 1,204	$ 12	1.12 %	$ (119)	(9.88)%
Efficiency ratio	79.11%	77.18%	77.81%	1.93%	2.50 %	1.30%	1.67 %

	Nine Months Ended September 30,		Increase/(Decrease) 2016 over 2015	
	2016	2015	Amount	Percent
Net commission and fee income				
Property and casualty	$ 26,029	$ 22,627	$ 3,402	15.04 %
Employee benefits	8,753	7,690	1,063	13.82 %
Travel insurance	3,546	2,668	878	32.91 %
Specialized benefit services	459	413	46	11.14 %
Total net commissions and fees	38,787	33,398	5,389	16.14 %
Contingency and bonus revenue	3,842	3,171	671	21.16 %
Other income	208	148	60	40.54 %
Total revenues	$ 42,837	$ 36,717	$ 6,120	16.67 %
Employee commission expense	6,903	6,723	180	2.68 %
Revenue, net of commission expense	$ 35,934	$ 29,994	$ 5,940	19.80 %
Salaries and employee benefits	$ 17,481	$ 14,111	$ 3,370	23.88 %
Occupancy expense	1,582	1,416	166	11.72 %
Furniture and equipment	562	669	(107)	(15.99)%
Amortization of intangible assets	2,083	1,609	474	29.46 %
Other expenses	4,361	4,157	204	4.91 %
Total operating expenses	26,069	21,962	4,107	18.70 %
Income before income tax, corporate allocation and noncontrolling interest	9,865	8,032	1,833	22.82 %
Corporate allocation	(484)	(501)	17	(3.39)%
Income before income tax provision and noncontrolling interest	9,381	7,531	1,850	24.57 %
Provision for income tax expense	3,332	2,749	583	21.21 %
Net income	6,049	4,782	1,267	26.50 %
Noncontrolling interest	(1,106)	(910)	(196)	21.54 %
Net income attributable to TowneBank	$ 4,943	$ 3,872	$ 1,071	27.66 %
Efficiency ratio	72.55%	73.22%	(0.67)%	(0.92)%

Total revenues for the third quarter of 2016 increased $1.40 million, or 11.88%, when compared to the same period in 2015, and increased $6.12 million, or 16.67%, for the nine months ended September 30, 2016. The increase from the comparative prior year periods was affected by the previously mentioned insurance agency acquisitions, which contributed additional revenue, net of commission expense of $0.97 million and $3.55 million for the three- and nine-month periods, respectively. Also contributing to the increase was improvement in commercial lines commissions due to organic growth and an increase in commissions from travel insurance of $0.30 million. The decrease in revenues of $0.31 million on a linked quarter basis was a result of a drop in contingency and bonus revenue of $0.40 million combined with a seasonal decrease in travel insurance commissions of $0.24 million, partially offset by an increase in property and casualty commissions of $0.25 million. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other things. Such commissions are seasonal in nature and are mostly received during the first quarter of each year.

Total operating expenses for the third quarter of 2016 increased $1.20 million, or 16.40%, when compared to the same period in 2015, and increased $4.11 million, or 18.70%, when compared to the nine months ended September 30, 2015. The largest factor in the increase from the comparative prior year period was salaries and employee benefits expense, which increased $1.21 million, or 26.34%, and $3.37 million, and 23.88%, when comparing the three- and nine-month periods ended September 30, 2016, to the same periods for 2015. The increase was largely driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $0.67 million and $2.15 million for the three- and nine-month periods, respectively. The decrease in operating expenses from the linked quarter of $0.28 million was primarily due to lower acquisition-related expenses and furniture and equipment expenses.

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2016, total assets were $7.83 billion, which is $1.66 billion, or 26.83%, higher than the period-end balance for comparative 2015, and $0.11 billion, or 1.39%, less than the balance at June 30, 2016. Our loan portfolio, less unearned income and deferred costs, made up 72.18% of our period-end assets and totaled $5.65 billion at September 30, 2016. Average assets for the quarter ended September 30, 2016, were $7.99 billion, up $1.88 billion, or 30.67%, from comparative September 30, 2015, and up $1.46 billion, or 22.30%, from the quarter ended June 30, 2016.

