TowneBank

2016 Annual Report

TowneBank

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BUSINESS PROFILE AND CORPORATE MISSION STATEMENT

BUSINESS PROFILE

TowneBank was organized in 1998 under the laws of the Commonwealth of Virginia to engage in a general retail and commercial banking business and began operations on April 8, 1999. We place special emphasis on serving the financial needs of small and medium-sized businesses, professionals, and individuals in Richmond, Virginia, the Greater Hampton Roads region in southeastern Virginia, and northeastern North Carolina. We offer a full range of banking and related financial services through our controlled divisions and subsidiaries, which include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, LLC ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; Towne Benefits; Out of Town, LLC, d/b/a Red Sky Travel Insurance; Towne Mortgage, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; SimonTowne Mortgage, LLC; Homesale Mortgage, LLC; Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head ("Beach Properties"); Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations ("Oak Island"); Towne 1031 Exchange, LLC; Towne New Markets CDE, Inc.; and Towne Realty, LLC, d/b/a Berkshire Hathaway HomeServices Towne Realty, which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements ("Virginia Home Title"); Towne Investment Group, which provides investment and asset management services; and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries.

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

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

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

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

CORPORATE MISSION STATEMENT

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

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

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2016	2015	Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 218,876	$ 180,442	$ 38,434	21.30 %
Noninterest income (1)	155,216	116,379	38,837	33.37 %
Total revenue	374,098	297,725	76,373	25.65 %
Noninterest expenses	267,828	202,157	65,671	32.49 %
Provision for loan losses	5,357	3,027	2,330	76.97 %
Net income attributable to TowneBank	67,250	62,382	4,868	7.80 %
Net income per common share - basic	1.18	1.22	(0.04)	(3.28)%
Net income per common share - diluted	1.18	1.22	(0.04)	(3.28)%
Period End Data:				
Total assets	$ 7,973,915	$ 6,296,574	$ 1,677,341	26.64 %
Total assets - tangible	7,671,149	6,115,579	1,555,570	25.44 %
Earning assets (2)	7,346,961	5,827,888	1,519,073	26.07 %
Loans (net of unearned income and deferred costs)	5,807,221	4,519,393	1,287,828	28.50 %
Allowance for loan losses	42,001	38,359	3,642	9.49 %
Goodwill and other intangibles	302,766	180,995	121,771	67.28 %
Noninterest-bearing deposits	1,947,312	1,393,264	554,048	39.77 %
Interest-bearing deposits	4,087,885	3,520,763	567,122	16.11 %
Total deposits	6,035,197	4,914,027	1,121,170	22.82 %
Equity	1,086,558	820,194	266,364	32.48 %
Equity - tangible	783,792	639,199	144,593	22.62 %
Book value per share	17.20	15.71	1.49	9.48 %
Book value per share - tangible (3)	12.36	12.21	0.15	1.23 %
Cash dividends declared per share	0.51	0.47	0.04	8.51 %
Daily Average Balances:				
Total assets	$ 7,205,236	$ 6,039,418	$ 1,165,818	19.30 %
Total assets - tangible	6,958,267	5,858,762	1,099,505	18.77 %
Earning assets (2)	6,603,377	5,528,362	1,075,015	19.45 %
Loans, excluding nonaccrual loans (net of unearned income)	5,129,990	4,239,887	890,103	20.99 %
Allowance for loan losses	39,547	37,194	2,353	6.33 %
Goodwill and other intangibles	246,968	180,656	66,312	36.71 %
Noninterest-bearing deposits	1,720,093	1,343,360	376,733	28.04 %
Interest-bearing deposits	3,852,100	3,324,533	527,567	15.87 %
Total deposits	5,572,193	4,667,893	904,300	19.37 %
Total equity	963,775	804,744	159,031	19.76 %
Total equity - tangible	716,807	624,088	92,719	14.86 %
Key Ratios:				
Return on average assets	0.93%	1.03%	(0.10)%	(9.71)%
Return on average tangible assets (3)	1.02%	1.10%	(0.08)%	(7.27)%
Return on average equity	6.98%	7.75%	(0.77)%	(9.94)%
Return on average tangible equity (3)	9.93%	10.34%	(0.41)%	(3.97)%
Net interest margin (2)(4)	3.50%	3.45%	0.05 %	1.45 %
Efficiency ratio (1)	71.59%	68.11%	3.48 %	5.11 %
Average earning assets/total average assets	91.65%	91.54%	0.11 %	0.12 %
Average loans/average deposits	92.06%	90.83%	1.23 %	1.35 %
Average noninterest deposits/total average deposits	30.87%	28.78%	2.09 %	7.26 %
Allowance for loan losses/period end loans	0.72%	0.85%	(0.13)%	(15.29)%
Period end equity/period end total assets	13.63%	13.03%	0.60 %	4.60 %

Notes:
(1) Excludes investment securities gains of $0.01 million in 2016 and securities losses of $0.90 million in 2015.
(2) Includes bank-owned life insurance.
(3) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of MD&A for reconciliation.
(4) Presented on a tax-equivalent basis.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2014	2013	2012
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 145,736	$ 143,895	$ 144,284
Noninterest income (1)	96,744	89,917	81,184
Total revenue	242,465	234,423	228,473
Noninterest expenses	178,864	168,792	158,749
Provision for loan losses	492	4,248	16,155
Net income attributable to TowneBank	42,169	41,762	37,931
Net income per common share - basic	1.18	1.14	1.03
Net income per common share - diluted	1.18	1.14	1.03
Period End Data:			
Total assets	$ 4,982,485	$ 4,672,997	$ 4,405,923
Total assets - tangible	4,846,816	4,552,935	4,286,921
Earning assets (2)	4,610,142	4,296,486	4,033,813
Loans (net of unearned income and deferred costs)	3,564,389	3,381,194	3,226,426
Allowance for loan losses	35,917	38,380	40,427
Goodwill and other intangibles	135,668	120,061	119,002
Noninterest-bearing deposits	1,224,466	1,037,028	978,818
Interest-bearing deposits	2,622,136	2,530,076	2,401,234
Total deposits	3,846,602	3,567,104	3,380,052
Shareholders’ equity	618,276	585,318	559,879
Shareholders’ equity - tangible	482,608	465,257	440,877
Book value per share	14.88	14.16	13.30
Book value per share - tangible (3)	11.09	10.76	9.52
Cash dividends declared per share	0.43	0.38	0.33
Daily Average Balances:			
Total assets	$ 4,866,584	$ 4,507,233	$ 4,201,452
Total assets - tangible	4,738,306	4,387,578	4,087,602
Earning assets (2)	4,472,117	4,123,527	3,811,846
Loans, excluding nonaccrual loans (net of unearned income)	3,450,730	3,258,562	3,048,121
Allowance for loan losses	37,168	39,698	40,100
Goodwill and other intangibles	128,278	119,655	113,850
Noninterest-bearing deposits	1,158,888	1,022,168	904,512
Interest-bearing deposits	2,590,162	2,415,178	2,370,003
Total deposits	3,749,050	3,437,346	3,274,515
Shareholders’ equity	606,777	574,558	545,566
Shareholders’ equity - tangible	478,499	454,903	431,716
Key Ratios:			
Return on average assets	0.87%	0.93%	0.90%
Return on average tangible assets (3)	0.93%	0.95%	0.93%
Return on average equity	6.95%	7.27%	6.95%
Return on average tangible equity (3)	9.16%	9.18%	8.79%
Net interest margin (2)(4)	3.38%	3.61%	3.92%
Efficiency ratio (1)	73.76%	72.19%	70.41%
Average earning assets/total average assets	91.89%	91.49%	90.73%
Average loans/average deposits	92.04%	94.80%	93.09%
Average noninterest deposits/total average deposits	30.91%	29.74%	27.62%
Allowance for loan losses/period end loans	1.01%	1.14%	1.25%
Period end equity/period end total assets	12.41%	12.53%	12.71%

Notes:
(1) Excludes investment securities gains of $0.02 million, $0.61 million, and $3.01 million in 2014, 2013, and 2012, respectively.
(2) Includes bank-owned life insurance.
(3) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of MD&A for reconciliation.
(4) Presented on a tax-equivalent basis.

OVERVIEW

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

Since our inception, we have expanded our financial services to include banking, real estate, mortgage, title, insurance, employee benefit services, and investments. We have three reportable segments: Banking, Realty, and Insurance. Our Banking segment provides loan and deposit services to retail and commercial customers and also provides commercial mortgage brokerage services and a variety of investment and asset management services. The Realty segment offers residential real estate services, originations of a variety of mortgage loans, resort property management, and residential and commercial title insurance. The Insurance segment provides property and casualty insurance as well as employee and group benefits through Towne Insurance and Towne Benefits. Through Towne Insurance, we offer a full line of commercial and consumer insurance products and financial services. Through Towne Benefits, we offer health, life, dental, vision, and disability plans to employers, brokers, and individuals.

The following is a summary of the Company's 2016 financial performance:

- Net income increased to $67.25 million compared with $62.38 million in 2015. Fully diluted earnings were $1.18 per common share as compared to $1.22 per common share in 2015. Earnings in 2016 included acquisition-related expenses of $12.90 million on an after-tax basis.

- Net interest income increased $38.43 million or 21.30%, primarily due to an increase in average earning assets as a result of the acquisition of Monarch Financial Holdings, Inc. ("Monarch") in the second quarter of 2016.

- The provision for loan losses increased $2.33 million, or 76.97%, from 2015. The loan loss reserve was 0.72% of loans at December 31, 2016, down from 0.85% at year-end 2015. The increase in the provision for loan losses from the prior year was primarily a result of loan growth, partially offset by a reduction in historical loss ratios. The decrease in the loan loss reserve as a percentage of total loans, excluding purchased loans, is consistent with continued stability in credit quality.

- Excluding gains and losses on investment securities, noninterest income increased by $38.84 million, or 33.37%, over 2015. The primary driver of the increase was an increase in residential mortgage banking income related to the Monarch acquisition, combined with increases resulting from our 2015 insurance agency acquisitions and our acquisition of a North Carolina resort property management company in January 2016.

- Noninterest expense increased $65.67 million, or 32.49%, compared to 2015. The increase was driven by increased operating expenses and acquisition 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.

- The effective tax rate decreased to 29.91% in 2016 compared to 30.11% in 2015. The decrease from the prior year was primarily a result of an increase in non-taxable income arising from bank-owned life insurance ("BOLI") and a decrease in nondeductible expenses, partially offset by an increase in taxable income subject to the federal statutory rate of 35%.

MERGER ACTIVITY

On 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 purchase price for the transaction was \$5.52 million in cash.

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

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

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

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

Goodwill is reviewed for potential impairment at the reporting unit level (one level below the business segments identified on pages 16-23) on an annual basis, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess.

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

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Results of Operations: We reported net income for the years ended December 31, 2016, 2015, and 2014, of $67.25 million, $62.38 million, and $42.17 million, respectively. Diluted earnings per share were $1.18, $1.22, and $1.18 for the years ended December 31, 2016, 2015, and 2014, respectively. Earnings per share were affected by the issuance of 10.49 million shares of TowneBank common stock related to the acquisition of Monarch on June 24, 2016. Additionally, earnings in 2016 included acquisition-related expenses of $12.90 million on an after-tax basis. Earnings per share in 2015 were affected by the issuance of 15.55 million shares of TowneBank common stock related to the acquisition of Franklin Financial Corporation ("Franklin") on January 2, 2015, and the reduction of preferred dividends related to the redemption in full of $76.46 million of outstanding Senior Non-Cumulative Perpetual Preferred Stock, Series C, liquidation value of $1,000 per share ("Series C Preferred Stock"), issued to the U.S. Department of Treasury (the "U.S. Treasury") under the Small Business Lending Fund on January 7, 2015.

Profitability, as measured by our return on average assets ("ROA"), was 0.93%, 1.03%, and 0.87% for the years ended December 31, 2016, 2015, and 2014, respectively. Return on average tangible assets was 1.02%, 1.10%, and 0.93% for the same respective periods. Return on average equity ("ROE") was 6.98%, 7.75%, and 6.95% for years ended December 31, 2016, 2015, and 2014, respectively; while return on average tangible equity was 9.93%, 10.34%, and 9.16% for the same respective years.

Our operating income, calculated as net interest income and noninterest income less gains on investment securities, was $374.09 million for the year ended December 31, 2016, compared to $296.82 million and $242.48 million for 2015 and 2014, respectively.

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

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

Net interest income, on a tax-equivalent basis, was $230.95 million for the year ended December 31, 2016, which was $40.39 million, or 21.20%, more than the $190.56 million reported in the previous year. In comparison to the prior year, net interest income rose primarily due to increased balances of earning assets related to the Monarch merger coupled with organic growth in earning assets. Accretion of purchase accounting marks added $6.24 million, or 10 basis points, to margin in the current year and added $3.79 million, or 9 basis points, to margin in 2015.

Interest income, on a tax-equivalent basis, was $266.69 million for the year ended December 31, 2016, which was $43.70 million, or 19.60%, greater than the $222.99 million for the year ended December 31, 2015. Average earning assets grew to $6.60 billion in 2016 from $5.53 billion in 2015, an increase of $1.08 billion, or 19.45%. The yield on earning assets was 4.04% in the year ended December 31, 2016, compared to 4.03% in the prior year. Average loan balances, excluding nonaccrual loans, of $5.13 billion were $890.10 million, or 20.99%, higher in 2016 than in 2015, while loan yields declined by 7 basis points. The increase in interest income from the prior year was primarily driven by growth in loans and loans held for sale resulting from the Monarch acquisition combined with organic loan growth, partially offset by the decrease in loan yields.

Interest expense, for the year ended December 31, 2016, increased by $3.31 million, or 10.20%, to $35.74 million compared to $32.43 million for the year ended December 31, 2015. The balance of average interest-bearing liabilities increased to $4.38 billion in 2016 from $3.79 billion in 2015, an increase of $587.78 million, or 15.52%. The increase in interest expense as compared to the prior year was primarily due to the merger-driven increase in interest-bearing deposits, partially offset by lower rates in borrowings. During fourth quarter 2016, the Company pre-funded $260 million of Federal Home Loan Bank of Atlanta ("FHLB") advances with maturities in 2017. The existing cost on these funds was an average of 4.28% and is being replaced at a cost of 1.26%. The resulting annualized pre-tax savings is expected to be approximately $7.90 million.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.50% in the year ended December 31, 2016, which was 5 basis points higher than the 3.45% a year ago. The margin improvement in comparison to prior year periods was driven by accretion of purchase accounting marks and rate decreases in borrowings. 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. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

The following table sets forth an estimate 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			
	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
Assets:				
Investment Securities	$ (35)	$ (30)	$ (24)	$ (18)
Loans	932	904	800	780
Liabilities:				
Deposits	(305)	(232)	(171)	(136)
Total estimated effect on net interest income	$ 1,202	$ 1,106	$ 947	$ 898

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.

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

	Year Ended December 31,								
	2016			2015			2014		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans (2)	$ 5,129,990	$ 234,318	4.57%	$ 4,239,887	$ 196,868	4.64%	$ 3,450,730	$ 162,347	4.70%
Taxable investment securities	695,082	11,254	1.62%	786,737	11,849	1.51%	574,229	6,895	1.20%
Tax-exempt investment securities	52,689	1,601	3.04%	61,489	1,952	3.17%	70,154	2,180	3.11%
Interest-bearing deposits	300,130	1,145	0.38%	188,546	499	0.26%	253,416	637	0.25%
Mortgage loans held for sale	267,721	9,152	3.42%	106,149	3,836	3.61%	65,746	2,586	3.93%
Bank-owned life insurance	157,765	9,220	5.84%	145,554	7,985	5.49%	57,842	3,290	5.69%
Total earning assets	6,603,377	266,690	4.04%	5,528,362	222,989	4.03%	4,472,117	177,935	3.98%
Less: allowance for loan losses	(39,547)			(37,194)			(37,168)		
Total nonearning assets	641,406			548,250			431,635		
Total assets	$ 7,205,236			$ 6,039,418			$ 4,866,584		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 2,012,061	$ 6,043	0.30%	$ 1,689,185	$ 4,721	0.28%	$ 1,306,738	$ 3,036	0.23%
Savings	309,049	2,859	0.93%	300,620	2,755	0.92%	310,722	2,855	0.92%
Certificates of deposit	1,530,990	13,414	0.88%	1,334,728	11,390	0.85%	972,702	7,461	0.77%
Total interest-bearing deposits	3,852,100	22,316	0.58%	3,324,533	18,866	0.57%	2,590,162	13,352	0.52%
FHLB advances and repurchase agreements	523,366	13,424	2.56%	463,153	13,565	2.93%	429,249	13,424	3.13%
Total interest-bearing liabilities	4,375,466	35,740	0.82%	3,787,686	32,431	0.86%	3,019,411	26,776	0.89%
Noninterest-bearing liabilities									
Demand deposits	1,720,093			1,343,360			1,158,888		
Other noninterest-bearing liabilities	145,902			103,628			81,508		
Total liabilities	6,241,461			5,234,674			4,259,807		
Shareholders' equity	963,775			804,744			606,777		
Total liabilities and equity	$ 7,205,236			$ 6,039,418			$ 4,866,584		
Net interest income (tax-equivalent basis)		$ 230,950			$ 190,558			$ 151,159	
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(9,220)			(7,985)			(3,290)	
Tax-equivalent basis adjustment		(2,854)			(2,131)			(2,133)	
Net interest income (GAAP)		$ 218,876			$ 180,442			$ 145,736	
Interest rate spread (3)			3.22%			3.17%			3.09%
Interest expense as a percent of average earning assets			0.54%			0.59%			0.60%
Net interest margin (tax-equivalent basis) (4)			3.50%			3.45%			3.38%
Total cost of deposits			0.40%			0.40%			0.36%

(1) Yields and interest income are presented on a taxable-equivalent basis using the federal statutory tax rate of 35%.
(2) Excludes average nonaccrual loans of $10.05 million in 2016, $8.77 million in 2015, and $9.27 million in 2014.
(3) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
(4) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.

