FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C. 20429

FORM 10-K

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

For the fiscal year ended December 31, 2018

FDIC Insurance Certificate Number: 35095

TOWNEBANK

(Exact name of registrant as specified in its charter)

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

(757) 638-7500

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

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

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

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐	Smaller reporting company ☐
	Emerging growth company ☐

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

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

The aggregate market value of the common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $2.10 billion.

Number of shares of common stock outstanding at February 21, 2019: 72,464,366 shares

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Registrant's 2018 Annual Report to Shareholders are incorporated by reference into Parts I, II, and IV; and
(2) Portions of the Registrant's 2019 Proxy Statement for its Annual Meeting of Shareholders to be held May 22, 2019 are incorporated by reference into Part III.

TOWNEBANK

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of U.S. federal securities laws. These forward-looking statements speak only as of the date of this report, are based on current expectations, and involve a number of assumptions. These include statements regarding future economic performance, financial condition, prospects, growth, strategies and expectations, and objectives of management, and are generally identified by the use of words such as "believe," "expect," "intend," "anticipate," "estimate," or "project," or similar expressions. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and we are including this statement for purposes of these safe harbor provisions. You should not place undue reliance on forward-looking statements, which are subject to assumptions that are subject to change. Our ability to predict results, or the actual effect of future plans or strategies, is inherently uncertain. These forward-looking statements are subject to a number of factors and uncertainties that could cause actual results to differ from those indicated or implied in the forward-looking statements and such differences may be material. Factors that could have a material effect on our operations and future prospects include but are not limited to: changes in interest rates, general economic and business conditions; legislative/regulatory changes; the monetary and fiscal policies of the U.S. government, including policies of the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System; the quality and composition of the loan and securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in our market area; implementation of new technologies and the ability to develop and maintain secure and reliable electronic systems; changes in the securities markets; changes in accounting principles, policies and guidelines; the ability to identify attractive acquisition targets, complete acquisitions at a reasonable cost, and integrate the operations of acquired businesses; and other risk factors detailed from time to time in filings we make with the Federal Deposit Insurance Corporation. We undertake no obligation to update or clarify these forward-looking statements, whether as a result of new information, future events, or otherwise. For additional information on factors that could materially influence forward-looking statements included in this report, see the risk factors in "Item 1A. Risk Factors" in this report.

Item 1. BUSINESS

Overview

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

PART I

Our foundation was built on providing banking services and, since inception, we have expanded to provide our members with complete residential real estate services, mortgage, personal and commercial insurance services, title-related services for both residential and commercial transactions, employee benefit services, and investment services. We offer a diversified range of financial services through our banking and non-banking subsidiaries. Additionally, through two controlled divisions, we provide investment and asset management services and originate mortgage loans which are sold to investors on the national secondary market. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries.

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

A list of our subsidiaries is included in the 2018 Annual Report to Shareholders ("Annual Report") filed as Exhibit 21, and additional information relating to our business and our subsidiaries is filed as Exhibit 13, hereto and incorporated herein by reference.

Organization

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

Banking Segment. The Banking segment provides loan and deposit services to retail and commercial customers. We also provide commercial mortgage brokerage services and a variety of investment and asset management services.

Realty Segment. The Realty segment provides residential real estate services and originations of a variety of mortgage loans. We also provide resort property management and residential and commercial title insurance.

Insurance Segment. The Insurance segment provides individual and business members with a wide array of insurance products, including life, property, casualty, travel, and vehicle insurance, as well as employee and group benefits.

Operating Philosophy

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

We maintain a "hometown" banking image by providing each Banking Group with its own president, commercial loan officers, and local board of directors who are active and visible in their respective communities. It is the responsibility of each local board, acting under delegated authority of the Company's Board of Directors, to direct

our overall development in their respective markets. The separate Banking Groups, with local decision-making authority, allow us to more effectively identify and respond to the financial needs of our members.

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

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

Services

We provide our members with high-quality, responsive, and technologically advanced services. Members have easy access to our decision-makers and enjoy continuity in service relationships, allowing a fast response to meet their needs. We plan to continue to pursue economically advantageous acquisitions and other strategic opportunities to grow our businesses.

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

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

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

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

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

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

Realty Services. The full spectrum of services offered in our Realty segment allows us to realize certain operational synergies in providing quality residential real estate services, originations of a variety of residential mortgages, and title services for residential and commercial title transactions.

We assist customers with the process of buying or selling a home. Additionally, we also provide other realty-related services, including relocation services for individuals and families, including those in the military; and property management services for single-family homes, condominiums, townhomes, apartments, offices, vacation rentals, and retail establishments. Our vacation rentals business specializes in resort property management, offering vacation rentals with many of the most distinctive resort properties in Hilton Head, South Carolina; McHenry, Maryland; and Oak Island, North Carolina.

TowneBank Mortgage processes residential mortgage loans, from application acceptance to loan closing and funds disbursement. Once finalized, they are packaged and sold principally in the secondary market through purchase commitments from investors that subject us to only *de minimis* market risk. In addition to relocation and property management services, we offer title and settlement services, perform real estate closings for residential properties, and issue title insurance policies for both residential and commercial transactions.

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

Competition

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

There is significant competition within the banking and financial services industry in our market areas. We face competition from other banks, savings institutions, credit unions, consumer finance companies, insurance companies, real estate companies, and other financial institutions in our targeted market areas. Many of our larger competitors have broader geographic markets and substantially greater resources and can offer more diversified products and services. Increasingly, we compete with other companies based on financial technology and capabilities. Competition among providers of financial products and services continues to increase as technology advances have lowered the barriers to entry for financial technology companies, with customers having the opportunity to select from a growing variety of traditional and nontraditional alternatives, including crowdfunding, digital wallets and money transfer services. The ability of non-banking financial institutions to provide services previously limited to commercial banks has intensified competition. Because nonbank financial institutions are not

subject to the same regulatory restrictions as banks and bank holding companies, they can often operate with greater flexibility and lower cost structures.

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

Market Area

Our primary service area is Richmond, Virginia, the Greater Hampton Roads region in southeastern Virginia, northeastern North Carolina, and following our acquisition of Paragon, the Raleigh and Charlotte metropolitan areas in North Carolina to our primary service areas. In Virginia, our service area encompasses the Virginia Beach-Norfolk-Newport News, VA-NC ("Hampton Roads") Metropolitan Statistical Area ("MSA"), the 37th largest metropolitan area in the United States, with a population of approximately 1.73 million as of July 2017, and the Richmond, VA ("Richmond") MSA, the 44th largest metropolitan area in the United States, with a population of approximately 1.29 million as of July 2017. In North Carolina, our service area now encompasses the Raleigh, North Carolina MSA, the 43rd largest metropolitan area in the United States, with a population of approximately 1.34 million as of July 2017 and includes the counties of Cabarrus, Gaston, Mecklenburg and Union (part of the Charlotte, North Carolina MSA), the 22nd largest metropolitan area in the United States, with a population of approximately 2.52 million as of July 2017.

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

Concentrations

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

Governmental Monetary Policies

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

These actions have a significant effect on the overall growth and distribution of loans, investments, and deposits, as well as rates earned on loans or paid on deposits. Federal Reserve monetary policies have had a significant effect

on the operating results of commercial banks in the past and are expected to do so in the future. Management is unable to predict the effect of possible changes in monetary policies upon our future operating results.

Development of Business

The following is a summary of developments in our business since January 1, 2018:

- Effective January 26, 2018, the Company completed its acquisition of Paragon and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices servicing Raleigh, Cary, and Charlotte, North Carolina. The Company acquired approximately $1.43 million in loans and assumed approximately $1.25 billion in deposits.

- Effective May 15, 2018, the Company acquired Michael R. Bare, LLC, an independent insurance agency, which was merged into the operations of TowneInsurance Agency, LLC, a wholly owned subsidiary of TowneBank.

- Effective November 6, 2018, the Company acquired Middle Peninsula Insurance Agency, Inc., an independent insurance agency, which was merged into the operations of TowneInsurance Agency, LLC.

- Effective January 1, 2019, the Company acquired Straus, Itzkowitz & LeCompte Insurance Agency, Inc., an independent insurance agency, which was also merged into the operations of TowneInsurance Agency, LLC.

- Effective February 19, 2019, we opened a banking office in Greenville, North Carolina. We have also received regulatory approval to open a banking office in Greensboro, North Carolina and anticipate its opening during the first quarter of 2019.

- TowneBank remained in first place, ahead of Wells Fargo, Bank of America, SunTrust, and BB&T, in the latest Hampton Roads Annual Deposit Market Share Report released by the FDIC. The report ranks institutions by share of FDIC-insured deposits in the Hampton Roads MSA as of June 30, 2018. TowneBank had a 22.29% share of deposits in Hampton Roads and was the only community bank with a share greater than 5%. TowneBank was in seventh place in the Richmond MSA in the FDIC's Annual Deposit Market Share Report with $860.27 million in deposits as of June 30, 2018.

Prior to 2018, our most recent acquisitions included the following:

- On June 24, 2016, TowneBank acquired Monarch Financial Holdings, Inc., and its wholly owned bank subsidiary, Monarch Bank, headquartered in Chesapeake, Virginia. The acquisition added approximately $808.14 million in loans and assumed approximately $1.06 billion in deposits.

- On January 2, 2015, TowneBank acquired Franklin Financial Corporation and its wholly owned subsidiary, Franklin Federal Savings Bank, based in Richmond, Virginia. The acquisition added eight office locations, approximately $491.96 million in loans, and assumed approximately $682.95 million in deposits.

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

Supervision and Regulation

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

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

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

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

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

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

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

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer will face limitations on the payment of dividends, common stock repurchases, and discretionary cash payments to executive officers based on the amount of the shortfall and the institution's "eligible retained income" (four quarter trailing net income, net of distributions and tax effects not reflected in net income).

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

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

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

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

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

In September 2017, the federal bank regulators proposed to revise and simplify the capital treatment for certain deferred tax assets, mortgage servicing assets, investments in non-consolidated financial entities and minority

interests for banking organizations, such as TowneBank, that are not subject to the advanced approaches requirements. In November 2017, the federal banking regulators revised the Basel III Capital Rules to extend the current transitional treatment of these items for non-advanced approaches banking organizations until the September 2017 proposal is finalized.

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

In December 2018, the federal bank regulators issued a final rule that would provide an optional three-year phase-in period for the day-one regulatory capital effects of the adoption of Accounting Standards Update ("ASU") 2016-13 "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," as amended, on January 1, 2020. The impact of this rule on the Company will depend on whether we elect to phase in the impact of the standard. See "Recent accounting pronouncements" contained in Note 1 of the Consolidated Financial Statements for additional information.

At December 31, 2018, we had the following risk-based capital and leverage ratios relative to regulatory minimums.

Ratio	TowneBank	Minimum	Well Capitalized
Common equity Tier 1	11.51%	4.50%	7.00%
Tier 1 risk-based capital	11.54%	6.00%	8.50%
Total risk-based capital	14.83%	8.00%	10.50%
Tier 1 leverage	9.87%	4.00%	5.00%

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

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

The Bureau of Financial Institutions and the FDIC have the general authority to limit dividends paid if such payments are deemed to constitute an unsafe and unsound practice. In particular, Section 38 of the Federal Deposit Insurance Act would prohibit us from making a dividend if we were "undercapitalized" or if such dividend would result in us becoming "undercapitalized."

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

Because our assets exceed $10 billion following the acquisition of Paragon on January 26, 2018, we are subject to the Durbin Amendment promulgated under the Dodd-Frank Act. Under the rule, the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and five basis points multiplied by the value of the transaction. The rules also allow for an upward adjustment of no more than one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. We are expecting this limitation on interchange fees to reduce 2019 noninterest income by approximately $1.50 million beginning in third quarter 2019.

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

The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, which was signed into law on May 24, 2018 (the "EGRRCPA"), amended the Dodd-Frank Act to provide regulatory relief for certain smaller and regional financial institutions. The EGRRCPA, among other things, exempted banks with less than $250 billion in total consolidated assets, such as the Company, from the enhanced prudential standards and the company-run and supervisory stress tests previously required under the Dodd-Frank Act. The amendments to the Dodd-Frank Act are expected to be effective for the Company in November 2019.

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

FDIC Insurance Assessments. Substantially all of our members' deposit accounts are insured up to applicable limits by the Deposit Insurance Fund (the "DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF.

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

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

exceeds certain thresholds. On September 30, 2018, the DIF reserve ratio reached 1.36%, exceeding the statutorily required minimum reserve ratio of 1.35% ahead of the 2020 deadline, and thus surcharges on insured depository institutions with total consolidated assets of $10 billion or more have ceased.

FDIC insurance expense totaled $2.89 million, $2.45 million, and $3.02 million in 2018, 2017, and 2016. FDIC insurance expense includes deposit insurance assessments and Financing Corporation ("FICO") assessments related to outstanding FICO bonds. FICO is a mixed-ownership government corporation established to recapitalize a predecessor to the DIF. The current annualized FICO assessment rate is 0.14 basis points, or 0.035 basis points per quarter. These assessments will continue until the FICO bonds mature in 2019.

Because our total consolidated assets exceed $10 billion, the FDIC uses a performance score and a loss-severity score to calculate our assessment rate. In calculating these scores, the FDIC uses a bank's capital level and regulatory supervisory ratings and certain financial measures to assess an institution's ability to withstand asset-related stress and funding-related stress. The FDIC also has the ability to make discretionary adjustments to the total score based upon significant risk factors that are not adequately captured in the calculations. In addition to ordinary assessments described above, the FDIC has the ability to impose special assessments in certain instances.

Historically, deposit insurance premiums we have paid to the FDIC have been deductible for federal income tax purposes; however, the Tax Cuts and Jobs Act of 2017 ("TCJA") disallows the deduction of such premium payments for banking organizations with total consolidated assets of $50 billion or more. For banks with less than $50 billion in total consolidated assets, such as the Company, the premium deduction is phased out based on the proportion of a bank's assets exceeding $10 billion. The premium expense disallowed in 2018 was insignificant.

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

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

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

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

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

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

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

Volcker Rule. In December 2013, five U.S. financial regulators, including the FDIC, adopted final rules implementing the Volcker Rule. The final rules, which became effective July 2015, prohibit banking entities from (i) engaging in short-term proprietary trading for their own accounts, and (ii) having certain ownership interests in and relationships with hedge funds or private equity funds. The Company has evaluated the impact of the Volcker Rule and does not anticipate that it will have a material effect on our operations, as we do not engage in activities prohibited by the Volcker Rule.

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

Section 956 of the Dodd-Frank Act requires the federal banking agencies and the Securities and Exchange Commission to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at

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

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

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

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

Ability-to-Repay and Qualified Mortgage Rule. Pursuant to the Dodd-Frank Act, the CFPB issued a final rule, amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) the monthly payment on the covered transaction;

(iv) the monthly payment on any simultaneous loan; (v) the monthly payment for mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) the monthly debt-to-income ratio or residual income; and (viii) credit history. Alternatively, the mortgage lender can originate “qualified mortgages,” which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a “qualified mortgage” is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Qualified mortgages that are “higher-priced” (e.g., subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not “higher-priced” (e.g., prime loans) are given a safe harbor of compliance. The Company is predominantly an originator of compliant qualified mortgages.

Tax Reform. On December 22, 2017, the President of the United States signed into law the TCJA. The legislation made key changes to the U.S. tax law, including the reduction of the U.S. federal corporate tax rate from 35% to 21%, effective January 1, 2018. As a result of the reduction in the U.S. corporate income tax rate from 35% to 21% under the TCJA, the Company revalued its ending net deferred tax assets at December 31, 2017 and recognized a provisional $10.11 million tax expense in the Company’s consolidated statement of income for the year ended December 31, 2017. An additional expense of $0.70 million was recognized in 2018 due to the finalization of the provisional component of the TCJA.

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

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

Employees

As of December 31, 2018, we had 2,410 full-time equivalent employees, excluding real estate sales agents. There were 487 real estate sales agents at December 31, 2018. Our real estate agents are independent contractors and not included as our employees. None of our employees are represented by any collective bargaining agreements, and relations with employees are considered good.

Available Information

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

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

Item 1A. RISK FACTORS

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

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

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

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

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

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

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

the interest rate sensitivity of our assets and liabilities, prepayments on our loans and investments, and the mix of our funding sources and assets.

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

Transition away from the benchmark rate London Interbank Offered Rate ("LIBOR") to another benchmark rate could adversely affect operations.

A benchmark rate represents the lowest interest rate an investor or lender will accept for participation in its activity. A significant number of contracts, including lending contracts, hedging contracts, and lease contracts are benchmarked to LIBOR. Additionally, U.S. Generally Accepted Accounting Principles ("GAAP") prescribe the use of LIBOR for valuation methods related to measurements such as fair value, hedging, impairment, and leases. The LIBOR benchmark is the result of the averaging of a series of interest rates at which a specific selection of banks, known as panel banks, are willing to lend to one another. The Financial Conduct Authority ("FCA") is the governing body responsible for collecting the data and providing regulation for the panel banks, which are selected annually by the ICE Benchmark Administration with the assistance for the Foreign Exchange and Money Markets Committee. In July 2017, the FCA announced it would no longer ask for rate submissions from the panel banks after 2021. With the widespread reliance on LIBOR, the transition to another benchmark, which includes activities such as identifying a comparable benchmark, identification and modification of impacted contracts, revision of policies and procedures, and revision of GAAP, is expected to require additional operational costs and resources.

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

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

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

As of December 31, 2018, we had $492.41 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates, or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our financial condition and results of operations.

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

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

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

Reliance on certain external vendors could adversely affect our operations.

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

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

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

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

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

our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Liquidity is essential to our businesses. Due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects third parties or the Company, our liquidity could be impaired by an inability to access the capital markets or an unforeseen outflow of cash or deposits which could constrain our ability to make new loans or meet our existing lending commitments and could ultimately jeopardize our overall liquidity and capitalization.

Our credit ratings are also important to our liquidity. These ratings are based on a number of factors, including our overall financial strength, as well as factors not entirely within our control, such as conditions affecting the financial services industry generally. As a result, there can be no assurance that we will maintain our current ratings. A reduction in our credit ratings could adversely affect our liquidity and competitive position, increase our borrowing costs or limit our access to the capital markets.

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

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

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

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

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

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

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

We offer a variety of loan products, including residential mortgage, consumer, construction, and commercial loans. At December 31, 2018, approximately 59.26% of loans were commercial loans, including those secured by commercial real estate. It is expected that, as we grow, this percentage will remain fairly constant.

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

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

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

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

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

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

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

In addition, the adoption of ASU 2016-13, as amended, on January 1, 2020 could result in an increase in the allowance for loan losses as a result of changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses for certain debt securities and other financial assets. Although we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date. In December 2018, the federal banking regulators issued a final rule that would provide an optional three-year phase-in period for the day-one regulatory capital effects of the adoption of ASU 2016-13. The impact of this rule on the Company will depend on whether we elect to phase in the regulatory capital effects of the standard. See "Recent accounting pronouncements" contained in Note 1 of the Consolidated Financial Statements for additional information.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Legislative reforms, such as the Dodd-Frank Act, can result in our business becoming subject to significant and extensive additional regulations, which could adversely affect our results of operations and financial condition.

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

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

In July 2013, the FDIC released its interim final rules that implement in the United States the Basel III regulatory capital reforms from the Basel Committee and certain changes required by the Dodd-Frank Act. Under the Basel III Capital Rules, minimum requirements have increased for both the quality and quantity of capital held by banking organizations. Consistent with the international Basel framework, the rules include a new minimum ratio

of CET1 capital to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets that apply to all supervised financial institutions. The rules also, among other things, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. The new rules became effective January 1, 2015. The potential impact of the Basel III Capital Rules includes, but is not limited to, reduced lending and negative pressure on profitability and return on equity due to higher capital requirements. To the extent the Company is required to increase capital in the future to comply with the Basel III Capital Rules, our ability to pay dividends may be reduced.

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

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

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

Extensive government regulation and monetary policy could adversely affect operations.

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

We are subject to additional regulatory scrutiny because our total assets exceed $10 billion.

As of December 31, 2018, we had $11.16 billion in total consolidated assets. The Dodd-Frank Act and its implementing regulations impose various additional requirements on banks with $10 billion or more in total assets, including examination by the CFPB with respect to various federal consumer financial protection laws and regulations. Previously, we were subject to regulations adopted by the CFPB, but the FDIC was primarily responsible for examining our compliance with consumer protection laws and those CFPB regulations.

In addition, because our assets now exceed $10 billion, we are subject to the Durbin Amendment promulgated under the Dodd-Frank Act. Under the Durbin Amendment, the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and five basis points multiplied by the value of

the transaction. The rules also allow for an upward adjustment of no more than one cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. This limitation on interchange fees will adversely impact our results of operations.

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

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

Changes in tax law could increase our effective tax rates. Such changes may be retroactive to previous periods and as a result could negatively affect our current and future financial performance. For example, the TCJA has had, and is expected to continue to have, far-reaching and significant effects on TowneBank, our customers, and the U.S. economy. The ongoing impact, and other actions that we may take as a result, of TCJA will continue as changes in interpretations, guidance or regulations are promulgated. Similarly, our customers are likely to experience varying effects from both the individual and business tax provisions of TCJA and such effects, whether positive or negative, may have a corresponding impact on our business and the economy as a whole.

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

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

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

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

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

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

Part I

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our bank's main office is located in Portsmouth, Virginia, and our Corporate Administration and Member Service Center is located in Suffolk, Virginia; we own both of these locations. As of December 31, 2018, we occupied an additional 149 properties, of which we own 45, in the cities and counties in which we operate. Additional information with respect to the amounts at which company premises and equipment are carried and commitments under long-term leases is set forth in Note 6 - Premises, Equipment, and Leases in the Annual Report and incorporated herein.

Item 3. LEGAL PROCEEDINGS

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

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Part II

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

Market Information

Our common stock is listed on the Nasdaq Global Select Market under the symbol TOWN.

Holders

As of December 31, 2018, we had issued and outstanding 72,465,923 shares of common stock. These shares were held by approximately 11,291 shareholders of record.

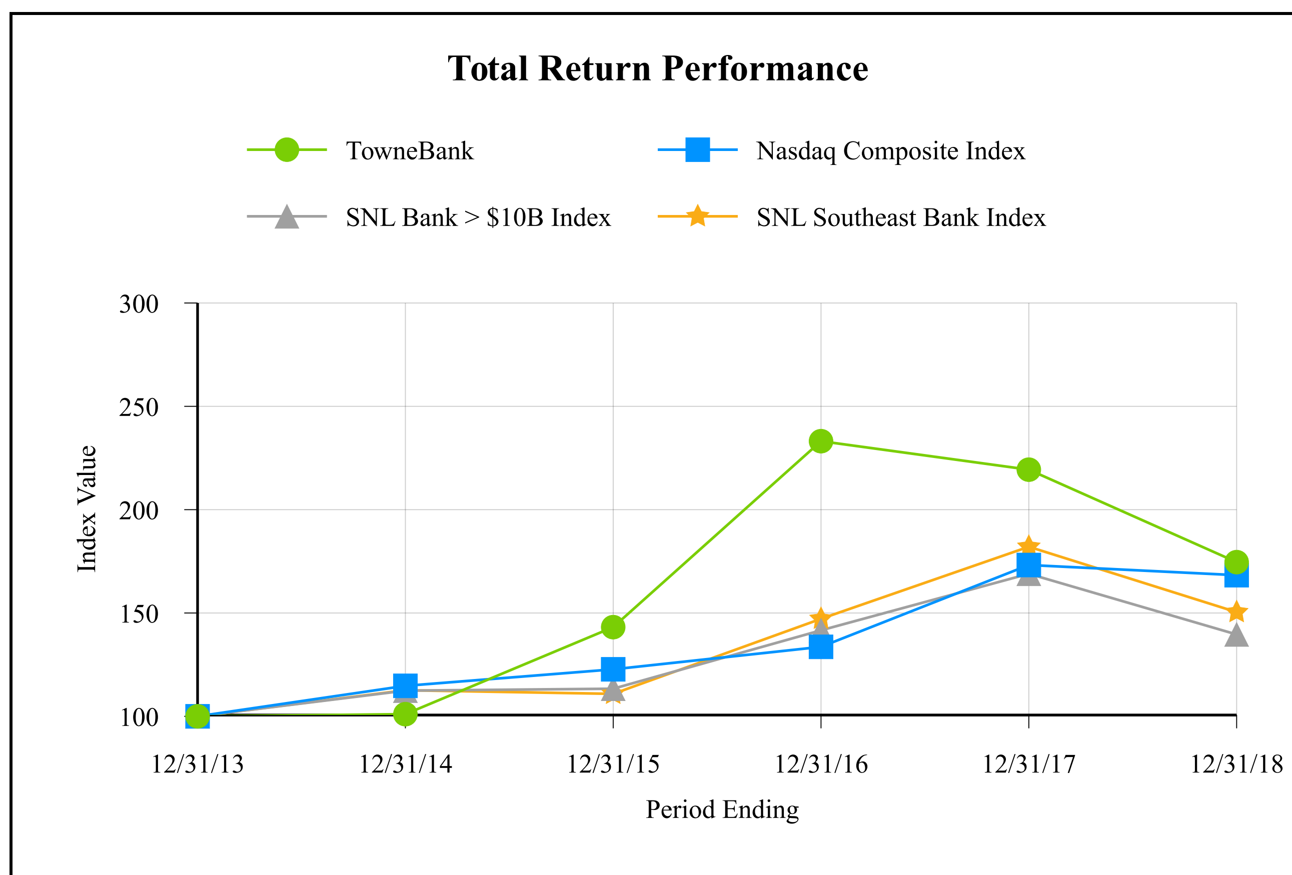
Dividends

In the first quarter of 2017, the Company declared a quarterly cash dividend of $0.13 per common share. In May, August, and November 2017, the Company declared quarterly cash dividends of $0.14 per common share. In the first quarter of 2018, we declared a quarterly cash dividend of $0.14 per common share. Beginning in the second quarter of 2018 through the first quarter of 2019, we declared cash dividends of $0.16 per common share. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory guidelines.

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

Stock Performance Graph

The following stock performance graph presents the cumulative total return comparison through December 31, 2018, of stock appreciation for our common stock, the Nasdaq Composite Index measuring all Nasdaq domestic and international-based common type stocks listed on the Nasdaq Stock Market ("Nasdaq Composite"), the SNL Securities Index including banks greater than $10 billion in total assets ("SNL Bank > $10B Index"), and the SNL Securities Index including only banks in the Southeast ("SNL Southeast Bank Index"). Returns assume an initial investment of $100 at the market close of December 31, 2013, and reinvestment of dividends.



Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
TowneBank	$ 100.00	$ 101.05	$ 143.16	$ 233.14	$ 219.36	$ 174.61
Nasdaq Composite Index	100.00	114.75	122.74	133.62	173.22	168.30
SNL Bank > $10B Index	100.00	112.43	113.36	141.62	168.97	139.61
SNL Southeast Bank Index	100.00	112.63	110.87	147.18	182.06	150.42

Item 6. SELECTED FINANCIAL DATA

Reference is made to the information in the section entitled, "Selected Financial Highlights," of our Annual Report for the year ended December 31, 2018, which is incorporated herein by reference.

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

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

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

None.

Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) was carried out as of December 31, 2018, under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer, and several other members of our senior management. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report.

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

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

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Reference is made to the information in the sections entitled, “Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” and “Board of Directors and Committees: *Audit Committee,”* of our Proxy Statement for the Annual Meeting of Stockholders to be held May 22, 2019 (“Proxy Statement”), which sections are incorporated herein by reference. The following information is provided, as of February 28, 2019, for those executive officers who are not directors.

Name (Age)	Principal Occupation During Past Five Years
W. Jeffrey Dyckman (68)	President of Towne Business Strategy Group since 2009.
Kevin L. Fly (53)	Senior Executive Vice President and Chief Accounting Officer since May 2018; Executive Vice President - Financial Reporting, Tax, and Policy from June 2013 to May 2018; Senior Vice President and Director of Financial Reporting from December 2007 to June 2013.
Dawn Glynn (51)	President, Retail and Private Banking since January 2019; President and Regional Executive Officer for Portsmouth/Chesapeake/Suffolk from 2016 to 2018; President for Portsmouth/Chesapeake/Suffolk from 2013 to 2016; President for Chesapeake from 2010 to 2013.
Keith D. Horton (60)	Senior Executive Vice President and Chief Administrative Officer since January 2005; Executive Vice President of Operations from 1999 to January 2005.
William B. Littreal (48)	Senior Executive Vice President and Chief Financial Officer since March 2018; Senior Executive Vice President and Chief Strategy Officer and Director of Investor Relations since June 2016; Senior Executive Vice President and Chief Operating Officer from April 2011 to June 2016; Executive Vice President and Director of Finance from April 2008 to April 2011.
U. Starr Oliver (67)	Senior Executive Vice President and Chief Marketing and Human Resources Officer since May 2011; Executive Vice President of Marketing and Retail Banking from 1999 to May 2011.
Philip M. Rudisill (53)	Senior Executive Vice President and Chief Credit Officer since July 2011; Senior Executive Vice President of Corporate Administration from March 2006 to May 2011.
Thomas V. Rueger (71)	Senior Executive Vice President since January 2013; President and Chief Executive Officer of SunTrust Bank, Hampton Roads from August 2006 to May 2012.
Brian Skinner (48)	Chief Banking Officer since January 2019; Regional Executive Officer of Peninsula/Williamsburg from 2007 to 2018.
George P. Whitley (66)	Senior Executive Vice President and Chief Legal Officer since October 2016. Partner, LeClairRyan, Richmond, Virginia, from May 1994 to September 2016.

Part III

Code of Ethical Conduct

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

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

Item 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to our definitive proxy statement for our 2019 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

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

The information concerning security ownership of certain beneficial owners and management required by this item is incorporated herein by reference to our definitive proxy statement for our 2019 Annual Meeting of Stockholders to be filed with the FDIC within 120 days of the end of our fiscal year.

The following table summarizes information, as of December 31, 2018, relating to our stock incentive plans, pursuant to which grants of options to acquire shares of common stock may be awarded from time to time.

	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans [1]
	(A)	(B)	(C)
Equity compensation plans approved by security holders	24,737	$14.14	2,187,633
Equity compensation plans not approved by security holders	—	—	—
Total	24,737	$14.14	2,187,633

(1) Consists of shares available for future issuance under TowneBank's equity compensation plans.

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

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

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

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

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

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

(1) ***Financial Statements***

The following documents are included in the 2018 Annual Report to Shareholders and are incorporated by reference in this report:

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

(2) ***Financial Statement Schedules***

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

(3) ***Exhibits***

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

Exhibit No.	Description
1.1	Purchase Agreement, dated July 12, 2017, by and between TowneBank and Sandler O'Neill + Partners, L.P. (incorporated herein by reference to Exhibit 1.1 to our Form 8-K, previously filed with the FDIC on July 14, 2017).
2.1	Agreement and Plan of Reorganization, dated April 26, 2017, by and among TowneBank, TB Acquisition, LLC, Paragon Commercial Corporation and Paragon Commercial Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed with the FDIC on May 2, 2017).
2.2	Agreement and Plan of Reorganization, dated as of December 16, 2015, by and among TowneBank, Monarch Financial Holdings, Inc. and Monarch Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on December 22, 2015).
2.3	Agreement and Plan of Reorganization, dated as of July 14, 2014, by and among TowneBank, Franklin Financial Corporation and Franklin Federal Savings Bank (incorporated herein by reference to Exhibit 2.1 to our Form 8-K, previously filed on July 16, 2014).
3.1	Articles of Incorporation, as amended (incorporated herein by reference to Exhibit 3.1 to our Form 10-Q, previously filed with the FDIC on August 6, 2014).
3.2	Articles of Amendment to the Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to our Form 8-K, previously filed with the FDIC on December 14, 2018).

PART IV

Exhibits continued

3.3	Bylaws, as amended (incorporated herein by reference to Exhibit 3.2 to our Form 8-K, previously filed with the FDIC on January 31, 2018).
4.1	Form of Global 4.50% Subordinated Note due 2027 (incorporated herein by reference to Exhibit 4.1 to our Form 8-K, previously filed with the FDIC on July 17, 2017).
10.2	Employment Agreement, dated October 1, 2005, between TowneBank and Jacqueline B. Amato (incorporated herein by reference to Exhibit 10 to our Form 8-K, previously filed with the FDIC on February 15, 2006).
10.3	Form of Employment Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.5 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).
10.4	Form of Employment Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, and U. Starr Oliver (incorporated herein by reference to Exhibit 10.4 to our 2002 Form 10-K, previously filed with the FDIC on March 26, 2003).
10.5	Form of Change in Control Agreement entered into between TowneBank and each of G. Robert Aston, Jr., J. Morgan Davis, and Philip M. Rudisill (incorporated herein by reference to Exhibit 10.4 to our 2003 Form 10-K, previously filed with the FDIC on February 25, 2004).
10.6	Form of Change in Control Agreement entered into between TowneBank and each of William I. Foster, III, Thomas L. Hasty, III, Keith D. Horton, and U. Starr Oliver (incorporated herein by reference to Exhibit 10.5 to our 2004 Form 10-K, previously filed with the FDIC on February 23, 2005).
10.7	Employment Agreement, dated April 19, 2011, between TowneBank and William B. Littreal (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on April 20, 2011).
10.8	Form of Supplemental Executive Retirement Plan (incorporated herein by reference to Exhibit 10.7 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.9	TowneBank 2008 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.8 to our 2008 Form 10-K, previously filed with the FDIC on March 13, 2009).
10.10	TowneBank Annual Incentive Plan applicable prior to 2017 (incorporated herein by reference to Appendix A to the Proxy Statement for the 2012 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 20, 2012).
10.11	TowneBank 2017 Stock Incentive Plan (incorporated herein by reference to Appendix A to the Proxy Statement for the 2017 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 21, 2017).

PART IV

Exhibits continued

10.12	TowneBank Annual Incentive Compensation Plan (incorporated herein by reference to Appendix B to the Proxy Statement for the 2017 Annual Meeting of Stockholders on Schedule 14A, previously filed with the FDIC on April 21, 2017).
10.13	Amended and Restated Split Dollar Life Insurance Agreement, dated as of August 24, 2016, entered into between TowneBank and the trustees of two separate irrevocable life insurance trusts established by G. Robert Aston, Jr., for the benefit of certain family members (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on August 30, 2016).
10.14	Transition and Consulting Agreement, dated as of November 9, 2016, entered into between TowneBank and Jacqueline B. Amato (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on November 15, 2016).
10.15	Employment Agreement, dated December 16, 2015, by and between TowneBank and Brad E. Schwartz (incorporated herein by reference to Exhibit 10.1 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.16	Employment Agreement, dated December 16, 2015, by and between TowneBank and William T. Morrison (incorporated herein by reference to Exhibit 10.3 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.17	Change in Control Employment Agreement, dated December 16, 2015, by and between TowneBank and Brad E. Schwartz (incorporated herein by reference to Exhibit 10.4 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.18	Change in Control Employment Agreement, dated December 16, 2015, by and between TowneBank and William T. Morrison (incorporated herein by reference to Exhibit 10.6 to our Form 10-Q, previously filed with the FDIC on August 9, 2016).
10.19	Retirement Agreement, dated February 5, 2018, by and between TowneBank and Clyde E. McFarland, Jr. (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on February 9, 2018).
10.20	Consulting Agreement, dated February 5, 2018, by and between TowneBank and Clyde E. McFarland, Jr. (incorporated herein by reference to Exhibit 10.2 to our Form 8-K, previously filed with the FDIC on February 9, 2018).
10.21	Employment and Consulting Agreement, dated April 26, 2017, by and between TowneBank and Robert C. Hatley (incorporated herein by reference to Exhibit 10.21 to our Form 10-K, previously filed with the FDIC on March 1, 2018).
10.22	Securities Purchase Agreement, dated September 22, 2011, between the Company and the Secretary of the U.S. Treasury (incorporated herein by reference to Exhibit 10.1 to our Form 8-K, previously filed with the FDIC on September 23, 2011).
13	2018 Annual Report to Shareholders.
14	Code of Ethical Conduct.
21	Subsidiaries of TowneBank.

PART IV

Exhibits continued

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

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

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

Item 16. FORM 10-K SUMMARY

Not applicable.

SIGNATURES

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

TOWNEBANK

Registrant

March 1, 2019	/s/ J. Morgan Davis
Date	By: J. Morgan Davis President/Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 1, 2019:

SIGNATURES

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

SIGNATURES

/s/ Bradford L. Cherry Bradford L. Cherry	Director
/s/ J. Morgan Davis J. Morgan Davis	President and Chief Executive Officer, Director (principal executive officer)
/s/ Douglas D. Ellis Douglas D. Ellis	Director
/s/ John W. Failes John W. Failes	Vice Chairman of the Board, Director
/s/ Andrew S. Fine Andrew S. Fine	Director
/s/ Kevin L. Fly Kevin L. Fly	Senior Executive Vice President and Chief Accounting Officer (principal accounting officer)
/s/ William I. Foster, III William I. Foster, III	President, Commercial and Real Estate Banking, Director
/s/ Robert C. Hatley Robert C. Hatley	Director
/s/ Howard Jung Howard J. Jung	Director

SIGNATURES

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

SIGNATURES

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

TowneBank

2018 Annual Report

TowneBank

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TOWNEBANK
BUSINESS PROFILE AND CORPORATE MISSION STATEMENT

BUSINESS PROFILE

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

We offer a full range of banking and related financial services through our controlled divisions and subsidiaries. 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.

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.

Insurance Segment. The Insurance segment provides individual and business members with a wide array of insurance products, including life, property, casualty, travel, and vehicle insurance, as well as employee and group benefits.

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

Year Ended December 31,	2018	2017	Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 341,073	$ 261,121	$ 79,952	30.62 %
Noninterest income	191,593	188,121	3,472	1.85 %
Total revenue	532,666	449,242	83,424	18.57 %
Noninterest expenses	352,124	296,214	55,910	18.87 %
Provision for loan losses	8,541	5,426	3,115	57.41 %
Net income attributable to TowneBank	133,793	87,663	46,130	52.62 %
Net income per common share - basic	1.88	1.41	0.47	33.33 %
Net income per common share - diluted	1.88	1.41	0.47	33.33 %
Period End Data:				
Total assets	$ 11,163,030	$ 8,522,176	$ 2,640,854	30.99 %
Total assets - tangible (1)	10,670,620	8,213,357	2,457,263	29.92 %
Earning assets	10,079,846	7,706,747	2,373,099	30.79 %
Loans (net of unearned income and deferred costs)	8,018,233	5,946,965	2,071,268	34.83 %
Allowance for loan losses	52,094	45,131	6,963	15.43 %
Goodwill and other intangibles	492,410	308,819	183,591	59.45 %
Noninterest-bearing deposits	2,622,761	2,157,338	465,423	21.57 %
Interest-bearing deposits	5,747,661	4,290,882	1,456,779	33.95 %
Total deposits	8,370,422	6,448,220	1,922,202	29.81 %
Equity	1,538,420	1,142,505	395,915	34.65 %
Equity - tangible (1)	1,046,010	833,686	212,324	25.47 %
Book value per share	21.05	18.06	2.99	16.56 %
Book value per share - tangible (1)	13.34	13.13	0.21	1.60 %
Cash dividends declared per share	0.62	0.55	0.07	12.73 %
Daily Average Balances:				
Total assets	$ 10,599,185	$ 8,334,999	$ 2,264,186	27.16 %
Total assets - tangible (1)	10,129,664	8,027,381	2,102,283	26.19 %
Earning assets	9,504,755	7,517,473	1,987,282	26.44 %
Loans, excluding nonaccrual loans (net of unearned income)	7,567,571	5,901,797	1,665,774	28.22 %
Allowance for loan losses	48,737	43,760	4,977	11.37 %
Goodwill and other intangibles	469,522	307,618	161,904	52.63 %
Noninterest-bearing deposits	2,517,173	2,094,753	422,420	20.17 %
Interest-bearing deposits	5,314,060	4,248,571	1,065,489	25.08 %
Total deposits	7,831,233	6,343,324	1,487,909	23.46 %
Equity	1,454,795	1,123,588	331,207	29.48 %
Equity - tangible (1)	985,274	815,969	169,305	20.75 %
Key Ratios:				
Return on average assets	1.26%	1.05%	0.21 %	20.00 %
Return on average tangible assets (1)	1.41%	1.15%	0.26 %	22.61 %
Return on average equity	9.20%	7.80%	1.40 %	17.95 %
Return on average tangible equity (1)	14.52%	11.35%	3.17 %	27.93 %
Net interest margin (2)	3.61%	3.51%	0.10 %	2.85 %
Efficiency ratio	66.11%	65.94%	0.17 %	0.26 %
Average earning assets/total average assets	89.67%	90.19%	(0.52)%	(0.58)%
Average loans/average deposits	96.63%	93.04%	3.59 %	3.86 %
Average noninterest deposits/total average deposits	32.14%	33.02%	(0.88)%	(2.67)%
Allowance for loan losses/period end loans	0.65%	0.76%	(0.11)%	(14.47)%
Period end equity/period end total assets	13.78%	13.41%	0.37 %	2.76 %

Notes:

(1) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of Management's Discussion and Analysis for reconciliation.

(2) Presented on a tax-equivalent basis.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Year Ended December 31,	2016	2015	2014
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 218,876	$ 180,442	$ 145,736
Noninterest income	155,222	117,283	96,729
Total revenue	374,098	297,725	242,465
Noninterest expenses	267,828	202,157	178,864
Provision for loan losses	5,357	3,027	492
Net income attributable to TowneBank	67,250	62,382	42,169
Net income per common share - basic	1.18	1.22	1.18
Net income per common share - diluted	1.18	1.22	1.18
Period End Data:			
Total assets	$ 7,973,915	$ 6,296,574	$ 4,982,485
Total assets - tangible (1)	7,671,149	6,115,579	4,846,816
Earning assets	7,346,961	5,827,888	4,610,142
Loans (net of unearned income and deferred costs)	5,807,221	4,519,393	3,564,389
Allowance for loan losses	42,001	38,359	35,917
Goodwill and other intangibles	302,766	180,995	135,668
Noninterest-bearing deposits	1,947,312	1,393,264	1,224,466
Interest-bearing deposits	4,087,885	3,520,763	2,622,136
Total deposits	6,035,197	4,914,027	3,846,602
Equity	1,086,558	820,194	618,276
Equity - tangible (1)	783,792	639,199	482,608
Book value per share	17.20	15.71	14.88
Book value per share - tangible (1)	12.36	12.21	11.09
Cash dividends declared per share	0.51	0.47	0.43
Daily Average Balances:			
Total assets	$ 7,205,236	$ 6,039,418	$ 4,866,584
Total assets - tangible (1)	6,958,267	5,858,762	4,738,306
Earning assets	6,603,377	5,380,881	4,414,274
Loans, excluding nonaccrual loans (net of unearned income)	5,129,990	4,239,887	3,450,730
Allowance for loan losses	39,547	37,194	37,168
Goodwill and other intangibles	246,968	180,656	128,278
Noninterest-bearing deposits	1,720,093	1,343,360	1,158,888
Interest-bearing deposits	3,852,100	3,324,533	2,590,162
Total deposits	5,572,192	4,667,893	3,749,050
Equity	963,775	804,744	606,777
Equity - tangible	716,807	624,088	478,499
Key Ratios:			
Return on average assets	0.93%	1.03%	0.87%
Return on average tangible assets (1)	1.02%	1.10%	0.93%
Return on average equity	6.98%	7.75%	6.95%
Return on average tangible equity (1)	9.93%	10.34%	9.16%
Net interest margin (2)	3.44%	3.39%	3.35%
Efficiency ratio	71.59%	68.11%	73.76%
Average earning assets/total average assets	89.41%	89.10%	90.71%
Average loans/average deposits	92.06%	90.83%	92.04%
Average noninterest deposits/total average deposits	30.87%	28.78%	30.91%
Allowance for loan losses/period end loans	0.72%	0.85%	1.01%
Period end equity/period end total assets	13.63%	13.03%	12.41%

Notes:
(1) Non-GAAP financial measure. See the Non-GAAP Financial Measures section of Management's Discussion and Analysis for reconciliation.
(2) Presented on a tax-equivalent basis.

OVERVIEW

TowneBank is a commercial and retail banking business serving Richmond, Virginia, the Greater Hampton Roads area in southeastern Virginia, and northeastern North Carolina. On January 26, 2018, TowneBank completed its acquisition of Paragon Commercial Corporation ("Paragon"), and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices serving the Raleigh and Charlotte, North Carolina metropolitan areas. The Company acquired approximately $1.43 billion in loans and assumed approximately $1.25 billion in deposits. The Company currently operates in the Raleigh and Charlotte markets under the Paragon brand as "Paragon Bank, a division of TowneBank." We place special emphasis on serving the financial needs of individuals, commercial enterprises, and professionals 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 individual and business members with a wide array of insurance products, including life, property, casualty, travel, and vehicle insurance, as well as employee and group benefits. Through Towne Insurance, we offer a full line of commercial and consumer insurance products and financial services. Through Towne Benefits, we offer health, life, dental, vision, and disability plans to employers, brokers, and individuals. Unless indicated otherwise, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries.

The following is a summary of the Company's 2018 financial performance:

- Net income increased to $133.79 million compared with $87.66 million in 2017. Fully diluted earnings were $1.88 per common share as compared to $1.41 per common share in 2017.

- Net interest income increased $79.95 million or 30.62%, primarily due to an increase in income from loans held for investment and investment securities.

- The provision for loan losses increased by $3.11 million, or 57.41%, from 2017. The loan loss reserve was 0.65% of total loans at December 31, 2018, down from 0.76% at year-end 2017. The increase in the provision for loan losses from the prior year was primarily a result of loan growth in our Paragon Bank division subsequent to our January 2018 acquisition of Paragon. Loan loss reserve as a percentage of total loans, excluding purchased loans was 0.82% and 0.86% at December 31, 2018, and 2017, respectively, which is consistent with continued stability in credit quality.

- Noninterest income increased by $3.47 million, or 1.85%, over 2017. Real estate brokerage and property management income, and insurance commissions were the primary sources of the growth. Insurance commissions income growth was driven by two agency acquisitions in 2018 and organic growth. Fee income increased due to organic growth and the Paragon merger. Residential mortgage brokerage income declined $10.75 million or 14.17%.

- Noninterest expense increased $55.91 million, or 18.87%, compared to 2017. The increase was driven by increased operating expenses related to the January 2018 acquisition of Paragon. Also contributing to the increase were increased operating expenses related to insurance agency acquisitions.

- The effective tax rate decreased to 20.37% in 2018 compared to 38.51% in 2017. The decrease in the rate from the prior year was primarily driven by the reduction of the federal corporate income tax rate from 35% to 21%, effective January 1, 2018, pursuant to the enactment of the Tax Cuts and Jobs Act ("TCJA") in December 2017. The decrease in the rate resulted in an additional net income tax expense of $10.11 million in 2017 primarily related to a revaluation of deferred tax assets at the lower statutory rate. An additional expense of $0.70 million was recognized in 2018 due to the finalization of the provisional component of the TCJA.

MERGER ACTIVITY

On January 26, 2018, the Company completed its acquisition of Paragon, and its wholly owned bank subsidiary, Paragon Commercial Bank, a Raleigh, North Carolina-based bank with three banking offices serving the metropolitan areas of Charlotte and Raleigh, North Carolina. The Company acquired $1.43 billion in loans and assumed $1.25 billion in deposits.

On May 15, 2018, the Company acquired Michael R. Bare, LLC, an independent insurance agency, which was merged into the operations of Towne Insurance Agency, LLC, a wholly owned subsidiary of TowneBank.

On November 6, 2018, the Company acquired Middle Peninsula Insurance Agency, Inc., an independent insurance agency, which was also merged into the operations of Towne Insurance Agency, LLC.

CRITICAL ACCOUNTING POLICIES

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

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

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

In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgments of information available to them at the time of their examination. Although management believes that we use the best information available to evaluate the adequacy of the allowance, unknown market or borrower

circumstances could result in adjustments and net earnings being significantly affected if conditions differ substantially from the assumptions used by management in determining the adequacy of the allowance.

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

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

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

On December 22, 2017, the President of the United States signed into law the TCJA. The legislation significantly changed U.S. tax law by, among other things, lowering corporate income tax rates, implementing a territorial tax system, and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The TCJA permanently reduces the U.S. corporate income tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018. The Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118 to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the TCJA. The Company recognized the provisional tax impact related to the revaluation of deferred tax assets and liabilities and included these amounts in its Consolidated Financial Statements for the year ended December 31, 2017. The Company finalized its analysis of the provisional tax impact and recognized an additional expense in its Consolidated Financial Statements for the year ended December 31, 2018.

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

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

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

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

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

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

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Results of Operations: We reported net income for the years ended December 31, 2018, 2017, and 2016, of $133.79 million, $87.66 million, and $67.25 million, respectively. Diluted earnings per share were $1.88, $1.41, and $1.18 for the years ended December 31, 2018, 2017, and 2016, respectively. In 2018, earnings per share were affected by the issuance of 9.46 million shares of common stock related to the acquisition of Paragon on January 26, 2018 and acquisition related expenses of $7.00 million on an after tax basis. Also, an additional expense of $0.70 million was recognized in 2018 due to the finalization of the provisional component of the TCJA. In 2017, earnings per share were affected by the enactment of the TCJA, which resulted in an additional net income tax expense of $10.11 million, primarily related to a revaluation of deferred tax assets at the lower statutory rate. Earnings per share in 2016 were affected by the issuance of 10.49 million shares of TowneBank common stock related to the acquisition of Monarch Financial Holdings, Inc. ("Monarch") on June 24, 2016. Additionally, earnings in 2016 included acquisition-related expenses of $12.90 million on an after-tax basis.

Profitability, as measured by our return on average assets ("ROA"), was 1.26%, 1.05%, and 0.93% for the years ended December 31, 2018, 2017, and 2016, respectively. Return on average tangible assets was 1.41%, 1.15%, and 1.02% for the same respective periods. Return on average equity ("ROE") was 9.20%, 7.80%, and 6.98% for years ended December 31, 2018, 2017, and 2016, respectively, while return on average tangible equity was 14.52%, 11.35%, and 9.93% for the same respective years.

Our operating income, calculated as net interest income and noninterest income less gains on investment securities, was $532.66 million for the year ended December 31, 2018, compared to $449.24 million and $374.09 million for 2017 and 2016, respectively.

Net Interest Income: Net interest income, the major source of our earnings, is the income generated by interest-earning assets reduced by the total interest cost of the funds incurred to carry them. It is impacted by market interest rates and the mix and volume of earning assets and interest-bearing liabilities. The yields and rates in this discussion and in the following tables have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 21% federal marginal tax rate for 2018 and 35% federal marginal tax rate for all prior periods shown.

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

Net interest income, on a tax-equivalent basis, was $343.31 million for the year ended December 31, 2018, which was $79.32 million, or 30.05%, more than the $263.99 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 Paragon merger coupled with organic growth in earning assets. Accretion of purchase accounting marks added $10.49 million, or 15 basis points, to margin in the current year and added $10.53 million, or 15 basis points, to margin in 2017. This was partially offset by an increase in interest expense due to a merger-related increase in interest-bearing liabilities.

Interest income, on a tax-equivalent basis, was $424.06 million for the year ended December 31, 2018, which was $116.08 million, or 37.69%, greater than the $307.98 million for the year ended December 31, 2017. Average earning assets grew to $9.50 billion in 2018 from $7.52 billion in 2017, an increase of $1.99 billion, or 26.43%. The yield on earning assets was 4.46% in the year ended December 31, 2018, compared to 4.10% in the prior year. Average loan balances, excluding nonaccrual loans of $5.43 million, were $7.57 billion, or 28.22%, higher in 2018 than in 2017, while loan yields increased by 24 basis points. The increase in interest income from the prior year was primarily driven by acquisition-related and organic growth in loans and investment securities, combined with an increase in yields on all earning assets.