Average earning assets increased $1.65 billion, or 29.47%, from $5.60 billion for the third quarter of 2015 to $7.26 billion for the third quarter of 2016. Compared to the second quarter of 2016, average earning assets increased $1.23 billion.

Our average total deposits were $6.18 billion for third quarter 2016, reflecting growth of $1.44 billion, or 30.49%, compared to third quarter 2015. Growth continued in average noninterest-bearing deposits, which increased $571.02 million, or 41.14%, from September 30, 2015.

Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest-bearing deposit balances at September 30, 2016, were $93.51 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 2016 was $287.67 million, or 3.96%, of average total earning assets compared with $167.25 million, or 2.98%, of average total earning assets for comparative 2015. For the second quarter of 2016, the average balance of interest-bearing deposits in other banks was $289.70 million, or 4.81%, of average total earning assets.

Securities Available for Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The available-for-sale securities portfolio was $704.42 million at September 30, 2016, compared with $542.63 million at September 30, 2015. The average balance during the third quarter of 2016 was $628.45 million, compared to the 2015 period average of $739.28 million, or 8.66%, and 13.19% of average earning assets, respectively. During the nine months ended September 30, 2016, we had sales, maturities, and calls totaling $628.22 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 $70.30 million at September 30, 2016, and $75.15 million at September 30, 2015. The average balance during the third quarter of 2016 was $66.0 million, compared with $78.85 million in the 2015 period, representing 0.91% and 1.41% 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, 2016, we held $439.61 million in mortgage loans originated and intended for sale in the secondary market, as compared with $99.33 million at September 30, 2015, and $474.98 million at June 30, 2016. Average loans held for sale were 6.63% and 2.36% of average earning assets for the quarters ended September 30, 2016 and 2015, respectively. Average loans held for sale were 2.60% of average earning assets for the quarter ended June 30, 2016. The majority of mortgage loans held for sale have been pre-committed to investors, which minimizes our interest rate risk.

Our mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate locked with the customer. The commitments are generally for periods of 60 days and are at market rates. In order to mitigate the effect of the interest rate risk inherent in providing rate lock commitments, we economically hedge our commitments by entering into either a forward loan sales contract under best efforts or a trade of TBA mortgage-backed securities ("notional securities") for mandatory delivery. The changes in fair value related to movements in market rates of the rate lock commitments and the forward loan sales contracts and notional securities generally move in opposite directions, and the net impact of changes in these valuations on net income during the loan commitment period is generally inconsequential. The Company has not formally designated these derivatives as a qualifying hedge relationship and, accordingly, accounts for such forward contracts as freestanding derivatives with changes in fair value recorded to earnings each period.

The fair value of interest rate lock commitments is based on current secondary market pricing and recognized on the income statement at the time of commitment. Gains on the sales of mortgages are recognized when the Company, the borrower, and the investor enter into a loan contract and the subject loan is closed.

Loan Portfolio. Loans, net of unearned income and deferred costs, were $5.65 billion at September 30, 2016, which was $1.28 billion, or 29.42%, above the $4.37 billion reported at September 30, 2015, and $0.09 billion, or 1.65%, above the $5.56 billion at June 30, 2016. The primary factor that contributed to the increase in loans from the prior year was the Monarch merger, which resulted in $808.14 million of acquired loans. Also contributing to the increase were the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers and directors. As a percentage of total average earning assets, average loans were 76.95% for the quarter ended September 30, 2016, compared with 76.74% for comparable 2015 and 78.05% for the quarter ended June 30, 2016.

Allowance for Loan Losses and Asset Quality. The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on

management's evaluation of the risk inherent in the loan portfolio at the balance sheet date and changes in the nature and volume of loan activity. This evaluation includes a review of loans for which collection may not be reasonably assured. It considers internal risk grades, estimated fair value of the underlying collateral, current economic conditions, historical loan loss experience, and other current factors that warrant consideration in determining an adequate allowance.