(in thousands)	2016 vs 2015 Increase (Decrease) Due to Changes In			2015 vs 2014 Increase (Decrease) Due to Changes In		
	Volume	**Rate (1)**	**Total**	**Volume**	**Rate (1)**	**Total**
Assets:						
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 40,705	$ (3,255)	$37,450	$ 36,668	$ (2,147)	$ 34,521
Taxable investment securities	(1,444)	849	(595)	2,936	2,018	4,954
Tax-exempt investment securities	(270)	(81)	(351)	(274)	46	(228)
Interest-bearing deposits	370	276	646	(170)	32	(138)
Loans held for sale	5,534	(218)	5,316	1,475	(225)	1,250
Bank-owned life insurance	695	540	1,235	4,816	(121)	4,695
Total earning assets	45,590	(1,889)	43,701	45,451	(397)	45,054
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	951	371	1,322	995	690	1,685
Savings	78	26	104	(93)	(7)	(100)
Certificates of deposit	1,712	312	2,024	3,017	912	3,929
Total interest-bearing deposits	2,741	709	3,450	3,919	1,595	5,514
FHLB advances and repurchase agreements	1,652	(1,793)	(141)	1,023	(882)	141
Total interest-bearing liabilities	4,393	(1,084)	3,309	4,942	713	5,655
Net interest income (tax equivalent basis)	$ 41,197	$ (805)	$40,392	$ 40,509	$ (1,110)	$ 39,399

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

Provision for Loan Losses: The provision for loan losses is charged against earnings in order to establish and maintain the allowance for loan losses at a level that reflects management's evaluation of the risk inherent in the portfolio. Management considers continuing assessments of nonperforming and "watch list" loans, analytical reviews of loan loss experience in relation to outstanding loans, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. The provisions for loan losses recorded in 2016, 2015, and 2014 were $5.36 million, $3.03 million, and $0.49 million, respectively. Net charge-offs were $1.72 million, $0.59 million, and $2.96 million for 2016, 2015, and 2014, respectively. The increase in the provision for loan losses in the current year period from the prior year was primarily due to loan growth, while the decrease in the provision for loan losses in 2015 from 2014 was primarily due to a combination of loan growth and a reclassification of industrial revenue bonds from investment securities to loans during second quarter 2015. The allowance for loan losses as a percentage of period-end loans was 0.72% and 0.85% at December 31, 2016 and 2015, respectively. The allowance for loan losses as a percentage of period-end loans, excluding purchased loans, was 0.87% and 0.94% at December 31, 2016 and 2015, respectively. For further discussion and analysis of the loan portfolio and the allowance for loan losses, see the "Analysis of Financial Condition" section found later in this report. Also, see Note 4, "Loans and Allowance for Loan Losses," in the Notes to Consolidated Financial Statements.

Noninterest Income: Total noninterest income for the year ended December 31, 2016, was $155.22 million, or $37.94 million, and 32.35% higher than 2015. Excluding gains and losses on investment securities, total noninterest income increased by $38.84 million, or 33.37%, over 2015. Total noninterest income for the year ended December 31, 2015, was $117.28 million, representing a $20.55 million, or 21.25%, increase from 2014. Excluding gains and losses on investment securities, total noninterest income increased by $19.64 million, or 20.30%, over 2014. Included in noninterest income were gains on investment securities of $0.01 million in 2016, gains of $0.90 million in 2015, and losses of $0.02 million in 2014. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2016, was 41.49% of total operating income, compared with 39.21% for 2015 and 39.90% for 2014.

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

				2016/2015 Increase/(Decrease)		2015/2014 Increase/(Decrease)	
For the Year Ended December 31,	**2016**	**2015**	**2014**	**Amount**	**%**	**Amount**	**%**
Residential mortgage banking income, net	$ 58,792	$ 34,211	$ 27,179	$ 24,581	71.85 %	$ 7,032	25.87 %
Real estate brokerage and property management income, net	20,515	16,326	12,634	4,189	25.66 %	3,692	29.22 %
Insurance commissions and other title fees and income, net	46,741	39,641	34,558	7,100	17.91 %	5,083	14.71 %
Service charges on deposit accounts	9,547	9,165	9,192	382	4.17 %	(27)	(0.29)%
Credit card merchant fees	4,508	2,588	3,576	1,920	74.19 %	(988)	(27.63)%
Other income							
Other	3,509	5,059	3,539	(1,550)	(30.64)%	1,520	42.95 %
Towne Investment income, net	3,246	2,851	2,703	395	13.85 %	148	5.48 %
Bank-owned life insurance income	5,993	5,190	2,139	803	15.47 %	3,051	142.64 %
Service fees on loans	1,108	639	282	469	73.40 %	357	126.60 %
Income from equity method investments	913	541	415	372	68.76 %	126	30.36 %
Commercial mortgage brokerage fees, net	344	168	527	176	104.76 %	(359)	(68.12)%
Total other income	15,113	14,448	9,605	665	4.60 %	4,843	50.42 %
Noninterest income before securities gain/(loss)	155,216	116,379	96,744	38,837	33.37 %	19,635	20.30 %
Gain/(loss) on securities available for sale	6	904	(15)	(898)	(99.34)%	919	N/M
Total noninterest income	$ 155,222	$ 117,283	$ 96,729	$ 37,939	32.35 %	$ 20,554	21.25 %

For the year ended December 31, 2016, residential mortgage banking income, net of commission expense, was $58.79 million, reflecting an increase of $24.58 million, or 71.85%, compared to 2015, which was $7.03 million, or 25.87%, higher than 2014. The increase in 2016 from 2015 was primarily due to higher production volumes resulting from the Monarch merger in June 2016. Also factoring in the variance from the prior period was a decrease in mortgage banking income of $1.50 million in 2016 as compared to an increase of $0.29 million in 2015 associated with the change in the value of rate lock commitments and forward contracts recorded as of December 31, 2016. The decrease in net mortgage banking income in 2015 from 2014 was primarily due to higher production volumes and improved pricing and margins. Also factoring in the variance from the prior period was an increase in mortgage banking income of $0.29 million in 2015 as compared to an increase of $0.36 million in 2014 associated with the change in the value of rate lock commitments recorded as of December 31, 2015. For further information, refer to our discussion of the Realty segment beginning on page 18 of this Annual Report, which provides a comparative schedule of operations.

Real estate brokerage and property management income, net of commission expense, for the year ended December 31, 2016, was $20.52 million, an increase of $4.19 million, or 25.66%, from 2015, which was

$3.69 million, or 29.22%, higher than 2014. The increase in 2016 from 2015 was primarily a result of an increase in property management fees associated with our purchase of Oak Island on January 14, 2016, combined with an increase of $0.96 million in real estate brokerage income. The total dollar volume of units sold increased by $189.55 million, or 17.53%, while the number of units sold was 4,339, an increase of 427 units, or 10.92%, from 2015. The increase was partially offset by the sale of our Corolla, North Carolina-based property management business ("Corolla") on April 1, 2015, which generated management fee revenue of $1.80 million in 2015 and $4.02 million in 2014. The Company recognized a nonrecurring gain of $1.36 million on the sale, which was recorded in other noninterest income. The increase in 2015 from 2014 was primarily attributable to an increase in property management fees associated with our purchase of Beach Properties on October 1, 2014, combined with a slight increase in real estate brokerage income.

For the year ended December 31, 2016, insurance commissions and other title income, net of commission expense, was $46.74 million, which was $7.10 million, or 17.91%, higher than comparative 2015. The increase from the prior year was largely due to an increase in property and casualty insurance commissions related to a full year of operations from three insurance agencies acquired in the second half of 2015. The acquired agencies contributed additional net commission and fee income of $3.63 million in 2016. The year ended December 31, 2016, included contingency and bonus revenue income of $4.01 million, compared to $3.22 million and $3.23 million for 2015 and 2014, respectively. When compared to 2014, insurance commissions for the year ended December 31, 2015 were $5.08 million, or 14.71%, higher, largely due to the acquisition of two insurance agencies in October 2015, an insurance agency in September 2015, and two insurance agencies in February 2015, combined with a full year of operations for Southern Insurance Agency, Inc. acquired in May 2014, which contributed additional net commission and fee income of $4.33 million in 2015.

Service charges on deposit accounts were $9.55 million for 2016, compared with $9.16 million and $9.19 million for 2015 and 2014, respectively. The increase from prior periods was primarily due to the addition of accounts related to the Monarch merger as average deposits increased 19.37% and 24.51% in the years ended December 31, 2016 and 2015, respectively.

For the year ended December 31, 2016, credit card merchant fees totaled $4.51 million, which was $1.92 million, or 74.19%, higher than comparative 2015, which was $0.99 million, or 27.63%, less than 2014. The increase from the prior year was primarily related to the effects of the Monarch merger, combined with a decrease in prior year merchant fees related to structural changes in vendor contractual terms and nonrecurring expenses due to a platform change and equipment purchases associated with Europay, MasterCard, and Visa (EMV) compliance. The Company believes the contractual changes will be beneficial in the long term, which is reflected in the increase from the prior year.

Other noninterest income for the year ended December 31, 2016 was $15.11 million, compared with $14.45 million for the year ended December 31, 2015, and $9.60 million for the year ended December 31, 2014. Other noninterest income includes income generated by Towne Investment Group, net of commission expense of $3.25 million, $2.85 million, and $2.70 million for the years ended December 31, 2016, 2015, and 2014, respectively. The increase in 2016 from 2015 was due to an increase in income from BOLI policies of $0.80 million combined with an increase in loan service fees and income from Towne Investment Group. The increase was partially offset by a decrease in other income related to nonrecurring gains in 2015 of $1.36 million on the sale of Corolla and $0.57 million on the sale of land in Virginia Beach. The increase in 2015 was largely due to an increase in income from BOLI policies of $3.05 million combined with the nonrecurring gains of $1.36 million and $0.57 million described above.

Noninterest Expense: Total noninterest expense for 2016 was $267.83 million, which was $65.67 million, or 32.49%, higher than 2015. Primary components of 2016 noninterest expense were salaries and employee benefits of $143.85 million, occupancy expenses of $23.72 million, furniture and equipment expenses of $11.32 million, advertising and marketing expenses of $8.44 million, acquisition-related expenses of $19.11 million, software expense of $7.12 million, and professional fees of $5.33 million. In comparison to 2015, the primary driver of the increase in total noninterest expense was the Monarch acquisition, which resulted in acquisition-related expenses of $18.47 million and additional increases in operational expenses. Additionally, insurance agency acquisitions in 2015 and the Oak Island acquisition in January 2016 contributed combined additional operational expenses of $7.11 million. Also contributing to the increase from 2015 was the opening of a new banking office in downtown Richmond, Virginia, in September 2016, which resulted in additional noninterest expenses of $1.0 million. A significant portion of the increase in total noninterest expense in 2015 from 2014 was due to $10.99 million of additional operational expenses related to the Franklin acquisition, excluding acquisition-related costs. Additionally, insurance agency acquisitions in 2015 and 2014 contributed additional operational expenses of $4.85 million, and the Beach Properties acquisition in October 2014 contributed $3.76 million of additional expenses. Also contributing to the increase from 2014 was the opening of a new banking office in the Ghent area of Norfolk, Virginia, in May 2015, which resulted in additional noninterest expenses of $0.60 million.

Total noninterest expense to total operating revenue, excluding securities gains and losses, was 71.59% for the year ended December 31, 2016, compared with 68.11% for 2015 and 73.76% for 2014. The following table provides an analysis of noninterest expense (dollars in thousands):

				2016/2015 Increase/(Decrease)		2015/2014 Increase/(Decrease)	
For the year ended December 31,	**2016**	**2015**	**2014**	**Amount**	**%**	**Amount**	**%**
Salaries and benefits	$143,847	$113,959	$ 99,007	$ 29,888	26.23 %	$ 14,952	15.10 %
Occupancy	23,717	19,645	17,863	4,072	20.73 %	1,782	9.98 %
Furniture and equipment	11,315	9,339	8,183	1,976	21.16 %	1,156	14.13 %
Other expenses							
Advertising and marketing	8,443	7,515	5,178	928	12.35 %	2,337	45.13 %
Acquisition-related expenses	19,111	1,312	4,280	17,799	N/M	(2,968)	(69.35)%
Charitable contributions	4,582	5,193	3,430	(611)	(11.77)%	1,763	51.40 %
Telephone and postage	5,996	4,701	4,184	1,295	27.55 %	517	12.36 %
Outside processing	6,420	4,844	3,631	1,576	32.54 %	1,213	33.41 %
Professional fees	5,329	5,764	5,178	(435)	(7.55)%	586	11.32 %
Other	9,417	6,019	6,260	3,398	56.45 %	(241)	(3.85)%
Stationery and office supplies	2,978	2,479	2,132	499	20.13 %	347	16.28 %
Amortization expense of intangibles	6,010	3,537	2,623	2,473	69.92 %	914	34.85 %
Foreclosed property expenses	1,335	1,785	3,992	(450)	(25.21)%	(2,207)	(55.29)%
FDIC and other insurance	4,613	4,954	3,885	(341)	(6.88)%	1,069	27.52 %
Software expense	7,116	5,916	4,615	1,200	20.28 %	1,301	28.19 %
Travel/Meals/Entertainment	2,044	1,452	1,133	592	40.77 %	319	28.16 %
Directors' expense	1,371	1,244	1,099	127	10.21 %	145	13.19 %
Bank franchise tax/SCC fees	4,184	2,499	2,191	1,685	67.43 %	308	14.06 %
Total other expenses	88,949	59,214	53,811	29,735	50.22 %	5,403	10.04 %
Total noninterest expense	$267,828	$202,157	$178,864	$ 65,671	32.49 %	$ 23,293	13.02 %

Salaries and employee benefits, the largest portion of noninterest expense, were $143.85 million, representing 53.71% of total noninterest expense for the year ended December 31, 2016. This was a $29.89 million, or 26.23%, increase over comparative 2015. The increase from prior year was primarily due to the addition of staff resulting from the Monarch acquisition. Also contributing to the increase was the addition of staff from Insurance and Realty segment acquisitions, which resulted in an increase of $4.57 million. Salaries and benefits expense for the year ended December 31, 2015, was $113.96 million, up 15.10%, or $14.95 million, over 2014. The increase was primarily due to the addition of staff resulting from the Franklin acquisition, which resulted in an increase of $5.18 million, and Insurance and Realty segment acquisitions, which resulted in an increase of $4.64 million. Additionally, company-wide annual salary adjustments effective July 1, 2015, combined with increases in employee profit-sharing expense and 401(k) matching expenses contributed to the increase.

In our Banking segment, we had a total of 848 full-time equivalent employees ("FTE") at December 31, 2016, which was up from 710 and 622 at December 31, 2015 and 2014, respectively. In our non-Banking segments at December 31, 2016, we had a total of 1,272 FTEs, excluding real estate sales agents, which was up from 767 and 722 at December 31, 2015 and 2014, respectively. Real estate agents are independent contractors and, therefore, not included as the Company's employees. There were 409 real estate agents at December 31, 2016. Total operating revenue, excluding securities gains, per FTE was approximately $176,000, $201,000, and $180,000 for the years ended December 31, 2016, 2015, and 2014, respectively. The decrease in revenue per FTE in 2016 from 2015 was due to the increase in employees related to the Monarch merger combined with having only approximately six months of revenue related to the acquired Monarch operations.

For the year ended December 31, 2016, occupancy expense totaled $23.72 million, representing an increase of $4.07 million, or 20.73%, over comparative 2015. Occupancy expense for 2015 was $1.78 million, or 9.98%, over the 2014 amount of $17.86 million. The increase from 2015 was primarily related to facilities acquired in the Monarch acquisition, combined with the opening of a new banking office in Richmond, Virginia, in September 2016. The increases in occupancy expense in 2015 from 2014 were primarily driven by increases related to the Franklin and Insurance segment acquisitions, combined with the opening of a new banking office in Norfolk in May 2015.

Furniture and equipment expense was $11.32 million for 2016, or $1.98 million and 21.16% higher than 2015. Furniture and equipment expense was $9.34 million for 2015, or $1.16 million and 14.13% higher than comparative 2014. The increase from 2015 was primarily related to facilities acquired in the Monarch acquisition. The increase in 2015 from 2014 was related to furnishing new facilities and the associated depreciation expense on the capitalized furnishings utilized in those facilities.

Other expenses for 2016 were $88.95 million, which was $29.74 million, or 50.22%, higher than the 2015 amount of $59.21 million. The primary driver of the increase from 2015 was the increase in acquisition-related expenses of $17.80 million driven by the Monarch acquisition, combined with increases in amortization expense, bank franchise taxes, and outside processing expenses. Partially offsetting the increases were decreases in charitable contributions of $0.61 million and expenses related to foreclosed properties of $0.45 million. Other expenses for 2015 were $59.21 million, or 10.04%, higher than the 2014 amount of $53.81 million due to the Franklin merger combined with increased charitable contributions and advertising and marketing expenses. Partially offsetting the increases were acquisition-related expenses, which decreased by $2.97 million, and expenses related to foreclosed properties, which decreased by $2.21 million.

Income Taxes: Income taxes for the year ended December 31, 2016 were $28.70 million. This was $1.82 million higher than the 2015 amount of $26.88 million, which was $8.70 million higher than the 2014 amount of $18.18 million. The effective tax rate for 2016 was 29.91% versus 30.11% for 2015 and 30.12% for 2014. The rate decrease from 2015 was primarily a result of the increase in non-taxable income arising from BOLI and a decrease in nondeductible expenses, partially offset by an increase in taxable income subject to the federal statutory rate of 35%. The rate decrease in 2015 from 2014 was primarily a result of the increase in non-taxable income arising from BOLI and the utilization of a capital loss carryforward acquired in the Franklin merger, partially offset by an increase in taxable income.

SEGMENT PERFORMANCE SUMMARY

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

Banking Segment: For the year ended December 31, 2016, the Banking segment represented 76.77%, or $51.63 million, of our total consolidated net income, compared to 81.03% and 82.33% for 2015 and 2014.

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

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

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

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

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

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

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

Pre-tax earnings for the year ended December 31, 2015, for the Banking segment were $69.83 million, increasing $22.02 million, or 46.05%, from comparative 2014. The increase in earnings was driven by a $36.63 million, or 22.37%, increase in total revenues, partially offset by a $2.63 million increase in the provision for loan losses and a $12.20 million, or 10.47%, increase in expenses.