Interest expense for the year ended December 31, 2018, increased by $36.77 million, or 83.59%, to $80.75 million, compared to $43.98 million for the year ended December 31, 2017. The balance of average interest-bearing liabilities increased to $6.46 billion in 2018 from $4.98 billion in 2017, an increase of $1.48 billion, or 29.77%. The increase in interest expense as compared to the prior year was primarily due to a merger-driven increase in interest-bearing deposits and an increase in costs related to interest-bearing deposits, combined with a full year of expense related to the issuance of $250.0 million of subordinated notes in July 2017.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.61% in the year ended December 31, 2018, which was 10 basis points higher than the 3.51% a year ago. The margin improvement in comparison to prior year periods was driven by higher earning asset volume combined with accretion of purchase accounting marks and rate increases on earning assets. Partially offsetting the increase were across the board rate increases in interest-bearing liabilities. We expect increases in deposit costs to continue as our deposit product mix changes and increasing competition for deposits puts upward pressure on deposit rates. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

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

	Year Ended December 31,								
	2018			2017			2016		
	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)	$ 7,567,570	$ 373,057	4.93%	$ 5,901,797	$ 276,747	4.69%	$ 5,129,990	$ 234,318	4.57%
Taxable investment securities	1,004,080	24,729	2.46%	600,080	11,597	1.93%	695,082	11,254	1.62%
Tax-exempt investment securities	79,720	2,920	3.66%	48,228	1,590	3.28%	52,689	1,601	3.04%
Interest-bearing deposits	560,368	10,229	1.83%	696,507	7,480	1.07%	300,130	1,145	0.38%
Mortgage loans held for sale	293,017	13,124	4.48%	271,281	10,561	3.89%	264,494	9,152	3.46%
Total earning assets	9,504,755	424,059	4.46%	7,517,893	307,975	4.10%	6,442,385	257,470	4.00%
Less: allowance for loan losses	(48,737)			(43,760)			(39,547)		
Total nonearning assets	1,143,167			860,866			802,398		
Total assets	$10,599,185			$ 8,334,999			$ 7,205,236		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 2,951,038	$ 16,458	0.56%	$ 2,260,378	$ 8,020	0.35%	$ 2,012,061	$ 6,043	0.30%
Savings	302,435	3,824	1.26%	319,940	3,305	1.03%	309,049	2,859	0.93%
Certificates of deposit	2,060,587	32,859	1.59%	1,668,252	17,467	1.05%	1,530,990	13,414	0.88%
Total interest-bearing deposits	5,314,060	53,141	1.00%	4,248,570	28,792	0.68%	3,852,100	22,316	0.58%
FHLB advances and repurchase agreements	897,574	15,542	1.71%	617,720	9,942	1.61%	523,366	13,424	2.56%
Subordinated debt, net	251,097	12,067	4.81%	113,752	5,249	4.61%	—	—	—%
Total interest-bearing liabilities	6,462,731	80,750	1.25%	4,980,042	43,983	0.88%	4,375,466	35,740	0.82%
Noninterest-bearing liabilities									
Demand deposits	2,517,173			2,094,753			1,720,093		
Other noninterest-bearing liabilities	164,486			136,616			145,902		
Total liabilities	9,144,390			7,211,411			6,241,461		
Shareholders' equity	1,454,795			1,123,588			963,775		
Total liabilities and equity	$10,599,185			$ 8,334,999			$ 7,205,236		
Net interest income (tax-equivalent basis)		$ 343,309			$ 263,992			$ 221,730	
Reconcilement of Non-GAAP Financial Measures:									
Tax-equivalent basis adjustment		(2,236)			(2,871)			(2,854)	
Net interest income (GAAP)		$ 341,073			$ 261,121			$ 218,876	
Interest rate spread (3)			3.21%			3.22%			3.18%
Interest expense as a percent of average earning assets			0.85%			0.59%			0.55%
Net interest margin (tax-equivalent basis) (4)			3.61%			3.51%			3.44%
Total cost of deposits			0.68%			0.45%			0.40%

(1) Yields and interest income are presented on a taxable-equivalent basis using the federal statutory tax rate of 21% in 2018 and 35% in 2017 and 2016.
(2) Excludes average nonaccrual loans of $5.43 million in 2018, $10.43 million in 2017, and $10.05 million in 2016.
(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)	2018 vs 2017 Increase (Decrease) Due to Changes In			2017 vs 2016 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	$ 81,500	$ 14,810	$ 96,310	$ 36,051	$ 6,378	$ 42,429
Taxable investment securities	9,330	3,802	13,132	(1,364)	1,707	343
Tax-exempt investment securities	1,137	193	1,330	(141)	130	(11)
Interest-bearing deposits	(1,686)	4,435	2,749	2,546	3,789	6,335
Loans held for sale	890	1,673	2,563	240	1,169	1,409
Total earning assets	91,171	24,913	116,084	37,332	13,173	50,505
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	2,939	5,499	8,438	800	1,177	1,977
Savings	(189)	708	519	104	342	446
Certificates of deposit	4,774	10,618	15,392	1,277	2,776	4,053
Total interest-bearing deposits	7,524	16,825	24,349	2,181	4,295	6,476
FHLB advances and repurchase agreements	4,796	804	5,600	2,126	(5,608)	(3,482)
Subordinated debt	6,591	227	6,818	5,249	—	5,249
Total interest-bearing liabilities	18,911	17,856	36,767	9,556	(1,313)	8,243
Net interest income (tax equivalent basis)	$ 72,260	$ 7,057	$ 79,317	$ 27,776	$ 14,486	$ 42,262

(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 2018, 2017, and 2016 were $8.54 million, $5.43 million, and $5.36 million, respectively. Net charge-offs were $1.58 million, $2.30 million, and $1.72 million for 2018, 2017, and 2016, respectively. The increase in the provision for loan losses in the current year period from the prior year and the increase in 2017 from 2016 was primarily due to loan growth. The allowance for loan losses as a percentage of period-end loans was 0.65% and 0.76% at December 31, 2018 and 2017, respectively. The allowance for loan losses as a percentage of period-end loans, excluding purchased loans, was 0.82% and 0.86% at December 31, 2018 and 2017, 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, 2018, was $191.59 million, or $3.47 million, and 1.85% higher than 2017. Total noninterest income for the year ended December 31, 2017, was $188.12 million, representing a $32.90 million, or 21.19%, increase from 2016. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2018, was 35.97% of total operating income, compared with 41.88% for 2017 and 41.49% for 2016.

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

				2018/2017 Increase/(Decrease)		2017/2016 Increase/(Decrease)	
For the Year Ended December 31,	**2018**	**2017**	**2016**	**Amount**	**%**	**Amount**	**%**
Residential mortgage banking income, net	$ 65,104	$ 75,851	$ 58,792	$ (10,747)	(14.17)%	$ 17,059	29.02 %
Real estate brokerage and property management income, net	31,863	27,487	20,515	4,376	15.92 %	6,972	33.98 %
Insurance commissions and other title fees and income, net	56,164	51,933	46,741	4,231	8.15 %	5,192	11.11 %
Service charges on deposit accounts	11,808	10,594	9,547	1,214	11.46 %	1,047	10.97 %
Credit card merchant fees	5,472	5,008	4,508	464	9.27 %	500	11.09 %
Bank-owned life insurance income	6,836	6,262	5,992	574	9.17 %	270	4.51 %
Other income							
Towne Investment income, net	6,354	4,870	3,246	1,484	30.47 %	1,624	50.03 %
Service fees on loans	2,209	1,629	1,108	580	35.60 %	521	47.02 %
Income from equity method investments	665	838	913	(173)	(20.64)%	(75)	(8.21)%
Commercial mortgage brokerage fees, net	199	202	344	(3)	(1.49)%	(142)	(41.28)%
Other	4,916	3,448	3,510	1,468	42.58 %	(62)	(1.77)%
Total other income	14,343	10,987	9,121	3,356	30.55 %	1,866	20.46 %
Noninterest income before securities gain/(loss)	191,590	188,122	155,216	3,468	1.84 %	32,906	21.20 %
Gain/(loss) on securities available for sale	3	(1)	6	4	(400.00)%	(7)	(116.67)%
Total noninterest income	$ 191,593	$ 188,121	$ 155,222	$ 3,472	1.85 %	$ 32,899	21.19 %

For the year ended December 31, 2018, residential mortgage banking income, net of commission expense, was $65.10 million, reflecting a decrease of $10.75 million, or 14.17%, compared to 2017, which was $17.06 million, or 29.02%, higher than 2016. Production volume declined $334.4 million in 2018, as compared to 2017. Approximately $110.0 million in the production decline was due to the loss of a group of mortgage producers. This one-time loss is expected to have a positive impact on net income in 2019 in the form of lower expenses. Fluctuations in mortgage rates and lower housing inventory levels contributed to the remaining decline. The 2018 change in the value of rate lock commitments and forward contracts recorded had a positive impact on mortgage banking income of $1.15 million, as compared to an increase of $0.33 million in 2017. The increase in residential mortgage banking income, net of commission expense, in 2017 compared to 2016 was primarily due to higher production volumes resulting from a full year of mortgage operations subsequent to the Monarch merger in June 2016. Also factoring into the 2017 variance from the prior period was the increase associated with the change in the value of rate lock commitments and forward contracts recorded in mortgage banking income of $0.33 million in 2017 as compared to a decrease of $1.50 million in 2016. For further information, refer to our discussion of the Realty segment in this Annual Report, which provides a comparative schedule of operations.

Real estate brokerage and property management income, net of commission expense, for the year ended December 31, 2018, was $31.86 million, an increase of $4.38 million, or 15.92%, from 2017, which was $6.97 million, or 33.98%, higher than 2016. The 2018 year-over-year improvement was primarily the result of higher property management fees due to an increase in the number of property units managed. Real estate sales

commissions, net increased $1.47 million in 2018 compared to 2017 on increased sales volume of $140.09 million. The number of units sold totaled 4,864, an increase of 476 units, or 10.85%, from 2017. In 2017, income growth compared to 2016 was attributable to increased property management fees associated with the purchase of Railey Mountain Lake Vacations, LLC ("Railey Mountain") in April 2017, which was merged with Towne Vacations Deep Creek, LLC ("Deep Creek"), combined with a slight increase of $0.16 million in real estate brokerage income.

For the year ended December 31, 2018, insurance commissions and other title income, net of commission expense, was $56.16 million, which was $4.23 million, or 8.15%, higher than comparative 2017. Property and casualty insurance commissions, net of commission expense, increased $3.32 million, driven primarily by 2018 acquisitions. Benefit and travel insurance commissions, net of commission expense, increased $0.93 million in 2018 compared to 2017. The acquired agencies contributed net commission and fee income of $2.03 million in 2018. The year ended December 31, 2018 included contingency and bonus revenue income of $4.89 million, compared to $6.32 million and $4.01 million for 2017 and 2016, respectively. With the adoption of Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* in 2018, we modified the timing for recognizing contingent commission revenue. For more information on the modification, see Note 15, Revenue, in the Notes to Consolidated Financial Statements. When compared to 2016, insurance commissions for the year ended December 31, 2017, were $5.19 million, or 11.11%, higher, largely due to a full year of operations from three insurance agencies acquired in the second half of 2016. The acquired agencies contributed additional net commission and fee income of $3.63 million in 2017. The Company goal is to grow insurance commissions, to $100.00 million over the next three to five years.

Service charges on deposit accounts were $11.81 million for 2018, compared with $10.59 million and $9.55 million for 2017 and 2016, respectively. The increase from prior periods was due primarily, to accounts acquired in the Paragon merger, and organic growth in 2017, as average deposits increased 23.46% and 13.84% in the years ended December 31, 2018 and 2017, respectively.

For the year ended December 31, 2018, credit card merchant fees totaled $5.47 million, which was $0.46 million, or 9.27%, higher than comparative 2017, which was $0.50 million, or 11.09%, higher than 2016. The increase from the prior year was largely due to higher transaction volume. The increase in 2017 from 2016 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. Beginning in third quarter 2019, our fee income will be negatively affected by Federal Reserve Board rules applicable to financial institutions that have assets of $10 billion or more. These rules provide that the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. An upward adjustment of no more than 1 cent to an issuer's debit card interchange fee is allowed if the card issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. We anticipate the impact of this rule will be to reduce fee income by approximately $1.50 million in 2019.

Income from bank-owned life insurance ("BOLI") was $6.84 million in 2018, compared to $6.26 million in 2017 and $5.99 million in 2016. The year-over-year increase was primarily due to higher average BOLI balances.

Other noninterest income for the year ended December 31, 2018 was $14.34 million, compared with $10.99 million for the year ended December 31, 2017, and $9.12 million for the year ended December 31, 2016. Other noninterest income includes income generated by Towne Investment Group and Wealth Management, net of commission expense of $6.35 million, $4.87 million, and $3.25 million for the years ended December 31, 2018, 2017, and 2016, respectively. The increase in Towne Investment Group and Wealth Management income for 2018 was driven by growth in assets under management by existing team members and the efforts of the teams built in

2017. Other contributing factors to the increase in noninterest income were an increase in loan service fees and gains on the sale of OREO. Growth in 2017 from 2016 was due to the increase in income from Towne Investment Group and Wealth Management, combined with an increase in loan service fees, and an increase in income from BOLI policies of $0.57 million.

Noninterest Expense: Total noninterest expense for 2018 was $352.12 million, which was $55.91 million, or 18.87%, higher than 2017. Primary components of 2018 noninterest expense were salaries and employee benefits of $201.84 million, occupancy expenses of $27.64 million, furniture and equipment expenses of $14.48 million, advertising and marketing expenses of $11.19 million, acquisition-related expenses of $8.43 million, amortization of intangibles of $11.71 million, and software expenses of $10.62 million. The primary driver of the increase in total noninterest expense in 2018 from 2017 was expenses related to the January 26, 2018, acquisition of Paragon. Other sources of the increase were two insurance agency acquisitions in 2018 plus a full year of expenses for two companies acquired in 2017. The increase in 2017 compared to 2016 was driven by a full year of operating expenses related to the Monarch acquisition. Additionally, the Railey Mountain acquisition in April 2017 and the W.A. Moore & Company insurance agency acquisition in August 2017 contributed combined additional operational expenses of $6.22 million.

Total noninterest expense to total operating revenue was 66.11% for the year ended December 31, 2018, compared with 65.94% for 2017 and 71.59% for 2016. The following table provides an analysis of noninterest expense (dollars in thousands):

				2018/2017 Increase/(Decrease)		2017/2016 Increase/(Decrease)	
For the year ended December 31,	**2018**	**2017**	**2016**	**Amount**	**%**	**Amount**	**%**
Salaries and benefits	$201,838	$169,449	$142,604	$ 32,389	19.11 %	$ 26,845	18.82 %
Occupancy	27,644	26,855	23,717	789	2.94 %	3,138	13.23 %
Furniture and equipment	14,477	14,072	11,315	405	2.88 %	2,757	24.37 %
Other expenses							
Acquisition-related expenses	8,428	2,268	19,111	6,160	271.60 %	(16,843)	(88.13)%
Advertising and marketing	11,194	9,867	8,443	1,327	13.45 %	1,424	16.87 %
Amortization - intangibles	11,710	7,656	6,010	4,054	52.95 %	1,646	27.39 %
Bank franchise tax/SCC fees	5,647	5,303	4,184	344	6.49 %	1,119	26.74 %
Charitable contributions	5,104	5,550	4,582	(446)	(8.04)%	968	21.13 %
Directors' expense	1,991	1,734	1,371	257	14.82 %	363	26.48 %
FDIC and other insurance	5,047	4,249	4,613	798	18.78 %	(364)	(7.89)%
Foreclosed property expenses	820	782	1,335	38	4.86 %	(553)	(41.42)%
Other	15,275	13,336	10,660	1,939	14.54 %	2,676	25.10 %
Outside processing	10,364	6,975	6,420	3,389	48.59 %	555	8.64 %
Professional fees	8,323	7,144	5,329	1,179	16.50 %	1,815	34.06 %
Stationery and office supplies	3,217	2,730	2,978	487	17.84 %	(248)	(8.33)%
Software expenses	10,621	8,517	7,116	2,104	24.70 %	1,401	19.69 %
Telephone and postage	6,788	6,907	5,996	(119)	(1.72)%	911	15.19 %
Travel/Meals/Entertainment	3,636	2,820	2,044	816	28.94 %	776	37.96 %
Total other expenses	108,165	85,838	90,192	22,327	26.01 %	(4,354)	(4.83)%
Total noninterest expense	$352,124	$296,214	$267,828	$ 55,910	18.87 %	$ 28,386	10.60 %

Salaries and employee benefits, the largest portion of noninterest expense, were $201.84 million, representing 57.32% of total noninterest expense for the year ended December 31, 2018. This was a $32.39 million, or 19.11%, increase over comparative 2017. The Paragon acquisition added $19.39 million in salary expense, while the insurance agency acquisitions added $1.26 million. Additional staffing requirements related to TowneBank exceeding $10.0 billion in assets also contributed to the increase. Salaries and benefits expense for the year ended December 31, 2017, was $169.45 million, up 18.82%, or $26.85 million, over 2016. The increase was primarily due to the addition of staff resulting from the Monarch acquisition. Also, the addition of staff resulting from Insurance and Realty segment acquisitions resulted in an increase of $3.72 million.

In our Banking segment, we had a total of 1,068 full-time equivalent employees ("FTE") at December 31, 2018, which was up from 877 and 848 at December 31, 2017 and 2016, respectively. In our non-Banking segments at December 31, 2018, we had a total of 1,342 FTEs, excluding real estate sales agents, a decrease from 1,436 at December 31, 2017, which had increased from 1,272 at December 31, 2016. Real estate sales agents are independent contractors and, therefore, not included as the Company's employees. There were 487 real estate sales agents at December 31, 2018.

For the year ended December 31, 2018, occupancy expense totaled $27.64 million, representing an increase of $0.79 million, or 2.94%, over comparative 2017. Occupancy expense for 2017 was $3.14 million, or 13.23%, greater than the 2016 amount of $23.72 million. Occupancy expense related to Paragon branches was $1.09 million. Excluding occupancy related to Paragon branches and the acquired insurance agencies, occupancy expense declined $0.39 million. The increases in occupancy expense in 2017 from 2016 was primarily related to a full year of operations of mortgage facilities acquired in the Monarch acquisition, combined with the acquisition of Deep Creek in April 2017.

Furniture and equipment expense was $14.48 million for 2018, or $0.41 million and 2.88% higher than 2017. Furniture and equipment expense was $14.07 million for 2017, or $2.76 million and 24.37% higher than comparative 2016. The increase from 2017 to 2018 was driven by acquisitions. Excluding acquisitions, furniture and equipment expense declined $0.35 million. The increase in 2017 from 2016 was primarily related to a full year of operations of mortgage facilities acquired in the Monarch acquisition.

Other expenses for 2018 were $108.17 million, which was $22.33 million, or 26.01%, greater than the 2017 amount of $85.84 million. The increase from 2017 to 2018 was largely driven by the increase in acquisition costs, primarily related to the Paragon acquisition of $6.16 million, along with increases in software expense of $2.10 million, outside processing fees of $3.39 million, and amortization of intangible assets of $4.05 million. The primary driver of the decrease from 2016 to 2017 was the reduction in acquisition-related expenses of $16.84 million, which was primarily the result of the Monarch acquisition in 2016, combined with decreases in foreclosed property expenses and Federal Deposit Insurance Corporation and other insurance expenses. Partially offsetting the decreases were increases in professional fees of $1.82 million, advertising and marketing expense of $1.42 million, and other expenses of $2.68 million.

Income Taxes: Income taxes for the year ended December 31, 2018, were $34.23 million. This was $20.59 million lower than the 2017 amount of $54.81 million, which was $26.12 million higher than the 2016 amount of $28.70 million. The effective tax rate decreased to 20.37% in 2018 compared to 38.51% in 2017. The decrease in the rate from the prior year was primarily driven by the reduction of the federal corporate income tax rate from 35% to 21%, effective January 1, 2018, pursuant to the enactment of the TCJA in December 2017. The decrease in the rate resulted in an additional net income tax expense of $10.11 million in 2017 primarily related to a revaluation of deferred tax assets at the lower statutory rate. An additional expense of $0.70 million was recognized in 2018 due to the finalization of the provisional component of the TCJA.

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 26, Segment Reporting, in the Notes to Consolidated Financial Statements.

Banking Segment: For the year ended December 31, 2018, the Banking segment represented 89.69%, or $120.00 million, of our total consolidated net income, compared to 83.97% and 76.77% for 2017 and 2016, respectively.

Pre-tax earnings for the year ended December 31, 2018, for the Banking segment were $148.89 million, increasing $30.69 million, or 25.97%, from comparative 2017. The increase in earnings was driven by an $83.19 million, or 29.64%, increase in total revenues, offset by an increase in total expenses of $49.30 million, or 31.03%. The provision for loan loss increased $3.12 million or 57.41%, from 2017 due to portfolio growth while the provision for income tax decreased $15.70 million. This was driven by the reduction of the federal corporate income tax rate from 35% to 21%, effective January 1, 2018, pursuant to the enactment of TCJA.

The increase in net interest income for the year ended December 31, 2018, of $78.58 million, or 31.31%, was primarily a result of additional interest income from an increase in earning assets related to the Paragon merger combined with organic growth and higher yields, as average loan balances increased by $1.67 billion to $7.57 billion and taxable investment securities increased by $0.40 billion to $1.00 billion. The increase was partially offset by additional interest expense of $7.36 million, the majority of which is due to increased costs related to interest-bearing deposits.

The increase in noninterest income of $4.61 million, or 15.56%, was primarily due to a combination of an increase from income generated by Towne Investment Group and Wealth Management, net of commission expense, of $1.48 million, an increase of service charges on deposit accounts of $1.21 million, income from BOLI policies of $0.58 million, and an increase in credit card merchant fees of $0.46 million. Gains and losses from the sale of OREO are carried in noninterest income. In 2018, we had gains on sale of OREO of $0.46 million, compared to losses of $0.53 million in 2017, for a benefit to noninterest income of $0.99 million.

Noninterest expense for the year ended December 31, 2018, increased $49.30 million, or 31.03%, over 2017 driven by expenses related to the acquisition of Paragon. Also impacting expenses were costs associated with additional regulatory and compliance demands due to Company assets exceeding $10.0 billion. Salaries and employee benefits expense increased $28.82 million, or 33.64%, $19.39 million of which was attributable to the acquisition of Paragon. Occupancy expense increased $1.05 million, or 6.39%, and furniture and equipment expense increased $0.51 million, or 5.38%. Merger and acquisition expenses increased $5.69 million and amortization of intangible assets increased $3.37 million in 2018 due to the Paragon merger. Other increases included outside processing expense of $2.83 million, professional fees of $1.44 million and software expense of $1.27 million.

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

The increase in net interest income for the year ended December 31, 2017, of $39.89 million, or 18.90%, was primarily a result of additional interest income from a combination of higher yields and increased earning assets, as average loan balances increased by $0.77 billion to $5.90 billion. The increase was partially offset by additional interest expense of $7.36 million, the majority of which is due to increased costs related to interest-bearing deposits, combined with the issuance of subordinated notes in July 2017.

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

Noninterest expense for the year ended December 31, 2017, decreased $3.49 million, or 2.15%, over 2016. The primary factor resulting in the decrease was a significant reduction in merger and acquisition expenses of $17.14 million, which were higher in 2016 due to the Monarch merger. This reduction was partially offset by an increase in salaries and employee benefits of $7.96 million, or 10.25%, occupancy expense of $0.76 million, or 4.84%, furniture and equipment expense of $0.96 million, or 11.38%, and charitable contributions of $1.04 million, or 24.79%.

The increase in salaries and employee benefits was primarily due to a full year of expense related to the addition of staff resulting from the Monarch acquisition, combined with increases in salaries due to annual salary adjustments. The increase was partially offset by decreased profit sharing accruals. The total increase in occupancy and furniture and equipment expense was primarily a full year of expenses related to the Monarch acquisition combined with a full year of expenses related to a branch opened in September 2016.

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

	Year Ended December 31,			Increase/(Decrease)			
				2018 over 2017		2017 over 2016	
	2018	2017	2016	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 329,584	$ 251,003	$ 211,112	$ 78,581	31.31 %	$ 39,891	18.90 %
Noninterest income							
Service charges on deposit accounts	11,808	10,594	9,547	1,214	11.46 %	1,047	10.97 %
Credit card merchant fees	5,472	5,008	4,508	464	9.27 %	500	11.09 %
Other income	16,833	14,046	11,503	2,787	19.84 %	2,543	22.11 %
Subtotal	34,113	29,648	25,558	4,465	15.06 %	4,090	16.00 %
Gain (loss) on investment securities	147	(1)	6	148	N/M	(7)	N/M
Total noninterest income	34,260	29,647	25,564	4,613	15.56 %	4,083	15.97 %
Total revenue	363,844	280,650	236,676	83,194	29.64 %	43,974	18.58 %
Provision for loan losses	8,541	5,426	5,326	3,115	57.41 %	100	1.88 %
Expenses							
Salaries and employee benefits	114,472	85,654	77,693	28,818	33.64 %	7,961	10.25 %
Occupancy expense	17,410	16,365	15,610	1,045	6.39 %	755	4.84 %
Furniture and equipment	9,912	9,406	8,445	506	5.38 %	961	11.38 %
Amortization of intangible assets	5,658	2,288	1,396	3,370	147.29 %	892	63.90 %
Other expenses	60,697	45,141	59,201	15,556	34.46 %	(14,060)	(23.75)%
Total expenses	208,149	158,854	162,345	49,295	31.03 %	(3,491)	(2.15)%
Income before income tax expense and corporate allocation	147,154	116,370	69,005	30,784	26.45 %	47,365	68.64 %
Corporate allocation	1,736	1,828	1,573	(92)	(5.03)%	255	16.21 %
Income before income tax provision	148,890	118,198	70,578	30,692	25.97 %	47,620	67.47 %
Provision for income tax expense	28,880	44,584	18,923	(15,704)	(35.22)%	25,661	135.61 %
Net income	120,010	73,614	51,655	46,396	63.03 %	21,959	42.51 %
Noncontrolling interest	(8)	1	(28)	(9)	N/M	29	N/M
Net income attributable to TowneBank	$ 120,002	$ 73,615	$ 51,627	$ 46,387	63.01 %	$ 21,988	42.59 %

Realty Segment: For the year ended December 31, 2018, the Realty segment represented 4.80%, or $6.42 million, of our total consolidated net income, compared to 8.39%, or $7.35 million, for 2017, and 15.30%, or $10.29 million, for 2016.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2018, for the Realty segment were $11.71 million, decreasing 30.71% from 2017. Total revenue decreased to $114.02 million in 2018 from $118.04 million in 2017.

Net residential mortgage banking income decreased by $9.55 million to $66.70 million from 2017 primarily as a result of a $334.4 million reduction in production volume. Residential mortgage banking income included an increase in the value of rate lock commitments and forward contracts of $1.15 million in 2018, as compared to an increase of $0.33 million in 2017. In 2019, we are anticipating the competitive landscape, coupled with margin compression and slightly lower mortgage volumes will continue to pressure mortgage banking results.

The increase in property management fees from 2017 was primarily due to increased revenue from additional rental properties. The increase in net interest and other income primarily resulted from a higher balance of average mortgage loans held for sale coupled with higher rates.

Expenses for the Realty segment increased 1.29%, or $1.29 million, when compared to 2017. Outside processing increased $0.64 million, or 36.81% and software expense increased $0.47 million, or 19.35%, when compared to 2017.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2017, for the Realty segment were $16.90 million, decreasing 16.09% from 2016. Total revenue increased to $118.04 million in 2017 from $92.00 million in 2016. Net residential mortgage banking income increased by $16.38 million to $76.25 million from 2016 as a result of a full year of mortgage operations subsequent to the Monarch merger. Residential mortgage banking income included an increase in the value of rate lock commitments and forward contracts of $0.33 million in 2017, as compared to a decrease of $1.50 million in 2016. The increase in property management fees from 2016 was primarily due to increased revenue from our purchase of Railey Mountain in April 2017. The increase in net interest and other income primarily resulted from a higher balance of average mortgage loans held for sale.