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

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

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

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

The allowance for loan losses at September 30, 2016, September 30, 2015, and June 30, 2016, was $40.66 million, $37.35 million, and $39.62 million, respectively. The allowance was equal to 0.72% of total loans outstanding at September 30, 2016, compared with 0.86% and 0.71% at September 30, 2015, and June 30, 2016, respectively. Excluding purchased loans, the allowance was equal to 0.91% of loans outstanding at September 30, 2016, compared with 0.96% and 0.90% at September 30, 2015, and June 30,

2016, respectively. We believe the decline in the ratio from the prior year, excluding purchased loans, is appropriate given continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Reflective of improving credit quality, classified loans, defined as loans in the substandard and doubtful categories, remained low at 1.36% of total loans at September 30, 2016, down from 1.58% at September 30, 2015, and 1.47% at December 31, 2015. Additionally, loans 30 to 89 days past due were $6.71 million, including purchased impaired loans of $0.84 million, at September 30, 2016, as compared to $5.86 million and $7.48 million at September 30, 2015, and December 31, 2015, respectively, and total past due and nonaccruing loans were $19.30 million, including purchased impaired past-due loans of $2.09 million, at September 30, 2016, from $22.29 million and $17.85 million at September 30, 2015, and December 31, 2015, respectively. Also reflecting improvement in our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 3.59x of nonperforming loans at September 30, 2016, compared with 4.41x and 3.74x at September 30, 2015, and June 30, 2016, respectively. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe that our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at September 30, 2016.

PART I. FINANCIAL INFORMATION

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

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

	Three Months Ended			Nine Months Ended	
	September 30,		June 30,	September 30,	
	2016	2015	2016	2016	2015
Allowance for loan losses					
Balance beginning of period	$ 39,618	$ 37,290	$ 37,760	$ 38,359	$ 35,917
Loans charged off:					
Residential 1-4 family	(245)	(401)	(575)	(1,140)	(1,090)
Multifamily	—	—	—	—	—
Commercial real estate	—	—	—	(66)	(278)
Construction	(26)	(32)	(4)	(92)	(198)
Commercial and industrial	(390)	—	—	(462)	(118)
Consumer and other	(226)	(55)	(12)	(250)	(91)
Total	(887)	(488)	(591)	(2,010)	(1,775)
Loans recovered:					
Residential 1-4 family	146	100	150	409	368
Multifamily	—	—	1	1	—
Commercial real estate	14	14	22	52	83
Construction	5	21	95	106	75
Commercial and industrial	3	243	47	80	415
Consumer and other	70	41	35	132	92
Total	238	419	350	780	1,033
Net loans charged off	(649)	(69)	(241)	(1,230)	(742)
Provision for loan losses	1,686	130	2,099	3,526	2,176
Balance end of period	$ 40,655	$ 37,351	$ 39,618	$ 40,655	$ 37,351
Nonperforming assets					
Nonperforming loans	$ 11,337	$ 8,477	$ 10,580	$ 11,337	$ 8,477
Foreclosed property	22,884	39,509	25,707	22,884	39,509
Total nonperforming assets	$ 34,221	$ 47,986	$ 36,287	$ 34,221	$ 47,986
Loans past due 90 days and still accruing interest	$ —	$ 31	$ —	$ —	$ 31
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	3.59x	4.41x	3.74x	3.59x	4.41x
Allowance for loan losses to period end loans	0.72%	0.86%	0.71%	0.72%	0.86%
Allowance for loan losses to period end loans excluding purchased loans	0.91%	0.96%	0.90%	0.91%	0.96%
Nonperforming loans to period end loans	0.20%	0.19%	0.19%	0.20%	0.19%
Nonperforming assets to period end assets	0.44%	0.78%	0.46%	0.44%	0.78%
Net charge-offs (recoveries) to average loans (annualized)	0.05%	0.01%	0.02%	0.03%	0.02%