The increase in net interest income for the year ended December 31, 2015, of $33.72 million, or 23.41%, was due to additional interest income from earning assets acquired in the Franklin merger, as average loan balances increased by $789.16 million to $4.24 billion and average investments increased to $848.23 million from $644.38 million. These factors were partially offset by an increase in interest expense as average interest-bearing deposits were higher by $734.37 million, primarily due to the Franklin merger.

The increase in noninterest income of $2.91 million, or 14.75%, was due to a combination of an increase in income from BOLI policies of $3.05 million and an increase in gains on securities sale of $0.92 million. The increase was partially offset by a decrease in credit card merchant fees of $0.99 million.

Noninterest expense for the year ended December 31, 2015, increased $12.20 million, or 10.47%, over 2014. Primary factors resulting in the increase were additional salaries and employee benefits of $8.04 million, or 13.17%, occupancy expense of $1.42 million, or 11.50%, furniture and equipment expense of $1.05 million, or 16.45%, charitable contributions of $1.69 million, or 51.77%, and advertising and marketing of $1.22 million, or 44.68%, which were partially offset by decreases in foreclosed property expense of $2.20 million, or 55.16%, and other expenses of $1.83 million, or 12.74%.

The increase in salaries and employee benefits was primarily due to the addition of staff resulting from the Franklin acquisition, which resulted in an increase of $5.18 million, combined with increases in profit sharing accruals, salaries due to annual salary adjustments, and matching contributions to employee retirement plans.

The total increase in occupancy and furniture and equipment expense was primarily related to the Franklin acquisition combined with the addition of a new branch in May 2015 and a full year of expenses related to a branch opened in June 2014. The total increase in occupancy and furniture and equipment expense in relation to the Franklin acquisition was $1.88 million, while additional branch costs added approximately $0.39 million.

The increases in noninterest expenses due to additional operational expenses related to the Franklin acquisition were partially offset by a decrease in foreclosed property expense due to a decrease in the associated valuation allowance and a decrease in total costs relating to mergers and acquisitions of $2.94 million.

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

	Year Ended December 31,			Increase/(Decrease) 2016 over 2015		2015 over 2014	
	2016	2015	2014	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 211,112	$ 177,715	$ 143,999	$ 33,397	18.79 %	$ 33,716	23.41 %
Noninterest income							
Service charges on deposit accounts	9,547	9,165	9,192	382	4.17 %	(27)	(0.29)%
Credit card merchant fees	4,508	2,588	3,576	1,920	74.19 %	(988)	(27.63)%
Other income	11,503	10,002	6,993	1,501	15.01 %	3,009	43.03 %
Subtotal	25,558	21,755	19,761	3,803	17.48 %	1,994	10.09 %
Gain (loss) on investment securities	6	904	(15)	(898)	(99.34)%	919	N/M
Total noninterest income	25,564	22,659	19,746	2,905	12.82 %	2,913	14.75 %
Total revenue	236,676	200,374	163,745	36,302	18.12 %	36,629	22.37 %
Provision for loan losses	5,326	3,027	396	2,299	75.95 %	2,631	664.39 %
Expenses							
Salaries and employee benefits	78,910	69,070	61,031	9,840	14.25 %	8,039	13.17 %
Occupancy expense	15,610	13,791	12,369	1,819	13.19 %	1,422	11.50 %
Furniture and equipment	8,445	7,404	6,358	1,041	14.06 %	1,046	16.45 %
Advertising and marketing	3,478	3,960	2,737	(482)	(12.17)%	1,223	44.68 %
Charitable contributions	4,192	4,943	3,257	(751)	(15.19)%	1,686	51.77 %
Outside processing	4,439	3,373	2,523	1,066	31.60 %	850	33.69 %
Foreclosed property expenses	1,335	1,785	3,981	(450)	(25.21)%	(2,196)	(55.16)%
FDIC and other insurance	4,243	4,624	3,660	(381)	(8.24)%	964	26.34 %
Professional fees	4,081	4,330	3,678	(249)	(5.75)%	652	17.73 %
Telephone and postage	3,420	2,928	2,583	492	16.80 %	345	13.36 %
Other expenses	34,191	12,540	14,371	21,651	172.66 %	(1,831)	(12.74)%
Total expenses	162,344	128,748	116,548	33,596	26.09 %	12,200	10.47 %
Income before income tax expense and corporate allocation	69,006	68,599	46,801	407	0.59 %	21,798	46.58 %
Corporate allocation	1,573	1,234	1,014	339	27.47 %	220	21.70 %
Income before income tax provision	70,579	69,833	47,815	746	1.07 %	22,018	46.05 %
Provision for income tax expense	(18,923)	(19,290)	(13,098)	367	(1.90)%	(6,192)	47.27 %
Net income	51,656	50,543	34,717	1,113	2.20 %	15,826	45.59 %
Noncontrolling interest	(28)	—	—	(28)	N/M	—	N/M
Net income attributable to TowneBank	$ 51,628	$ 50,543	$ 34,717	$ 1,085	2.15 %	$ 15,826	45.59 %

Realty Segment: For the year ended December 31, 2016, the Realty segment represented 15.30%, or $10.29 million, of our total consolidated net income, compared to 12.38%, or $7.73 million, for 2015, and 6.42%, or $2.71 million, for 2014.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2016, for the Realty segment were $20.14 million, increasing 36.57% from 2015. Total revenue increased to $92.0 million in 2016 from $58.52 million in 2015.

Net residential mortgage banking income increased by $24.92 million to $59.87 million from 2015 as a result of increased production volume related to the Monarch merger. Residential mortgage banking income included a decrease in the value of rate lock commitments and forward contracts of $1.50 million in 2016, as compared to an increase of $0.29 million in 2015. The increase in property management fees from 2015 was primarily due to increased revenue from our purchase of Oak Island on January 14, 2016. The increase in net interest and other income resulted from a higher balance of average mortgage loans held for sale, leading to additional net interest income of $5.04 million as compared to the prior year.

Expenses for the Realty segment increased 64.02%, or $27.69 million, when compared to 2015. The increase in expenses was primarily due to an increase in mortgage operation expenses related to the Monarch merger. Also contributing to the increase in expenses over the prior year were additional operating expenses of $4.47 million related to Oak Island operations.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2015, for the Realty segment were $14.75 million, increasing 122.15% from 2014. Total revenue increased to $58.52 million in 2015 from $44.70 million in 2014. Net residential mortgage banking income increased by $7.46 million to $34.95 million from 2014 as a result of increased production volume and improved pricing. Residential mortgage banking income included an increase in the value of rate lock commitments of $0.29 million in 2015, as compared to an increase of $0.36 million in 2014. The increase in property management fees from 2014 was primarily due to our purchase of Beach Properties on October 1, 2014 and was partially offset by fees lost due to the sale of our North Carolina-based property management business on April 1, 2015. The increase in net interest and other income was related to increased production volume leading to higher average mortgage loans held for sale, resulting in additional net interest income of $0.99 million as compared to the prior year. Additionally, net interest and other income in second quarter 2015 included a nonrecurring gain of $1.36 million on the sale of our North Carolina-based property management business, partially offset by expenses of $0.24 million recorded in noninterest expense.

Expenses for the Realty segment increased 15.37%, or $5.76 million, when compared to 2014. The increase in expenses was primarily due to additional operating expenses of $3.76 million related to Beach Properties operations combined with a full year of expenses related to the expansion of our mortgage processing centers in 2014.

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

	Year Ended December 31,			Increase/(Decrease)			
				2016 over 2015		2015 over 2014	
	2016	2015	2014	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage banking income, net	$ 59,870	$ 34,952	$ 27,492	$ 24,918	71.29%	$ 7,460	27.14 %
Real estate brokerage income, net	7,833	6,874	6,439	959	13.95%	435	6.76 %
Title insurance and settlement fees	1,883	1,574	1,516	309	19.63%	58	3.83 %
Property management fees, net	12,682	9,452	6,195	3,230	34.17%	3,257	52.57 %
Income from unconsolidated subsidiary	881	648	516	233	35.96%	132	25.58 %
Net interest and other income	8,854	5,022	2,538	3,832	76.30%	2,484	97.87 %
Total revenue	92,003	58,522	44,696	33,481	57.21%	13,826	30.93 %
Expenses							
Salaries and employee benefits	41,706	24,916	21,903	16,790	67.39%	3,013	13.76 %
Occupancy expense	5,989	3,900	3,806	2,089	53.56%	94	2.47 %
Furniture and equipment	2,113	1,030	1,088	1,083	105.15%	(58)	(5.33)%
Amortization of intangible assets	1,829	1,027	685	802	78.09%	342	49.93 %
Other expenses	19,292	12,371	10,001	6,921	55.95%	2,370	23.70 %
Total expenses	70,929	43,244	37,483	27,685	64.02%	5,761	15.37 %
Income before income tax, corporate allocation, and noncontrolling interest	21,074	15,278	7,213	5,796	37.94%	8,065	111.81 %
Corporate allocation	(935)	(532)	(575)	(403)	75.75%	43	(7.48)%
Income before income tax provision and noncontrolling interest	20,139	14,746	6,638	5,393	36.57%	8,108	122.15 %
Provision for income tax	(6,184)	(4,770)	(1,874)	(1,414)	29.64%	(2,896)	154.54 %
Net income	13,955	9,976	4,764	3,979	39.89%	5,212	109.40 %
Noncontrolling interest	(3,669)	(2,250)	(2,056)	(1,419)	63.07%	(194)	9.44 %
Net income attributable to TowneBank	$ 10,286	$ 7,726	$ 2,708	$ 2,560	33.13%	$ 5,018	185.30 %

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

	Year Ended December 31,			Increase/(Decrease)			
				2016 over 2015		2015 over 2014	
	2016	2015	2014	Amount	Percent	Amount	Percent
Key data							
Number of units sold	4,339	3,912	3,627	427	10.92 %	285	7.86 %
Volume of units sold	$1,270,900	$1,081,353	$1,009,539	$ 189,547	17.53 %	$ 71,814	7.11 %
Number of real estate agents	409	412	376	(3)	(0.73)%	36	9.57 %
Loans originated, mortgage	$2,254,975	$ 795,087	$ 540,470	$1,459,888	183.61 %	$ 254,617	47.11 %
Loans originated, joint ventures	902,607	777,906	682,023	124,701	16.03 %	95,883	14.06 %
Total loans originated	$3,157,582	$1,572,993	$1,222,493	$1,584,589	100.74 %	$ 350,500	28.67 %
Number of loans, mortgage	8,712	3,440	2,405	5,272	153.26 %	1,035	43.04 %
Number of loans, joint ventures	4,190	3,629	3,248	561	15.46 %	381	11.73 %
Total number of loans	12,902	7,069	5,653	5,833	82.52 %	1,416	25.05 %
Average loan amount, mortgage	$ 259	$ 231	$ 225	$ 28	12.12 %	$ 6	2.67 %
Average loan amount, joint ventures	215	214	210	1	0.47 %	4	1.90 %
Average loan amount	$ 245	$ 223	$ 216	$ 22	9.87 %	$ 7	3.24 %
Average number of originators, mortgage	158	70	67	88	125.71 %	3	4.48 %
Average number of originators, joint ventures	56	52	61	4	7.69 %	(9)	(14.75)%
Average number of originators	214	122	128	92	75.41 %	(6)	(4.69)%

Mortgage. The loan volume for combined mortgage operations showed increases during the year ended December 31, 2016, as compared to 2015. Total loans originated in 2016 were $3.16 billion, a 100.74%, or $1.58 billion, increase from $1.57 billion in 2015, which was a $350.50 million, or 28.67%, increase compared to the 2014 volume of $1.22 billion. Refinance activity comprised $727.09 million of loan volume for the year ended December 31, 2016, while purchases accounted for the remaining $2.43 billion in loan volume for the year. For the years ended December 31, 2015 and 2014, refinance volume was $263.92 million and $164.44 million, respectively, while purchase volume was $1.31 billion and $1.06 billion, respectively.

Insurance Segment: The Insurance segment comprises property and casualty and group benefits divisions. The Insurance segment represented 7.93%, or $5.34 million, of our total consolidated net income in 2016 compared to 6.59%, or $4.11 million, in 2015.

Earnings before taxes and noncontrolling interest for the Insurance segment were $10.20 million in 2016, as compared to $7.96 million in 2015. The primary factors affecting earnings were increases in income related to a full year of operations for insurance agencies acquired in 2015 and growth in our travel insurance business. Also contributing to the increase was higher contingency and bonus revenue of $0.79 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.

Earnings before taxes and noncontrolling interest for the Insurance segment were $7.96 million in 2015, as compared to $8.66 million in 2014. The primary factors affecting earnings were increased operating expenses related to acquisitions of five insurance agencies in 2015 and an increase in amortization of intangible assets related to the acquisitions.

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

	Year Ended December 31,			Increase/(Decrease)			
				2016 over 2015		2015 over 2014	
	2016	2015	2014	Amount	Percent	Amount	Percent
Commission and fee income							
Property and casualty	$ 33,544	$ 29,978	$ 25,067	$ 3,566	11.90 %	$ 4,911	19.59 %
Employee benefits	11,683	10,279	10,732	1,404	13.66 %	(453)	(4.22)%
Travel insurance	4,374	3,297	2,353	1,077	32.67 %	944	40.12 %
Specialized benefit services	623	557	544	66	11.85 %	13	2.39 %
Total commissions and fees	50,224	44,111	38,696	6,113	13.86 %	5,415	13.99 %
Contingency and bonus revenue	4,008	3,223	3,231	785	24.36 %	(8)	(0.25)%
Other income	280	206	343	74	35.92 %	(137)	(39.94)%
Total revenue	54,512	47,540	42,270	6,972	14.67 %	5,270	12.47 %
Employee commission expense	9,124	8,711	8,342	413	4.74 %	369	4.42 %
Revenue, net of commission expense	$ 45,388	$ 38,829	$ 33,928	$ 6,559	16.89 %	$ 4,901	14.45 %
Salaries and employee benefits	23,231	19,974	16,073	3,257	16.31 %	3,901	24.27 %
Occupancy expense	2,117	1,954	1,688	163	8.34 %	266	15.76 %
Furniture and equipment	758	904	737	(146)	(16.15)%	167	22.66 %
Amortization of intangible assets	2,784	2,285	1,879	499	21.84 %	406	21.61 %
Other expenses	5,665	5,048	4,456	617	12.22 %	592	13.29 %
Total expenses	34,555	30,165	24,833	4,390	14.55 %	5,332	21.47 %
Income before income tax, corporate allocation, and noncontrolling interest	10,833	8,664	9,095	2,169	25.03 %	(431)	(4.74)%
Corporate allocation	(638)	(702)	(439)	64	(9.12)%	(263)	59.91 %
Income before income tax provision and noncontrolling interest	10,195	7,962	8,656	2,233	28.05 %	(694)	(8.02)%
Provision for income tax expense	(3,591)	(2,816)	(3,207)	(775)	27.52 %	391	(12.19)%
Net income	6,604	5,146	5,449	1,458	28.33 %	(303)	(5.56)%
Noncontrolling interest	(1,268)	(1,033)	(705)	(235)	22.75 %	(328)	46.52 %
Net income attributable to TowneBank	$ 5,336	$ 4,113	$ 4,744	$ 1,223	29.73 %	$ (631)	(13.30)%

Total revenue for the year ended December 31, 2016, increased $6.97 million, or 14.67%. The increase from the prior period was positively impacted by the 2015 insurance agency acquisitions. The acquired insurance agencies contributed additional revenue, net of commission expense of $3.63 million. Also contributing to the increase was improvement in commercial lines commissions due to organic growth and an increase in commissions of $1.08 million from our travel insurance product lines.

Salaries and employee benefits expense increased $3.26 million, or 16.31%, when comparing 2016 to 2015, and increased $3.90 million, or 24.27%, when comparing 2015 to 2014. The increases were mainly driven by the insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $2.03 million and $3.02 million for 2016 and 2015, respectively.

Occupancy expense increased $0.16 million, or 8.34%, when comparing 2016 to 2015, and increased $0.27 million, or 15.76%, when comparing 2015 to 2014 as a result of the insurance agency acquisitions.

Amortization of intangible assets increased $0.50 million, or 21.84%, during the year ended December 31, 2016, compared to 2015, and increased $0.41 million, or 21.61%, when comparing 2015 to 2014, which was also a result of the acquisitions.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $1.68 billion, or 26.64%, to $7.97 billion at December 31, 2016, from $6.30 billion at December 31, 2015. Our loan portfolio grew by 28.50%, or $1.29 billion, to $5.81 billion at December 31, 2016, from $4.52 billion at December 31, 2015.

Our total average assets were $7.21 billion for 2016, reflecting an increase of $1.17 billion, or 19.30%, compared to the 2015 average of $6.04 billion. Total average assets for 2015 increased $1.17 billion, or 24.10%, compared to the 2014 average of $4.87 billion. Average earning assets, including BOLI assets, were $6.60 billion in 2016, reflecting an increase of $1.08 billion, or 19.45%, compared to 2015.

Our average total deposits were $5.57 billion in 2016, reflecting growth of $904.30 million, or 19.37%, compared to 2015. Growth continued in average noninterest-bearing deposits, which increased $376.73 million, or 28.04%.

Securities: Our securities consist of available-for-sale securities and held-to-maturity securities. Our available-for-sale securities portfolio, which is held primarily for earnings, liquidity, and asset/liability management purposes, is reported at fair value based on market prices for similar instruments. Our held-to-maturity securities portfolio, which is held primarily for yield and pledging purposes, is valued at amortized cost. Our investment portfolio totaled $915.40 million as of December 31, 2016, with a balance of $812.97 million in available-for-sale, $66.49 million in held-to-maturity, and $35.94 million in FHLB stock. Average yield on available-for-sale securities was 1.27% at December 31, 2016, compared with 1.49% at December 31, 2015, and 1.10% at December 31, 2014. Average yield on held-to-maturity securities was 3.19% at December 31, 2016, compared to 3.25% at December 31, 2015, and 3.18% at December 31, 2014.