Expenses for the Realty segment increased 40.89%, or $29.00 million, when compared to 2016. The increase in expenses was primarily due to a full year of mortgage operation expenses related to the Monarch merger. Also contributing to the increase in expenses over the prior year were additional operating expenses of $5.38 million related to Deep Creek operations.

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

	Year Ended December 31,			Increase/(Decrease)			
				2018 over 2017		2017 over 2016	
	2018	2017	2016	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage banking income, net	$ 66,696	$ 76,245	$ 59,870	$ (9,549)	(12.52)%	$ 16,375	27.35 %
Real estate brokerage income, net	9,458	7,991	7,833	1,467	18.36 %	158	2.02 %
Title insurance and settlement fees	1,877	1,877	1,883	—	— %	(6)	(0.32)%
Property management fees, net	22,405	19,496	12,682	2,909	14.92 %	6,814	53.73 %
Income from unconsolidated subsidiary	370	704	881	(334)	(47.44)%	(177)	(20.09)%
Net interest and other income	13,210	11,725	8,854	1,485	12.67 %	2,871	32.43 %
Total revenue	114,016	118,038	92,003	(4,022)	(3.41)%	26,035	28.30 %
Expenses							
Salaries and employee benefits	58,450	58,586	41,680	(136)	(0.23)%	16,906	40.56 %
Occupancy expense	7,871	8,171	5,989	(300)	(3.67)%	2,182	36.43 %
Furniture and equipment	3,697	3,865	2,113	(168)	(4.35)%	1,752	82.92 %
Amortization of intangible assets	2,782	2,566	1,829	216	8.42 %	737	40.30 %
Other expenses	28,416	26,742	19,318	1,674	6.26 %	7,424	38.43 %
Total expenses	101,216	99,930	70,929	1,286	1.29 %	29,001	40.89 %
Income before income tax, corporate allocation, and noncontrolling interest	12,800	18,108	21,074	(5,308)	(29.31)%	(2,966)	(14.07)%
Corporate allocation	(1,091)	(1,210)	(935)	119	(9.83)%	(275)	29.41 %
Income before income tax provision and noncontrolling interest	11,709	16,898	20,139	(5,189)	(30.71)%	(3,241)	(16.09)%
Provision for income tax	2,892	5,791	6,184	(2,899)	(50.06)%	(393)	(6.36)%
Net income	8,817	11,107	13,955	(2,290)	(20.62)%	(2,848)	(20.41)%
Noncontrolling interest	(2,398)	(3,756)	(3,669)	1,358	(36.16)%	(87)	2.37 %
Net income attributable to TowneBank	$ 6,419	$ 7,351	$ 10,286	$ (932)	(12.68)%	$ (2,935)	(28.53)%

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

	Year Ended December 31,			Increase/(Decrease) 2018 over 2017		Increase/(Decrease) 2017 over 2016	
	2018	2017	2016	Amount	Percent	Amount	Percent
Key data							
Number of units sold	4,864	4,388	4,339	476	10.85 %	49	1.13 %
Volume of units sold	$1,482,919	$1,342,828	$1,270,900	$ 140,091	10.43 %	$ 71,928	5.66 %
Number of real estate agents	411	414	409	(3)	(0.72)%	5	1.22 %
Loans originated, mortgage	$2,114,558	$2,580,913	$2,254,975	$ (466,355)	(18.07)%	$ 325,938	14.45 %
Loans originated, joint ventures	911,475	779,558	647,465	131,917	16.92 %	132,093	20.40 %
Total loans originated	$3,026,033	$3,360,471	$2,902,440	$ (334,438)	(9.95)%	$ 458,031	15.78 %
Number of loans, mortgage	7,656	9,887	8,712	(2,231)	(22.56)%	1,175	13.49 %
Number of loans, joint ventures	4,006	3,561	3,065	445	12.50 %	496	16.18 %
Total number of loans	11,662	13,448	11,777	(1,786)	(13.28)%	1,671	14.19 %
Average loan amount, mortgage	$ 276	$ 261	$ 259	$ 15	5.75 %	$ 2	0.77 %
Average loan amount, joint ventures	228	219	211	9	4.11 %	8	3.79 %
Average loan amount	$ 259	$ 250	$ 246	$ 9	3.60 %	$ 4	1.63 %
Number of originators, mortgage	213	232	246	(19)	(8.19)%	(14)	(5.69)%
Number of originators, joint ventures	80	78	47	2	2.56 %	31	65.96 %
Number of originators	293	310	293	(17)	(5.48)%	17	5.80 %

Mortgage. The loan volume for combined mortgage operations declined during the year ended December 31, 2018, as compared to 2017. Total loans originated in 2018 were $3.03 billion, a 9.95%, or $0.33 billion, decrease from $3.36 billion in 2017, which was a $0.46 billion, or 15.78%, increase compared to the 2016 volume of $2.90 billion. Refinance activity comprised $349.02 million of loan volume for the year ended December 31, 2018, while purchases accounted for the remaining $2.68 billion in loan volume for the year. For the years ended December 31, 2017 and 2016, refinance volume was $532.71 million and $727.09 million, respectively, while purchase volume was $3.04 billion and $2.43 billion, respectively. Home sale inventories have been declining over the past few years while rates have risen from historic lows. Funding cost increases have outpaced the rising rates, creating margin compression. With fewer homes available in the market, competition has increased. Although for the borrower the increase in rates has not been significant, refinance activity has been adversely impacted.

Insurance Segment: The Insurance segment comprises property and casualty and group benefits divisions. The Insurance segment represented 5.51%, or $7.37 million, of our total consolidated net income in 2018 compared to 7.64%, or $6.70 million, in 2017.

Earnings before taxes and noncontrolling interest for the Insurance segment were $11.40 million in 2018, as compared to $12.51 million in 2017. The primary factors affecting earnings were increases in our property and casualty and benefits income related to new agency acquisitions in 2018, offset by decreases in contingent commission and bonus income. There was an increase in total commissions and fees of $7.26 million, or 13.56%, over 2017, and a decrease in contingency and bonus revenue of $1.43 million. This decrease from 2017 was related to a one time accrual made prior to the accounting changes in 2018. With the adoption of ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* in 2018, we modified the timing for recognizing contingent commissions revenue. For more information on the modification, see Note 15, Revenue, in the Notes to Consolidated Financial Statements. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine

the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other things.

Earnings before taxes and noncontrolling interest for the Insurance segment were $12.51 million in 2017, as compared to $10.20 million in 2016. The primary factors affecting earnings were increases in income related to a full year of operations for insurance agencies acquired in 2016 and growth in our travel insurance business.

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

	Year Ended December 31,			Increase/(Decrease) 2018 over 2017		2017 over 2016	
	2018	2017	2016	Amount	Percent	Amount	Percent
Commission and fee income							
Property and casualty	$ 40,948	$ 35,694	$ 33,544	$ 5,254	14.72 %	$ 2,150	6.41 %
Employee benefits	14,088	12,551	11,683	1,537	12.25 %	868	7.43 %
Travel insurance	5,123	4,668	4,374	455	9.75 %	294	6.72 %
Specialized benefit services	673	657	623	16	2.44 %	34	5.46 %
Total commissions and fees	60,832	53,570	50,224	7,262	13.56 %	3,346	6.66 %
Contingency and bonus revenue	4,888	6,322	4,008	(1,434)	(22.68)%	2,314	57.73 %
Other income	295	308	280	(13)	(4.22)%	28	10.00 %
Total revenue	66,015	60,200	54,512	5,815	9.66 %	5,688	10.43 %
Employee commission expense	11,209	9,646	9,124	1,563	16.20 %	522	5.72 %
Revenue, net of commission expense	$ 54,806	$ 50,554	$ 45,388	$ 4,252	8.41 %	$ 5,166	11.38 %
Salaries and employee benefits	28,916	25,209	23,231	3,707	14.71 %	1,978	8.51 %
Occupancy expense	2,363	2,319	2,117	44	1.90 %	202	9.54 %
Furniture and equipment	868	801	758	67	8.36 %	43	5.67 %
Amortization of intangible assets	3,269	2,803	2,784	466	16.63 %	19	0.68 %
Other expenses	7,343	6,298	5,665	1,045	16.59 %	633	11.17 %
Total expenses	42,759	37,430	34,555	5,329	14.24 %	2,875	8.32 %
Income before income tax, corporate allocation, and noncontrolling interest	12,047	13,124	10,833	(1,077)	(8.21)%	2,291	21.15 %
Corporate allocation	(645)	(618)	(638)	(27)	4.37 %	20	(3.13)%
Income before income tax provision and noncontrolling interest	11,402	12,506	10,195	(1,104)	(8.83)%	2,311	22.67 %
Provision for income tax expense	2,455	4,438	3,591	(1,983)	(44.68)%	847	23.59 %
Net income	8,947	8,068	6,604	879	10.89 %	1,464	22.17 %
Noncontrolling interest	(1,575)	(1,371)	(1,268)	(204)	14.88 %	(103)	8.12 %
Net income attributable to TowneBank	$ 7,372	$ 6,697	$ 5,336	$ 675	10.08 %	$ 1,361	25.51 %

Total revenue for the year ended December 31, 2018, increased $5.82 million, or 9.66%. The increase from the prior period was driven by an increase in property and casualty fee income of $5.25 million and was positively impacted by the 2018 insurance agency acquisitions. The acquired insurance agencies contributed additional revenue, net of commission expense, of $2.03 million. Also contributing to the increase was improvement in commercial lines commissions due to organic growth and an increase in employee benefits commissions of $1.54 million.

Salaries and employee benefits expense increased $3.71 million, or 14.71%, when comparing 2018 to 2017, and increased $1.98 million, or 8.51%, when comparing 2017 to 2016. The increases were mainly driven by insurance agency acquisitions, which resulted in additional salaries and employee benefit expenses of $1.26 million and $0.59 million for 2018 and 2017, respectively.

Occupancy expense increased $0.04 million, or 1.90%, when comparing 2018 to 2017, and increased $0.20 million, or 9.54%, when comparing 2017 to 2016, largely as a result of the insurance agency acquisitions.

Amortization of intangible assets increased slightly by $0.47 million, or 16.63%, during the year ended December 31, 2018, compared to 2017, and increased $0.02 million, or 0.68%, when comparing 2017 to 2016, which was also a result of the acquisitions.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $2.64 billion, or 30.99%, to $11.16 billion at December 31, 2018, from $8.52 billion at December 31, 2017. Our loan portfolio grew by 34.83%, or $2.07 billion, to $8.02 billion at December 31, 2018, from $5.95 billion at December 31, 2017.

Our total average assets were $10.60 billion for 2018, reflecting an increase of $2.26 billion, or 27.16%, compared to the 2017 average of $8.33 billion. Total average assets for 2017 increased $1.13 billion, or 15.68%, compared to the 2016 average of $7.21 billion. Average earning assets were $9.50 billion in 2018, reflecting an increase of $1.99 billion, or 26.43%, compared to 2017.

Our average total deposits were $7.83 billion in 2018, reflecting growth of $1.49 billion, or 23.46%, compared to 2017. Growth continued in average noninterest-bearing deposits, which increased $422.42 million, or 20.17%.

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 $1.19 billion as of December 31, 2018, with a balance of $1.10 billion in available-for-sale, $50.60 million in held-to-maturity, $4.80 million in other equity securities, and $43.23 million in Federal Home Loan Bank of Atlanta ("FHLB") stock. Average yield on available-for-sale securities was 2.56% at December 31, 2018, compared with 1.61% at December 31, 2017, and 1.27% at December 31, 2016. Average yield on held-to-maturity securities was 3.23% at December 31, 2018, compared to 3.26% at December 31, 2017, and 3.19% at December 31, 2016.

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, Investment Securities, in the Notes to Consolidated Financial Statements.

	Year Ended December 31,								
	2018			2017			2016		
	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	$ 362,272	$ 358,542	1.88%	$ 277,062	$ 274,468	1.40%	$ 293,663	$ 292,470	1.20%
U.S. Treasury notes	1,247	1,246	2.11%	301,472	301,497	1.03%	251,994	252,001	0.32%
Municipal securities	87,044	87,308	3.21%	17,495	17,487	2.59%	23,502	23,552	2.81%
Trust preferred corporate securities	30,498	30,992	4.94%	22,799	23,364	4.97%	1,978	2,533	8.09%
Mortgage-backed securities	626,188	617,251	2.76%	253,737	249,322	2.16%	245,106	240,903	2.13%
Total securities available for sale	1,107,249	1,095,339	2.56%	872,565	866,138	1.61%	816,243	811,459	1.27%
Securities Held to Maturity:									
Trust preferred corporate securities	500	676	8.75%	500	731	8.75%	500	704	8.75%
Municipal securities	34,488	35,541	3.69%	40,825	42,572	3.80%	40,922	42,746	3.86%
Mortgage-backed securities	15,610	15,051	2.04%	19,979	19,582	2.01%	25,068	24,746	1.99%
Total securities held to maturity	50,598	51,268	3.23%	61,304	62,885	3.26%	66,490	68,196	3.19%
Total Portfolio	$ 1,157,847	$ 1,146,607	2.59%	$ 933,869	$ 929,023	1.72%	$ 882,733	$ 879,655	1.41%

The following table indicates the maturities of securities at December 31, 2018 (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	$ 111,883	$ 110,965	1.21%	$ —	$ —	—
After one year through five years	240,103	237,149	2.20%	—	—	—
After five years through ten years	—	—	—	—	—	—
After ten years	11,533	11,674	—	—	—	—
Municipal securities						
Due in one year or less	3,005	2,991	1.65%	—	—	—
After one year through five years	7,417	7,369	2.47%	6,485	6,574	2.96%
After five years through ten years	40,788	41,117	3.28%	21,103	21,651	3.75%
After ten years	35,834	35,831	3.41%	6,900	7,316	4.19%
Mortgage-backed securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	25,807	25,738	2.76%	4,127	3,994	1.42%
After five years through ten years	131,112	128,995	2.46%	10,711	10,244	1.93%
After ten years	469,269	462,518	2.84%	772	813	6.79%
Trust preferred corporate securities						
Due in one year or less	—	—	—	—	—	—
After one year through five years	—	—	—	—	—	—
After five years through ten years	28,518	28,452	4.72%	—	—	—
After ten years	1,980	2,540	8.09%	500	676	8.75%
Total Portfolio	$ 1,107,249	$ 1,095,339	2.58%	$ 50,598	$ 51,268	3.23%

Loans Held for Sale: At December 31, 2018, we held $220.99 million in mortgage loans originated and intended for sale in the secondary market, compared with $313.26 million at December 31, 2017. Average loans held for sale were 3.08% and 3.61% of average earning assets for the years ended December 31, 2018 and 2017, respectively. The majority of loans held for sale have been pre-committed to investors, minimizing our interest rate risk.

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

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

Loan Portfolio: Our loan portfolio, net of unearned income and deferred costs, totaled $8.02 billion on December 31, 2018. As a percentage of total average earning assets, average loans were 79.62% in 2018, compared with 78.50% in 2017 and 79.63% in 2016. Lending activities represent our primary source of income. Through our acquisition of Paragon we added $1.43 billion in loans to our portfolio. Excluding acquired loans, our portfolio increased $0.64 billion in 2018. Management expects growth of between 7% and 9% in the loan portfolio in 2019. 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,	2018	2017	2016	2015	2014
Real estate loans					
1-4 family residential	$ 1,626,896	$ 1,217,349	$ 1,215,823	$ 973,331	$ 837,370
Commercial	3,241,340	2,283,541	2,251,312	1,784,393	1,447,078
Construction and land development	1,067,239	930,426	826,027	598,875	452,481
Multi-family	260,987	198,720	222,791	167,371	51,472
Total real estate loans	6,196,462	4,630,036	4,515,953	3,523,970	2,788,401
Commercial and industrial loans	1,510,364	1,087,157	1,089,539	857,036	700,623
Consumer loans and other	311,407	229,772	201,729	138,387	75,365
Loans, net of unearned income and deferred costs	$ 8,018,233	$ 5,946,965	$ 5,807,221	$ 4,519,393	$ 3,564,389

Year Ended December 31,	2018	2017	2016	2015	2014
Real estate loans					
1-4 family residential	20.29%	20.47%	20.94%	21.54%	23.49%
Commercial	40.43%	38.40%	38.77%	39.48%	40.60%
Construction and land development	13.31%	15.65%	14.22%	13.25%	12.70%
Multi-family	3.25%	3.34%	3.84%	3.70%	1.44%
Total real estate loans	77.28%	77.86%	77.77%	77.97%	78.23%
Commercial and industrial loans	18.84%	18.28%	18.76%	18.97%	19.66%
Consumer loans and other	3.88%	3.86%	3.47%	3.06%	2.11%
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, 2018 (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	Adjustable Rates
Real estate loans						
1-4 family residential	$ 106,347	$ 268,270	$ 1,252,279	$ 1,626,896	$ 738,404	$ 782,145
Commercial	170,601	866,099	2,204,640	3,241,340	2,697,016	373,723
Construction and land development	575,617	334,604	157,018	1,067,239	211,843	279,779
Multifamily	7,570	71,058	182,359	260,987	224,467	28,950
Total real estate loans	860,135	1,540,031	3,796,296	6,196,462	3,871,730	1,464,597
Commercial and industrial loans	618,340	436,034	455,990	1,510,364	722,034	160,321
Consumer loans and other	36,273	151,006	124,128	311,407	270,997	13,806
Loans, net of unearned income and deferred costs	$ 1,514,748	$ 2,127,071	$ 4,376,414	$ 8,018,233	$ 4,864,761	$ 1,638,724

At December 31, 2018, approximately 87% of our floating rate loans are tied to LIBOR interest rates or Wall Street Journal Prime interest rates. London Interbank Offered Rate ("LIBOR") is the global benchmark rate supporting a diverse range of financial activities in the US and abroad. The FCA, which is the governing body responsible for collecting and communicating LIBOR rates, has announced they will cease their activities in 2021. Transition to another benchmark is expected to have a financial impact on the banking industry, as a whole. The full impact of the transition cannot be determined at this time.

The following table is a summary of our floating rate loan portfolio and contractual interest rate indices at December 31, 2018 (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	$ 39,084	$ 1,510,439	$ 5,658	$ 1,555,181
LIBOR	16,451	742,570	45,840	804,861
Other contractual interest rate indices	2,694	352,538	—	355,232
	$ 58,229	$ 2,605,547	$ 51,498	$ 2,715,274

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.

Loans 30 to 89 days past due totaled $14.33 million, or 0.18% of total loans, including purchased impaired loans of $0.83 million, at December 31, 2018, up from $5.96 million, or 0.10% of total loans, at December 31, 2017. Total past due and nonaccruing loans were $20.20 million, or 0.25% of total loans, including purchased impaired past-due loans of $1.56 million, at December 31, 2018, compared to $11.37 million, or 0.19% of total loans, at December 31, 2017.

The allowance for loan losses at December 31, 2018, 2017, and 2016, was $52.09 million, $45.13 million, and $42.0 million, respectively. The allowance was equal to 0.65% of total loans outstanding at December 31, 2018, compared with 0.76% at December 31, 2017, and 0.72% at December 31, 2016. Excluding purchased loans, the allowance was equal to 0.82% of total loans outstanding at December 31, 2018, compared with 0.86% at December 31, 2017, and 0.87% at December 31, 2016. We believe the slight 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 0.57% of total loans at December 31, 2018, down from 0.68% at December 31, 2017. 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 10.97x of nonperforming loans at December 31, 2018, compared with 9.39x at December 31, 2017. Additionally, overall economic conditions and labor market conditions have continued to show relative strength. 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, 2018.

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,	**2018**	**2017**	**2016**	**2015**	**2014**
Balance beginning of period	$ 45,131	$ 42,001	$ 38,359	$ 35,917	$ 38,380
Loans charged off:					
Real estate - residential 1-4 family	(1,102)	(2,291)	(1,448)	(1,443)	(1,473)
Real estate - multi-family	—	—	—	—	(493)
Real estate -commercial	(168)	(139)	(399)	(279)	(1,165)
Real estate - construction and development	(72)	—	(107)	(208)	(561)
Commercial and industrial	(716)	(345)	(481)	(122)	(432)
Consumer and other loans	(748)	(644)	(459)	(109)	(415)
Total	(2,806)	(3,419)	(2,894)	(2,161)	(4,539)
Loans recovered:					
Real estate - residential 1-4 family	531	286	716	636	661
Real estate - multi-family	—	2	2	1	47
Real estate -commercial	32	339	59	244	452
Real estate - construction and development	74	34	110	80	134
Commercial and industrial	263	82	121	493	130
Consumer and other loans	328	380	171	122	160
Total	1,228	1,123	1,179	1,576	1,584
Net loans charged off	(1,578)	(2,296)	(1,715)	(585)	(2,955)
Provision for loan losses	8,541	5,426	5,357	3,027	492
Balance end of period	$ 52,094	$ 45,131	$ 42,001	$ 38,359	$ 35,917
Nonperforming assets:					
Nonperforming loans	$ 4,749	$ 4,807	$ 13,099	$ 8,670	$ 6,741
Former bank premises	2,253	3,469	3,494	—	—
Foreclosed property	17,163	19,818	21,011	34,420	35,115
Total nonperforming assets	$ 24,165	$ 28,094	$ 37,604	$ 43,090	$ 41,856
Loans past due 90 days accruing interest	$ 394	$ 103	$ 76	$ 424	$ 12
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	10.97x	9.39x	3.21x	4.42x	5.33x
Allowance to nonperforming assets	2.16x	1.61x	1.12x	.89x	.86x
Allowance for loan losses to period end loans	0.65%	0.76%	0.72%	0.85%	1.01%
Allowance for loan losses to period end loans excluding purchased loans	0.82%	0.86%	0.87%	0.94%	1.02%
Nonperforming loans to period end loans	0.06%	0.08%	0.23%	0.19%	0.19%
Nonperforming assets to period end assets	0.22%	0.33%	0.47%	0.68%	0.84%
Net charge-offs to average loans	0.03%	0.04%	0.03%	0.01%	0.09%

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, 2018, we had $24.17 million in nonperforming assets, which amounted to 0.22% of total assets. Nonperforming assets consist of $4.75 million in nonperforming loans, $2.25 million in former bank premises related to the Monarch merger, as well as $17.16 million in foreclosed property. Nonperforming loans decreased by $0.06 million from December 31, 2017, as additions to nonaccrual loans during 2018 were more than offset by transfers to OREO, charge-offs, and payments received. At December 31, 2018, foreclosed property totaled $17.16 million, a decrease from $19.82 million at December 31, 2017. Foreclosed property consists of eight residential properties, 15 construction and development properties, and two commercial properties. The ten largest foreclosed property developments represented approximately 97.62% of total foreclosed property at December 31, 2018, with the largest development representing approximately 42.80%.

At December 31, 2018, loans 60 to 89 days delinquent, excluding nonperforming loans, totaled $2.80 million. Additionally, there are other performing loans, totaling $26.65 million, that are current but have certain documentation deficiencies or other potential weaknesses that management believes 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, 2018, nonaccruing TDRs, which are included in nonperforming loans, totaled $0.90 million, and accruing TDRs totaled $21.20 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, 2018	December 31, 2017
Real estate - residential 1-4 family	$ 1,954	$ 2,184
Real estate - commercial	538	1,191
Real estate - construction and development	—	273
Commercial and industrial loans	1,820	673
Consumer and other loans	437	486
Total nonperforming loans	$ 4,749	$ 4,807

Allocation of the Allowance for Loan Losses: At December 31, 2018, 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,	**2018**	**2017**	**2016**	**2015**	**2014**
Real estate loans:					
1-4 family residential	$ 10,245	$ 9,345	$ 9,050	$ 8,990	$ 9,121
Commercial	19,488	16,864	16,248	14,687	14,226
Construction	6,171	5,753	4,280	4,984	5,661
Multi-family	1,011	1,075	1,370	945	667
Total real estate loans	36,915	33,037	30,948	29,606	29,675
Commercial and industrial loans	8,669	6,596	6,410	5,774	4,963
Consumer and other loans	6,510	5,498	4,643	2,979	1,279
Total	$ 52,094	$ 45,131	$ 42,001	$ 38,359	$ 35,917

In the opinion of management, the allowance was adequate at December 31, 2018, 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, 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. Competition for deposits has been strong in 2018 and we anticipate it will continue to have an impact on rates in 2019.

Deposit accounts held as of December 31, 2018, totaled $8.37 billion. This represented an increase of $1.92 billion, or 29.81%, over 2017, which was $0.41 billion, or 6.84%, over 2016. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in our market area. 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 $319.70 million and CDARS deposits of $115.19 million at December 31, 2018.

The following table provides the average balance and cost rate of interest-bearing deposits for the periods indicated (dollars in thousands). The aggregate amount of time deposits of $250,000 or more was $742.85 million and $617.51 million at December 31, 2018 and 2017, respectively. See Note 9, Deposits, in the Notes to Consolidated Financial Statements for additional information on deposits.

	Average Balance			Average Cost Rate		
For the Year Ended December 31,	**2018**	**2017**	**2016**	**2018**	**2017**	**2016**
Noninterest-bearing demand deposits	$ 2,517,173	$ 2,094,753	$ 1,720,093	—	—	—
Demand and money markets	2,951,038	2,260,378	2,012,061	0.56%	0.35%	0.30%
Savings	302,435	319,940	309,049	1.26%	1.03%	0.93%
Certificates of deposit:						
Less than $250,000	1,380,611	1,143,687	1,188,072	1.60%	1.03%	0.88%
$250,000 or more	679,976	524,566	342,918	1.58%	1.09%	0.86%
Total interest-bearing deposits	5,314,060	4,248,571	3,852,100	1.00%	0.68%	0.58%
Total deposits	$ 7,831,233	$ 6,343,324	$ 5,572,193	0.68%	0.45%	0.40%

Average noninterest-bearing demand deposits were 32.14% of average total deposits during the year ended December 31, 2018, and 33.02% and 30.87% during 2017 and 2016, respectively. The 2018 variance from the prior year is primarily attributable to a change in the deposit mix related to the Paragon merger. The average cost of interest-bearing deposits was 1.00% for the year ended December 31, 2018, compared with 0.68% for 2017, and 0.58% for 2016.