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

At September 30, 2016, we had $34.22 million in nonperforming assets, which amounted to 0.44% of total assets. Additionally, there were no loans past due 90 days or more that were accruing interest. Nonperforming assets consist of $11.34 million in nonperforming loans as well as $22.88 million in foreclosed property. Nonperforming loans increased by $0.76 million from June 30, 2016, as additions to nonaccrual loans during the third quarter of 2016 outpaced transfers to other real estate owned ("OREO"), charge-offs, and payments received. Nonperforming residential loans increased by $0.90 million as new nonperforming loans of $1.68 million outpaced paydowns of $0.08 million, transfers to OREO of $0.20 million, and charge-offs of $0.50 million. There was also an increase in nonperforming commercial real estate loans, which rose by $0.34 million, with new nonperforming loans of $0.74 million and paydowns of $0.07 million. Additionally, new construction and development nonperforming loans decreased $0.31 million. Foreclosed property decreased from $25.71 million at June 30, 2016, and $39.51 million at September 30, 2015. The 10 largest foreclosed property developments represented approximately 89.92% of total foreclosed property at September 30, 2016, with the largest development representing approximately 42%. Foreclosed property consists of 17 residential properties, 20 construction and development properties, and 4 commercial properties.

At September 30, 2016, loans 60-89 days past due, excluding nonperforming loans, totaled $1.49 million. Additionally, there are other performing loans, totaling $37.11 million, that are current but have certain documentation deficiencies or other potential weaknesses that management has determined warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At September 30, 2016, nonaccruing TDRs, which are included in nonperforming loans, totaled $6.14 million, and accruing TDRs totaled $28.34 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or longer, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

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

	September 30, 2016	December 31, 2015
Construction and land development	$ 768	$ 1,243
Commercial real estate	3,422	2,093
Multifamily real estate	695	731
1-4 family residential real estate	5,979	4,267
Commercial and industrial business loans	359	282
Consumer loans and other	114	54
Total nonperforming loans	$ 11,337	$ 8,670

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

	September 30,		June 30,
	2016	2015	2016
Real estate loans:			
Residential 1-4 family	$ 8,992	$ 9,060	$ 8,775
Commercial	15,585	14,869	15,596
Construction	4,504	4,671	4,630
Multifamily	1,209	658	870
Total real estate loans	30,290	29,258	29,871
Commercial and industrial loans	5,959	5,496	5,846
Consumer loans and other	4,406	2,597	3,901
Total	$ 40,655	$ 37,351	$ 39,618

Deposits. Total deposits at September 30, 2016, were $6.15 billion, representing an increase of 28.39%, or $1.36 billion, over September 30, 2015, and a decrease of $39.33 million, or 0.64%, compared to June 30, 2016. The primary factor that contributed to the increase in deposits from the prior year was the Monarch merger, which resulted in $1.06 billion of assumed deposits. Total average deposits were $6.18 billion during the third quarter of 2016, compared to $4.73 billion during the third quarter of 2015, and $5.08 billion during the second quarter of 2016.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 31.71% during the third quarter of 2016 and 29.31% during the same period in 2015. Average noninterest-bearing demand deposits were 30.27% of average total deposits for the second quarter of 2016. The cost of interest-bearing deposits was 0.56% for the third quarter of 2016, compared with 0.58% for the third quarter of 2015, and 0.60% for the second quarter of 2016.

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

	Average Balance/Cost Rate					
	Three Months Ended					
	September 30,				June 30,	
	2016		2015		2016	
Interest-bearing demand and money market accounts	$ 2,216,987	0.30%	$ 1,693,424	0.28%	$ 1,813,502	0.29%
Regular savings	318,193	0.90%	297,041	0.93%	301,542	0.95%
Certificates of deposit	1,684,136	0.83%	1,356,409	0.87%	1,429,449	0.92%
Total interest bearing	4,219,316	0.56%	3,346,874	0.58%	3,544,493	0.60%
Noninterest bearing	1,959,025		1,388,002		1,538,370	
Total	$ 6,178,341	0.38%	$ 4,734,876	0.41%	$ 5,082,863	0.42%

	Average Balance/Cost Rate			
	Nine Months Ended			
	September 30,		September 30,	
	2016		2015	
Interest-bearing demand and money market accounts	$ 1,938,818	0.30%	$ 1,658,531	0.28%
Regular savings	306,644	0.93%	300,996	0.92%
Certificates of deposit	1,510,707	0.88%	1,319,827	0.83%
Total interest bearing	3,756,169	0.58%	3,279,354	0.56%
Noninterest bearing	1,638,902		1,317,517	
Total	$ 5,395,071	0.41%	$ 4,596,871	0.40%