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

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

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

	Year Ended December 31,								
	2016			2015			2014		
	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Securities Available for Sale:									
U.S. agency securities	$ 293,663	$ 292,470	1.20%	$ 540,984	$ 537,812	1.20%	$ 512,762	$ 512,441	0.81%
U.S. Treasury notes	251,994	252,001	0.32%	1,004	997	0.67%	—	—	—
Municipal securities	23,502	23,552	2.81%	21,445	21,849	2.89%	24,148	24,719	3.12%
Trust preferred corporate securities	1,978	2,533	8.09%	3,974	4,593	4.55%	6,327	7,063	3.47%
Other corporate securities	1,515	1,515	1.09%	1,435	1,435	1.08%	1,393	1,393	1.30%
Mortgage-backed securities	245,106	240,903	2.13%	157,425	156,803	2.24%	57,240	58,292	2.52%
Total securities available for sale	817,758	812,974	1.27%	726,267	723,489	1.49%	601,870	603,908	1.10%
Securities Held to Maturity:									
Trust preferred corporate securities	500	704	8.75%	500	714	8.75%	500	722	8.75%
Municipal securities	40,922	42,746	3.86%	44,377	47,488	3.89%	56,923	60,888	3.92%
Mortgage-backed securities	25,068	24,746	1.99%	24,168	24,165	1.96%	27,824	27,942	1.58%
Total securities held to maturity	66,490	68,196	3.19%	69,045	72,367	3.25%	85,247	89,552	3.18%
Total Portfolio	$ 884,248	$ 881,170	1.41%	$ 795,312	$ 795,856	1.65%	$ 687,117	$ 693,460	1.36%

The following table indicates the maturities of securities at December 31, 2016 (dollars in thousands):

	Available for Sale			Held to Maturity		
	Amortized Cost	Fair Market Value	Weighted Average Yield	Amortized Cost	Fair Market Value	Weighted Average Yield
U.S. Treasury & U.S. agency securities						
Due in one year or less	$ 308,648	$ 308,636	0.40%	$ —	$ —	—
After one year through five years	237,009	235,835	1.30%	—	—	—
After five years through ten years	—	—	—	—	—	—
After ten years	—	—	—	—	—	—
Municipal securities						
Due in one year or less	3,260	3,259	1.40%	—	—	—
After one year through five years	11,207	11,133	2.25%	2,881	2,967	4.65%
After five years through ten years	3,716	3,708	3.22%	19,906	20,562	3.41%
After ten years	5,319	5,452	4.59%	18,135	19,217	4.23%
Mortgage-backed securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	3,746	3,722	1.81%	—	—	—
After five years through ten years	26,751	26,598	2.45%	23,732	23,315	1.72%
After ten years	214,609	210,583	2.09%	1,336	1,431	6.79%
Trust preferred corporate securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	—	—	—	—	—	—
After five years through ten years	—	—	—	—	—	—
After ten years	1,978	2,533	8.09%	500	704	8.75%
Other securities						
Due in one year or less	1,065	1,065	1.25%	—	—	—
After one year through five years	250	250	1.30%	—	—	—
After five years through ten years	200	200	—	—	—	—
After ten years	—	—	—	—	—	—
No stated maturity	—	—	—	—	—	—
Total Portfolio	$ 817,758	$ 812,974	1.27%	$ 66,490	$ 68,196	3.19%

Loans Held for Sale: At December 31, 2016, we held $314.12 million in mortgage loans originated and intended for sale in the secondary market, compared with $102.35 million at December 31, 2015. Average loans held for sale were 4.05% and 1.92% of average earning assets for the years ended December 31, 2016 and 2015, respectively. The majority of loans held for sale have been pre-committed to investors, minimizing our interest rate risk.

Our mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate locked with the customer. The commitments are generally for periods of 60 days and are at market rates. In order to mitigate the effect of the interest rate risk inherent in providing rate lock commitments, we economically hedge our commitments by entering into either a forward loan sales contract under best efforts or a trade of "to be announced" ("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: Our loan portfolio, net of unearned income and deferred costs, totaled $5.81 billion on December 31, 2016. As a percentage of total average earning assets, average loans were 77.69% in 2016, compared with 76.69% in 2015 and 77.16% in 2014. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were continued improvements in our local economy and the efforts of our loan officers in developing new loan relationships, combined with the support of existing customers. The following tables provide the balance and composition of the loan portfolio by major classification for the periods indicated (dollars in thousands):

Year Ended December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
Real estate loans					
1-4 family residential	$ 1,215,823	$ 973,331	$ 837,370	$ 797,723	$ 754,593
Commercial	2,251,312	1,784,393	1,447,078	1,365,572	1,231,819
Construction and land development	826,027	598,875	452,481	469,679	618,562
Multifamily	222,791	167,371	51,472	53,562	57,831
Total real estate loans	4,515,953	3,523,970	2,788,401	2,686,536	2,662,805
Commercial and industrial loans	1,089,539	857,036	700,623	645,960	520,913
Consumer loans and other	201,729	138,387	75,365	48,698	42,708
Loans, net of unearned income and deferred costs	$ 5,807,221	$ 4,519,393	$ 3,564,389	$ 3,381,194	$ 3,226,426

Year Ended December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
Real estate loans					
1-4 family residential	20.94%	21.54%	23.49%	23.59%	23.39%
Commercial	38.77%	39.48%	40.60%	40.39%	38.18%
Construction and land development	14.22%	13.25%	12.70%	13.89%	19.17%
Multifamily	3.84%	3.70%	1.44%	1.58%	1.79%
Total real estate loans	77.77%	77.97%	78.23%	79.45%	82.53%
Commercial and industrial loans	18.76%	18.97%	19.66%	19.11%	16.15%
Consumer loans and other	3.47%	3.06%	2.11%	1.44%	1.32%
Loans, net of unearned income and deferred costs	100.00%	100.00%	100.00%	100.00%	100.00%

The table below provides the maturity and sensitivity of the loan portfolio at December 31, 2016 (in thousands):

	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years	Totals	Due After One Year: Fixed Rates	Due After One Year: Adjustable Rates
Real estate loans						
1-4 family residential	$ 110,482	$ 148,246	$ 957,095	$ 1,215,823	$ 447,384	$ 657,956
Commercial	194,802	363,145	1,693,365	2,251,312	1,793,245	263,265
Construction and land development	606,846	141,902	77,279	826,027	76,141	143,040
Multifamily	38,947	34,545	149,299	222,791	159,319	24,524
Total real estate loans	951,077	687,838	2,877,038	4,515,953	2,476,089	1,088,785
Commercial and industrial loans	458,923	288,910	341,706	1,089,539	474,970	155,646
Consumer loans and other	32,448	88,822	80,459	201,729	164,030	5,251
Loans, net of unearned income and deferred costs	$ 1,442,448	$ 1,065,570	$ 3,299,203	$ 5,807,221	$ 3,115,089	$ 1,249,682

At December 31, 2016, approximately 89% of our floating rate loans are tied to LIBOR interest rates or Wall Street Journal Prime interest rates. The following table is a summary of our floating rate loan portfolio and contractual interest rate indices at December 31, 2016 (in thousands):

Contractual Interest Rate Index	Floating Rate (at floor rate)	Floating Rate (not at floor or ceiling rate)	Floating Rate (at ceiling rate)	Total Floating Rate
Wall Street Journal Prime	$ 575,007	$ 774,163	$ 679	$ 1,349,849
LIBOR	120,440	577,724	—	698,164
Other contractual interest rate indices	10,993	251,779	—	262,772
	$ 706,440	$ 1,603,666	$ 679	$ 2,310,785

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

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

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

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

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

The allowance for loan losses at December 31, 2016, 2015, and 2014 was $42.0 million, $38.36 million, and $35.92 million, respectively. The allowance was equal to 0.72% of total loans outstanding at December 31, 2016, compared with 0.85% at December 31, 2015, and 1.01% at December 31, 2014. Excluding purchased loans, the allowance was equal to 0.87% of total loans outstanding at December 31, 2016, compared with 0.94% at December 31, 2015, and 1.02% at December 31, 2014. We believe the decline in the ratio, excluding purchased loans, is appropriate given the continued improvement in the risk profile of our loan portfolio and diversification efforts in the loan portfolio. Reflective of improving credit quality, classified loans, defined as loans in the substandard and doubtful categories, remained low at 1.31% of total loans at December 31, 2016, down from 1.47% at December 31, 2015. Additionally, loans 30 to 89 days past due were $10.46 million, or 0.18% of total loans, including purchased impaired loans of $1.53 million, at December 31, 2016, up slightly from $7.48 million, or 0.17% of total loans, at December 31, 2015, and total past due and nonaccruing loans were $25.21 million, or 0.43% of total loans, including purchased impaired past-due loans of $3.11 million, at December 31, 2016, compared to $17.85 million, or 0.40% of total loans, at December 31, 2015. Also reflecting the credit quality of our loan portfolio and supporting the adequacy of coverage levels of the allowance for loan losses, the allowance was equal to 3.21x of nonperforming loans at December 31, 2016, compared with 4.42x at December 31, 2015. Additionally, overall economic conditions and labor market conditions have continued to show improvement. Given the combination of these noted factors, we believe our allowance for loan losses is adequate to cover loan losses inherent in the loan portfolio at December 31, 2016.

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

Year Ended December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
Balance beginning of period	$ 38,359	$ 35,917	$ 38,380	$ 40,427	$ 39,740
Loans charged off:					
1-4 family residential real estate	(1,448)	(1,443)	(1,473)	(4,402)	(4,640)
Multifamily	—	—	(493)	(14)	(345)
Commercial real estate	(399)	(279)	(1,165)	(396)	(3,295)
Construction and land development	(107)	(208)	(561)	(1,734)	(5,989)
Commercial and industrial	(481)	(122)	(432)	(1,040)	(1,791)
Consumer and other	(459)	(109)	(415)	(397)	(504)
Total	(2,894)	(2,161)	(4,539)	(7,983)	(16,564)
Loans recovered:					
Residential 1-4 family	716	636	661	465	860
Multifamily	2	1	47	—	—
Commercial real estate	59	244	452	335	60
Construction and land development	110	80	134	367	54
Commercial and industrial	121	493	130	466	66
Consumer and other	171	122	160	55	56
Total	1,179	1,576	1,584	1,688	1,096
Net loans charged off	(1,715)	(585)	(2,955)	(6,295)	(15,468)
Provision for loan losses	5,357	3,027	492	4,248	16,155
Balance end of period	$ 42,001	$ 38,359	$ 35,917	$ 38,380	$ 40,427
Nonperforming assets:					
Nonperforming loans	$ 13,099	$ 8,670	$ 6,741	$ 12,753	$ 40,691
Former bank premises	3,494	—	—	—	—
Foreclosed property	21,011	34,420	35,115	39,534	30,297
Total nonperforming assets	$ 37,604	$ 43,090	$ 41,856	$ 52,287	$ 70,988
Loans past due 90 days accruing interest	$ 76	$ 424	$ 12	$ —	$ 222
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	3.21x	4.42x	5.33x	3.01x	0.99x
Allowance to nonperforming assets	1.12x	.89x	.86x	.73x	.57x
Allowance for loan losses to period end loans	0.72%	0.85%	1.01%	1.14%	1.25%
Allowance for loan losses to period end loans excluding purchased loans	0.87%	0.94%	1.02%	1.15%	1.27%
Nonperforming loans to period end loans	0.23%	0.19%	0.19%	0.38%	1.26%
Nonperforming assets to period end assets	0.47%	0.68%	0.84%	1.12%	1.61%
Net charge-offs to average loans	0.03%	0.01%	0.09%	0.19%	0.51%

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

At December 31, 2016, we had $37.60 million in nonperforming assets, which amounted to 0.47% of total assets. Nonperforming assets consist of $13.10 million in nonperforming loans, $3.49 million in former bank premises related to the Monarch merger, as well as $21.01 million in foreclosed property. Nonperforming loans increased by $4.43 million, from December 31, 2015, as additions to nonaccrual loans during 2016 were more than offset by transfers to OREO, charge-offs, and payments received. Nonperforming 1-4 family residential real estate loans increased by $1.85 million with paydowns of $1.58 million, charge-offs of $1.65 million, and transfers to OREO of $1.91 million. Nonperforming construction and development loans decreased by $0.55 million with paydowns of $0.58 million, charge-offs of $0.11 million, and transfers to OREO of $0.12 million. Additionally, nonperforming commercial real estate loans increased by $3.02 million as paydowns of $0.79 million, charge-offs of $0.44 million, and transfers to OREO of $1.59 million were outpaced by new nonperforming loans. At December 31, 2016, foreclosed property totaled $21.01 million, a decrease from $34.42 million at December 31, 2015. The seven largest foreclosed property developments represented 86.44% of total foreclosed property at December 31, 2016. Foreclosed property consists of 12 residential properties, 19 construction and development properties, and three commercial properties.

At December 31, 2016, loans 60 to 89 days delinquent, excluding nonperforming loans, totaled $1.62 million. Additionally, there are other performing loans, totaling $30.51 million, that are current but have certain documentation deficiencies or other potential weaknesses that management considers warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At December 31, 2016, nonaccruing TDRs, which are included in nonperforming loans, totaled $6.10 million, and accruing TDRs totaled $31.35 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

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

	December 31, 2016	December 31, 2015
Construction and land development	$ 696	$ 1,243
Commercial real estate	5,110	2,093
Multifamily real estate	690	731
1-4 family residential real estate	6,113	4,267
Commercial and industrial loans	362	282
Consumer loans and other	128	54
Total nonperforming loans	$ 13,099	$ 8,670

Allocation of the Allowance for Loan Losses: At December 31, 2016, all of the allowance for loan losses was allocated to specific loan categories. Management monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Company experiences over time. This allocation of the allowance for loan losses is calculated on an approximate basis and is not intended as an indication of the specific amounts, by loan classification, to be charged to the allowance. The entire amount of the allowance is available to absorb losses occurring in any category of loans. The following table provides a breakdown of the allowance for loan losses among the various loan types for the periods indicated (in thousands):

Year Ended December 31,	**2016**	**2015**	**2014**	**2013**	**2012**
Real estate loans:					
1-4 family residential	$ 9,050	$ 8,990	$ 9,121	$ 10,730	$ 10,722
Commercial	16,248	14,687	14,226	13,621	12,521
Construction	4,280	4,984	5,661	7,925	11,691
Multifamily	1,370	945	667	699	589
Total real estate loans	30,948	29,606	29,675	32,975	35,523
Commercial and industrial loans	6,410	5,774	4,963	4,711	4,378
Consumer loans and other	4,643	2,979	1,279	694	526
Total	$ 42,001	$ 38,359	$ 35,917	$ 38,380	$ 40,427

In the opinion of management, the allowance was adequate at December 31, 2016, based on known conditions. However, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, changes in the value of collateral, and changes in general economic conditions and other risk factors.

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

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

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

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

Deposit accounts held as of December 31, 2016, totaled $6.04 billion. This represented an increase of $1.12 billion, or 22.82%, over 2015, which was $1.07 billion, or 27.75%, over 2014. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina. The deposits consist of demand deposits, interest-bearing checking accounts, money market deposit accounts, and time deposits. Some of our interest-bearing deposits were obtained through brokered transactions and our participation in CDARS. We had brokered time deposits of $91.70 million and CDARS deposits of $49.54 million at December 31, 2016.

The following tables provide the average balance and cost rate of interest-bearing deposits in addition to maturities of certificates of deposit of $250,000 and greater for the periods indicated (dollars in thousands). The aggregate amount of time deposits of $250,000 or more was $367.81 million and $390.22 million at December 31, 2016 and 2015, respectively. See Note 9 in the Notes to Consolidated Financial Statements for additional information on deposits.

	Average Balance			Average Cost Rate		
For the Year Ended December 31,	**2016**	**2015**	**2014**	**2016**	**2015**	**2014**
Noninterest-bearing demand deposits	$ 1,720,093	$ 1,343,360	$ 1,158,888	—	—	—
Demand and money markets	2,012,061	1,689,185	1,306,738	0.30%	0.28%	0.23%
Savings	309,049	300,620	310,722	0.93%	0.92%	0.92%
Certificates of deposit:						
Less than $250,000	1,188,072	1,059,192	573,750	0.88%	0.87%	0.73%
$250,000 or more	342,918	275,536	398,952	0.86%	0.81%	0.81%
Total interest-bearing deposits	3,852,100	3,324,533	2,590,162	0.58%	0.57%	0.52%
Total deposits	$ 5,572,193	$ 4,667,893	$ 3,749,050	0.40%	0.40%	0.36%

Average noninterest-bearing demand deposits were 30.87% of average total deposits during the year ended December 31, 2016, and 28.78% and 30.91% during 2015 and 2014, respectively. The variance from the prior year is primarily attributable to a change in the deposit mix related to the Monarch merger. The average cost of interest-bearing deposits was 0.58% for the year ended December 31, 2016, compared with 0.57% for 2015, and 0.52% for 2014.

Advances from the Federal Home Loan Bank: Our ability to borrow funds through nondeposit sources provides additional flexibility in meeting the liquidity needs of customers while enhancing our cost of funds structure. Average funds borrowed were $483.74 million and $424.59 million for the years ended December 31, 2016 and 2015, respectively. The balance at December 31, 2016, of $687.51 million, increased $258.43 million from the balance at December 31, 2015, of $429.08 million. Refer to Note 10 in the Notes to Consolidated Financial Statements for additional disclosures related to borrowing arrangements.

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

We maintained an average of $300.13 million outstanding in overnight interest-bearing deposits during 2016, compared with $188.55 million for 2015. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2016, we primarily funded our growth in total assets with deposit growth.

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

On September 22, 2011, the Company entered into a Securities Purchase Agreement with the U.S. Treasury, pursuant to which the Company sold and issued 76,458 shares of the Company's Series C Preferred Stock, for a total purchase price of $76.46 million. The issuance was pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

On January 7, 2015, the Company used internally available funds to repurchase all 76,458 outstanding shares of its Series C Preferred Stock for a redemption price of $76.46 million, plus accrued but unpaid dividends.