Advances from the Federal Home Loan Bank: Our ability to borrow funds through nondeposit sources provides additional flexibility in meeting the liquidity needs of customers while enhancing our cost of funds structure. Average funds borrowed from the FHLB were $849.99 million and $587.28 million for the years ended December 31, 2018 and 2017, respectively. The balance at December 31, 2018, of $799.32 million, increased $272.39 million from the balance at December 31, 2017, of $526.92 million. Refer to Note 10, Borrowings, in the Notes to Consolidated Financial Statements for additional disclosures related to borrowing arrangements.

Subordinated Debt: On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027, in a public offering. The Company received $247.07 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.55%. The Company may redeem the subordinated notes, in whole or in part, on or after July 30, 2022. At December 31, 2018, the carrying value of the notes totaled $247.86 million and average subordinated debt during 2018 was $251.10 million, while the average cost of the debentures was 4.81%. At December 31, 2017, the carrying value of the notes totaled $247.20 million and average subordinated debt during 2017 was $113.75 million, while the average cost of the debentures was 4.61%.

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

We maintained an average of $560.37 million outstanding in overnight interest-bearing deposits during 2018, compared with $696.51 million for 2017. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2018, we primarily funded our growth in total assets with deposit growth.

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

Additional information concerning our capital resources is contained in Note 17, Regulatory Capital Requirements, in 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, 2018 (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	$ 54,358	$ 10,886	$ 13,861	$ 9,659	$ 19,952
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	799,315	527,000	265,000	—	7,315
Other commitments					
Standby letters of credit	119,380	119,380	—	—	—
Commitments to extend credit	2,701,184	2,203,688	497,496	—	—
Total contractual obligations	$ 3,674,237	$ 2,860,954	$ 776,357	$ 9,659	$ 27,267

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,	**2018**	**2017**	**2016**
Return on average assets	1.26%	1.05%	0.93%
Return on average equity	9.20%	7.80%	6.98%
Return on average tangible equity	14.52%	11.35%	9.93%
Average equity to average assets	13.73%	13.48%	13.38%

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, 2018, we had $1.61 billion 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	6.86 %
+ 200 basis points	4.87 %
+ 100 basis points	3.14 %
- 100 basis points	(4.61)%
- 200 basis points	(12.61)%

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	$ (108,294)
+ 200 basis points	$ (75,810)
+ 100 basis points	$ (22,913)
- 100 basis points	$ (17,492)
- 200 basis points	$ (218,888)

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

FORWARD-LOOKING STATEMENTS

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

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

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

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

We undertake no obligation to update or clarify these forward-looking statements, whether as a result of new information, future events or otherwise.

NON-GAAP FINANCIAL MEASURES

This report contains financial information determined by methods other than in accordance with GAAP. The Company's management uses these non-GAAP financial measures in its analysis of the Company's performance. Management believes presentations of these non-GAAP financial measures provide useful supplemental information that is essential to a proper understanding of the operating results of the Company's core businesses. These non-GAAP disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

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

Year Ended December 31,	2018	2017
Return on average assets (GAAP basis)	1.26%	1.05%
Impact of excluding average goodwill and other intangibles and amortization	0.15%	0.10%
Return on average tangible assets (non-GAAP)	1.41%	1.15%
Return on average equity (GAAP basis)	9.20%	7.80%
Impact of excluding average goodwill and other intangibles and amortization	5.32%	3.55%
Return on average tangible equity (non-GAAP)	14.52%	11.35%

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,	2018	2017
Book value (GAAP basis)	$ 21.05	$ 18.06
Impact of excluding average goodwill and other intangibles and amortization	(7.71)	(4.93)
Tangible book value (non-GAAP)	$ 13.34	$ 13.13

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

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of TowneBank

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of TowneBank and subsidiaries (the "Company") as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2018 and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

Basis for Opinion

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

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

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ Dixon Hughes Goodman LLP

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

Norfolk, Virginia
March 1, 2019

TOWNEBANK
MANAGEMENT'S REPORT ON INTERNAL CONTROL

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

The Audit Committee of the Board of Directors participates in the adequacy of the system of internal controls and financial reporting. The Audit Committee consists of independent directors who meet regularly with management, the internal auditor, 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, 2018, 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, 2018, 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, 2018, 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, 2018.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Federal Financial Institutions Examination Council instructions for Consolidated Reports of Condition and Income, as of December 31, 2018, has been audited by Dixon Hughes Goodman LLP, the independent registered public accounting firm, as stated in their report dated March 1, 2019. A copy of this report, which is combined with the report expressing an opinion on the consolidated financial statements, precedes.

March 1, 2019

/s/ J. Morgan Davis

J. Morgan Davis
President and Chief Executive Officer

/s/ William B. Littreal

William B. Littreal
Senior Executive Vice President and Chief Financial Officer

TOWNEBANK
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)
December 31, 2018 and 2017

ASSETS

	2018	2017
Cash and due from banks	$ 665,029	$ 504,095
Interest-bearing deposits in financial institutions	21,667	17,094
Total Cash and Cash Equivalents	686,696	521,189
Securities available for sale, at fair value	1,095,339	866,138
Securities held to maturity, at amortized cost	50,598	61,304
Other equity securities	4,797	1,516
Federal Home Loan Bank stock	43,229	29,595
Total Securities	1,193,963	958,553
Mortgage loans held for sale	220,986	313,256
Loans, net of unearned income and deferred costs:	8,018,233	5,946,965
Less: allowance for loan losses	(52,094)	(45,131)
Net Loans	7,966,139	5,901,834
Premises and equipment, net	211,796	194,900
Goodwill	433,658	270,250
Other intangible assets, net	58,752	38,568
Bank-owned life insurance policies	237,371	195,775
Other assets	153,669	127,851
TOTAL ASSETS	$ 11,163,030	$ 8,522,176
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 2,622,761	$ 2,157,338
Interest-bearing:		
Demand and money market accounts	3,223,215	2,225,211
Savings	286,684	315,889
Certificates of deposit	2,237,762	1,749,782
Total Deposits	8,370,422	6,448,220
Advances from the Federal Home Loan Bank	799,315	526,923
Subordinated debt, net	247,861	247,196
Repurchase agreements and other borrowings	47,156	24,850
Total Borrowings	1,094,332	798,969
Other liabilities	159,856	132,482
TOTAL LIABILITIES	9,624,610	7,379,671
Preferred stock		
Authorized and unissued shares - 2,000,000	—	—
Common stock, $1.667 par value		
Authorized shares - 150,000,000		
Issued and outstanding shares 72,465,923 in 2018 and 62,629,001 in 2017	120,801	104,403
Capital surplus	1,034,676	749,800
Retained earnings	379,239	282,729
Common stock issued to deferred compensation trust, at cost 769,200 shares in 2018 and 729,919 shares in 2017	(13,955)	(12,524)
Deferred compensation trust	13,955	12,524
Accumulated other comprehensive loss	(9,190)	(5,692)
TOTAL SHAREHOLDERS' EQUITY	1,525,526	1,131,240
Noncontrolling interest	12,894	11,265
TOTAL EQUITY	1,538,420	1,142,505
TOTAL LIABILITIES AND EQUITY	$ 11,163,030	$ 8,522,176

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, 2018, 2017, and 2016

	2018	2017	2016
INTEREST INCOME:			
Loans, including fees	$ 371,343	$ 273,999	$ 231,464
Investment securities	27,127	13,064	12,855
Interest-bearing deposits in financial institutions and federal funds sold	10,229	7,480	1,145
Mortgage loans held for sale	13,124	10,561	9,152
Total interest income	421,823	305,104	254,616
INTEREST EXPENSE:			
Deposits	53,141	28,792	22,316
Advances from the Federal Home Loan Bank	15,340	9,837	13,320
Subordinated debt, net	12,067	5,249	—
Repurchase agreements and other borrowings	202	105	104
Total interest expense	80,750	43,983	35,740
Net interest income	341,073	261,121	218,876
PROVISION FOR LOAN LOSSES	8,541	5,426	5,357
Net interest income after provision for loan losses	332,532	255,695	213,519
NONINTEREST INCOME:			
Residential mortgage banking income, net	65,104	75,851	58,792
Insurance commissions and other title fees and income, net	56,164	51,933	46,741
Real estate brokerage and property management income, net	31,863	27,487	20,515
Service charges on deposit accounts	11,808	10,594	9,547
Credit card merchant fees, net	5,472	5,008	4,508
Bank-owned life insurance	6,836	6,262	5,992
Other income	14,343	10,987	9,121
Gain (loss) on investment securities	3	(1)	6
Total noninterest income	191,593	188,121	155,222
NONINTEREST EXPENSE:			
Salaries and employee benefits	201,838	169,449	142,604
Occupancy	27,644	26,855	23,717
Furniture and equipment	14,477	14,072	11,315
Other expenses	108,165	85,838	90,192
Total noninterest expense	352,124	296,214	267,828
Income before income tax expense and noncontrolling interest	172,001	147,602	100,913
Provision for income tax expense	34,227	54,813	28,698
Net income	$ 137,774	$ 92,789	$ 72,215
Net income attributable to noncontrolling interest	(3,981)	(5,126)	(4,965)
Net income attributable to TowneBank	$ 133,793	$ 87,663	$ 67,250
Per common share information			
Basic earnings	$ 1.88	$ 1.41	$ 1.18
Diluted earnings	$ 1.88	$ 1.41	$ 1.18
Cash dividends declared	$ 0.62	$ 0.55	$ 0.51

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

For the Years Ended December 31, 2018, 2017, and 2016

	2018	2017	2016
Net income	$ 137,774	$ 92,789	$ 72,215
Other comprehensive income (loss)			
Unrealized losses on securities			
Unrealized holding losses arising during the period	(5,511)	(1,644)	(2,000)
Deferred tax benefit	1,224	575	700
Realized (gains) losses reclassified into earnings	(3)	1	(6)
Deferred tax benefit	1	—	2
Net unrealized losses	(4,289)	(1,068)	(1,304)
Pension and postretirement benefit plans			
Prior service costs	(224)	(1,027)	—
Deferred tax benefit	49	359	—
Actuarial gain (loss)	2,327	(400)	323
Deferred tax benefit (expense)	(506)	142	(113)
Amortization of prior service costs	305	288	151
Deferred tax expense	(66)	(100)	(53)
Amortization of net actuarial loss	85	156	7
Deferred tax expense	(19)	(56)	(3)
Change in retirement plans, net of tax	1,951	(638)	312
Other comprehensive loss, net of tax	(2,338)	(1,706)	(992)
Comprehensive income	$ 135,436	$ 91,083	$ 71,223
Comprehensive income attributable to noncontrolling interest	(3,981)	(5,126)	(4,965)
Comprehensive income attributable to TowneBank	$ 131,455	$ 85,957	$ 66,258

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF EQUITY

(dollars in thousands, except share data)

For the Years Ended December 31, 2018, 2017, and 2016

	Common Shares	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive (Loss)	Non-controlling Interests	Total
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 income, 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)
Issuance of common stock - acquisitions	10,487,069	17,482	204,949	—	—	—	—	—	222,431
Conversion of convertible debt into common stock	833	2	9	—	—	—	—	—	11
Issuance of common stock - stock compensation plans	297,774	496	3,263	—	—	—	—	—	3,759
Issuance of common stock - net contingent consideration earned on acquisitions	100,971	168	2,096	—	—	—	—	—	2,264
Balance, December 31, 2016	**62,492,168**	**$ 104,174**	**$ 745,411**	**$ 229,503**	**$ 11,168**	**$ (11,168)**	**$ (3,986)**	**$ 11,456**	**$ 1,086,558**
Net income	—	—	—	87,663	—	—	—	5,126	92,789
Other comprehensive loss, net of taxes	—	—	—	—	—	—	(1,706)	—	(1,706)
Cash dividends declared on common stock	—	—	—	(34,437)	—	—	—	—	(34,437)
Directors' deferred compensation	—	—	—	—	1,356	(1,356)	—	—	—
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	1,029	1,029
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	(6,346)	(6,346)
Conversion of convertible debt into common stock	1,528	2	20	—	—	—	—	—	22
Issuance of common stock - stock compensation plans	65,459	110	2,314	—	—	—	—	—	2,424
Issuance of common stock - net contingent consideration earned on acquisitions	69,846	117	2,055	—	—	—	—	—	2,172
Balance, December 31, 2017	**62,629,001**	**$ 104,403**	**$ 749,800**	**$ 282,729**	**$ 12,524**	**$ (12,524)**	**$ (5,692)**	**$ 11,265**	**$ 1,142,505**
Impact of adoption of new accounting standards (1)	—	—	—	7,579	—	—	(1,160)	—	6,419
Net income	—	—	—	133,793	—	—	—	3,981	137,774
Other comprehensive loss, net of taxes	—	—	—	—	—	—	(2,338)	—	(2,338)
Cash dividends declared on common stock	—	—	—	(44,862)	—	—	—	—	(44,862)
Directors' deferred compensation	—	—	—	—	1,431	(1,431)	—	—	—
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	2,945	2,945
Distribution of interests in joint ventures, net	—	—	—	—	—	—	—	(5,297)	(5,297)
Conversion of convertible debt into common stock	553	1	8	—	—	—	—	—	9
Issuance of common stock - acquisitions	9,457,197	15,764	279,293	—	—	—	—	—	295,057
Issuance of common stock - stock compensation plans	293,349	490	3,112	—	—	—	—	—	3,602
Issuance of common stock - net contingent consideration earned on acquisitions	85,823	143	2,463	—	—	—	—	—	2,606
Balance, December 31, 2018	**72,465,923**	**$ 120,801**	**$ 1,034,676**	**$ 379,239**	**$ 13,955**	**$ (13,955)**	**$ (9,190)**	**$ 12,894**	**$ 1,538,420**

(1) Represents the impact of adopting Accounting Standards Update ("ASU") No. 2018-02 and ASU No. 2014-09. See Note 1 to the Consolidated Financial Statements for more information.

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2018, 2017, and 2016

OPERATING ACTIVITIES:	2018	2017	2016
Net income	$ 137,774	$ 92,789	$ 72,215
Adjustments to reconcile net income to net cash from operating activities:			
Net amortization of securities	2,874	2,359	2,688
Investment securities (gains) loss	(3)	1	(6)
Depreciation, amortization, and other intangible amortization	28,724	24,500	20,552
Amortization of debt issuance costs	665	124	—
Provision for loan losses	8,541	5,426	5,357
Bank-owned life insurance income	(6,836)	(6,262)	(5,992)
Deferred income tax (benefit) expense	(1,300)	570	3,154
Share-based compensation expense	2,905	2,706	2,162
(Gain) loss on sale and write-down of foreclosed assets	(956)	1,087	520
Originations of mortgage loans held for sale	(2,984,899)	(3,329,859)	(2,860,710)
Proceeds from sales of mortgage loans held for sale	3,179,752	3,443,801	3,031,817
Gain on sales of mortgage loans held for sale	(102,583)	(113,152)	(99,350)
Changes in:			
Interest receivable	(10,579)	(2,213)	(3,766)
Other assets	11,456	27,337	(163)
Interest payable	3,224	5,720	646
Other liabilities	38,591	(13,856)	15,386
Net cash from operating activities	307,350	141,078	184,510
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(960,334)	(1,139,278)	(971,506)
Purchase of held-to-maturity securities	—	—	(6,062)
Purchase of other securities	(964)	(28)	(2,526)
Sale of available-for-sale securities	48,549	306	—
Sale of Federal Home Loan Bank stock	6,721	6,816	3,121
Proceeds from maturities, calls, and prepayments of available-for-sale securities	851,369	1,080,013	882,914
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	10,555	4,988	8,408
Proceeds from maturities, calls, and prepayments of other securities	1,176	27	2,605
Net increase in loans	(643,266)	(146,610)	(485,411)
Purchases of premises and equipment	(20,847)	(13,445)	(18,055)
Proceeds from sales of premises and equipment	634	674	2,981
Proceeds from sales of foreclosed assets	7,994	7,595	20,477
Proceeds from bank-owned life insurance	582	—	530
Investment from noncontrolling interest in consolidated joint ventures	123	1,029	—
Acquisition of business, net of cash acquired	61,100	(11,469)	61,930
Net cash used for investing activities	(636,608)	(209,382)	(500,594)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	673,566	413,022	59,550
Net change in borrowings	(113,387)	(168,256)	170,708
Proceeds from (repayments of) subordinated debt	(18,558)	247,072	—
Proceeds (payments) from share-based compensation activity	697	(282)	1,597
Proceeds from issuance of common stock	2,606	2,172	2,264
Distribution of interest in joint ventures	(5,297)	(6,346)	(2,782)
Cash dividends paid	(44,862)	(34,437)	(30,542)
Net cash from financing activities	494,765	452,945	200,795
Change in cash and cash equivalents	165,507	384,641	(115,289)
Cash and cash equivalents at beginning of year	521,189	136,548	251,837
Cash and cash equivalents at end of year	$ 686,696	$ 521,189	$ 136,548
Supplemental cash flow information:			
Cash paid for interest	$ 58,578	$ 38,262	$ 35,095
Cash paid for income taxes	$ 24,612	$ 35,972	$ 23,459
Noncash financing and investing activities:			
Transfer from loans to foreclosed property	$ 2,917	$ 4,570	$ 4,006
Sales of foreclosed assets financed by the Company	$ 1,340	$ 1,012	$ 5,583
Transfers to foreclosed property from premises and equipment	$ —	$ 843	$ 3,659
Net unrealized loss on available-for-sale securities	$ (4,289)	$ (1,068)	$ (1,304)
Dividends declared but not paid	$ 11,699	$ 8,769	$ 8,124
Common stock issued in connection with business acquisitions	$ 295,057	$ —	$ 222,431

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. With its January 26, 2018, acquisition of Paragon, and its wholly owned bank subsidiary, Paragon Commercial Bank, the company added three banking offices serving the Raleigh and Charlotte, North Carolina metropolitan areas.

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.

During the second quarter of 2017, the Company determined that certain purchased loans acquired in the acquisition of Monarch Financial Holdings, Inc. ("Monarch") in 2016 had revolving credit privileges in place at the time of the transaction and were incorrectly classified as purchased impaired credits. During the quarter, the Company reclassified these loans as purchased performing loans and recorded a cumulative adjustment to interest income related to the accretion of purchased loan discounts. Additionally, certain purchased impaired loans were removed from pools and accounted for using the cost recovery method. The Company assessed the materiality of the misclassifications in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 99, *Materiality*, codified in Accounting Standards Codification ("ASC") 250, *Presentation of Financial Statements*, and concluded that these misstatements were not material to the current year or any prior annual or interim periods. The reclassification of these purchased loans resulted in an increase in interest income of $3.89 million for the year ended December 31, 2017.

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

Cash and cash equivalents: For purposes of reporting cash flows, the Company considers cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold as cash and cash equivalents. Generally, federal funds and securities purchased under agreements to resell are purchased and sold for one-day periods. The Company is required to maintain average reserve balances in cash with the Federal Reserve Bank of Richmond; required reserves were $28.72 million and $53.88 million at December 31, 2018 and 2017, 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 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 debt securities for indicators of other-than-temporary impairment ("OTTI") on a quarterly basis . 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 if (i) management intends to sell the security; (ii) 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 by recording an allowance with offset to 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.

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

Allowance for loan losses: The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on management's evaluation of the

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

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

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

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

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

Loans acquired: Loans acquired through the completion of a transfer, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable, are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation

allowance. Loans are evaluated individually to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans, if the loans being aggregated have common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. The difference between the contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference. A subsequent decrease in the estimate of cash flows expected to be received on purchased credit-impaired loans generally results in the recognition of an allowance for loan losses. Increases in cash flows result in reversal of any nonaccretable difference (or allowance for loan losses to the extent any has been recorded) with a positive impact on interest income subsequently recognized. The measurement of cash flows involves assumptions and judgments for interest rates, prepayments, default rates, loss severity, and collateral values. All of these factors are inherently subjective and significant changes in the cash flow estimates over the life of the loan can result.

For purchased loans that are not deemed impaired at acquisition, 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 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 2018, 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, 2018.

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 2018 testing. The Company monitored events and circumstances during the fourth quarter of 2018, and it determined that there were no triggering events requiring an updated impairment test as of December 31, 2018.

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, and incorporating general economic and market conditions. 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 lower of carrying value or 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 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 after the close of such loans. This differs from a "best efforts" delivery, which sets the sale price with the investor on a loan-by-loan basis when each loan is locked with the respective borrower. The Company has not formally designated these derivatives as a qualifying hedge relationship, accordingly, changes to fair value are recorded to earnings each period.

Revenue recognition: Revenue earned on interest-earning assets is recognized based on the effective yield of the financial instrument. Revenue recognized from contracts with customers, which is accounted for under ASC 606, is primarily included in the Company's noninterest income. Interest income and certain other types of noninterest income are accounted for under other applicable accounting standards. See "Recent accounting pronouncements" contained in this Note 1 and Note 15 for additional information about the adoption of ASU No. 2014-09.

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

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 26 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 21 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 27 for further discussion on the Company's earnings per share.

Recent accounting pronouncements:

Accounting standards adopted in current year		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 220 - Income Statement - Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. **ASU 2018 - 02** **Issued February 2018**	Provides financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income ("AOCI") to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the TCJA (or portion thereof) is recorded.	The Company adopted the standard effective January 1, 2018 through a $1.16 million cumulative-effect adjustment from AOCI to increase retained earnings related to unrealized gains and losses on available-for-sale securities and unrealized actuarial gains and losses on pension and postretirement plans. No other income tax effects related to the application of the TCJA were reclassified from AOCI to retained earnings.
Topic 230 - Statement of Cash Flows: Restricted Cash **ASU 2016 - 15** **Issued August 2016**	Designed to reduce the existing diversity in how certain cash receipts and cash payments are presented and classified in the Consolidated Statements of Cash Flows.	The Company adopted the standard effective January 1, 2018. The guidance became effective on a retrospective basis. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.
Topic 230 - Statement of Cash Flows: Restricted Cash **ASU 2016 - 18** **Issued November 2016**	Clarifies guidance on the classification and presentation of restricted cash in the Consolidated Statements of Cash Flows. Requires restricted cash to be combined with unrestricted cash when reconciling the beginning and ending cash balances on the Consolidated Statements of Cash Flows.	The Company adopted the standard effective January 1, 2018. The guidance became effective on a retrospective basis. To align the Consolidated Balance Sheets with the Consolidated Statements of Cash Flows, the Company reclassified restricted cash into cash and due from banks.

Accounting standards adopted in current year		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 310 - Receivables - Subtopic 310 - 20 - Nonrefundable Fees and Other Costs: Premium Amortization On Purchased Callable Debt Securities **ASU 2017 - 08** **Issued March 2017**	Shortens the amortization period for certain callable debt securities held at a premium by requiring the premium to be amortized to the earliest call date. Does not require an accounting change for securities held at a discount; the discount continues to amortize to maturity.	The Company adopted the standard effective January 1, 2018. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.
Topic 606 - Revenue from Contracts with Customers **ASU 2014 - 09** **Issued May 2014**	Topic 606 supersedes most of the existing revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. Requires entities to recognize revenue at an amount that reflects the consideration to which they expect to be entitled in exchange for transferring goods or services to a customer. 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.	The Company adopted the standard effective January 1, 2018 using the modified retrospective approach. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements. See Note 15 for additional information.
Topic 718 - Compensation - Stock Compensation: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost **ASU 2017 - 07** **Issued March 2017**	Requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., salaries and benefits) as other employee compensation costs arising from services rendered during the period. Only the service cost component is eligible for capitalization in assets. All other components of net periodic benefit cost are to be presented separately (e.g., other noninterest expense) from the line that includes service cost.	The Company adopted the standard effective January 1, 2018. The guidance became effective on a retrospective basis. The service cost component is included in salaries and employee benefits expense, and the other components of net benefit costs are included in other expenses in the Consolidated Statements of Income. The prior period was reclassified to conform to the current presentation.

Accounting standards adopted in current year		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 740 - Income Taxes: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin ("SAB") No. 118 **ASU 2018 - 05** **Issued March 2018**	Adds SEC guidance to the FASB ASC regarding the TCJA pursuant to the issuance of SAB 118.	Effective upon addition to the FASB ASC. Disclosures related to the effect of the TCJA and the Company's utilization of SAB 118 appear in Note 21.
Topic 815 - Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities **ASU 2017 - 12** **Issued August 2017**	Better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results.	The Company early adopted the standard effective January 1, 2018. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.
Topic 825 - Financial Instruments - Subtopic 825-10 - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities **ASU 2016 - 01** **Issued January 2016**	Amends the Financial Instruments topic to address certain aspects of recognition, measurement, presentation and disclosure of financial instruments.	The Company adopted the standard effective January 1, 2018. In accordance with the new guidance, the Company began measuring the fair value of its loan portfolio as of March 31, 2018, using an exit price notion. See Note 18 for additional information.

Accounting standards not yet adopted		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 326 - Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments **ASU 2016 - 13** **Issued June 2016**	Changes the accounting for credit losses and modifies the impairment model for debt securities. Eliminates the probable recognition threshold for credit losses on financial assets measured at amortized cost. Requires those financial assets to be presented at the net amount expected to be collected (i.e., net of expected credit losses). Measurement of expected credit losses should be based on relevant information including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount.	Effective for interim and annual periods beginning after December 15, 2019. The Company has selected a vendor, identified a team to oversee implementation of the standard, and engaged a nationally recognized accounting firm to assist management in implementation of the standard. The Company is currently focused on several areas, including developing credit models as well as accounting, reporting, and governance processes to comply with the new credit reserve requirements. The Company expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the Consolidated Financial Statements.
Topic 350 - Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment **ASU 2017 - 04** **Issued January 2017**	Simplifies 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. Requires the entity to instead 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.	Effective for the Company on January 1, 2020. The guidance is to be applied on a prospective basis. 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.

Accounting standards not yet adopted		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 350 - Intangibles - Goodwill and Other **Subtopic 350 - 40 - Internal Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract** **ASU 2018 - 15** **Issued August 2018**	Aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include internal-use software licenses).	Effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted. Can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. 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.
Topic 715 - Compensation - Retirement Benefits **Subtopic 715 - 20 - Defined Benefit Plans - General: Disclosure Framework - Changes in the Disclosure Requirements for Defined Benefit Plans** **ASU 2018 - 14** **Issued August 2018**	Removes, adds and clarifies certain required financial statement disclosures that apply to all employers that sponsor defined benefit pension or other postretirement plans.	Effective for fiscal years ending after December 15, 2020. 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.
Topic 718 - Compensation - Stock Compensation: Improvements to Non-employee Share-Based Payment Accounting **ASU 2018 - 07** **Issued June 2018**	Expands the scope of the Topic (which currently only includes share-based payments issued to employees) to include share-based payments issued to non-employees for goods and services. Substantially aligns the accounting for share-based payments to employees and non-employees. Supersedes Subtopic 505-50 - Equity - Equity-Based Payments to Non-Employees.	Effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted, but no earlier than a company's adoption date of Topic 606 - Revenue from Contracts with Customers. 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.