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

	Average Balance and Composition Three Months Ended					
	September 30,				June 30,	
	2016		2015		2016	
Interest-bearing demand and money market accounts	$ 2,216,987	35.88%	$ 1,693,424	35.77%	$ 1,813,502	35.68%
Regular savings	318,193	5.15%	297,041	6.27%	301,542	5.93%
Certificates of deposit	1,684,136	27.26%	1,356,409	28.65%	1,429,449	28.12%
Total-interest bearing	4,219,316	68.29%	3,346,874	70.69%	3,544,493	69.73%
Noninterest-bearing	1,959,025	31.71%	1,388,002	29.31%	1,538,370	30.27%
Total	$ 6,178,341	100.00%	$ 4,734,876	100.00%	$ 5,082,863	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the Federal Home Loan Bank of Atlanta ("FHLB") at September 30, 2016, were $427.65 million, compared to $437.28 million at September 30, 2015, and $500.80 million at June 30, 2016. The average borrowing cost for the third quarter of 2016 was 2.72%, 3.10% in the third quarter of 2015, and 2.94% in the second quarter of 2016.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2016, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
03/06/2017	4.08%	12/06/2016	$ 100,000
05/18/2017	4.35%	11/18/2016	80,000
05/18/2017	4.48%	11/18/2016	80,000
01/29/2018	3.05%	—	13,000
11/15/2028	3.43%	—	5,038
12/01/2028	2.83%	—	3,617
12/07/2020	0.42%	10/07/2016	74,000
08/29/2019	0.37%	10/31/2016	72,000
		Total FHLB Loans	**$ 427,655**

During fourth quarter 2016, the Company pre-funded $260 million of FHLB advances with maturities in 2017. The existing cost on these funds was an average of 4.28% and is being replaced at a cost of 1.26%. The resulting annualized pre-tax savings is expected to be approximately $7.9 million.

At September 30, 2016, certain residential HELOCS, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of $1.01 billion collateralized the advances from the FHLB. At September 30, 2015, certain loans with carrying values of $751.05 million collateralized the advances from the FHLB. At June 30, 2016, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $1.15 billion collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of September 30, 2016, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the third quarter of 2016 were $512.03 million, compared with $472.12 million for the third quarter of 2015, and $469.94 million for the second quarter of 2016, while the average cost of these funds was 2.53%, 2.85%, and 2.69%, respectively.

Common Stock and Dividends. For the high and low prices of our common stock, see *Selected Quarterly Information* starting on page 45 in this report.

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

On May 18, 2016, we declared a quarterly shareholder cash dividend of $0.13 per common share. The dividend was paid on July 12, 2016, to shareholders of record on June 30, 2016.

On August 24, 2016, we declared a quarterly shareholder cash dividend of $0.13 per common share. The dividend was paid October 12, 2016, to shareholders of record on September 30, 2016. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

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

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

In July 2013, the FDIC and the other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the FDIC final rule's revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. A transition period for the capital conservation buffer under Basel III for all banking organizations began on January 1, 2016, and will end January 1, 2019.

Risk-based capital ratios, which include common equity tier I, tier I capital, total capital and leverage capital, are calculated based on Basel III regulatory transitional guidance related to the measurement of capital, risk-weighted assets, and average assets. As indicated below, our risk-based capital ratios are 11.74% for common equity tier I, 11.81% for tier I capital, and 12.42% for total capital, which are well above the required minimums of 4.50%, 6.00%, and 8.00%, respectively. Under the FDIC rules, we are considered "well capitalized" as of September 30, 2016.