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

Contractual Obligations, Contingent Liabilities, and Commitments: The following table summarizes our significant contractual obligations, contingent liabilities, and certain other commitments outstanding as of December 31, 2016 (in thousands):

	Payments Due by Period				
Contractual Obligations	**Total**	**Less Than 1 Year**	**1 - 3 years**	**3 - 5 years**	**More Than 5 Years**
Operating lease obligations	$ 51,327	$ 10,402	$ 14,519	$ 5,814	$ 20,592
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	687,511	260,000	13,000	—	414,511
Other commitments					
Standby letters of credit	84,307	84,307	—	—	—
Commitments to extend credit	2,084,992	2,084,992	—	—	—
Total contractual obligations	$ 2,908,137	$ 2,439,701	$ 27,519	$ 5,814	$ 435,103

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

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

Year Ended December 31,	**2016**	**2015**	**2014**
Return on average assets	0.93%	1.03%	0.87%
Return on average equity	6.98%	7.75%	6.95%
Return on average tangible equity	9.93%	10.34%	9.16%
Average equity to average assets	13.38%	13.32%	12.47%

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

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

An asset-sensitive balance sheet structure implies that assets, such as loans and securities, will reprice faster than liabilities; consequently, net interest income should be positively affected in an increasing interest rate environment. Conversely, a liability-sensitive balance sheet structure implies that liabilities, such as deposits, will reprice faster than assets; consequently, net interest income should be positively affected in a decreasing interest rate environment. At December 31, 2016, we had $481.09 million more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position.

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

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

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

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

Change in Prime Rate	% Change in Net Interest Income
+ 300 basis points	9.83 %
+ 200 basis points	6.76 %
+ 100 basis points	3.34 %
- 100 basis points	(4.75)%

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	$ (134,161)
+ 200 basis points	$ (111,437)
+ 100 basis points	$ (35,729)
- 100 basis points	$ (77,042)

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

FORWARD-LOOKING STATEMENTS

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

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

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

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

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

NON-GAAP FINANCIAL MEASURES

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

Year Ended December 31,	**2016**	**2015**
Return on average assets (GAAP basis)	0.93%	1.03%
Impact of excluding average goodwill and other intangibles	0.09%	0.07%
Return on average tangible assets	1.02%	1.10%
Return on average equity (GAAP basis)	6.98%	7.75%
Impact of excluding average goodwill and other intangibles	2.95%	2.59%
Return on average tangible equity	9.93%	10.34%

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

	Per share	
Year Ended December 31,	**2016**	**2015**
Book value (GAAP basis)	$ 17.20	$ 15.71
Impact of excluding average goodwill and other intangibles	4.84	3.50
Tangible book value	$ 12.36	$ 12.21

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

Year Ended December 31,	**2016**	**2015**
Efficiency ratio (GAAP basis)	71.59%	67.90%
Impact of excluding securities gains	—%	0.21%
Efficiency ratio, as reported	71.59%	68.11%

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
TowneBank

We have audited the accompanying consolidated balance sheets of TowneBank and subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited TowneBank's internal control over financial reporting as of December 31, 2016, including controls over the preparation of regulatory financial statements in accordance with the instructions for Consolidated Reports of Condition and Income (Call Report) of the Federal Financial Institutions Examination Council, based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). TowneBank's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of consolidated financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income (call report). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles and call report instructions, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the consolidated financial statements.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TowneBank and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, TowneBank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We do not express an opinion or any other form of assurance on management's statements in the accompanying Management's Report on Internal Control in the section Compliance with Designated Laws and Regulations.

/s/ Dixon Hughes Goodman LLP

Norfolk, Virginia
March 1, 2017

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016, including controls over regulatory financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013). Based on our assessment we believe that, as of December 31, 2016, our internal control over financial reporting is effective based on those criteria.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2016, and for the year then ended. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include amounts, some of which are based on management's judgments and estimates.

Compliance with Designated Laws and Regulations

Our management is also responsible for compliance with federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations. Management assessed our compliance with the designated laws and regulations. Based on this assessment, our management believes that we complied, in all significant respects, with the designated laws and regulations relating to safety and soundness for the year ended December 31, 2016.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income, as of December 31, 2016, has been audited by Dixon Hughes Goodman LLP, the independent registered public accounting firm, as stated in their report dated March 1, 2017. A copy of this report, which is combined with the report expressing an opinion on the consolidated financial statements, precedes.

March 1, 2017

/s/ G. Robert Aston, Jr.

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

/s/ Clyde E. McFarland, Jr.

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

TOWNEBANK
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)
December 31, 2016 and 2015

ASSETS	2016	2015
Cash and due from banks	$ 130,967	$ 250,836
Interest-bearing deposits in financial institutions	5,581	1,001
Total Cash and Cash Equivalents	136,548	251,837
Securities available for sale, at fair value	812,974	723,489
Securities held to maturity, at amortized cost	66,490	69,045
Federal Home Loan Bank stock, at amortized cost	35,937	23,691
Total Securities	915,401	816,225
Mortgage loans held for sale	314,117	102,346
Loans, net of unearned income and deferred costs:	5,807,221	4,519,393
Less: allowance for loan losses	(42,001)	(38,359)
Net Loans	5,765,220	4,481,034
Premises and equipment, net	198,568	173,695
Goodwill	264,910	154,842
Other intangible assets, net	37,856	26,153
Bank-owned life insurance policies	189,499	149,452
Other assets	151,796	140,990
TOTAL ASSETS	$ 7,973,915	$ 6,296,574
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 1,947,312	$ 1,393,264
Interest-bearing:		
Demand and money market accounts	2,263,894	1,824,226
Savings	319,611	300,408
Certificates of deposit	1,504,380	1,396,129
Total Deposits	6,035,197	4,914,027
Advances from the Federal Home Loan Bank	687,511	429,080
Repurchase agreements and other borrowings	31,747	37,434
Total Borrowings	719,258	466,514
Other liabilities	132,902	95,839
TOTAL LIABILITIES	6,887,357	5,476,380
Preferred stock		
Authorized and unissued shares - 2,000,000	—	—
Common stock, $1.667 par value		
Authorized shares - 90,000,000		
Issued and outstanding shares 62,492,168 in 2016 and 51,605,521 in 2015	104,174	86,026
Capital surplus	745,411	535,094
Retained earnings	229,503	192,795
Common stock issued to deferred compensation trust, at cost 692,431 shares in 2016 and 648,350 shares in 2015	(11,168)	(10,172)
Deferred compensation trust	11,168	10,172
Accumulated other comprehensive loss	(3,986)	(2,994)
TOTAL SHAREHOLDERS' EQUITY	1,075,102	810,921
Noncontrolling interest	11,456	9,273
TOTAL EQUITY	1,086,558	820,194
TOTAL LIABILITIES AND EQUITY	$ 7,973,915	$ 6,296,574

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands, except per share data)
For the Years Ended December 31, 2016, 2015, and 2014

	2016	2015	2014
INTEREST INCOME:			
Loans, including fees	$ 231,464	$ 194,737	$ 160,213
Investment securities	12,855	13,801	9,076
Interest-bearing deposits in financial institutions and federal funds sold	1,145	499	637
Mortgage loans held for sale	9,152	3,836	2,586
Total interest income	254,616	212,873	172,512
INTEREST EXPENSE:			
Deposits	22,316	18,866	13,352
Advances from the Federal Home Loan Bank	13,320	13,486	13,373
Repurchase agreements and other borrowings, net of capitalized interest	104	79	51
Total interest expense	35,740	32,431	26,776
Net interest income	218,876	180,442	145,736
PROVISION FOR LOAN LOSSES	5,357	3,027	492
Net interest income after provision for loan losses	213,519	177,415	145,244
NONINTEREST INCOME:			
Residential mortgage banking income, net	58,792	34,211	27,179
Insurance commissions and other title fees and income, net	46,741	39,641	34,558
Real estate brokerage and property management income, net	20,515	16,326	12,634
Service charges on deposit accounts	9,547	9,165	9,192
Credit card merchant fees, net	4,508	2,588	3,576
Other income	15,113	14,448	9,605
Gain (loss) on investment securities	6	904	(15)
Total noninterest income	155,222	117,283	96,729
NONINTEREST EXPENSE:			
Salaries and employee benefits	143,847	113,959	99,007
Occupancy	23,717	19,645	17,863
Furniture and equipment	11,315	9,339	8,183
Other expenses	88,949	59,214	53,811
Total noninterest expense	267,828	202,157	178,864
Income before income tax expense & noncontrolling interest	100,913	92,541	63,109
Provision for income tax expense	28,698	26,876	18,179
Net income	$ 72,215	$ 65,665	$ 44,930
Net income attributable to noncontrolling interest	(4,965)	(3,283)	(2,761)
Net income attributable to TowneBank	$ 67,250	$ 62,382	$ 42,169
Preferred stock dividends and accretion	—	13	765
Net income available to common shareholders	$ 67,250	$ 62,369	$ 41,404
Per common share information			
Basic earnings	$ 1.18	$ 1.22	$ 1.18
Diluted earnings	$ 1.18	$ 1.22	$ 1.18
Cash dividends declared	$ 0.51	$ 0.47	$ 0.43

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
For the Years Ended December 31, 2016, 2015, and 2014

	2016	2015	2014
Net income	$ 72,215	$ 65,665	$ 44,930
Other comprehensive income (loss)			
Unrealized gains (losses) on securities			
Unrealized holding gains (losses) arising during the period	(2,000)	(4,031)	2,404
Deferred tax benefit (expense)	700	1,411	(844)
Realized (gains) losses reclassified into earnings	(6)	(785)	15
Deferred tax benefit (expense)	2	275	(6)
Net unrealized gains (losses)	(1,304)	(3,130)	1,569
Pension and postretirement benefit plans			
Prior service costs	—	(1,405)	—
Deferred tax benefit	—	492	—
Actuarial gain (loss)	323	694	(1,196)
Deferred tax benefit (expense)	(113)	(243)	418
Amortization of prior service costs	151	—	—
Deferred tax expense	(53)	—	—
Amortization of net actuarial loss	7	215	17
Deferred tax expense	(3)	(75)	(6)
Change in retirement plans, net of tax	312	(322)	(767)
Other comprehensive income (loss), net of tax	(992)	(3,452)	802
Comprehensive income	$ 71,223	$ 62,213	$ 45,732

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF EQUITY
(dollars in thousands, except share data)
For the Years Ended December 31, 2016, 2015, and 2014

	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total
Balance, December 31, 2013	**35,306,281**	**$ 76,458**	**$ 58,856**	**$ 312,811**	**$ 128,527**	**$ 8,595**	**$ (8,595)**	**$ (344)**	**$ 9,010**	**$ 585,318**
Net income	—	—	—	—	42,169	—	—	—	2,761	44,930
Other comprehensive income, net of taxes	—	—	—	—	—	—	—	802	—	802
Cash dividends declared on common stock	—	—	—	—	(15,276)	—	—	—	—	(15,276)
Cash dividends declared on preferred stock	—	—	—	—	(765)	—	—	—	—	(765)
Directors' deferred compensation	—	—	—	—	—	1,079	(1,079)	—	—	—
Distribution of interests in joint ventures, net	—	—	—		—	—	—	—	(2,439)	(2,439)
Issuance of common stock - acquisitions	312,891	—	521	4,042	—	—	—	—	—	4,563
Conversion of convertible debt into common stock	6,526	—	12	82	—	—	—	—	—	94
Issuance of common stock - stock compensation plans	159,981	—	266	783	—	—	—	—	—	1,049
Balance, December 31, 2014	**35,785,679**	**$ 76,458**	**$ 59,655**	**$ 317,718**	**$ 154,655**	**$ 9,674**	**$ (9,674)**	**$ 458**	**$ 9,332**	**$ 618,276**
Net income	—	—	—	—	62,382	—	—	—	3,283	65,665
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(3,452)	—	(3,452)
Cash dividends declared on common stock	—	—	—	—	(24,229)	—	—	—	—	(24,229)
Cash dividends declared on preferred stock	—	—	—	—	(13)	—	—	—	—	(13)
Directors' deferred compensation	—	—	—	—	—	498	(498)	—	—	—
Distribution of interests in joint ventures, net	—	—	—		—	—	—	—	(3,342)	(3,342)
Issuance of common stock - acquisitions	15,633,024	—	26,058	214,210	—	—	—	—	—	240,268
Redemption of preferred stock	—	(76,458)	—	—	—	—	—	—	—	(76,458)
Conversion of convertible debt into common stock	1,674	—	4	22	—	—	—	—	—	26
Issuance of common stock - stock compensation plans	138,599	—	233	2,003	—	—	—	—	—	2,236
Issuance of common stock - net contingent consideration earned on acquisitions	46,545	—	76	1,141	—	—	—	—	—	1,217
Balance, December 31, 2015	**51,605,521**	**$ —**	**$ 86,026**	**$ 535,094**	**$ 192,795**	**$ 10,172**	**$ (10,172)**	**$ (2,994)**	**$ 9,273**	**$ 820,194**
Net income	—	—	—	—	67,250	—	—	—	4,965	72,215
Other comprehensive loss, net of taxes	—	—	—	—	—	—	—	(992)	—	(992)
Cash dividends declared on common stock	—	—	—	—	(30,542)	—	—	—	—	(30,542)
Directors' deferred compensation	—	—	—	—	—	996	(996)	—	—	—
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	—	(2,782)	(2,782)
Conversion of convertible debt into common stock	833	—	2	9	—	—	—	—	—	11
Issuance of common stock - acquisitions	10,487,069	—	17,482	204,949	—	—	—	—	—	222,431
Issuance of common stock - stock compensation plans	297,774	—	496	3,263	—	—	—	—	—	3,759
Issuance of common stock - net contingent consideration earned on acquisitions	100,971	—	168	2,096	—	—	—	—	—	2,264
Balance, December 31, 2016	**62,492,168**	**$ —**	**$ 104,174**	**$ 745,411**	**$ 229,503**	**$ 11,168**	**$ (11,168)**	**$ (3,986)**	**$ 11,456**	**$ 1,086,558**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2016, 2015, and 2014

OPERATING ACTIVITIES:	2016	2015	2014
Net income	$ 72,215	$ 65,665	$ 44,930
Adjustments to reconcile net income to net cash from operating activities:			
Net amortization of securities	2,688	3,238	3,173
Investment securities loss (gains)	(6)	(904)	15
Depreciation, amortization, and other intangible amortization	20,552	16,147	13,900
Provision for loan losses	5,357	3,027	492
Bank-owned life insurance income	(5,993)	(5,190)	(2,139)
Deferred income tax expense (benefit)	3,154	3,671	(1,146)
Share-based compensation expense	2,162	1,917	1,391
Loss on sale and write-down of foreclosed assets	520	310	1,784
Originations of mortgage loans held for sale	(2,860,710)	(1,448,009)	(1,130,200)
Proceeds from sales of mortgage loans held for sale	3,031,817	1,467,932	1,155,261
Gain on sales of mortgage loans held for sale	(99,350)	(50,879)	(37,809)
Changes in:			
Interest receivable	(3,766)	(4,247)	(1,089)
Other assets	366	(37,119)	(10,013)
Interest payable	646	499	(238)
Other liabilities	15,387	65,029	6,209
Net cash from operating activities	185,039	81,087	44,521
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(974,031)	(515,713)	(325,395)
Purchase of held-to-maturity securities	(6,062)	—	(60,443)
Sale of available-for-sale securities	—	414,141	1,861
Sale of held-to-maturity securities	—	2,272	—
Sale of Federal Home Loan Bank Stock	3,121	8,113	1,082
Proceeds from maturities, calls, and prepayments of available-for-sale securities	885,519	196,160	262,438
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	8,408	13,821	12,185
Net increase in loans	(485,411)	(463,224)	(164,231)
Purchases of premises and equipment	(18,055)	(23,315)	(11,926)
Proceeds from sales of premises and equipment	2,981	3,713	152
Proceeds from sales of foreclosed assets	20,477	24,227	14,185
Acquisition of business, net of cash acquired	61,930	241,332	(12,798)
Net cash used for investing activities	(501,123)	(98,473)	(282,890)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	59,550	384,479	279,497
Net change in borrowings	170,708	(229,013)	(13,094)
Proceeds (payments) from share-based compensation activity	1,597	322	(342)
Proceeds from issuance of common stock	2,264	1,215	—
Distribution of interest in joint ventures, net	(2,782)	(3,342)	(2,439)
Redemption of preferred stock	—	(76,458)	—
Cash dividends paid	(30,542)	(21,985)	(16,041)
Net cash from financing activities	200,795	55,218	247,581
Change in cash and cash equivalents	(115,289)	37,832	9,212
Cash and cash equivalents at beginning of year	251,837	214,005	204,793
Cash and cash equivalents at end of year	$ 136,548	$ 251,837	$ 214,005
Supplemental cash flow information:			
Cash paid for interest	$ 35,095	$ 31,933	$ 27,014
Cash paid for income taxes	$ 23,459	$ 15,129	$ 18,271
Noncash financing and investing activities:			
Transfer from loans to foreclosed property	$ 4,006	$ 6,516	$ 10,684
Sales of foreclosed assets financed by the Company	$ 5,583	$ 9,890	$ 3,138
Transfers (to) from foreclosed property to premises and equipment	$ 3,659	$ 277	$ (549)
Net unrealized gain (loss) on available-for-sale securities	$ (1,304)	$ (3,130)	$ 1,569
Dividends declared but not paid	$ 8,124	$ 6,193	$ 3,936
Common stock issued in connection with business acquisitions	$ 222,431	$ 240,268	$ 4,563

See accompanying Notes to Consolidated Financial Statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

In order to better reflect the Company's view of the business and credit characteristics of the instruments, a reclassification of industrial revenue bonds ("IRB") from investment securities to loans held for investment was made during 2015. At December 31, 2015, the Company had $240.64 million in IRBs classified as loans held for investment and recorded $5.71 million in interest income from loans related to IRBs for the year then ended. Because there was no allowance for loan loss previously associated with the IRBs, the Company recorded a provision for loan loss related to the IRBs attributable to prior periods of $0.80 million in second quarter 2015 and recorded a total provision for loan loss related to the IRBs of $1.10 million in 2015. Additionally, the Company reclassified $4.32 million in interest income from loans related to IRBs from investment securities income to interest income from loans for the year ended December 31, 2014.