Accounting standards not yet adopted		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 815 - Derivatives and Hedging **ASU 2018 - 16** **Issued October 2018**	Permits the use of the Overnight Index Swap ("OIS") rate based on the Secured Overnight Financing Rate as a U.S. benchmark interest rate for hedge accounting purposes in addition to the U.S. Treasury rate, the London Interbank Offered Rate ("LIBOR") swap rate, the OIS rate based on the Fed Funds Effective Rate, and the Securities Industry and Financial Markets Association Municipal Swap Rate.	Effective for interim and annual periods beginning after December 15, 2018. The Company has already adopted the related ASU 2017-12 and does not expect the adoption of this guidance to have a material impact on its Consolidated Financial Statements.

Accounting standards not yet adopted		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 842 - Leases **ASU 2016 - 02** **Issued February 2016** **Leases: Codification Improvements** **ASU 2018 - 10** **ASU 2018 - 11** **Issued July 2018** **ASU 2018 - 20** **Issued December 2018** **Issued July 2018** **ASU 2018 - 20** **Issued December 2018**	ASU 2016 - 02 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. Requires the lessee to 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. ASU 2018 - 10 Narrows aspects of the guidance issued in ASU 2016 - 02. Provides clarification to the guidance and corrects the unintended application of the existing guidance. ASU 2018 - 11 Provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balances of retained earnings in the period of adoption. In applying this transition method, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840 - Leases). ASU 2018 - 20 Clarifies the accounting by lessors for variable payments that relate to both a lease component and a non-lease component. It is related to sales taxes and other similar taxes collected from lessees.	Effective for annual periods beginning after December 15, 2018, and interim periods therein. The Company will adopt the standard by applying the alternative transition method whereby comparative periods will not be restated, and any cumulative effect adjustment to the opening balance of retained earnings would be recognized as of January 1, 2019. The impact to retained earnings is expected to be immaterial. The Company also expects to elect the ASU's package of three practical expedients, which allows the Company to forego a reassessment of (1) whether any expired or existing contracts are or contain leases, (2) the lease classification for any expired or existing leases, and (3) the initial direct costs for any existing leases. The Company has implemented a lease management system to assist in accounting for all leases and is finalizing its evaluation of the ASU on its financial statements and disclosures, as well as any additional changes to processes and internal controls to ensure we meet the ASU's reporting and disclosure requirements. While the Company continues to assess the impact of this ASU on its consolidated financial statements, the Company currently expects to record right-of-use assets and additional lease liabilities in the range of $40 million to $45 million, based on the present value of the expected remaining lease payments. The adoption of this ASU is not expected to have a significant impact on the Company's Consolidated Statement of Income.

NOTE 2: MERGERS AND ACQUISITIONS

Middle Peninsula Insurance Agency, Inc.: Effective November 6, 2018, the Company acquired Middle Peninsula Insurance Agency, Inc., an independent insurance agency, which was merged into the operations of Towne Insurance Agency, LLC, a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations,* and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. Such fair values were preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing November 6, 2018.

Michael R. Bare, LLC: Effective May 15, 2018, the Company acquired Michael R. Bare, LLC, an independent insurance agency, which was merged into the operations of Towne Insurance Agency, LLC, a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing May 15, 2018.

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

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

Paragon Bank was headquartered in Raleigh, North Carolina and had three branches serving the metropolitan areas of Charlotte and Raleigh, North Carolina. TowneBank engaged in this transaction with the expectation that it would expand its community banking franchise into new geographic markets that it believes are demographically attractive and rapidly growing. The integration of Paragon Bank's deposit system and the conversion of Paragon Bank's branches to TowneBank's operating platform were completed over the weekend of January 27-28, 2018. Paragon Bank's three branches re-opened January 29, 2018 as Paragon Bank, a division of TowneBank.

The Paragon merger has been accounted for under the acquisition method of accounting, in accordance with ASC 805, *Business Combinations*. Under this guidance, an entity is required to recognize the assets acquired, liabilities assumed, and the consideration given at their fair value on the acquisition date. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the January 26, 2018, merger date. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the

merger date, or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of deferred tax assets and the residual goodwill. The fair value of consideration exchanged exceeded the recognized amounts of the identifiable net assets and resulted in goodwill of $149.73 million. Goodwill resulted from a combination of expected synergies, expansion in the metropolitan areas of Charlotte and Raleigh, North Carolina with the addition of three branch locations, and growth opportunities. None of the goodwill recognized is expected to be deductible for income tax purposes.

The following table presents the estimated fair values of the assets acquired and liabilities assumed for Paragon as of January 26, 2018 (dollars in thousands):

Fair value of assets acquired:		
Cash and cash equivalents	$	79,372
Securities available for sale		184,184
Loans held for investment		1,432,497
Bank premises and equipment		13,647
OREO		1,330
Core deposit intangible		21,520
Other assets		69,315
Total assets	$	1,801,865
Fair value of liabilities assumed:		
Deposits	$	1,248,636
Total borrowings		378,558
Other liabilities		30,326
Total liabilities	$	1,657,520
Net identifiable assets acquired		144,345
Goodwill		149,725
Net assets acquired	$	294,070
Purchase price:		
Company common shares issued		9,425,213
Purchase price per share of Company’s common stock	$	31.20
Common stock issued	$	294,067
Cash exchanged for fractional shares		3
Fair value of total consideration transferred	$	294,070

During the year ended December 31, 2018, adjustments were made to the purchase price allocations that resulted in a decrease to the initial fair value estimate of OREO of $1.12 million, a decrease in deferred tax assets of $0.20 million, and a decrease to acquired net assets of $1.86 million resulting from adjustments to other assets and liabilities. The loans acquired in the Paragon 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 26, 2018, the estimated fair value of the Paragon purchased performing loans acquired was $1.42 billion, the related gross contractual amount was $1.67 billion, and the estimated contractual cash flows not expected to be collected were $12.51 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	$	26,697
Nonaccretable difference		(10,672)
Expected cash flows at acquisition		16,025
Accretable yield		(1,857)
Estimated fair value of loans acquired with a deterioration of credit quality	$	14,168

Results of operations for Paragon prior to the acquisition date are not included in the Consolidated Statements of Income for the year ended December 31, 2018. The results of activities from the former Paragon Bank operations that are included in the Consolidated Statements of Income from the date of acquisition through December 31, 2018 are broken out in the following table (dollars in thousands):

	Actual from Acquisition Date Through December 31, 2018
Revenues (net interest income plus noninterest income)	$ 69,351
Net Income	$ 28,651

The following table presents unaudited pro forma results of operations for the comparative periods presented as if the Paragon acquisition had been completed on January 1, 2017. The pro forma results of operations include the historical accounts of the Company and Paragon, and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. Pro forma earnings were adjusted to exclude $7.47 million of acquisition-related expenses for the year ended December 31, 2018. The pro forma earnings for the year ended December 31, 2017, 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 Paragon acquisition been completed at the beginning of 2017. 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, 2018**		**Pro Forma for the Year Ended December 31, 2017**	
Revenues (net interest income plus noninterest income)	$	529,370	$	509,965
Net income	$	130,324	$	97,436

W.A. Moore & Company: Effective August 1, 2017, the Company acquired W.A. Moore & Company ("W.A. Moore"), an independent insurance agency, which was merged with the operations of Towne Insurance Agency, LLC ("Towne Insurance"), a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing August 1, 2017.

Railey Mountain Lake Vacations, LLC: Effective April 11, 2017, the Company acquired Railey Mountain Lake Vacations, LLC ("Railey Mountain"), an independent resort property management company that was merged with the operations of Towne Vacations Deep Creek, LLC, a division of TowneBank's Realty segment. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing April 11, 2017.

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 was considered final, whichever was earlier. The application of the acquisition method of accounting resulted in goodwill of approximately $108.05 million. All of the recognized goodwill was non-deductible for tax purposes.

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

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

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

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

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

Contractual principal and interest at acquisition	$	36,510
Nonaccretable difference		(19,264)
Expected cash flows at acquisition		17,246
Accretable yield		(2,207)
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 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
Revenues (net interest income plus noninterest income)	$	439,240
Net income	$	79,956

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.

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, 2018

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 362,272	$ 143	$ (3,873)	$ 358,542
U.S. Treasury notes	1,247	—	(1)	1,246
Municipal securities	87,044	679	(415)	87,308
Trust preferred and other corporate securities	30,498	601	(107)	30,992
Mortgage-backed securities issued by GSE	626,188	2,000	(10,937)	617,251
Total available-for-sale securities	$ 1,107,249	$ 3,423	$ (15,333)	$ 1,095,339

December 31, 2017

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 277,062	$ 6	$ (2,600)	$ 274,468
U.S. Treasury notes	301,472	25	—	301,497
Municipal securities	17,495	100	(108)	17,487
Trust preferred and other corporate securities	22,799	645	(80)	23,364
Mortgage-backed securities issued by GSE	253,737	229	(4,644)	249,322
Total available-for-sale securities	$ 872,565	$ 1,005	$ (7,432)	$ 866,138

For the year ended December 31, 2018, the Company had proceeds from sales of securities available for sale in the amount of $48.55 million, resulting in gross realized gains of $3,000. For the year ended December 31, 2017, the Company had proceeds from sales of securities available for sale in the amount of $0.31 million, resulting in gross realized losses of $1,000. For the year ended December 31, 2016, there were no proceeds from sales of securities available for sale.

Held-to-maturity securities

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

December 31, 2018

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 500	$ 176	$ —	$ 676
Municipal securities	34,488	1,053	—	35,541
Mortgage-backed securities issued by GSE	15,610	42	(601)	15,051
Total held-to-maturity securities	$ 50,598	$ 1,271	$ (601)	$ 51,268

December 31, 2017

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

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, 2018	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 114,888	$ 113,956	$ —	$ —
Due after one year through five years	273,327	270,256	10,612	10,568
Due after five years through 10 years	200,418	198,564	31,814	31,895
Due after 10 years	518,616	512,563	8,172	8,805
	1,107,249	1,095,339	50,598	51,268
Other equity securities	4,797	4,797	—	—
	$ 1,112,046	$ 1,100,136	$ 50,598	$ 51,268

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

Pledged securities

At December 31, 2018 and 2017, the Company had investment securities with market values of $232.61 million and $208.30 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, 2018 or 2017. The Company also had $66.24 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2018, compared to $36.48 million at December 31, 2017.

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, 2018	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	$ 120,117	$ (1,100)	$ 227,833	$ (2,774)	$ 347,950	$ (3,874)
Municipal securities	22,758	(250)	11,672	(165)	34,430	(415)
Mortgage-backed securities issued by GSE	172,481	(1,987)	243,672	(9,551)	416,153	(11,538)
Trust preferred and other corporate obligations	6,001	(46)	20,548	(61)	26,549	(107)
Total temporarily impaired securities	$ 321,357	$ (3,383)	$ 503,725	$ (12,551)	$ 825,082	$ (15,934)

December 31, 2017	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 57,411	$ (529)	$ 218,189	$ (2,072)	$ 275,600	$ (2,601)
Municipal securities	11,510	(89)	1,211	(19)	12,721	(108)
Mortgage-backed securities issued by GSE	87,001	(842)	167,273	(4,280)	254,274	(5,122)
Trust preferred and other corporate obligations	20,740	(80)	—	—	20,740	(80)
Total temporarily impaired securities	$ 176,662	$ (1,540)	$ 386,673	$ (6,371)	$ 563,335	$ (7,911)

U.S. Treasury obligations and direct obligations of U.S. government agency securities

At December 31, 2018, 18 securities had unrealized losses of $3.87 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, 2018, 40 securities had unrealized losses of $0.42 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, 2018, 77 securities experienced a total unrealized loss of $11.54 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 The Federal National Mortgage Association ("FNMA") and The Federal Home Loan Mortgage Corporation ("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, 2018, three securities had unrealized losses of $0.11 million. The unrealized losses were caused by interest rate fluctuations. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Federal Home Loan Bank ("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 $43.23 million and $29.60 million of FHLB stock at December 31, 2018 and 2017, 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 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,	2018	2017
Real estate loans:		
1-4 family residential	$ 1,626,896	$ 1,217,349
Commercial	3,241,340	2,283,541
Construction and land development	1,067,239	930,426
Multifamily	260,987	198,720
Total real estate loans	6,196,462	4,630,036
Commercial and industrial business	1,510,364	1,087,157
Consumer loans and other	311,407	229,772
Loans, net of unearned income and deferred costs	$ 8,018,233	$ 5,946,965

Unearned loan income was $7.06 million in excess of deferred loan costs at December 31, 2018, $4.83 million at December 31, 2017, and $4.02 million at December 31, 2016. There were $4.75 million, $4.81 million, and $13.10 million in nonaccrual loans at December 31, 2018, 2017, and 2016, respectively. The Company would have earned $0.23 million in 2018, $0.14 million in 2017, and $0.18 million in 2016 if interest on the loans had been accruing. Of total loans, $1.59 billion were pledged as collateral to secure overnight borrowings with the FHLB, and $78.49 million was pledged to secure borrowings from the discount window at the FRB at December 31, 2018.

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 $52.09 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2018.

The following table presents, by portfolio segment, the changes in the allowance for loan losses for the years ended December 31, 2018, 2017, and 2016 (in thousands):

December 31, 2018	**Real Estate Construction and Land Development**	**Real Estate Commercial**	**Real Estate Multi-Family**	**Real Estate 1-4 Family Residential**	**Commercial and Industrial Business**	**Consumer and Other Loans**	**Total**
Allowance for loan losses:							
Balance, beginning of year	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131
Provision charged to expense	416	2,760	(64)	1,471	2,526	1,432	8,541
Losses charged off	(72)	(168)	—	(1,102)	(716)	(748)	(2,806)
Recoveries	74	32	—	531	263	328	1,228
Balance, end of year	$ 6,171	$ 19,488	$ 1,011	$ 10,245	$ 8,669	$ 6,510	$ 52,094
December 31, 2017							
Allowance for loan losses:							
Balance, beginning of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001
Provision charged to expense	1,439	416	(297)	2,300	449	1,119	5,426
Losses charged off	—	(139)	—	(2,291)	(345)	(644)	(3,419)
Recoveries	34	339	2	286	82	380	1,123
Balance, end of year	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131
December 31, 2016							
Allowance for loan losses:							
Balance, beginning of year	$ 4,984	$ 14,687	$ 945	$ 8,990	$ 5,774	$ 2,979	$ 38,359
Provision charged to expense	(707)	1,901	423	792	996	1,952	5,357
Losses charged off	(107)	(399)	—	(1,448)	(481)	(459)	(2,894)
Recoveries	110	59	2	716	121	171	1,179
Balance, end of year	$ 4,280	$ 16,248	$ 1,370	$ 9,050	$ 6,410	$ 4,643	$ 42,001

The following table presents, by portfolio segment, the allocation of the allowance for loan losses at December 31, 2018 and 2017 (in thousands):

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate 1-4 Family Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 13	$ 557	$ 42	$ 629	$ 82	$ 29	$ 1,352
Loans collectively evaluated for impairment	6,158	18,931	969	9,547	8,587	6,481	50,673
Loans acquired with deteriorated credit quality	—	—	—	69	—	—	69
Balance, end of year	$ 6,171	$ 19,488	$ 1,011	$ 10,245	$ 8,669	$ 6,510	$ 52,094
December 31, 2017							
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 34	$ 789	$ 30	$ 938	$ 47	$ 7	$ 1,845
Loans collectively evaluated for impairment	5,719	16,075	1,045	8,345	6,549	5,491	43,224
Loans acquired with deteriorated credit quality	—	—	—	62	—	—	62
Balance, end of year	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131

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

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate 1-4 Family Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Ending balance: individually evaluated for impairment	$ 1,589	$ 18,924	$ 1,158	$ 12,467	$ 12,923	$ 938	$ 47,999
Ending balance: collectively evaluated for impairment	1,052,383	3,202,982	247,571	1,592,449	1,497,441	310,469	7,903,295
Ending balance: loans acquired with deteriorated credit quality	13,267	19,434	12,258	21,980	—	—	66,939
Ending Balance	$ 1,067,239	$ 3,241,340	$ 260,987	$ 1,626,896	$ 1,510,364	$ 311,407	$ 8,018,233
December 31, 2017							
Ending balance: individually evaluated for impairment	$ 2,552	$ 22,183	$ 1,218	$ 14,460	$ 4,253	$ 766	$ 45,432
Ending balance: collectively evaluated for impairment	916,333	2,232,057	182,354	1,175,215	1,082,904	229,006	5,817,869
Ending balance: loans acquired with deteriorated credit quality	11,541	29,301	15,148	27,674	—	—	83,664
Ending Balance	$ 930,426	$ 2,283,541	$ 198,720	$ 1,217,349	$ 1,087,157	$ 229,772	$ 5,946,965

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

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

The following table presents changes in the accretable yield for purchased impaired loans for the years ended December 31, 2018 and 2017 (in thousands):

	December 31,	
	2018	2017
Balance at beginning of period	$ 38,542	$ 40,467
Additions	1,857	—
Accretion	(10,686)	(9,300)
Reclassifications from nonaccretable balance, net	6,469	4,512
Other changes, net	(721)	2,863
Balance at end of period	$ 35,461	$ 38,542

At December 31, 2018, none of the purchased impaired loans were classified as nonperforming assets. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and expected cash flows, is being recognized on all purchased loans. Any decreases in cash flows expected to be collected (other than due to decreases in interest rate indices and changes in prepayment assumptions), will be charged to the provision for loan losses, resulting in an increase to the allowance for loan losses.

Portfolio Quality Indicators

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

The Company’s internally assigned grades are as follows:

- Pass – Several pass credit grades comprise loans in this category, which are assigned based on varying levels of risk, ranging from credits that are secured by cash or marketable securities, to management

attention credits which have all the characteristics of an acceptable credit risk but warrant more than the normal level of monitoring.

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

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

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

The following tables represent consumer credit exposures by internally assigned grades for the years ended December 31, 2018 and 2017 (in thousands):

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate 1-4 Family Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Pass	$ 1,048,291	$ 3,217,386	$ 256,977	$ 1,612,970	$ 1,490,207	$ 310,364	$7,936,195
Special Mention	16,981	8,234	3,559	3,228	4,416	104	36,522
Substandard	1,967	15,720	451	10,698	15,741	939	45,516
Doubtful	—	—	—	—	—	—	—
Total	$ 1,067,239	$ 3,241,340	$ 260,987	$ 1,626,896	$ 1,510,364	$ 311,407	$8,018,233

December 31, 2017	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate 1-4 Family Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Pass	$ 923,501	$ 2,246,128	$ 197,502	$ 1,198,462	$ 1,074,176	$ 229,005	$5,868,774
Special Mention	3,786	19,991	717	4,675	8,737	—	37,906
Substandard	3,139	17,422	501	14,212	4,244	767	40,285
Doubtful	—	—	—	—	—	—	—
Total	$ 930,426	$ 2,283,541	$ 198,720	$ 1,217,349	$ 1,087,157	$ 229,772	$5,946,965

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, 2018. 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).

December 31, 2018	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
Real estate - construction and development	$ 1,292	$ 452	$ 611	$ —	$ 2,355	$ 1,064,884	$ 1,067,239	$ —
Real estate - commercial	2,740	292	—	538	3,570	3,237,770	3,241,340	—
Real estate - multi-family	—	—	—	—	—	260,987	260,987	—
Real estate - residential 1-4 family	5,859	1,415	320	1,954	9,548	1,617,348	1,626,896	209
Commercial and industrial business	184	14	—	1,820	2,018	1,508,346	1,510,364	—
Consumer and other loans	1,462	623	185	437	2,707	308,700	311,407	185
Total	$ 11,537	$ 2,796	$ 1,116	$ 4,749	$ 20,198	$ 7,998,035	$ 8,018,233	$ 394

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

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, 2018						
Real estate - construction and development	$ 11	$ —	$ 611	$ 622	$ 12,645	$ 13,267
Real estate - commercial	424	—	—	424	19,010	19,434
Real estate - multi-family	—	—	—	—	12,258	12,258
Real estate - residential 1-4 family	83	315	111	509	21,471	21,980
Commercial and industrial business	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	—	—
Total	$ 518	$ 315	$ 722	$ 1,555	$ 65,384	$ 66,939

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
December 31, 2017						
Real estate - construction and development	$ —	$ —	$ —	$ —	$ 11,541	$ 11,541
Real estate - commercial	—	—	—	—	29,301	29,301
Real estate - multi-family	—	—	—	—	15,148	15,148
Real estate - residential 1-4 family	106	44	494	644	27,030	27,674
Commercial and industrial business	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	—	—
Total	$ 106	$ 44	$ 494	$ 644	$ 83,020	$ 83,664

Impaired Loans

Management considers a loan to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), impairment is recognized as a specific component to be provided for in the allowance for loan losses, or the impaired balance on collateral dependent loans is charged off if it is determined that such amount represents a confirmed loss. Smaller balance loans (under $1,000,000) are generally not individually assessed for impairment but are evaluated collectively.

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

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, 2018	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	Interest Income Recognized
Loans without a specific valuation allowance					
Real estate - construction and development	$ 452	$ 452	$ —	$ 397	$ 23
Real estate - commercial	5,441	5,441	—	5,483	274
Real estate - multi-family	—	—	—	—	—
Real estate - residential 1-4 family	2,457	2,456	—	2,375	89
Commercial and industrial business	10,893	10,605	—	11,363	582
Consumer and other loans	—	—	—	—	—
Total	$ 19,243	$ 18,954	$ —	$ 19,618	$ 968
Loans with a specific valuation allowance					
Real estate - construction and development	$ 1,137	$ 1,137	$ 13	$ 1,163	$ 62
Real estate - commercial	13,672	13,483	557	14,165	856
Real estate - multi-family	1,158	1,158	42	1,188	76
Real estate - residential 1-4 family	10,304	10,011	629	10,500	527
Commercial and industrial business	2,405	2,318	82	3,034	169
Consumer and other loans	971	938	29	1,096	50
Total	$ 29,647	$ 29,045	$ 1,352	$ 31,146	$ 1,740
Total impaired loans					
Real estate - construction and development	$ 1,589	$ 1,589	$ 13	$ 1,560	$ 85
Real estate - commercial	19,113	18,924	557	19,648	1,130
Real estate - multi-family	1,158	1,158	42	1,188	76
Real estate - residential 1-4 family	12,761	12,467	629	12,875	616
Commercial and industrial business	13,298	12,923	82	14,397	751
Consumer and other loans	971	938	29	1,096	50
Total	$ 48,890	$ 47,999	$ 1,352	$ 50,764	$ 2,708

Included in the table above are accruing TDRs of $21.20 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $0.90 million.

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Specific Allowance	Average Recorded Investment	Interest Income Recognized
Loans without a specific valuation allowance					
Real estate - construction and development	$ 151	$ 151	$ —	$ 162	$ 13
Real estate - commercial	11,959	11,886	—	12,667	689
Real estate - multi-family	—	—	—	—	—
Real estate - residential 1-4 family	2,432	2,282	—	2,603	102
Commercial and industrial business	2,825	2,641	—	3,017	158
Consumer and other loans	—	—	—	—	—
Total	$ 17,367	$ 16,960	$ —	$ 18,449	$ 962
Loans with a specific valuation allowance					
Real estate - construction and development	$ 2,773	$ 2,401	$ 34	$ 2,799	$ 124
Real estate - commercial	10,384	10,296	789	10,840	524
Real estate - multi-family	1,218	1,218	30	1,252	80
Real estate - residential 1-4 family	12,353	12,177	938	13,893	667
Commercial and industrial business	1,726	1,612	47	1,847	105
Consumer and other loans	779	767	7	868	34
Total	$ 29,233	$ 28,471	$ 1,845	$ 31,499	$ 1,534
Total impaired loans					
Real estate - construction and development	$ 2,924	$ 2,552	$ 34	$ 2,961	$ 137
Real estate - commercial	22,343	22,182	789	23,507	1,213
Real estate - multi-family	1,218	1,218	30	1,252	80
Real estate - residential 1-4 family	14,785	14,459	938	16,496	769
Commercial and industrial business	4,551	4,253	47	4,864	263
Consumer and other loans	779	768	7	868	34
Total	$ 46,600	$ 45,432	$ 1,845	$ 49,948	$ 2,496

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

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

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. 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.

For the year ended December 31, 2018, there were no loans modified in TDRs. The following table shows the loans modified in TDRs for the year ended December 31, 2017 (in thousands, except number of loans):

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

The restructured loans generally include terms to reduce the interest rate and extend payment terms. We have not forgiven any principal on the above loans. No loans were restructured within the last 12 months and subsequently defaulted.

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At December 31, 2018, the large majority of 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,	
	2018	2017
Beginning balance	$ 23,288	$ 24,505
Additions and capital improvements	3,177	7,635
Paragon merger	1,330	—
Sales	(9,334)	(8,608)
Net change in valuation allowance	(73)	42
Gain (loss) on sale and write-downs, net	1,028	(1,129)
Transfers from premises and equipment	—	843
Ending balance	$ 19,416	$ 23,288

As of December 31, 2018, the Company's recorded investment in OREO collateralized by residential real estate was $3.86 million. As of December 31, 2018, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $0.19 million.

NOTE 6: PREMISES, EQUIPMENT, AND LEASES

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

	Useful Life	December 31,	
		2018	2017
Land and improvements	—	$ 39,599	$ 35,001
Buildings and improvements	10 to 45 years	146,250	136,243
Autos	3 to 5 years	7,014	6,160
Computer equipment	2 to 5 years	14,333	13,405
Equipment	5 to 10 years	26,755	24,305
Furniture and fixtures	5 to 20 years	53,742	49,269
Leasehold improvements	Lesser of lease term or 10 years	31,021	29,028
Construction in progress	—	7,247	416
		325,961	293,827
Less accumulated depreciation		(114,165)	(98,927)
Net premises and equipment		$ 211,796	$ 194,900

Depreciation and leasehold amortization expense for the years ended December 31, 2018, 2017, and 2016, was $15.91 million, $15.90 million, and $13.70 million, respectively.

Various facilities and equipment are leased under noncancellable operating leases with initial remaining terms in excess of one year and an option for renewal. In addition to minimum rentals, certain leases have escalation clauses and include provisions for additional payments to cover taxes, insurance, and maintenance. The effects of scheduled rent increases, which are included in the minimum lease payments, are recognized on a straight-line basis over the lease term. Rental expense was $11.22 million for 2018, compared to $11.21 million for 2017, and $9.37 million for 2016.

Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2018, are listed in the following chart (in thousands):

2019	$ 10,886
2020	7,957
2021	5,903
2022	5,435
2023	4,224
Thereafter	19,952
	$ 54,357

Rental income for the year ended December 31, 2018, was $0.99 million, compared to $0.93 million for 2017, and $0.96 million for 2016. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2018 (in thousands):

2019	$ 1,198
2020	787
2021	597
2022	301
2023	186
Thereafter	817
	$ 3,886

NOTE 7: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2018		2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 31,339	$ 9,773	$ 9,819	$ 4,115
Non-compete agreements	1,910	969	1,368	838
Customer lists	55,985	24,351	48,307	20,584
Trade names	—	—	211	211
Total intangible assets subject to amortization	89,234	35,093	59,705	25,748
Intangible assets not subject to amortization				
Trade names	1,380	—	1,380	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	4,611	—	4,611	—
Total intangible assets	$ 93,845	$ 35,093	$ 64,316	$ 25,748

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2018, was $11.71 million, compared to $7.66 million for 2017, and $6.01 million for 2016. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2018, is as follows: 2019, $5.91 million; 2020, $5.02 million; 2021, $3.97 million; 2022, $3.15 million; and 2023, $2.55 million.

During 2018, the Company recorded $163.41 million in net increases to goodwill and $20.18 million in intangible assets. This represents the acquisitions of Middle Peninsula Insurance Agency, Inc., Michael R. Bare, LLC, Paragon, and other immaterial acquisitions. During 2017, the Company recorded $5.34 million in net increases to goodwill and $0.71 million in intangible assets. This represents the acquisitions of W.A. Moore, Railey Mountain Lake, and an insurance-related book of business. The intangible assets acquired are finite-lived, consisting primarily of customer list purchases.

No impairment charges were recorded in any year reported. Impairment testing indicated that goodwill was not impaired in 2018, 2017, or 2016. 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, 2016	$ 194,913	$ 23,495	$ 46,502	$ 264,910
Additions to goodwill	—	3,336	2,655	5,991
Other adjustments	—	(651)	—	(651)
Balance, December 31, 2017	$ 194,913	$ 26,180	$ 49,157	$ 270,250
Additions to goodwill	146,539	1,747	12,175	160,461
Other adjustments	3,186	(239)	—	2,947
Balance, December 31, 2018	$ 344,638	$ 27,688	$ 61,332	$ 433,658

NOTE 8: BANK-OWNED LIFE INSURANCE POLICIES

The total carrying amount of bank-owned life insurance ("BOLI") as of December 31, 2018, was $237.37 million. The Company had $195.78 million of BOLI at December 31, 2017, and $189.50 million at December 31, 2016. The Company recognized BOLI income, included in other noninterest income, of $6.84 million, $6.26 million, and $5.99 million for the years ended December 31, 2018, 2017, and 2016, respectively. The Company has a related retirement plan, which provides retirement benefits to the executives covered under the plan. Although the retirement plan is technically unfunded, the life insurance policies are available to finance future benefits. Refer to Note 12 for additional discussions regarding retirement plans.

NOTE 9: DEPOSITS

A summary of time deposits by maturity at December 31, 2018, is shown in the following chart (dollars in thousands):

Maturity	Total
2019	$ 1,218,325
2020	608,294
2021	277,946
2022	95,580
2023 and thereafter	37,617
	$ 2,237,762

At year-end 2018, TowneBank had a total of $426.13 million in no-penalty time deposits as compared to $407.03 million at December 31, 2017. The aggregate amount of time deposits of $250,000 or more was $742.85 million and $617.51 million at December 31, 2018 and 2017, respectively.

Some of the Company's officers and directors, and the respective companies in which the officers and directors have a financial interest, have deposit relationships with the Company. Related party deposits amounted to approximately $96.44 million and $96.83 million at December 31, 2018 and 2017, 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):

	2018	2017
Balance outstanding at end of year	$ 799,315	$ 526,923
Average balance outstanding	$ 849,988	$ 587,281
Maximum outstanding at any month-end	$ 873,923	$ 687,511
Average interest rate during the year	1.91%	1.68%
Average interest rate at end of year	2.11%	1.40%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2018, are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Call/Reset Date	Outstanding Amount
11/15/2028	3.43%	—	$ 4,267
12/01/2028	2.83%	—	3,048
08/29/2019	2.56%	01/29/2019	72,000
11/04/2019	1.26%	—	260,000
03/06/2020	2.48%	01/07/2019	100,000
04/09/2020	2.53%	01/09/2019	115,000
04/16/2019	2.49%	01/16/2019	135,000
10/25/2019	2.60%	01/25/2019	60,000
05/03/2021	2.48%	01/31/2019	50,000
			$ 799,315

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

	2018	2017
Balance outstanding at end of year	$ 46,439	$ 24,094
Average balance outstanding	$ 46,859	$ 29,676
Maximum outstanding at any month-end	$ 51,792	$ 34,562
Average interest rate during the year	0.43%	0.36%
Average interest rate at end of year	0.58%	0.42%

Retail repurchase agreements (“REPOs”) totaled $46.44 million at December 31, 2018. All REPOs are overnight short-term investments and are not insured by the Federal Deposit Insurance Corporation (“FDIC”). Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and are therefore accounted for as a secured borrowing. Due to the overnight short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily. In addition, federal funds lines with other financial institutions of $140.00 million were available at December 31, 2018, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2018 and 2017, the Company had an unused line of credit with the FHLB totaling $2.37 billion and $1.85 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 $1.59 billion at December 31, 2018.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2018, which provide potential additional funding.

On July 17, 2017, the Company issued $250.0 million of fixed-to-floating rate subordinated notes due July 30, 2027 in a public offering. The Company received $247.07 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30,

2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.550%. The Company may redeem the subordinated notes in whole or in part, on or after July 30, 2022. At December 31, 2018, the carrying value of the notes totaled $247.86 million, compared to $247.20 million at December 31, 2017.

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,	**2018**	**2017**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 2,701,184	$ 2,282,303
Standby letters of credit	119,380	83,620
	$ 2,820,564	$ 2,365,923

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, 2018. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

Additionally, the Company had $112.92 million in mortgage loans sold to investors with various recourse and warranty provisions as of December 31, 2018.

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 2018, 2017, and 2016. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2018, 2017, or 2016. The Company made matching contributions of $4.58 million, $4.35 million, and $3.46 million for the years ended December 31, 2018, 2017, and 2016, 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 interest bearing deposits on the balance sheet. Changes in the obligation are recorded in compensation expense, which resulted in an increase in expenses of $0.43 million, $0.41 million, and $0.68 million for the years ended December 31, 2018, 2017, and 2016, respectively. The Company did not make matching contributions to the plan for the years ended December 31, 2018, 2017, or 2016.

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 10-year, 15-year, or 20-year period, beginning upon the later of separation of service or the attainment of contractual retirement age. The SERP agreements provide for an annual vesting schedule until the participating officer reaches retirement age. In the case of a participating officer's voluntary termination of employment, disability, or termination for cause, the annual amount payable under the SERP is equal to the amount of the vested benefit earned as of the date of termination of employment. In the case of involuntary termination without cause or termination of employment for good reason by the participating officer, the participating officer becomes fully vested in the full retirement benefit. Upon termination of employment, payment of the retirement benefit generally does not begin until the participating officer reaches the designated retirement age set forth in the SERP agreement. In the event of death, the full amount of the retirement benefit is payable. We also provide postretirement benefits other than pensions for certain employees, which include health care, dental care, Medicare Part B reimbursement and life insurance benefits. Benefits under this plan are accounted for under the guidance of ASC 715 *Compensation - Retirement 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,	**2018**	**2017**	**2018**	**2017**
Change in benefit obligation				
Benefit obligation, beginning of year	$ 35,105	$ 30,290	$ 1,345	$ 918
Service cost	3,096	3,336	—	39
Interest cost	1,429	1,146	59	(41)
Net amortization	338	436	52	8
Benefits paid	(2,010)	(654)	(12)	(9)
Prior service cost	224	1,027	—	—
Net actuarial (gain) loss	(2,658)	(476)	(59)	430
Benefit obligation, end of year	$ 35,524	$ 35,105	$ 1,385	$ 1,345
Change in plan assets				
Fair value of plan assets, beginning of year	—	—	—	—
Employer contributions	2,010	654	12	9
Benefits paid	(2,010)	(654)	(12)	(9)
Fair value of plan assets, end of year	$ —	$ —	$ —	$ —
Funded status, end of year	$ (35,524)	$ (35,105)	$ (1,385)	$ (1,345)
Accumulated benefit obligation, end of year	$ 32,720	$ 31,927	$ 230	$ 1,345
Amounts recognized in other comprehensive income, pretax				
Prior service cost	$ 224	$ 1,027	$ —	$ —
Net actuarial (gain) loss	$ (2,658)	$ (476)	$ (59)	$ 430

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

	SERP			Other Postretirement Benefits		
	2018	**2017**	**2016**	**2018**	**2017**	**2016**
Service cost	$ 3,096	$ 3,336	$ 2,270	$ —	$ 39	$ 111
Interest cost	1,429	1,146	1,092	59	(41)	32
Prior service cost	305	288	151	—	—	—
Net amortization	32	148	66	52	8	(59)
Net periodic benefit cost	$ 4,862	$ 4,918	$ 3,579	$ 111	$ 6	$ 84

The service cost component of net periodic benefit costs is included in salaries and employee benefits. All other components of net periodic benefit costs are included in other expenses.

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

	SERP		Other Postretirement Benefits	
December 31,	**2018**	**2017**	**2018**	**2017**
Prior service cost	$ 2,032	$ 2,114	$ —	$ —
Net actuarial (gain) loss	(2,329)	25	132	191
Deferred tax benefit (expense)	65	(749)	(29)	(67)
Amounts included in accumulated other comprehensive income, net of tax	$ (232)	$ 1,390	$ 103	$ 124

Pre-tax amounts recorded in accumulated other comprehensive income as of December 31, 2018 that are expected to be recognized as a component of our net periodic benefit cost in 2019 consist of the following (in thousands):

	SERP	Other Postretirement Benefits
Net actuarial (gain) loss	$ (651)	$ 9
Prior service cost	$ 307	$ —

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 4.45% in 2018, 3.78% in 2017, and 4.32% 2016. The rate of increase in future compensation levels used was 4.0% in 2018, 2017, and 2016. The discount rate used to determine net periodic benefit cost and benefit obligation of other postretirement benefits was 4.45% in 2018, 3.78% in 2017, and 4.32% 2016. 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
2019	$ 1,794	$ 59
2020	2,461	63
2021	2,677	67
2022	2,757	71
2023	2,976	71
2024-2028	17,272	426

In conjunction with its acquisition of Paragon, the Company assumed the liabilities related to Paragon's existing non-qualifying supplemental retirement contractual agreements with several key executives. The executives were fully vested in their benefits prior to the acquisition. The agreements typically require a fixed retirement benefit paid over a 20 year period following retirement. The agreements are accounted for under ASC 710 *Compensation - General*.

The initial accrued liability assumed at acquisition was $3.32 million. In 2018, net periodic benefits costs related to the agreements were service costs totaling $1.29 million, and interest costs totaling $0.14 million. Distributions related to agreements under the plan in 2018 totaled $1.17 million. The service costs component is included in salaries and employee benefits and interest costs in other expenses. The accrued liability related to the agreements was $3.57 million, as of December 31, 2018, and is included as a component of other liabilities on the Consolidated Balance Sheets. The discount rate used to determine net periodic benefit costs and benefit obligation of postretirement benefits was 4.45% in 2018.

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 stockholder approved with an established termination date. In May 2017, stockholders approved the TowneBank 2017 Stock Incentive Plan ("2017 Plan"), which became effective May 24, 2017. This plan replaced the TowneBank 2008 Stock Incentive Plan ("2008 Plan") and no additional awards were made under the 2008 Plan after the effective date of the 2017 Plan. Except as specifically disclosed, the terms and limitations of the 2017 Plan and 2008 Plan are the same and shall be referred to collectively as the Plan.

The Plan is administered by the Compensation Committee of the Board of Directors (the "Compensation Committee"). The maximum aggregate number of shares that may be issued under the Plan may not exceed 2.50 million. The Company has a policy of using authorized and unissued common shares to satisfy share option exercises and vesting of restricted stock awards. At December 31, 2018, approximately 2.19 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,	**2018**		**2017**		**2016**	
	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	46,391	$ 14.97	97,590	$ 16.24	277,287	$ 17.69
Granted	—	—	—	—	—	—
Exercised	(20,624)	15.76	(50,066)	17.36	(125,622)	17.59
Expired	(1,030)	19.11	(824)	18.81	(51,500)	20.87
Forfeited	—	—	(309)	17.96	(2,575)	14.18
Options outstanding, ending balance	24,737	$ 14.14	46,391	$ 14.97	97,590	$ 16.24
Options exercisable at December 31,	14,953	$ 13.74	30,171	$ 14.90	66,799	$ 16.51

	Number of Shares	Weighted-Average Exercise Price
Unvested stock options, December 31, 2017	16,220	$ 15.11
Granted	—	—
Vested	(6,436)	15.62
Forfeited	—	—
Unvested stock options, December 31, 2018	9,784	$ 14.77

For the years ended December 31, 2018, 2017, and 2016, there were no stock options granted. In 2018, the total intrinsic value of options exercised was $0.29 million. In 2017, the total intrinsic value of options exercised was $0.73 million. In 2016, the total intrinsic value of options exercised was $1.27 million. Additional information pertaining to options outstanding at December 31, 2018, is as follows:

	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	24,737	$ 14.14	$ 242,557	1.51
Options vested or expected to vest	24,479	$ 14.14	$ 240,222	1.50
Options exercisable	14,953	$ 13.74	$ 152,714	1.25

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, 2018, 2017, and 2016, the tax benefit on cash paid for stock options exercised was $0.06 million, $0.25 million, and $0.45 million, respectively. Compensation expense related to stock options for the years ended December 31, 2018, 2017, and 2016, was $0.02 million, $0.06 million, and $0.07 million, respectively. As of December 31, 2018, there was $0.03 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 1.63 years.

Restricted stock awards ("RSAs"): Under the Plan, grantees of restricted stock awards have full voting rights on the shares. Grants issued under the 2008 Plan were also entitled to cash and stock dividends as they were paid. Under the 2017 Plan, cash and stock dividends on restricted stock awards are accumulated and retained for the grantee by the Company until the stock vests. The accumulated cash and stock dividends on restricted stock awards are distribute with the award at vesting. RSAs granted under the Plan are generally subject to vesting requirements ranging from two to 10 years. The shares are subject to forfeiture if vesting and other contractual provision requirements are not met.

The following chart shows a summary of restricted stock award activity and related information, assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2018:

	Number of Shares	Weighted-Average Price
Unvested RSAs, beginning balance	375,781	$ 21.01
Granted	307,473	29.90
Vested	(134,211)	19.46
Forfeited	(20,257)	23.96
Unvested RSAs, ending balance	528,786	$ 26.46

Compensation expense related to awards for the years ended December 31, 2018, 2017, and 2016, was $4.05 million, $2.53 million, and $2.09 million, respectively. The total fair value of awards vested during 2018, 2017, and 2016 was $2.61 million, $2.32 million, and $1.76 million, respectively. As of December 31, 2018, there was $10.99 million of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 2.79 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 $13.96 million and $12.52 million at December 31, 2018 and 2017, respectively.

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

The Company has a 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, 2018, the Company entered the open market and acquired 84,056 shares at an average price of $29.95 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2018, the Company entered the open market and acquired 170,268 shares at an average price of $31.19 per share.

In connection with the member stock purchase component of the plan for the year ended December 31, 2017, the Company entered the open market and acquired 78,215 shares at an average price of $31.75 per share. In connection with the dividend reinvestment component of the plan for the year ended December 31, 2017, the Company entered the open market and acquired 153,894 shares at an average price of $32.05 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In February 2018, the Company declared a quarterly cash dividend of $0.14 per common share. In May, August, and November 2018, the Company declared quarterly cash dividends of $0.16 per common share. In February 2017, the Company declared a quarterly cash dividend of $0.13 per common share. In May, August, and November 2017, the Company declared quarterly cash dividends of $0.14 per common share. In February 2016, the Company declared a quarterly cash dividend of $0.12 per common share. In May, August, and November 2016, the Company declared quarterly cash dividends of $0.13 per common share. The quarterly dividends were paid on April 12, 2016; July 12, 2016; October 12, 2016; January 12, 2017; April 12, 2017;

July 12, 2017; October 12, 2017; January 12, 2018; April 10, 2018; July 10, 2018; October 10 2018; and January 11, 2019.

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

NOTE 15: REVENUE

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU replaces nearly all previous GAAP revenue recognition guidance. The standard prescribes a five step model for recognizing revenue, and requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract.

On January 1, 2018, the Company adopted the standard using the modified retrospective method for all contracts. Results for reporting periods beginning January 1, 2018 are presented under the new standard, while prior-period amounts have not been adjusted and continue to be reported in accordance with the Company's historic accounting under ASC 605.

The Company recorded a net increase to beginning retained earnings of $6.42 million as of January 1, 2018 due to the cumulative impact of adopting the standard. The adoption did not have a significant impact on the Company's Consolidated Financial Statements for the year ended December 31, 2018 and, as a result, comparisons of revenues and operating profit performance between periods are not materially affected by the adoption of this ASU.

The ASU requires the disaggregation of revenue from contracts with customers into categories that show how economic factors affect the nature, timing, and uncertainty of revenue and cash flows. Suggested categories of disaggregation included but were not limited to: (1) type of good or service, (2) geographical region, (3) market or type of customer, (4) type of contract, (5) contract duration, (6) timing of the transfer of goods or services, (7) sales channels. The Company disaggregates revenue from contracts by major product line, a type of good or service.

The following table presents certain selected financial information for the periods indicated (dollars in thousands):

For the year ended December 31,	2018	2017
Revenue from Contracts with Customers:		
(1) Investment management income		
Investment commissions, net	$ 6,354	$ 4,870
Total	$ 6,354	$ 4,870
(2) Insurance income		
Property and casualty insurance income, net	$ 38,327	$ 35,004
Benefit insurance income, net	10,387	9,917
Travel insurance commissions, net	5,123	4,667
Total	$ 53,837	$ 49,588
(3) Real estate and property management income		
Real estate sales commissions, net	$ 9,458	$ 7,991
Real estate property management income, net	22,405	19,496
Total	$ 31,863	$ 27,487

(1) Investment management services are provided by Towne Investment Group ("TIG") and Towne Wealth Management ("TWM"), which are included in the Banking segment of TowneBank. TIG and TWM market services to our customers on behalf of Raymond James Financial Services, Inc. ("RJFS"). RJFS is a broker-dealer and investment advisory firm registered with the Securities and Exchange Commission and is a member of the Financial Industry Regulatory Authority. RJFS provides our customers brokerage and investment advisory services for the purchase and sale of non-deposit investment and/or insurance products.

TIG and TWM earn revenue in the form of commissions and fees. TIG and TWM's performance obligation is related to the referral of business to a third party asset manager. Performance obligations are satisfied when a new customer enters into a contract with the third party asset manager and when the manager collects a fee from the customer. Commissions are typically collected shortly after fees are collected by the third party asset manager and there is no material over time recognition of revenue. In carrying out this performance obligation, TowneBank acts in the capacity of an agent.

(2) Insurance revenue is included in the Insurance segment. This segment earns revenue in the form of commissions by binding insured parties' insurance policies with external insurance companies. Insurance revenue is earned in the form of commissions received for selling insurance policies as an independent agent of external insurance companies who underwrite the insurance policies. The external insurance companies retain the risks associated with the insurance policies. Under the new standard, the income stream for insurance revenue fluctuated quarterly when compared to prior year but had only a nominal impact on the full year ending December 31, 2018, compared to 2017. These fluctuations were due to a change in the timing of the recognition of contingency income. Under the new guidance, contingency income is being recognized up front using historical trends. Under the old guidance, contingency income revenue was recognized upon receipt of funds. The Insurance segment's performance obligation is related to the referral of business to third party insurance companies. Performance obligations are satisfied when a new customer enters into a contract with the third party insurance company. Commissions are typically collected shortly thereafter and there is no material over time recognition of revenue. Contingent income is estimated and recorded at the time of the sale of the insurance policy to

the extent that it is probable that there will not be a material amount of the income reversed. In carrying out this performance obligation, TowneBank acts in the capacity of an agent.

(3) Real estate and property management revenue is mainly in the form of commissions, fee, and title income. The revenue is earned on both residential and commercial properties. Real estate and property management revenues fall within the Realty segment. Towne Realty, LLC provides real estate services, and residential and title insurance. Revenue is recognized as commissions and fee income are received. Performance obligations are satisfied with the receipt of commissions and fee income and there is no material over time recognition of revenue.

TowneBank's performance obligation related to the property management business is to market the property, take reservations (including the collection of rent) and provide facility management services. The performance obligation to take reservations is satisfied when a customer makes a booking. Facility management services obligations are ongoing until a customer vacates a property. Fees are typically collected half upon booking and half upon a customer vacating a property. Materially all of the value of the performance obligation is related to the booking of the reservation, therefore, the Company recognizes the commission at the time the reservation is confirmed via the receipt of deposit. This is a change from how revenue was recognized by the Company prior to adopting the new standard. In applying the new revenue standard, management relied on significant judgment to determine the value provided under the contract with the property owner related to the reservations system. This led to earlier revenue recognition for these contracts. In carrying out these performance obligations, TowneBank acts in the capacity of an agent. Under the new revenue standard, the quarterly property management income stream fluctuated when compared to prior year but did not have an impact on year over year income.

Remaining performance obligations related to ASC 606 application to the above revenue streams represent performance obligations with an original contract term greater than one year, which are fully or partially unsatisfied at the end of the period. The Company applies the practical expedient in ASC paragraph 606-10-50-14(a) and does not disclose information about remaining performance obligations that are part of a contract with an original expected duration of one year or less. The timing of revenue billings and cash collections may result in contract assets (the Company performing on its obligations prior to receiving payment unrelated to the passage of time) and contract liabilities (the Company receiving payment from a customer prior to performing on its obligation to that customer) on the Consolidated Balance Sheets. The Company had no material contract assets or contract liabilities recorded on the Consolidated Balance Sheets as of December 31, 2018.

Note: This disclosure includes only revenue from contracts with third party customers. See Note 26 for additional information regarding other revenue streams, primarily from revenue between the Company's consolidated subsidiaries and lines of business, in addition to those included in the table above.

NOTE 16: OTHER EXPENSES

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

Year Ended December 31,	2018	2017	2016
Acquisition-related expenses	$ 8,428	$ 2,268	$ 19,111
Advertising and marketing	11,194	9,867	8,443
Amortization - intangibles	11,710	7,656	6,010
Bank franchise tax/SCC fees	5,647	5,303	4,184
Charitable contributions	5,104	5,550	4,582
Directors' expense	1,991	1,734	1,371
FDIC and other insurance	5,047	4,249	4,613
Foreclosed property expenses	820	782	1,335
Other	15,275	13,336	10,660
Outside processing	10,364	6,975	6,420
Professional fees	8,323	7,144	5,329
Stationery and office supplies	3,217	2,730	2,978
Software expense	10,621	8,517	7,116
Telephone and postage	6,788	6,907	5,996
Travel/Meals/Entertainment	3,636	2,820	2,044
	$ 108,165	$ 85,838	$ 90,192

NOTE 17: REGULATORY CAPITAL REQUIREMENTS

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

In July 2013, the FDIC and the other federal banking agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). On January 1, 2015, the Company became subject to the FDIC final rule's revised definitions of regulatory capital, the new minimum regulatory capital ratios, and various regulatory capital adjustments and deductions according to transition provisions and timelines. All banking organizations began calculating standardized total risk-weighted assets on January 1, 2015. A transition period for the capital conservation buffer under Basel III for all banking organizations began on January 1, 2016, and ended 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, 2018.

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

As of December 31, 2018	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)	$ 1,050,018	11.51%	$ 410,632	4.50%	$ 638,762	7.00%
Tier 1 capital						
(to risk-weighted assets)	$ 1,053,030	11.54%	$ 547,510	6.00%	$ 775,639	8.50%
Total risk-based capital						
(to risk-weighted assets)	$ 1,352,985	14.83%	$ 730,013	8.00%	$ 958,142	10.50%
Tier 1 leverage ratios						
(to average assets)	$ 1,053,030	9.87%	$ 426,611	4.00%	$ 533,263	5.00%

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

NOTE 18: 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, 2018 and 2017, the Company used weighted average fall-out rates of 14.90%, and 17.14%, 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, 2018			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 358,542	$ —	$ 358,542
U.S. Treasury notes	$ —	$ 1,246	$ —	$ 1,246
Municipal securities	$ —	$ 87,308	$ —	$ 87,308
Mortgage-backed securities issued by GSE	$ —	$ 617,251	$ —	$ 617,251
Trust preferred and other corporate securities	$ —	$ 30,992	$ —	$ 30,992
Other equity securities	$ —	$ 4,797	$ —	$ 4,797
Derivative assets	$ —	$ 1,996	$ 1,200	$ 3,196
Derivative liabilities	$ —	$ 1,507	$ —	$ 1,507

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 274,468	$ —	$ 274,468
U.S. Treasury notes	$ —	$ 301,497	$ —	$ 301,497
Municipal securities	$ —	$ 17,487	$ —	$ 17,487
Mortgage-backed securities issued by GSE	$ —	$ 249,322	$ —	$ 249,322
Trust preferred and other corporate securities	$ —	$ 23,364	$ —	$ 23,364
Other equity securities	$ —	$ 1,516	$ —	$ 1,516
Derivative assets	$ —	$ 499	$ 2,000	$ 2,499
Derivative liabilities	$ —	$ 297	$ —	$ 297

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, 2018	Level 1	Level 2	Level 3	Total
Impaired loans	$ —	$ —	$ 5,896	$ 5,896
Foreclosed property	$ —	$ —	$ 19,416	$ 19,416
December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans	$ —	$ —	$ 9,852	$ 9,852
Other real estate owned	$ —	$ —	$ 23,288	$ 23,288

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 1.38% to 16.38%, with a weighted average of 12.32%.

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

Foreclosed property: The fair value of foreclosed property is measured at fair value on a nonrecurring basis (upon initial recognition or subsequent impairment) and is classified within Level 3 of the valuation hierarchy. When transferred from the loan portfolio, other real estate is adjusted to fair value less estimated selling costs and is subsequently carried at the lower of carrying value or fair value less estimated selling costs. The fair value is generally determined using an external appraisal process and is discounted based on internal criteria when deemed necessary.

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

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

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

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

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

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

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

Repurchase agreements: The carrying amount approximates fair value.