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

	September 30,		June 30,
	2016	2015	2016
Tier I Capital:			
Shareholders' equity	$ 1,078,878	$ 816,069	$ 1,061,548
Less: goodwill and disallowed intangible assets, net of deferred tax	286,665	160,677	280,669
AOCI-related adjustments	1,339	1,036	1,604
Noncontrolling interests	11,685	8,917	11,188
Total common equity tier I capital	779,189	645,439	768,087
Included noncontrolling interests	4,984	5,470	4,689
Total tier I capital	784,173	650,909	772,776
Tier II Capital:			
Qualifying allowance for loan losses (1)	40,655	37,351	39,618
Total tier II capital	40,655	37,351	39,618
Total Risk-Based Capital	$ 824,828	$ 688,260	$ 812,394
Total assets	$ 7,830,142	$ 6,173,891	$ 7,940,741
Total risk-weighted assets (2)	6,639,020	5,157,275	6,499,191
Average assets for leverage capital purposes	7,704,548	5,955,003	6,253,394
Risk-weighted assets to total assets	84.79%	83.53%	81.85%
Risk-based capital ratios:			
Common equity tier I (4.5% minimum requirement)	11.74%	12.52%	11.82%
Tier I (6% minimum requirement)	11.81%	12.62%	11.89%
Total (8% minimum requirement)	12.42%	13.35%	12.50%
Tier I leverage ratio (4% minimum requirement)	10.18%	10.93%	12.36%

(1) Limited to 1.25% of risk-weighted assets.
(2) Risk-weighted assets are determined based on the regulatory capital requirements in effect for the periods presented.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Return on average assets (GAAP basis)	1.20%	1.14%	0.93%	1.12%
Impact of excluding average goodwill and other intangibles and amortization	0.09%	0.07%	0.07%	0.07%
Return on average tangible assets	1.29%	1.21%	1.00%	1.19%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Return on average equity (GAAP basis)	8.95%	8.58%	6.99%	8.36%
Impact of excluding average goodwill and other intangibles and amortization	3.92%	2.67%	2.71%	2.76%
Return on average tangible equity	12.87%	11.25%	9.70%	11.12%

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,	
	2016	2015
Book value (GAAP basis)	$ 17.11	$ 15.65
Impact of excluding goodwill and other intangibles and amortization	(4.88)	(3.40)
Tangible book value	$ 12.23	$ 12.25

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

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

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

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

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

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

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

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

At September 30, 2016, we had $847.61 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

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

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

Change in Prime Rate	% Change in Net Interest Income
+ 300 basis points	8.72 %
+ 200 basis points	5.98 %
+ 100 basis points	3.13 %
- 100 basis points	(3.91)%

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

Change in Prime Rate	Change in Net Market Value (dollars in thousands)
+ 300 basis points	$ (78,312)
+ 200 basis points	$ (64,676)
+ 100 basis points	$ (20,614)
- 100 basis points	$ (105,054)

PART I. FINANCIAL INFORMATION
Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2016, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2016. There were no changes that occurred during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

For information regarding factors that could affect the Company's results of operations, financial condition, or liquidity, see the risk factors discussed in Part I, Item 1A, of TowneBank's 2015 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2, of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2015 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No.	Description
(2.1)	Agreement and Plan of Reorganization, dated as of December 16, 2015, by and among TowneBank, Monarch Financial Holdings, Inc., and Monarch Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on December 22, 2015)
(2.2)	Agreement and Plan of Reorganization, dated as of July 14, 2014, by and among TowneBank, Franklin Financial Corporation, and Franklin Federal Savings Bank (incorporated by reference to Exhibit 2.1 to TowneBank's Current Report on Form 8-K filed on July 16, 2014)
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
(99)	Independent Accountants' Report by Dixon Hughes Goodman LLP, dated November 9, 2016

Signatures

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

TOWNEBANK

November 9, 2016	By: /s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer
November 9, 2016	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, 2016 of TowneBank;

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

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

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

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

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

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

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

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

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

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

November 9, 2016	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer

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

Exhibit (31.2)

CERTIFICATIONS

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

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2016 of TowneBank;

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

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

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

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

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

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

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

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

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

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

November 9, 2016	/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, 2016, (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

November 9, 2016	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman of the Board/Chief Executive Officer

November 9, 2016	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/Chief Financial Officer

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

Exhibit (99)

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, 2016 and 2015, the related consolidated statements of income and comprehensive income for the three-month and nine-month periods ended September 30, 2016 and 2015, and the related consolidated statements of equity and cash flows for the nine months ended September 30, 2016. This condensed financial information is the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated balance sheet of TowneBank and subsidiaries as of December 31, 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated February 29, 2016, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2015, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Dixon Hughes Goodman LLP

Norfolk, Virginia
November 09, 2016