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

Cash and cash equivalents: For purposes of reporting cash flows, the Company considers cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold as cash and cash equivalents. Generally, federal funds and securities purchased under agreements to resell are purchased and sold for one-day periods. The Company is required to maintain average reserve balances in cash with the Federal Reserve Bank of Richmond; required reserves were $40.61 million and $17.52 million at December 31, 2016 and 2015, respectively.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Goodwill is tested for impairment at the reporting unit level on an annual basis as of August 31, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step (step 1) compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. For our annual impairment testing conducted during 2016, we identified six reporting units with goodwill: Berkshire Hathaway HomeServices Towne Realty; property and casualty insurance division; benefits insurance division; mortgage division; resort property management division; and Banking. For purposes of performing step 1 of the goodwill impairment test, the Company primarily uses the income approach to value its reporting units. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the respective reporting units. The significant inputs to the income approach include expected future cash flows, the long-term target tangible equity to tangible assets ratio, and the discount rate. Discount rates are unique to each reporting unit and are based upon the cost of capital specific to the industry in which the reporting unit operates. Management evaluated the sensitivity of the significant assumptions in its impairment analysis, including consideration of the effect of changes in estimated future cash flows or the discount rate for each reporting unit. Based on our analysis, we determined there is no goodwill impairment, since the fair value for all reporting units was in excess of the respective reporting unit's carrying value as of August 31, 2016. The fair value of each of the Company's reporting units exceeded its respective carrying value by at least the 17.09% margin as calculated for our Banking segment.

The second step (step 2) of impairment testing is necessary only if the reporting unit does not pass step 1. Step 2 compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination. Significant judgment and estimates are involved in estimating the fair value of the assets and liabilities of the reporting unit. Since none of the reporting units failed step 1, step 2 was not applicable during 2016 testing. The Company monitored events and circumstances during the fourth quarter of 2016, and it determined that there were no triggering events requiring an updated impairment test as of December 31, 2016.

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

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

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

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

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

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

We may also participate in a "mandatory" delivery program for mortgage loans. Under the mandatory delivery system, loans with interest rate locks are paired with the sale of a "to be announced" ("TBA") mortgage-backed security bearing similar attributes. Under the mandatory delivery program, we commit to deliver loans to an investor at an agreed upon price prior to the close of such loans. This differs from a "best efforts" delivery, which sets the sale price with the investor on a loan-by-loan basis when each loan is locked. The Company has not formally designated these derivatives as a qualifying hedge relationship, accordingly, changes to fair value are recorded to earnings each period.

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

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

Insurance commission income is recorded as of the effective date of insurance coverage or the billing date, whichever is later. Contingent commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known.

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

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

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

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

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

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

Advertising costs: Advertising costs are expensed as incurred.

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

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

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

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

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

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

Recent accounting pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers*. The ASU will supersede most of the existing revenue recognition requirements in GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which the Company expects to be entitled in exchange for transferring goods or services to a customer. The new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. The pronouncement is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying the pronouncement recognized at the date of initial application. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The Company is currently evaluating the impact the pronouncement will have on its consolidated financial statements and related disclosures.

In February 2015, the FASB issued 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: (i) modifying the evaluation of limited partnerships and similar legal entities, (ii) amending when fees paid to a decision maker should be included in the variable interest entity analysis, (iii) amending the related party relationship guidance, and (iv) 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, although early adoption was permitted. 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 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 had 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 Accounting Standards Codification 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 adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The ASU was issued in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. The ASU is effective for interim and annual periods beginning after December 15, 2018, using a modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The ASU amends ASC Topic 718, *Compensation – Stock Compensation*. The ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The ASU 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 No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The ASU was issued to change the accounting for credit losses and modify the impairment model for certain debt securities. The ASU is effective for the Company for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the effect that implementation of the new standard will have on its Consolidated Financial Statements.

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

NOTE 2: 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 0.8830 shares of TowneBank common stock. TowneBank issued an aggregate of 10.49 million shares of TowneBank common stock to Monarch stockholders. Based on the closing price of TowneBank's common stock on June 24, 2016, of $21.21 per share, the aggregate consideration paid to Monarch common stockholders to acquire Monarch common stock was approximately $222.44 million.

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

The Monarch merger has been accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the June 24, 2016, merger date. Such fair values were preliminary estimates and were subject to adjustment for up to one year after the merger date or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. The application of the acquisition method of accounting resulted in goodwill of approximately $108.05 million. All of the recognized goodwill is expected to be non-deductible for tax purposes.

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

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

During the year ended December 31, 2016, adjustments were made to the purchase price allocations that resulted in a decrease to the initial fair value estimate of loans of $9.98 million, an increase in deferred tax assets of

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

The loans acquired in the Monarch merger were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 (purchased impaired), and loans that do not meet this criteria, which are accounted for under ASC 310-20 (purchased performing). As of June 24, 2016, as revised for measurement period adjustments, the 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 $18.47 million of acquisition-related expenses for the year ended December 31, 2016. The pro forma earnings for the year ended December 31, 2015, were adjusted to include these expenses. The pro forma information is intended for informational purposes only and is not necessarily indicative of our future operating results or operating results that would have occurred had the Monarch acquisition been completed at the beginning of 2015. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies, or asset dispositions.

(in thousands)	Pro Forma for the Year Ended December 31, 2016	Pro Forma for the Year Ended December 31, 2015
Revenues (net interest income plus noninterest income)	$ 439,240	$ 431,455
Net income	$ 79,956	$ 62,512

Oak Island Accommodations, Inc.: Effective January 14, 2016, the Company acquired Oak Island Accommodations, Inc. (“Oak Island”), an independent resort property management company that was merged with the operations of Towne Vacations Oak Island, LLC, a division of TowneBank’s Realty segment. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing January 14, 2016. The purchase price for the transaction was $5.52 million in cash. The allocation of the purchase price resulted in tangible assets of $0.36 million, goodwill of $1.58 million, and other intangible assets of $3.58 million.

Insurance Agencies: Effective October 1, 2015, the Company acquired two insurance agencies, SIFA Corporation d/b/a B.H. Baird Insurance Agency and Invincia Corporation, which were merged with the operations of Towne Insurance Agency ("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 common stock, and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of $0.06 million, goodwill of $1.0 million, and other intangible assets of $0.39 million.

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

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

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

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

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

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

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

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

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

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

The Company's operating results for the year ended December 31, 2015 include the results from the operations acquired in the Franklin transaction since January 2, 2015. Franklin's operations contributed approximately $31.73 million in total revenue (net interest income plus noninterest income) and an estimated $13.26 million in net income for the period from the acquisition date. Acquisition-related expenses of $0.49 million and $3.99 million were recorded in the Consolidated Statements of Income for the years ended December 31, 2015 and 2014, respectively.

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

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

Beach Properties of Hilton Head: Effective October 1, 2014, the Company acquired Beach Properties of Hilton Head, Inc., an independent resort property management company that was merged with the operations of Towne Vacations, 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 October 1, 2014. The purchase price for the transaction was $8.60 million in cash and common stock. The allocation of the purchase price resulted in tangible assets of $3.53 million, goodwill of $1.52 million, other intangible assets including customer lists of $5.47 million, and assumed liabilities of $1.88 million.

Southern Insurance Agency: Effective May 1, 2014, the Company acquired Southern Insurance Agency, Inc., which is affiliated with Towne Insurance. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing May 1, 2014. The purchase price for the transaction was $11.81 million in cash, common stock, and contingent common stock consideration. The allocation of the purchase price resulted in tangible assets of $1.22 million, goodwill of $7.14 million, other intangible assets including customer lists of $3.90 million, and assumed liabilities of $0.45 million.

Excluding Monarch and Franklin, the acquisitions, when considered individually or in aggregate under relevant disclosure guidance, do not require the presentation of separate pro forma financial information.

NOTE 3: INVESTMENT SECURITIES

Available-for-sale securities

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

December 31, 2016

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

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

For the year ended December 31, 2016, there were no proceeds from sales of securities available for sale. For the year ended December 31, 2015, proceeds from sales of securities available for sale amounted to $414.14 million and resulted in gross realized gains of $0.91 million and gross realized losses of $2,000. For the year ended December 31, 2014, the Company had proceeds from sales of securities available for sale in the amount of $1.86 million, resulting in gross realized gains of $45,000 gross realized losses of $60,000.

Held-to-maturity securities

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

December 31, 2016

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

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) in the following tables (in thousands):

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

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

Pledged securities

At December 31, 2016 and 2015, the Company had investment securities with market values of $226.13 million and $210.65 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the Federal Reserve Bank of Richmond ("FRB") at December 31, 2016 or 2015. The Company also had $42.01 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2016, compared to $50.34 million at December 31, 2015.

Unrealized losses

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

December 31, 2016	Less than 12 months		12 months or more		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 241,582	$ (1,297)	$ —	$ —	$ 241,582	$ (1,297)
Municipal securities	12,176	(134)	—	—	12,176	(134)
Mortgage-backed securities issued by GSE	230,504	(4,897)	5,122	(102)	235,626	(4,999)
Total temporarily impaired securities	$ 484,262	$ (6,328)	$ 5,122	$ (102)	$ 489,384	$ (6,430)

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 securities	—	—	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 agency securities

At December 31, 2016, 22 securities had unrealized losses of $1.30 million. The Company's unrealized losses on U.S. government agency securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

At December 31, 2016, 17 securities had unrealized losses of $0.13 million. The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

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

At December 31, 2016, 36 securities experienced a total unrealized loss of $5.0 million. The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because our mortgage-related securities are backed by FNMA and FHLMC, which are GSEs, or are collateralized by securities backed by these agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Trust preferred and other corporate securities

At December 31, 2016, the Company had no unrealized losses on corporate securities.

Other investments, including common stock

At December 31, 2016, the Company had no unrealized losses in other investments or common stocks.

FHLB stock

The Company is required to maintain an investment in the capital stock of the FHLB. The FHLB stock is stated at cost, as this is a restricted security without a readily determinable fair value. The Company had $35.94 million and $23.69 million of FHLB stock at December 31, 2016 and 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.

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

December 31,	**2016**	**2015**
Real estate loans		
1-4 family residential	$ 1,215,823	$ 973,331
Commercial	2,251,312	1,784,393
Construction and land development	826,027	598,875
Multifamily	222,791	167,371
Total real estate loans	4,515,953	3,523,970
Commercial and industrial business	1,089,539	857,036
Consumer loans and other	201,729	138,387
Loans, net of unearned income and deferred costs	$ 5,807,221	$ 4,519,393

Unearned loan income was $4.02 million in excess of deferred loan costs at December 31, 2016, $2.86 million at December 31, 2015, and $2.57 million at December 31, 2014. There were $13.10 million, $8.67 million, and $6.74 million in nonaccrual loans at December 31, 2016, 2015, and 2014, respectively. The Company would have earned $0.18 million in 2016, $0.13 million in 2015, and $0.17 million in 2014 if interest on the loans had been accrued. Of total loans, $1.22 billion was pledged as collateral to secure overnight borrowings with the FHLB, and $65.34 million was pledged to secure borrowings from the discount window at the FRB at December 31, 2016.

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 $42.0 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2016. The following table presents, by portfolio segment, the changes in the allowance for loan losses for the years ended December 31, 2016, 2015, and 2014 (in thousands):

December 31, 2016	**Construction and Land Development**	**Commercial Real Estate**	**Multi-Family Real Estate**	**1-4 Family Residential Real Estate**	**Commercial and Industrial Business**	**Consumer Loans and Other**	**Total**
Allowance for loan losses:							
Balance, beginning of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359
Provision charged to expense	(707)	1,901	423	792	996	1,952	5,357
Losses charged off	(107)	(399)	—	(1,448)	(481)	(459)	(2,894)
Recoveries	110	59	2	716	121	171	1,179
Balance, end of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
December 31, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917
Provision charged to expense	(549)	496	277	676	440	1,687	3,027
Losses charged off	(208)	(279)	—	(1,443)	(122)	(109)	(2,161)
Recoveries	80	244	1	636	493	122	1,576
Balance, end of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359
December 31, 2014							
Allowance for loan losses:							
Balance, beginning of year	$ 7,925	$ 13,621	$ 699	$ 10,730	$ 4,711	$ 694	$ 38,380
Provision charged to expense	(1,837)	1,318	414	(797)	554	840	492
Losses charged off	(561)	(1,165)	(493)	(1,473)	(432)	(415)	(4,539)
Recoveries	134	452	47	661	130	160	1,584
Balance, end of year	$ 5,661	$ 14,226	$ 667	$ 9,121	$ 4,963	$ 1,279	$ 35,917

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

December 31, 2016	**Construction and Land Development**	**Commercial Real Estate**	**Multi-Family Real Estate**	**1-4 Family Residential Real Estate**	**Commercial and Industrial Business**	**Consumer Loans and Other**	**Total**
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 61	$ 1,078	$ 13	$ 1,384	$ 71	$ 14	$ 2,621
Loans collectively evaluated for impairment	4,179	15,102	1,357	7,473	6,339	4,629	39,079
Loans acquired with deteriorated credit quality	40	68	—	193	—	—	301
Balance, end of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
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 (in thousands):

December 31, 2016	**Construction and Land Development**	**Commercial Real Estate**	**Multi-Family Real Estate**	**1-4 Family Residential Real Estate**	**Commercial and Industrial Business**	**Consumer Loans and Other**	**Total**
Ending balance: individually evaluated for impairment	$ 18,923	$ 31,586	$ 1,507	$ 21,128	$ 3,247	$ 348	$ 76,739
Ending balance: collectively evaluated for impairment	797,575	2,186,027	205,551	1,163,958	1,084,620	201,381	5,639,112
Ending balance: loans acquired with deteriorated credit quality	9,529	33,699	15,733	30,737	1,672	—	91,370
Ending Balance	$ 826,027	$ 2,251,312	$222,791	$ 1,215,823	$ 1,089,539	$ 201,729	$ 5,807,221
December 31, 2015							
Ending balance: individually evaluated for impairment	$ 9,566	$ 13,627	$ 731	$ 13,286	$ 496	$ 78	$ 37,784
Ending balance: collectively evaluated for impairment	582,901	1,740,467	150,282	930,185	856,540	138,309	4,398,684
Ending balance: loans acquired with deteriorated credit quality	6,408	30,299	16,358	29,860	—	—	82,925
Ending Balance	$ 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 years ended December 31, 2016 and 2015 (in thousands):

	December 31, 2016	December 31, 2015
Balance at beginning of period	$ 43,959	$ 2,107
Additions	2,207	45,755
Accretion	(6,595)	(7,377)
Reclassifications from nonaccretable balance, net	3,761	3,182
Other changes, net	(2,865)	292
Balance at end of period	$ 40,467	$ 43,959

At December 31, 2016, none of the purchased impaired loans were classified as nonperforming assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased loans. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses.

Portfolio Quality Indicators

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

The Company's internally assigned grades are as follows:

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

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

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

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

The following tables represent consumer credit exposures by internally assigned grades for the years ended December 31, 2016 and 2015 (in thousands):

December 31, 2016	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Pass	$ 802,941	$ 2,204,051	$ 221,284	$ 1,191,410	$ 1,083,798	$ 201,406	$5,704,890
Special Mention	5,327	16,944	—	2,405	1,866	—	26,542
Substandard	17,759	30,317	1,507	22,008	3,795	323	75,709
Doubtful	—	—	—	—	80	—	80
Total	$ 826,027	$ 2,251,312	$ 222,791	$ 1,215,823	$ 1,089,539	$ 201,729	$5,807,221

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

Age Analysis of Past-Due Financing Receivables by Class

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

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

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

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

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
December 31, 2016						
Construction and land development	$ —	$ —	$ 396	$ 396	$ 9,133	$ 9,529
Commercial real estate	—	346	19	365	33,334	33,699
Multifamily real estate	—	—	—	—	15,733	15,733
1-4 family residential real estate	902	—	1,158	2,060	28,678	30,738
Commercial and industrial business loans	205	75	4	284	1,387	1,671
Consumer loans and other	—	—	—	—	—	—
Total	$ 1,107	$ 421	$ 1,577	$ 3,105	$ 88,265	$ 91,370

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
December 31, 2015						
Construction and land development	$ —	$ —	$ 386	$ 386	$ 6,022	$ 6,408
Commercial real estate	59	1	—	60	30,239	30,299
Multifamily real estate	—	—	—	—	16,358	16,358
1-4 family residential real estate	372	206	895	1,473	28,387	29,860
Commercial and industrial business loans	—	—	—	—	—	—
Consumer loans and other	—	—	—	—	—	—
Total	$ 431	$ 207	$ 1,281	$ 1,919	$ 81,006	$ 82,925

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

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

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

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

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

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

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

December 31, 2014	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	Interest Income Recognized
Loans without a specific valuation allowance					
Construction and land development	$ 9,288	$ 9,043	$ —	$ 9,602	$ 451
Commercial real estate	10,232	9,964	—	10,342	486
1-4 family residential real estate	6,686	6,459	—	6,730	288
Commercial and industrial business loans	572	443	—	578	23
Consumer loans and other	41	41	—	53	4
Total	$ 26,819	$ 25,950	$ —	$ 27,305	$ 1,252
Loans with a specific valuation allowance					
Construction and land development	$ 2,076	$ 1,881	$ 464	$ 2,452	$ 36
Commercial real estate	9,350	9,177	1,177	9,474	377
1-4 family residential real estate	8,077	7,920	1,195	8,141	391
Commercial and industrial business loans	255	231	231	282	13
Consumer loans and other	—	—	—	—	—
Total	$ 19,758	$ 19,209	$ 3,067	$ 20,349	$ 817
Total impaired loans					
Construction and land development	$ 11,364	$ 10,924	$ 464	$ 12,054	$ 487
Commercial real estate	19,582	19,141	1,177	19,816	863
1-4 family residential real estate	14,763	14,379	1,195	14,871	679
Commercial and industrial business loans	827	674	231	860	36
Consumer loans and other	41	41	—	53	4
Total	$ 46,577	$ 45,159	$ 3,067	$ 47,654	$ 2,069

Included in the table above are accruing TDRs of $38.42 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $2.50 million.

Troubled Debt Restructurings

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

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

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

	Year Ended December 31, 2015		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial real estate	1	$ 468	$ 468
Multifamily real estate	1	755	742
1-4 family residential real estate	15	1,352	1,334
Commercial and industrial	1	21	20
Consumer loans and other	1	3	3
Total	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 relationship consisting of five commercial loans, which totaled $1.52 million, was restructured within the last 12 months and subsequently defaulted.

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

Nonaccrual Loans

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

NOTE 5: OTHER REAL ESTATE OWNED

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

	Year Ended December 31,	
	2016	2015
Beginning balance	$ 34,420	$ 35,115
Additions and capital improvements	7,657	18,202
Franklin merger	(234)	15,807
Sales	(20,477)	(34,117)
Valuation allowance	(301)	678
Loss on sale and write-downs	(219)	(988)
Transfers (to) from premises and equipment	3,659	(277)
Ending balance	$ 24,505	$ 34,420

NOTE 6: PREMISES, EQUIPMENT, AND LEASES

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

	Useful Life	December 31,	
		2016	2015
Land and improvements	—	$ 34,040	$ 31,467
Buildings and improvements	10 to 45 years	133,362	119,147
Autos	3 to 5 years	5,768	4,426
Computer equipment	2 to 5 years	16,175	12,785
Equipment	5 to 10 years	22,950	16,219
Furniture and fixtures	5 to 20 years	49,071	41,073
Leasehold improvements	Lesser of lease term or 15 years	29,466	21,242
Construction in progress	—	102	322
		290,934	246,681
Less accumulated depreciation		(92,366)	(72,986)
Net premises and equipment		$ 198,568	$ 173,695

Depreciation and leasehold amortization expense for the years ended December 31, 2016, 2015, and 2014 was $13.70 million, $11.72 million, and $10.46 million, respectively.

Various facilities and equipment are leased under noncancellable operating leases with initial remaining terms in excess of one year and an option for renewal. In addition to minimum rentals, certain leases have escalation clauses and include provisions for additional payments to cover taxes, insurance, and maintenance. The effects of scheduled rent increases, which are included in the minimum lease payments, are recognized on a straight-line basis over the lease term. Rental expense was $9.37 million for 2016, compared to $7.57 million for 2015, and $7.64 million for 2014.

Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2016, are listed in the following chart (in thousands):

2017	$ 10,402
2018	8,783
2019	5,736
2020	3,769
2021	2,045
Thereafter	20,592
	$ 51,327

Rental income for the year ended December 31, 2016 was $0.96 million, compared to $0.64 million for 2015, and $0.33 million for 2014. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2016 (in thousands):

2017	$ 744
2018	506
2019	428
2020	351
2021	311
Thereafter	228
	$ 2,568

NOTE 7: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2016		2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 9,818	$ 1,827	$ 1,918	$ 431
Non-compete agreements	2,201	1,407	1,531	1,190
Customer lists	43,291	17,493	34,158	13,148
Trade names	211	169	211	127
Total intangible assets subject to amortization	55,521	20,896	37,818	14,896
Intangible assets not subject to amortization				
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	3,231	—	3,231	—
Total intangible assets	$ 58,752	$ 20,896	$ 41,049	$ 14,896

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2016 was $6.01 million, compared to $3.54 million for 2015, and $2.62 million for 2014. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2016, is as follows: 2017, $6.90 million; 2018, $6.32 million; 2019, $5.54 million; 2020, $4.87 million; and 2021, $4.16 million.

During 2016, the Company recorded $110.07 million in net increases to goodwill and $11.70 million in intangible assets. This represents the acquisitions of Monarch, Oak Island, and an insurance-related book of business. During 2015, the Company recorded $41.68 million in net increases to goodwill and $3.64 million in intangible assets. This represents the acquisitions of Franklin and five insurance agencies, and an insurance-related book of business. The intangible assets acquired are finite-lived, consisting primarily of book-of-business purchases.

No impairment charges were recorded in any year reported. Impairment testing indicated that goodwill was not impaired in 2016, 2015, or 2014. Changes in the carrying amount of goodwill related to each of the Company's segments are as follows (in thousands):

	Bank	Realty	Insurance	Consolidated Totals
Balance, December 31, 2014	$ 58,884	$ 17,340	$ 36,935	$ 113,159
Additions to goodwill	35,435	—	9,589	45,024
Other adjustments	—	(3,341)	—	(3,341)
Balance, December 31, 2015	$ 94,319	$ 13,999	$ 46,524	$ 154,842
Additions to goodwill	100,129	10,263	—	110,392
Other adjustments	465	(767)	(22)	(324)
Balance, December 31, 2016	$ 194,913	$ 23,495	$ 46,502	$ 264,910

NOTE 8: BANK-OWNED LIFE INSURANCE POLICIES

The total carrying amount of bank-owned life insurance policies ("BOLI") as of December 31, 2016 was $189.50 million. The Company had $149.45 million of BOLI at December 31, 2015, and $58.72 million at December 31, 2014. The Company recognized BOLI income, included in other noninterest income, of $5.99 million, $5.19 million, and $2.14 million for the years ended December 31, 2016, 2015, and 2014, respectively. The Company has a related retirement plan, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits. Refer to Note 12 for additional discussions regarding retirement plans.

NOTE 9: DEPOSITS

A summary of time deposits by maturity at December 31, 2016, is shown in the following chart (dollars in thousands):

Maturity	Total
2017	$ 1,009,278
2018	310,735
2019	65,729
2020	46,308
2021 and thereafter	72,330
	$ 1,504,380

At year-end 2016, TowneBank had a total of $407.94 million in no-penalty time deposits as compared to $398.72 million at December 31, 2015. The aggregate amount of time deposits of $250,000 or more was $367.81 million and $390.22 million at December 31, 2016 and 2015, respectively.

Some of the Company's officers and directors, and the respective companies in which the officers and directors have a financial interest, have deposit relationships with the Company. Related party deposits amounted to approximately $82.29 million and $54.76 million at December 31, 2016 and 2015, respectively.

NOTE 10: BORROWINGS

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

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

	2016	2015
Balance outstanding at end of year	$ 687,511	$ 429,080
Average balance outstanding	$ 483,739	$ 424,585
Maximum outstanding at any month-end	$ 687,572	$ 437,697
Average interest rate during the year	2.75%	3.18%
Average interest rate at end of year	2.32%	2.90%

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

Maturity Date	Interest Rate	Call Date	Outstanding Amount
03/06/2017	4.08%	—	$ 100,000
05/18/2017	4.35%	02/21/2017	80,000
05/18/2017	4.48%	02/21/2017	80,000
01/29/2018	3.05%	—	13,000
11/15/2028	3.43%	—	4,955
12/01/2028	2.83%	—	3,556
12/07/2020	0.53%	01/09/2017	74,000
08/29/2019	0.65%	01/30/2017	72,000
11/04/2019	1.26%	—	260,000
			$ 687,511

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

	2016	2015
Balance outstanding at end of year	$ 31,747	$ 37,434
Average balance outstanding	$ 36,088	$ 38,561
Maximum outstanding at any month-end	$ 39,442	$ 39,206
Average interest rate during the year	0.25%	0.15%
Average interest rate at end of year	0.27%	0.16%

Retail repurchase agreements (“REPOs”) totaled $31.75 million at December 31, 2016. 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. Due to the overnight short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily. In addition, federal funds lines with other financial institutions of $140.00 million were available at December 31, 2016, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2016 and 2015, the Company had an unused line of credit with the FHLB totaling $1.60 billion and $1.36 billion, respectively. The FHLB advances are secured by a blanket floating lien on certain 1-4 family residential, multifamily, HELOCS, second mortgages, and commercial mortgages with carrying values of $1.22 billion at December 31, 2016.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2016, which provide potential additional funding.

NOTE 11: COMMITMENTS

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

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

Our contractual amounts are as follows (in thousands):

December 31,	**2016**	**2015**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 2,084,992	$ 1,400,395
Standby letters of credit	84,307	37,198
	$ 2,169,299	$ 1,437,593

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

Standby letters of credit are conditional commitments issued to guarantee performance of a customer to a third party. The letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral supporting those commitments is generally held, if deemed necessary. The Company provides an allowance for estimated losses from such provisions that management considered adequate at December 31, 2016. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

NOTE 12: RETIREMENT PLANS

Defined Contribution Plans

The Company has a defined contribution 401(k) plan. All employees who are at least 18 years of age and have completed one quarter of a year of service are eligible to participate. Under the plan, employees may contribute a percentage of their annual salary, subject to statutory limitations, and the Company will make a discretionary match of the employees' contributions up to 6% of their salary. The Company matched employee contributions up to 3.0% in 2016, 4.2% in 2015, and did not match employee contributions in 2014. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2016, 2015, or 2014. The Company made matching contributions of $3.46 million, $1.19 million, and $0 for the years ended December 31, 2016, 2015, and 2014, respectively.

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

The funds for the non-qualified deferred compensation plan are held in a rabbi trust and invested in certificates of deposit, which are included in other assets on the balance sheet. Changes in the obligation are recorded in compensation expense, which resulted in an increase in expenses of $0.68 million, $0.46 million, and $0.42 million for the years ended December 31, 2016, 2015, and 2014, respectively. The Company did not make matching contributions to the plan for the years ended December 31, 2016, 2015, or 2014.

Retirement Plans

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

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

	SERP		Other Postretirement Benefits	
December 31,	**2016**	**2015**	**2016**	**2015**
Change in benefit obligation				
Benefit obligation, beginning of year	$ 23,970	$ 21,179	$ 843	$ 1,039
Service cost	2,270	1,497	111	3
Interest cost	1,092	874	32	1
Net amortization	217	146	(59)	69
Benefits paid	(469)	(469)	(17)	(22)
Benefit obligation assumed through acquisition	3,699	—	—	—
Prior service cost	—	1,405	—	—
Net actuarial (gain) loss	(489)	(662)	8	(247)
Benefit obligation, end of year	$ 30,290	$ 23,970	$ 918	$ 843
Change in plan assets				
Fair value of plan assets, beginning of year	—	—	—	—
Employer contributions	469	469	17	22
Benefits paid	(469)	(469)	(17)	(22)
Fair value of plan assets, end of year	$ —	$ —	$ —	$ —
Funded status, end of year	$ (30,290)	$ (23,970)	$ (918)	$ (843)
Accumulated benefit obligation, end of year	$ 28,433	$ 22,027	$ 918	$ 843
Amounts recognized in other comprehensive income, pretax				
Prior service cost	$ —	$ 1,405	$ —	$ —
Net actuarial (gain) loss	$ (489)	$ (662)	$ 8	$ (247)

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

	SERP			Other Postretirement Benefits		
	2016	**2015**	**2014**	**2016**	**2015**	**2014**
Service cost	$ 2,270	$ 1,497	$ 3,026	$ 111	$ 3	$ 220
Interest cost	1,092	874	755	32	1	44
Prior service cost	151	—	—	—	—	—
Net amortization	66	146	17	(59)	69	—
Net periodic benefit cost	$ 3,579	$ 2,517	$ 3,798	$ 84	$ 73	$ 264

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

	SERP		Other Postretirement Benefits	
December 31,	**2016**	**2015**	**2016**	**2015**
Prior service cost	$ 1,254	$ 1,405	$ —	$ —
Net actuarial (gain) loss	334	671	(239)	(247)
Deferred tax benefit (expense)	(556)	(726)	83	86
Amounts included in accumulated other comprehensive income, net of tax	$ 1,032	$ 1,350	$ (156)	$ (161)

Pre-tax amounts recorded in accumulated other comprehensive income as of December 31, 2016 that are expected to be recognized as a component of our net periodic benefit cost in 2017 consist of the following:

	SERP	Other Postretirement Benefits
Net actuarial (gain) loss	$ 135	$ (24)
Prior service cost	$ 164	$ —

The Company used certain weighted average assumptions to determine benefit obligations and net benefit costs, including discount rate and rate of increase in future compensation levels. The discount rate used to determine net periodic benefit cost and benefit obligation of the SERP was 4.32% in 2016, 4.32% in 2015, and 4.08% 2014. The rate of increase in future compensation levels used was 4.0% in 2016, 2015, and 2014. The discount rate used to determine net periodic benefit cost and benefit obligation of other postretirement benefits was 4.32% in 2016, 4.32% in 2015, and 4.08% 2014.When estimating the discount rate, we review yields available on high-quality, fixed-income debt instruments and use a yield curve model from which the discount rate is derived by applying the projected benefit payments under the plan to points on a published yield curve.

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

Year	SERP	Other Postretirement Benefits
2017	$ 1,749	$ 32
2018	1,802	34
2019	2,089	36
2020	2,231	55
2021	2,447	58
2022-2026	13,657	340

NOTE 13: SHARE-BASED COMPENSATION

The Company maintains a share-based compensation plan ("Plan") that provides for the granting of incentive and non-statutory stock options and restricted common stock. The Plan is administered by the Compensation Committee of the Board of Directors (the "Compensation Committee"). The maximum number of shares reserved under the Plan is equal to 20% of the fully diluted number of shares of the Company's common stock outstanding, or such lesser number of shares as the Compensation Committee shall determine. The Company has a policy of using authorized and unissued common shares to satisfy share option exercises and vesting of restricted stock awards. At December 31, 2016, approximately 8.92 million common shares were available for issuance under the Plan.

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

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

For the Year Ended December 31,	2016		2015		2014	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
Options outstanding, beginning balance	277,287	$ 17.69	414,005	$ 18.44	514,086	$ 18.43
Granted	—	—	—	—	—	—
Exercised	(125,622)	17.59	(28,690)	17.50	—	—
Expired	(51,500)	20.87	(105,453)	20.68	(96,270)	18.50
Forfeited	(2,575)	14.18	(2,575)	17.96	(3,811)	16.05
Options outstanding, ending balance	97,590	$ 16.24	277,287	$ 17.69	414,005	$ 18.44
Options exercisable at December 31,	66,799	$ 16.51	226,973	$ 18.07	338,781	$ 18.88

	Number of Shares	Weighted-Average Exercise Price
Unvested stock options, December 31, 2015	50,314	$ 15.99
Granted	—	—
Vested	(18,238)	16.71
Forfeited	(1,285)	14.18
Unvested stock options, December 31, 2016	30,791	$ 15.64

For the years ended December 31, 2016, 2015, and 2014, there were no stock options granted. In 2016, the total intrinsic value of options exercised was $1.27 million. In 2015, the total intrinsic value of options exercised was $0.09 million. There were no stock options exercised in 2014. Additional information pertaining to options outstanding at December 31, 2016, is as follows:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	97,590	$ 16.24	$ 1,660,323	1.87
Options vested or expected to vest	96,464	$ 16.25	$ 1,639,904	1.85
Options exercisable	66,799	$ 16.51	$ 1,118,050	1.51

The grant-date fair value of each option grant is estimated using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of the Company's stock over the most recent period of time equal to the expected term of the option. The average expected life was based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior based on historical patterns. The risk-free interest rate is based on the U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. Forfeitures are estimated based on historical voluntary termination behavior.

For the years ended December 31, 2016 and 2015, the tax benefit on cash paid for stock options exercised was $0.45 million and $0.30 million, respectively. There were no exercises of stock options for the year ended December 31, 2014, for which cash was received and, therefore, no tax benefit realized. Compensation expense related to stock options for the years ended December 31, 2016, 2015, and 2014 was $0.07 million, $0.11 million, and $0.16 million, respectively. As of December 31, 2016, there was $0.11 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 2.58 years.

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

The following chart shows a summary of the restricted stock award activity and related information, assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2016:

	Number of Shares	Weighted-Average Price
Unvested RSAs, beginning balance	376,990	$ 15.08
Granted	201,896	21.33
Vested	(117,439)	14.97
Forfeited	(5,062)	17.79
Unvested RSAs, ending balance	456,385	$ 17.84

Compensation expense related to awards for the years ended December 31, 2016, 2015, and 2014 was $2.09 million, $1.81 million, and $1.49 million, respectively. The total fair value of awards vested during 2016, 2015, and 2014 was $1.76 million, $1.51 million, and $1.57 million, respectively. As of December 31, 2016, there was $6.78 million of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 3.75 years.

The Company has a directors' deferred compensation plan whereby the directors may elect to defer up to 100% of their directors' fees. All deferred compensation is invested in the Company's common stock and is held in a rabbi trust. The stock is held in the nominee name of the trustee, and the principal and earnings of the trust are held separate and apart from other funds of the Company, and are used exclusively for the uses and purposes of the deferred compensation agreement. The accounts of the trust have been consolidated in the financial statements of the Company with common stock reported separately in a manner similar to treasury stock (that is, changes in fair value are not recognized) and a corresponding deferred compensation obligation reflected in additional paid-in capital of $11.17 million and $10.17 million at December 31, 2016 and 2015, respectively.

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

The Board of Directors approved and adopted the Member Stock Purchase and Dividend Reinvestment Plan to raise additional capital by providing a convenient and cost-effective way for shareholders, customers, and employees to purchase shares of TowneBank common stock. In connection with the member stock purchase component of the plan for the year ended December 31, 2016, the Company entered the open market and acquired 101,867 shares at an average price of $22.28 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2016, the Company entered the open market and acquired 216,312 shares at an average price of $21.81 per share.

In connection with the member stock purchase component of the plan for the year ended December 31, 2015, the Company entered the open market and acquired 118,823 shares at an average price of $17.60 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2015, the Company entered the open market and acquired 263,453 shares at an average price of $17.13 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In February 2016, the Company declared a quarterly cash dividend of $0.12 per common share. In May, August, and November of 2016, the Company declared quarterly cash dividends of $0.13 per common share. In February 2015, the Company declared a quarterly cash dividend of $0.11 per common share. In May, August, and November of 2015, the Company declared quarterly cash dividends of $0.12 per common share. In February 2014, the Company declared a quarterly cash dividend of $0.10 per common share. In May, August, and November of 2014, the Company declared quarterly cash dividends of $0.11 per common share. The quarterly dividends were paid on April 12, 2013; July 12, 2013; October 11, 2013; January 12, 2014; April 11, 2014; July 11, 2014; October 10, 2014; January 12, 2015; April 10, 2015; July 10, 2015; October 9, 2015; January 12, 2016; April 12, 2016; July 12, 2016; October 12, 2016; and January 12, 2017.

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

Preferred Stock

On September 22, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the U.S. Department of the Treasury (the “U.S. Treasury”), pursuant to which the Company sold and issued 76,458 shares of the Company’s Senior Non-Cumulative Perpetual Preferred Stock, Series C (“Series C Preferred Stock”), for a total purchase price of $76.46 million. The issuance was pursuant to the Small Business Lending Fund program, a $30 billion fund established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets of less than $10 billion.

The holder of the Series C Preferred Stock was entitled to receive non-cumulative dividends, payable quarterly, on January 1, April 1, July 1, and October 1 of each year. The dividend rate could fluctuate on a quarterly basis during the first 10 quarters during which the Series C Preferred Stock was outstanding, based upon changes in the level of “Qualified Small Business Lending” (“QSBL”) by the Company as compared to the Company’s baseline QSBL level, which was established at the closing of the issuance. Due to the Company’s loan growth, the blended rate for the years ended December 31, 2013 and 2014, was 1.0% and remained fixed at that rate through the date of repayment.

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

NOTE 15: OTHER EXPENSES

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

Year Ended December 31,	**2016**	**2015**	**2014**
Advertising and marketing	$ 8,443	$ 7,515	$ 5,178
Acquisition-related expenses	19,111	1,312	4,280
Charitable contributions	4,582	5,193	3,430
Telephone and postage	5,996	4,701	4,184
Outside processing	6,420	4,844	3,631
Professional fees	5,329	5,764	5,178
Other	9,417	6,019	6,260
Stationery and office supplies	2,978	2,479	2,132
Amortization of intangible assets	6,010	3,537	2,623
Foreclosed property expenses	1,335	1,785	3,992
FDIC and other insurance	4,613	4,954	3,885
Software expense	7,116	5,916	4,615
Travel/Meals/Entertainment	2,044	1,452	1,133
Directors' expense	1,371	1,244	1,099
Bank franchise tax/SCC fees	4,184	2,499	2,191
	$ 88,949	$ 59,214	$ 53,811

NOTE 16: REGULATORY CAPITAL REQUIREMENTS

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

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

Risk-based capital ratios, which include common equity tier I, tier I capital, total capital and leverage capital, are calculated based on Basel III regulatory transitional guidance related to the measurement of capital, risk-weighted assets, and average assets. To be categorized as "well-capitalized," the Company must maintain minimum total common equity tier I, tier 1 capital, total capital, and leverage capital ratios as set forth in the table below. Under the FDIC rules, we are considered "well capitalized" as of December 31, 2016.

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

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

As of December 31, 2015	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Common equity tier 1						
(to risk-weighted assets)	$ 649,657	12.59%	$ 232,278	4.50%	$ 335,512	6.50%
Tier 1 capital						
(to risk-weighted assets)	$ 655,337	12.70%	$ 309,703	6.00%	$ 412,938	8.00%
Total risk-based capital						
(to risk-weighted assets)	$ 693,695	13.44%	$ 412,938	8.00%	$ 516,173	10.00%
Tier 1 leverage ratios						
(to average assets)	$ 655,337	10.67%	$ 245,653	4.00%	$ 307,066	5.00%

NOTE 17: FAIR VALUE DISCLOSURES

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

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

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

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

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

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

Derivative Financial Instruments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the years ended December 31, 2016 and 2015, the Company used weighted average fall-out rates of 17.99%, 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 TBA mortgage-backed security under mandatory delivery. The forward sales contracts lock in a price for the sale of loans with similar characteristics to the specific rate lock commitments. The Company has not formally designated these derivatives as a qualifying hedge relationship, accordingly, changes to fair value are recorded to earnings each period. These valuations fall into a Level 2 category.

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

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

	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 GSE	$ —	$ 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 (in thousands):

December 31, 2016	Level 1	Level 2	Level 3	Total
Impaired loans	$ —	$ —	$ 12,097	$ 12,097
Foreclosed property	$ —	$ 20,355	$ 4,150	$ 24,505
December 31, 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 13,858	$ 13,858
Foreclosed property	$ —	$ 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, where available, or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 0.56% to 58.69%, with a weighted average of 14.75%.

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 5.86% to 57.08%, with a weighted average of 9.86%.

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

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

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

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

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

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

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

Repurchase agreements: The carrying amount approximates fair value.

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

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

December 31, 2016	**Carrying Value**	**Estimated Fair Value**	**Level 1**	**Level 2**	**Level 3**
Cash and due from banks	$ 130,967	$ 130,967	$ 130,967	$ —	$ —
Interest-bearing deposits in financial institutions	$ 5,581	$ 5,581	$ 5,581	$ —	$ —
Securities available for sale	$ 812,974	$ 812,974	$ —	$ 812,974	$ —
Securities held to maturity	$ 66,490	$ 68,196	$ —	$ 68,196	$ —
Mortgage loans held for sale	$ 314,117	$ 314,409	$ —	$ 314,409	$ —
Loans, net	$ 5,807,221	$ 5,828,335	$ —	$ —	$ 5,828,335
Interest receivable	$ 20,288	$ 20,288	$ —	$ 20,288	$ —
Deposits	$ 6,035,197	$ 5,468,657	$ —	$ 5,468,657	$ —
Advances from the Federal Home Loan Bank of Atlanta	$ 687,511	$ 687,100	$ —	$ 687,100	$ —
Repurchase agreements and other borrowings	$ 31,747	$ 31,750	$ —	$ 31,750	$ —
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	$ —
Loans, net	$ 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 18. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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):

	December 31, 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	$ 14,923	$ 78	$ —	$ —
Interest rate lock commitments	215,166	2,282	76,815	1,239
TBA mortgage-backed securities	73,500	1,469	—	—
Total included in other assets		$ 3,829		$ 1,239
Included in other liabilities:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 29,881	$ 647	$ —	$ —
Total included in other liabilities		$ 647		$ —

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

	December 31,	
	2016	2015
Interest rate lock commitments	$ (2,407)	$ 293
Forward sales contracts	908	—
	$ (1,499)	$ 293

NOTE 19: VARIABLE INTEREST ENTITIES

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

Low Income Housing Tax Credit Partnerships

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

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $92.44 million and $61.71 million in these partnerships were not included in the Consolidated Balance Sheets at December 31, 2016 and 2015, respectively. These limited partner interests had carrying values of $14.94 million and $16.16 million at December 31, 2016 and 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 $21.02 million and $16.16 million at December 31, 2016 and 2015, respectively. As of December 31, 2016, the Company has $19.92 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 12-month period ended December 31, 2016, a tax benefit totaling $1.38 million, net of amortization of $2.78 million, was recognized as a component of income tax expense.

NOTE 20: INCOME TAXES

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

For the Year Ended December 31,	**2016**	**2015**	**2014**
Current income tax expense			
Federal	$ (24,520)	$ (22,163)	$ (18,778)
State	(1,024)	(1,042)	(547)
Total current tax expense	(25,544)	(23,205)	(19,325)
Deferred income tax (expense) benefit			
Federal	(3,154)	(3,671)	1,146
State	—	—	—
Total deferred income tax (expense) benefit	(3,154)	(3,671)	1,146
Income tax expense	$ (28,698)	$ (26,876)	$ (18,179)

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

	2016		2015		2014	
For the Year Ended December 31,	**$**	**Rate**	**$**	**Rate**	**$**	**Rate**
Federal income tax expense at statutory rate	$ (33,582)	(35.00)%	$ (31,240)	(35.00)%	$ (21,122)	(35.00)%
State income tax expense, net of federal benefit	(666)	(0.69)%	(677)	(0.76)%	(332)	(0.55)%
Tax advantaged income	4,981	5.19 %	3,850	4.31 %	2,760	4.57 %
Tax credits	—	— %	204	0.23 %	222	0.37 %
LIHTC, net of amortization	1,378	1.44 %	1,291	1.45 %	1,152	1.91 %
Franklin Federal capital loss carryforward utilized	—	— %	452	0.51 %	—	—
Section 162(m) disallowance	—	— %	(615)	(0.69)%	(171)	(0.28)%
Merger and acquisition expense	(476)	(0.50)%	(212)	(0.24)%	(534)	(0.88)%
Other	(333)	(0.35)%	71	0.08 %	(154)	(0.26)%
Income tax expense	$ (28,698)	(29.91)%	$ (26,876)	(30.11)%	$ (18,179)	(30.12)%

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management believes it is more likely than not that the Company will realize the benefits of the Company's deferred tax assets.

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

Year Ended December 31,	**2016**	**2015**
Deferred tax assets:		
Allowance for loan losses	$ 14,700	$ 13,426
Stock-based compensation	754	975
Basis differences due to tax credits and partnerships	2,576	335
Other	3,590	3,424
Accrued expenses	3,009	3,408
Retirement plan	11,348	8,545
Unrealized loss on securities available for sale	1,674	972
Deferred compensation	7,103	5,951
Assets acquired in acquisitions	20,189	14,847
Total deferred tax assets	64,943	51,883
Deferred tax liabilities:		
Depreciation	12,270	13,424
Noncompete and intangibles	6,580	2,867
Other	3,028	1,224
Total deferred tax liabilities	21,878	17,515
Net deferred tax assets	$ 43,065	$ 34,368

As of December 31, 2016 and December 31, 2015, the Company did not have any unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next 12 months. The Company recognizes interest and penalties related to unrecognized tax benefits as "Interest Expense" and "Other Expense," respectively, and not as part of the tax provision. The Company did not recognize any interest expense or penalties for the years ended December 31, 2016, 2015, and 2014. Additionally, there were no interest or penalties accrued at December 31, 2016 or 2015. The Company is no longer subject to examination for federal and state purposes for tax years prior to 2013.

NOTE 21: ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the components of accumulated other comprehensive income (loss) at December 31, 2016, 2015, and 2014, and changes during the years then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the consolidated statements of income, while the amounts reclassified from accumulated other comprehensive income for the defined benefit retirement plan are a component of salaries and employee benefits expense on the consolidated statements of income.

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2013	$ (244)	$ (100)	$ (344)
Other comprehensive income (loss) before reclassifications, net of tax	1,560	(778)	782
Amounts reclassified from AOCI, net of tax	9	11	20
Net change	1,569	(767)	802
Balance, December 31, 2014	1,325	(867)	458
Other comprehensive loss before reclassifications, net of tax	(2,620)	(462)	(3,082)
Amounts reclassified from AOCI, net of tax	(510)	140	(370)
Net change	(3,130)	(322)	(3,452)
Balance, December 31, 2015	(1,805)	(1,189)	(2,994)
Other comprehensive loss before reclassifications, net of tax	(1,300)	210	(1,090)
Amounts reclassified from AOCI, net of tax	(4)	102	98
Net change	(1,304)	312	(992)
Balance, December 31, 2016	$ (3,109)	$ (877)	$ (3,986)

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

NOTE 22: LEGAL CONTINGENCIES

Various legal actions arise from time to time in the normal course of our business. There were no significant asserted claims or assessments at December 31, 2016. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2016.

NOTE 23: OTHER RELATED PARTY TRANSACTIONS

Loans are made to the Company's executive officers and directors and their associates during the ordinary course of business. The aggregate amount of loans to such related parties totaled $364.33 million, $258.01 million, and $218.21 million as of December 31, 2016, 2015, and 2014, respectively. During 2016, new advances on all commitments to such parties totaled $433.53 million, additions to loans associated with related parties resulting from the Monarch merger totaled $29.62 million, and repayments amounted to $353.09 million. Included in the loans to related parties, at December 31, 2016, we had $168.81 million in unfunded commitments to extend credit to such related parties.

The Company rents space for various financial centers from companies associated with its directors. Rent expense related to these leases was $2.76 million, $2.44 million, and $2.38 million for the years ended December 31, 2016, 2015, and 2014, respectively.

In the ordinary course of business, the Company acquired certain goods and services from companies associated with its directors and employees, including purchases of automobiles, construction of Company-owned facilities, and maintenance and furnishing of Company facilities. Amounts paid to these companies during the years ended December 31, 2016, 2015, and 2014 approximated $1.67 million, $1.09 million, and $0.77 million, respectively.

NOTE 24: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2016 and 2015, is as follows (in thousands, except per share data):

2016	Fourth	Third	Second	First
Interest income	$ 71,818	$ 71,823	$ 56,241	$ 54,734
Interest expense	9,667	9,218	8,457	8,398
Provision for loan losses	1,831	1,686	2,099	(259)
Noninterest income	39,512	46,821	36,468	32,415
Net gain on investment securities	6	—	—	—
Noninterest expense	72,834	70,933	71,899	52,161
Income before income tax expense and noncontrolling interest	27,004	36,807	10,254	26,849
Income tax expense	7,160	10,974	2,375	8,188
Net income	19,844	25,833	7,879	18,661
Noncontrolling interest	(848)	(1,657)	(1,620)	(842)
Net income attributable to TowneBank	$ 18,996	$ 24,176	$ 6,259	$ 17,819
Net income per common share				
Basic	$ 0.31	$ 0.39	$ 0.12	$ 0.35
Diluted	$ 0.31	$ 0.39	$ 0.12	$ 0.35
Comprehensive income	$ 14,518	$ 25,568	$ 9,467	$ 21,672
Dividends	$ 0.13	$ 0.13	$ 0.13	$ 0.12

2015	Fourth	Third	Second	First
Interest income	$ 54,811	$ 53,987	$ 52,708	$ 51,368
Interest expense	8,480	8,317	7,824	7,812
Provision for loan losses	852	130	1,723	323
Noninterest income	25,079	29,568	32,966	28,767
Net gain on investment securities	—	736	119	49
Noninterest expense	52,743	49,906	49,067	50,440
Income before income tax expense and noncontrolling interest	17,815	25,938	27,179	21,609
Income tax expense	4,846	7,444	8,201	6,385
Net income	12,969	18,494	18,978	15,224
Noncontrolling interest	(503)	(928)	(1,166)	(686)
Net income attributable to TowneBank	$ 12,466	$ 17,566	$ 17,812	$ 14,538
Net income per common share				
Basic	$ 0.24	$ 0.34	$ 0.35	$ 0.29
Diluted	$ 0.24	$ 0.34	$ 0.35	$ 0.29
Comprehensive income	$ 8,939	$ 19,239	$ 16,910	$ 17,125
Dividends	$ 0.12	$ 0.12	$ 0.12	$ 0.11

NOTE 25: SEGMENT REPORTING

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina and includes the operations of TowneBank Commercial Mortgage and Towne Investment Group. The Realty segment combines the operations of Berkshire Hathaway HomeServices Towne Realty with TowneBank Mortgage; Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements; SimonTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; NewTowne Mortgage, LLC; Homesale Mortgage, LLC; Towne Vacations, LLC, d/b/a Beach Properties of Hilton Head; and Towne Vacations Oak Island, LLC, d/b/a Oak Island Accommodations, to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance and 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 businesses, while the Banking segment is driven principally by net interest income.

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

Information about reportable segments and reconciliation of such information to the consolidated financial statements follows (dollars in thousands):

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

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

For the Year Ended December 31, 2014	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 143,999	$ 1,737	$ —	$ 145,736
Provision for loan losses	396	96	—	492
Net interest income after provision for loan losses	143,603	1,641	—	145,244
Residential mortgage banking income, net	(313)	27,492	—	27,179
Real estate brokerage and property management income, net	—	12,634	—	12,634
Insurance commissions and other title fees and income, net	—	1,516	33,042	34,558
Other noninterest income	20,059	1,413	886	22,358
Noninterest expense	107,162	35,546	22,255	164,963
Depreciation and amortization	9,386	1,937	2,578	13,901
Income before income tax, corporate allocation, and noncontrolling interest	46,801	7,213	9,095	63,109
Corporate allocation	1,014	(575)	(439)	—
Income before income tax provision and noncontrolling interest	47,815	6,638	8,656	63,109
Income tax provision	13,098	1,874	3,207	18,179
Net income	34,717	4,764	5,449	44,930
Noncontrolling interest	—	(2,056)	(705)	(2,761)
Net income attributable to TowneBank	$ 34,717	$ 2,708	$ 4,744	$ 42,169
Net income as percentage of total	82.33%	6.42%	11.25%	100.00%
Assets	$ 4,730,447	$ 145,274	$ 106,764	$ 4,982,485
Efficiency ratio	71.18%	83.68%	73.19%	73.76%

The following table provides the change in net income and total assets for each segment, comparing the years ended December 31, 2016 and 2015 (dollars in thousands):

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 1,085	$ 2,560	$ 1,223	$ 4,868
Net Income (%)	2.15%	33.13%	29.73%	7.80%
Total Assets ($)	$ 1,341,548	$ 306,356	$ 29,437	$ 1,677,341
Total Assets (%)	22.39%	174.94%	22.59%	26.64%

NOTE 26: EARNINGS PER SHARE

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

Year Ended December 31,	**2016**	**2015**	**2014**
Basic			
Net income, as reported	$ 67,250	$ 62,382	$ 42,169
Preferred stock dividends and accretion of discount	—	(13)	(765)
Net income available to common shareholders	$ 67,250	$ 62,369	$ 41,404
Average common shares outstanding	56,837,018	51,064,719	35,160,747
Basic earnings per common share	$ 1.18	$ 1.22	$ 1.18
Diluted			
Net income available to common shareholders, for diluted EPS	$ 67,250	$ 62,369	$ 41,404
Average common shares outstanding	56,837,018	51,064,719	35,160,747
Effect of dilutive securities:			
Stock compensation plans, net of tax benefit (1)	146,287	96,522	48,333
Average diluted shares outstanding	56,983,305	51,161,241	35,209,080
Diluted earnings per common share	$ 1.18	$ 1.22	$ 1.18

(1) Stock options and restricted stock shares totaling 80,045; 12,814; and 140,172 were excluded from the computation of diluted earnings per share during 2016, 2015, and 2014, respectively, because their inclusion would be antidilutive.

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

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 24, 2017, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

The Company's Common Stock is listed on the NASDAQ Global Select Market under the symbol TOWN. The following are the quarterly high and low closing sale prices of the Company's common stock for the periods indicated.

	2016		2015	
Quarter	**High**	**Low**	**High**	**Low**
First	$ 20.88	$ 16.65	$ 16.38	$ 14.28
Second	22.64	19.10	17.00	15.66
Third	24.03	21.66	19.23	16.05
Fourth	34.10	23.83	22.51	18.57

INVESTOR RELATIONS

Our Annual Report, Form 10-K, and other corporate publications are available to shareholders on request, without charge, by writing:

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These reports are also available on our website at http://www.townebank.com/investor_relations.

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