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

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

December 31, 2018	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 665,029	$ 665,029	$ 665,029	$ —	$ —
Interest-bearing deposits in financial institutions	$ 21,667	$ 21,667	$ 21,667	$ —	$ —
Securities available for sale	$ 1,095,339	$ 1,095,339	$ —	$ 1,095,339	$ —
Securities held to maturity	$ 50,598	$ 51,268	$ —	$ 51,268	$ —
Other equity securities	$ 4,797	$ 4,797	$ —	$ 4,797	$ —
Mortgage loans held for sale	$ 220,986	$ 221,086	$ —	$ 221,086	$ —
Loans, net	$ 7,966,139	$ 7,894,198	$ —	$ —	$ 7,894,198
Interest receivable	$ 33,080	$ 33,080	$ —	$ 33,080	$ —
Non-maturity deposits	$ 6,020,094	$ 5,609,446	$ —	$ 5,609,446	$ —
Time deposits	$ 2,350,328	$ 2,339,663	$ —	$ 2,339,663	$ —
Advances from the Federal Home Loan Bank of Atlanta	$ 799,315	$ 795,871	$ —	$ 795,871	$ —
Subordinated debentures	$ 247,861	$ 248,750	$ —	$ 248,750	$ —
Repurchase agreements and other borrowings	$ 47,156	$ 46,449	$ —	$ 46,449	$ —
Interest payable	$ 9,638	$ 9,638	$ —	$ 9,638	$ —

December 31, 2017	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 500,408	$ 500,408	$ 500,408	$ —	$ —
Interest-bearing deposits in financial institutions	$ 4,471	$ 4,471	$ 4,471	$ —	$ —
Securities available for sale	$ 866,138	$ 866,138	$ —	$ 866,138	$ —
Securities held to maturity	$ 61,304	$ 62,885	$ —	$ 62,885	$ —
Other equity securities	$ 1,516	$ 1,516	$ —	$ 1,516	$ —
Mortgage loans held for sale	$ 313,256	$ 313,453	$ —	$ 313,453	$ —
Loans, net	$ 5,946,965	$ 5,910,115	$ —	$ —	$ 5,910,115
Interest receivable	$ 22,501	$ 22,501	$ —	$ 22,501	$ —
Non-maturity deposits	$ 4,642,360	$ 4,638,361	$ —	$ 4,638,361	$ —
Time deposits	$ 1,805,860	$ 1,793,106	$ —	$ 1,793,106	$ —
Advances from the Federal Home Loan Bank of Atlanta	$ 526,923	$ 522,720	$ —	$ 522,720	$ —
Subordinated debentures	$ 247,196	$ 256,305	$ —	$ 256,305	$ —
Repurchase agreements and other borrowings	$ 24,850	$ 24,853	$ —	$ 24,853	$ —
Interest payable	$ 9,274	$ 9,274	$ —	$ 9,274	$ —

NOTE 19. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company enters into interest rate lock commitments with its mortgage customers. The Company is also a party to forward mortgage loan sales contracts to sell loans servicing released and sales of TBA mortgage-backed securities. When the interest rate is locked with the borrower, the rate lock commitment, forward sale agreement,

and mortgage-backed security position are undesignated derivatives and marked to fair value through earnings. The fair value of the rate lock derivative is based on quoted prices for similar loans in the secondary market adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. Both the rate lock commitment and the corresponding forward sales contracts are considered derivatives, but are not accounted for using hedge accounting. As such, changes in the estimated fair value of the derivatives during the commitment period are recorded in current earnings and included in net residential mortgage banking income in the Consolidated Statements of Income.

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

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

	December 31, 2018		December 31, 2017	
	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	$ 165,388	$ 1,996	$ 125,092	$ 410
Interest rate lock commitments	231,852	1,200	199,837	2,000
TBA mortgage-backed securities	—	—	67,500	89
Total included in other assets		$ 3,196		$ 2,499
Included in other liabilities:				
Forward contracts related to interest rate lock commitments and mortgage loans held for sale	$ 10,262	$ 38	$ 32,326	$ 126
TBA mortgage-backed securities	171,000	1,469	127,000	171
Total included in other liabilities		$ 1,507		$ 297

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

	December 31,		
	2018	2017	2016
Interest rate lock commitments	$ (800)	$ (282)	$ (2,407)
Forward sales contracts	1,953	613	908
Total	$ 1,153	$ 331	$ (1,499)

NOTE 20: 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 $151.84 million and $112.66 million were not included in the Consolidated Balance Sheets at December 31, 2018 and 2017, respectively. These limited partner interests had carrying values of $33.03 million and $22.79 million at December 31, 2018 and 2017, 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 $42.34 million and $30.15 million at December 31, 2018 and 2017, respectively. As of December 31, 2018, the Company has $36.15 million in funding commitments that are dependent on certain contractual milestones and $9.20 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the year ended December 31, 2018, a tax benefit totaling $0.87 million, net of amortization of $4.51 million, was recognized as a component of income tax expense. The tax benefits net of amortization includes additional one time amortization expense of $0.21 million as a result of the TCJA.

NOTE 21: INCOME TAXES

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

On December 22, 2017, the President of the United States signed into law the TCJA. The legislation made key changes to U.S. tax law, including the reduction of the U.S. federal corporate tax rate from 35% to 21%, effective January 1, 2018.

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. As a result of the reduction in the U.S. corporate income tax rate from 35% to 21% under the TCJA, the Company revalued its ending net deferred tax assets at December 31, 2017, and recognized a provisional $10.11 million tax expense in the Company's consolidated statement of income for the year ended December 31, 2017. An additional expense of $0.70 million was recognized in 2018 due to the finalization of the provisional component of the TCJA.

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

For the Year Ended December 31,	2018	2017	2016
Current income tax expense			
Federal	$ (30,867)	$ (51,925)	$ (24,520)
State	(2,060)	(2,318)	(1,024)
Total current tax expense	(32,927)	(54,243)	(25,544)
Deferred income tax (expense) benefit			
Federal	(1,013)	9,210	(3,154)
State	409	332	—
Revaluation of deferred taxes	(696)	(10,112)	—
Total deferred income tax expense	(1,300)	(570)	(3,154)
Income tax expense	$ (34,227)	$ (54,813)	$ (28,698)

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):

	2018		2017		2016	
For the Year Ended December 31,	**$**	**Rate**	**$**	**Rate**	**$**	**Rate**
Federal income tax expense at statutory rate	$ (35,284)	(21.00)%	$ (49,867)	(35.00)%	$ (33,582)	(35.00)%
Revaluation of deferred taxes	(696)	(0.41)%	(10,112)	(7.10)%	—	— %
State income tax expense, net of federal benefit	(1,667)	(0.99)%	(1,507)	(1.06)%	(666)	(0.69)%
Tax advantaged income	3,469	2.06 %	5,062	3.55 %	4,981	5.19 %
LIHTC, net of amortization	874	0.52 %	1,750	1.23 %	1,378	1.44 %
Merger and acquisition expense, non-deductible	(233)	(0.14)%	(412)	(0.29)%	(476)	(0.50)%
Other	(690)	(0.41)%	273	0.16 %	(333)	(0.35)%
Income tax expense	$ (34,227)	(20.37)%	$ (54,813)	(38.51)%	$ (28,698)	(29.91)%

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

Year Ended December 31,	**2018**	**2017**
Deferred tax assets:		
Allowance for loan losses	$ 11,581	$ 9,819
Stock-based compensation	491	465
Other	2,902	940
Accrued expenses	1,759	1,322
Retirement plan	9,849	8,485
Unrealized loss on securities available for sale	2,591	1,398
Deferred compensation	4,866	3,908
Assets acquired in acquisitions	8,511	7,936
Total deferred tax assets	42,550	34,273
Deferred tax liabilities:		
Depreciation	12,647	8,387
Noncompete and intangibles	7,761	3,920
Basis differences due to tax credits and partnerships	(116)	80
Other	1,197	5,273
Total deferred tax liabilities	21,489	17,660
Net deferred tax assets	$ 21,061	$ 16,613

As of December 31, 2018 and December 31, 2017, 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 is no longer subject to examination for federal and state purposes for tax years prior to 2015.

NOTE 22: ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table summarizes the components of accumulated other comprehensive income (loss) at December 31, 2018, 2017, and 2016, and changes during the years then ended. The amounts reclassified from accumulated other comprehensive income for the securities available for sale are included in gain on investment securities, net on the Consolidated Statements of Income, while the amounts reclassified from accumulated other comprehensive income for the defined benefit retirement plan are a component of salaries and employee benefits expense on the Consolidated Statements of Income.

(in thousands)	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2015	$ (1,805)	$ (1,189)	$ (2,994)
Other comprehensive income (loss) before reclassifications, net of tax	(1,300)	210	(1,090)
Amounts reclassified from AOCI, net of tax	(4)	102	98
Net change	(1,304)	312	(992)
Balance, December 31, 2016	(3,109)	(877)	(3,986)
Other comprehensive loss before reclassifications, net of tax	(1,069)	(826)	(1,895)
Amounts reclassified from AOCI, net of tax	1	188	189
Net change	(1,068)	(638)	(1,706)
Balance, December 31, 2017	(4,177)	(1,515)	(5,692)
Impact from adoption of new accounting standards	(851)	(309)	(1,160)
Other comprehensive income (loss) before reclassifications, net of tax	(4,287)	1,712	(2,575)
Amounts reclassified from AOCI, net of tax	(2)	239	237
Net change	(4,289)	1,951	(2,338)
Balance, December 31, 2018	$ (9,317)	$ 127	$ (9,190)

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

NOTE 23: 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, 2018. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2018.

NOTE 24: 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 $341.09 million, $363.08 million, and $364.33 million as of December 31, 2018, 2017, and 2016, respectively. During 2018, new advances on all commitments to such parties totaled $36.81 million, and repayments amounted to $469.64 million. Included in the loans to related parties, at December 31, 2018, we had $74.28 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 $2.96 million, $2.92 million, and $2.76 million for the years ended December 31, 2018, 2017, and 2016, 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, 2018, 2017, and 2016, approximated $7.55 million, $1.28 million, and $1.67 million, respectively.

NOTE 25: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2018 and 2017, is as follows (in thousands, except per share data):

2018	Fourth	Third	Second	First
Interest income	$ 114,307	$ 110,394	$ 105,256	$ 91,866
Interest expense	25,099	21,697	18,433	15,521
Provision for loan losses	2,292	1,241	3,056	1,952
Noninterest income	42,209	49,217	50,235	49,929
Net gain on investment securities	—	—	—	3
Noninterest expense	82,337	88,262	89,221	92,304
Income before income tax expense and noncontrolling interest	46,788	48,411	44,781	32,021
Income tax expense	10,348	9,159	8,643	6,077
Net income	36,440	39,252	36,138	25,944
Noncontrolling interest	(450)	(959)	(1,334)	(1,238)
Net income attributable to TowneBank	$ 35,990	$ 38,293	$ 34,804	$ 24,706
Net income per common share				
Basic	$ 0.50	$ 0.53	$ 0.48	$ 0.36
Diluted	$ 0.50	$ 0.53	$ 0.48	$ 0.36
Dividends	$ 0.16	$ 0.16	$ 0.16	$ 0.14

2017	Fourth	Third	Second	First
Interest income	$ 78,465	$ 77,871	$ 78,681	$ 70,087
Interest expense	12,801	11,948	9,428	9,806
Provision for loan losses	869	696	1,320	2,541
Noninterest income	43,477	49,416	50,344	44,886
Net gain on investment securities	—	—	(1)	—
Noninterest expense	73,660	74,186	78,119	70,248
Income before income tax expense and noncontrolling interest	34,612	40,457	40,156	32,378
Income tax expense	21,325	11,862	12,240	9,386
Net income	13,287	28,594	27,916	22,992
Noncontrolling interest	(954)	(1,445)	(1,704)	(1,024)
Net income attributable to TowneBank	$ 12,333	$ 27,149	$ 26,212	$ 21,968
Net income per common share				
Basic	$ 0.20	$ 0.44	$ 0.42	$ 0.35
Diluted	$ 0.20	$ 0.44	$ 0.42	$ 0.35
Dividends	$ 0.14	$ 0.14	$ 0.14	$ 0.13

NOTE 26: 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 following our acquisition of Paragon in January 2018, the Raleigh and Charlotte metropolitan areas in North Carolina. The Realty segment provides 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, employee benefit services and travel insurance.

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

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

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

For the Year Ended December 31, 2018	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 329,584	$ 11,489	$ —	$ 341,073
Provision for loan losses	8,541	—	—	8,541
Net interest income after provision for loan losses	321,043	11,489	—	332,532
Residential mortgage banking income, net	(1,592)	66,696	—	65,104
Real estate brokerage and property management income, net	—	31,863	—	31,863
Insurance commissions and other title fees and income, net	449	1,877	53,838	56,164
Other noninterest income	35,403	2,091	968	38,462
Noninterest expense	208,149	101,216	42,759	352,124
Income before income tax, corporate allocation, and noncontrolling interest	147,154	12,800	12,047	172,001
Corporate allocation	1,736	(1,091)	(645)	—
Income before income tax provision and noncontrolling interest	148,890	11,709	11,402	172,001
Income tax provision	28,880	2,892	2,455	34,227
Net income	120,010	8,817	8,947	137,774
Noncontrolling interest	(8)	(2,398)	(1,575)	(3,981)
Net income attributable to TowneBank	$ 120,002	$ 6,419	$ 7,372	$ 133,793
Net income as percentage of total	89.69%	4.80%	5.51%	100.00%
Assets	$ 10,475,712	$ 441,282	$ 246,036	$ 11,163,030
Efficiency ratio	57.23%	88.77%	78.02%	66.11%

For the Year Ended December 31, 2017	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 251,003	$ 10,118	$ —	$ 261,121
Provision for loan losses	5,426	—	—	5,426
Net interest income after provision for loan losses	245,577	10,118	—	255,695
Residential mortgage banking income, net	(394)	76,245	—	75,851
Real estate brokerage and property management income, net	—	27,487	—	27,487
Insurance commissions and other title fees and income, net	468	1,877	49,588	51,933
Other noninterest income	29,573	2,311	966	32,850
Noninterest expense	158,854	99,930	37,430	296,214
Income before income tax, corporate allocation, and noncontrolling interest	116,370	18,108	13,124	147,602
Corporate allocation	1,828	(1,210)	(618)	—
Income before income tax provision and noncontrolling interest	118,198	16,898	12,506	147,602
Income tax provision	44,584	5,791	4,438	54,813
Net income	73,614	11,107	8,068	92,789
Noncontrolling interest	1	(3,756)	(1,371)	(5,126)
Net income attributable to TowneBank	$ 73,615	$ 7,351	$ 6,697	$ 87,663
Net income as percentage of total	83.97%	8.39%	7.64%	100.00%
Assets	$ 7,842,558	$ 504,516	$ 175,102	$ 8,522,176
Efficiency ratio	56.60%	84.66%	74.04%	65.94%

For the Year Ended December 31, 2016	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 211,112	$ 7,763	$ 1	$ 218,876
Provision for loan losses	5,326	31	—	5,357
Net interest income after provision for loan losses	205,786	7,732	1	213,519
Residential mortgage banking income, net	(1,078)	59,870	—	58,792
Real estate brokerage and property management income, net	—	20,515	—	20,515
Insurance commissions and other title fees and income, net	373	1,883	44,485	46,741
Other noninterest income	26,269	2,003	902	29,174
Noninterest expense	162,344	70,929	34,555	267,828
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%

The following table provides the change in net income and total assets for each segment, comparing the years ended December 31, 2018 and 2017 (dollars in thousands):

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 46,387	$ (932)	$ 675	$ 46,130
Net Income (%)	63.01%	(12.68)%	10.08%	52.62%
Total Assets ($)	$ 2,633,154	$ (63,234)	$ 70,934	$ 2,640,854
Total Assets (%)	33.58%	(12.53)%	40.51%	30.99%

NOTE 27: 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,	2018	2017	2016
Basic			
Net income available to common shareholders	$ 133,793	$ 87,663	$ 67,250
Weighted average common shares outstanding	71,148,230	62,168,455	56,837,018
Basic earnings per common share	$ 1.88	$ 1.41	$ 1.18
Diluted			
Net income available to common shareholders, for diluted EPS	$ 133,793	$ 87,663	$ 67,250
Weighted average common shares outstanding	71,148,230	62,168,455	56,837,018
Effect of dilutive securities:			
Stock compensation plans (1)	144,899	225,827	146,287
Weighted average diluted shares outstanding	71,293,129	62,394,282	56,983,305
Diluted earnings per common share	$ 1.88	$ 1.41	$ 1.18

(1) Stock options and restricted stock shares totaling 75,742; 13,643; and 80,045 were excluded from the computation of diluted earnings per share during 2018, 2017, and 2016, respectively, because their inclusion would be antidilutive.

NOTE 28: SUBSEQUENT EVENTS

None.

TOWNEBANK
SHAREHOLDER INFORMATION

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 22, 2019, 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.

INVESTOR RELATIONS

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

TowneBank
6001 Harbour View Boulevard
Suffolk, Virginia 23435
email: investor.relations@townebank.net

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

INDEPENDENT AUDITORS

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1400 Wells Fargo Center
440 Monticello Avenue
Norfolk, Virginia 23510

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P.O. Box 30170
College Station, Texas 77842-3170
800-368-5948
www.computershare.com/investor

CORPORATE COUNSEL

Williams Mullen
200 South 10th Street, Suite 1600
Richmond, Virginia 23219

Troutman Sanders L.L.P.
222 Central Park Avenue, Suite 2000
Virginia Beach, Virginia 23462

Exhibit (14)

TOWNEBANK
CHIEF EXECUTIVE OFFICER, EXECUTIVE OFFICERS and SENIOR FINANCIAL OFFICERS
CODE OF ETHICAL CONDUCT

Preface

The honesty, integrity, and sound judgment of the Chief Executive Officer ("CEO"), executive and senior financial officers are fundamental to the reputation and success of TowneBank. While all employees, officers, and directors are required to adhere to the TowneBank ***Standards of Conduct***, the professional and ethical conduct of the CEO, executive and senior financial officers is essential to the proper function and success of TowneBank as a leading financial services provider.

The CEO, executive and senior financial officers hold an important and elevated role in corporate governance. These individuals are key members of the management team, who are uniquely capable and empowered to ensure that the interests of stakeholders (including shareholders, clients, employees, suppliers, and citizens of the communities in which TowneBank operates) are appropriately balanced, protected, and preserved. The CEO, executive and senior financial officers fulfill this responsibility by prescribing and enforcing the policies and procedures employed in TowneBank's financial operations.

Code of Ethical Conduct

General standards of ethical behavior

The CEO, executive and senior financial officers of TowneBank performing accounting, audit, financial management, or similar functions must:

- Act with honesty and integrity, avoiding actual or apparent conflicts of interest in personal and professional relationships.
- Provide colleagues with information that is accurate, complete, objective, relevant, timely, and understandable.
- Comply with applicable laws, rules, and regulations of federal, state, and local governments (both United States and foreign) and other appropriate private and public regulatory agencies.
- Act in good faith, with due care, competence, and diligence, without misrepresenting material facts or allowing independent judgment to be subordinated.
- Respect the confidentiality of information acquired in the course of employment.
- Share knowledge and maintain skills necessary and relevant to TowneBank's needs.

- Proactively promote ethical and honest behavior within the workplace.

- Assure responsible use of and control of all assets, resources, and information in possession of TowneBank.

- Keep management informed of financial information of importance, including departures from sound policy, practice and accounting norms.

Standards regarding financial records and reporting

The CEO, executive and senior financial officers of TowneBank performing accounting, audit, financial management, or similar functions must:

- Establish systems and procedures to ensure business transaction are recorded in accordance with Generally Accepted Accounting Principles, company policy and appropriate regulatory pronouncements and guidelines.

- Protect and maintain accounting records and information as required by applicable law, regulation, or regulatory guidelines.

- Inform the Board of Directors and the Audit Committee of any material information that affects the disclosures made by the Bank in its public filings.

- Report to the Board of Directors and the Audit Committee concerning (a) significant deficiencies in the design and operation of internal controls or (b) any fraud involving management or other employees with a significant role in the Bank's financial reporting, disclosures or internal controls.

The CEO, executive and senior financial officers are expected to adhere to both the TowneBank ***Standards of Conduct*** and the ***TowneBank Chief Executive Officer and Senior Financial Officers Code of Ethical Conduct*** at all times. The board of directors shall have the sole and absolute discretionary authority to approve any deviation or waiver from the ***Code of Ethical Conduct***. Any waiver and the grounds for such waiver for the CEO, executive or senior financial officer shall be promptly disclosed through a filing with the Federal Deposit Insurance Corporation on Form 8-K. Additionally, any change of this ***Code of Ethical Conduct*** shall be promptly disclosed to stockholders.

The policy is applicable to the Chief Executive Officer (CEO), Chief Financial Officer (CFO), Controller, Corporate Treasurer, Internal Audit members, any person Assistant Vice President and above in an Accounting/ Financial position, Senior Financial Analyst, any Regulation O Executive Officers along with any person serving in an equivalent position regardless of whether or not they are designated as executive officers for Regulation O purposes, or any persons serving in equivalent positions within the Bank or any of its subsidiaries.

TOWNEBANK
CHIEF EXECUTIVE OFFICER, EXECUTIVE OFFICERS and SENIOR FINANCIAL OFFICERS
CODE OF ETHICAL CONDUCT

Please indicate that you have received, read and will abide by the ***TowneBank Chief Executive Officer, Executive Officer and Senior Financial Officers Code of Ethical Conduct*** by signing your name and dating the attached acknowledgment and returning it promptly to the Chairman and CEO of TowneBank.

ACKNOWLEDGMENT

I certify that I have received and read and that I will abide by the ***TowneBank Chief Executive Officer, Executive Officer and Senior Financial Officers Code of Ethical Conduct*** distributed to me on this _____________ day of _____________, 20___.

____
OFFICER

____
DATE

Exhibit (21)

Subsidiaries of TowneBank

Subsidiary	State of Incorporation or Organization
TowneBank Investment Corporation	Virginia
Towne Investments, LLC	Virginia
TowneBank Woodview Investment Co., LLC	Virginia
TowneBank Woodview Investment Co. II, LLC	Virginia
TowneBank Heritage Forest, LLC	Virginia
TowneBank Cromwell House Affordable Housing, LLC	Virginia
TowneBank Pavilion Place Affordable Housing, LLC	Virginia
TowneBank Westbury Cottages Affordable Housing, LLC	Virginia
TB Affordable Housing Equity Fund XX, LLC	Virginia
TowneBank Catalina Crossing Affordable Housing, LLC	Virginia
Hamilton Place Towne I, LLC	Virginia
Hamilton Place Towne II, LLC	Virginia
TowneBank VCDC Fund 18, LLC	Virginia
TowneBank VCDC Fund 19, LLC	Virginia
TowneBank VCDC Fund 20, LLC	Virginia
TB Acquisition, LLC	Virginia
TB Affordable Housing Equity Fund XXI, LLC	Virginia
TB Affordable Housing Equity Fund XXII, LLC	Virginia
TB Forrest Landing II Affordable Housing, LLC	Virginia
TB Dale II Affordable Housing, LLC	Virginia
TB NC Affordable Housing Equity Fund XXIII, LLC	Virginia
TB Sunset Hampton Affordable Housing, LLC	Virginia
TB York Senior Affordable Housing, LLC	Virginia
TB Suffolk Senior Affordable Housing, LLC	Virginia
TB Shoulders Hill Senior Affordable Housing, LLC	Virginia
Towne Financial Services Group, LLC	Virginia
GSH Residential Real Estate Corporation	Virginia
Towne Oak Island RE, LLC	Virginia
Towne Vacations Oak Island, LLC, t/a Oak Island Accommodations	Virginia
Towne Vacations, LLC, t/a Beach Properties of Hilton Head	Virginia
Palmetto Sands, LLS	Virginia
Towne Vacations Deep Creek, LLC t/a Railey Mountain Lake Vacations	Virginia
Towne Deep Creek RE, LLC	Virginia
Deep Creek Lodging, LLC	Virginia
GSH NC Realty, LLC	Virginia
Towne Realty LLC, t/a Berkshire Hathaway HomeServices Towne Realty	Virginia
Lawyers Escrow & Title Agency, LLC	Virginia
Eastern Title Company, Inc.	Virginia
PTR Referral, LLC	Virginia
Virginia Home Title and Settlements, LLC	Virginia

Subsidiaries of TowneBank (continued)

Subsidiary	State of Incorporation or Organization
Towne Insurance Agency, LLC	Virginia
The Frieden Agency LLC, t/a Towne Benefits	Virginia
Benefit Design Group, LLC	Virginia
Beneflex Management, LLC	Virginia
Towne Insurance Agency of North Carolina, LLC	North Carolina
Out of Towne, LLC, t/a Red Sky Insurance	Virginia
TowneBank Commercial Mortgage, LLC	Virginia
Towne Hall, LLC	Virginia
Towne 1031 Exchange, LLC	Virginia
Towne Security, LLC	Virginia
Towne Mortgage, LLC	Virginia
NewTowne Mortgage, LLC	Virginia
SimonTowne Mortgage, LLC	Virginia
Coastal Towne Mortgage, LLC	Virginia
Advance Financial Group, LLC	Virginia
Towne First Mortgage, LLC	Virginia
Franklin Service Corporation	Virginia
Homesale Mortgage, LLC	Virginia
Mayberry Real Estate Holdings, LLC	Virginia
PCB Trustee, INC.	Virginia
Reality Holdings, LLC	Virginia
Reality I, LLC	Virginia
Reality X, LLC	Virginia
Southeastern Virginia Investment Properties, LLC	Virginia
Southeastern Virginia Coastal Properties I, LLC	Virginia
Southeastern Virginia Properties, LLC	Virginia
Southeastern Virginia Properties at Uncles Neck, LLC	Virginia
Towne Mortgage of the Carolinas, LLC	North Carolina
Northeastern North Carolina Properties, LLC	North Carolina
Northeastern North Carolina Properties at Bermuda Bay, LLC	Virginia
Northeastern North Carolina Properties at Hamilton Cay, LLC	North Carolina
Northeastern North Carolina Properties Corolla Soundside, LLC	North Carolina
Northeastern North Carolina Properties Oceanside Villas, LLC	North Carolina
Virginia Hotel Properties, LLC	Virginia
Virginia Properties Apartment and Land, LLC	Virginia
CPF Partners, LLC	Virginia
TBNCT, LLC	North Carolina
TBVAT, LLC	Virginia
West Suffolk Properties, LLC	Virginia
TB Travel Services, LLC	Virginia
TB Acquisition, LLC	Virginia
Monarch Investment, LLC	Virginia
Real Estate Security Agency, LLC	Virginia

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Morgan Davis, President and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of TowneBank;

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

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

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

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

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

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

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

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

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

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

March 1, 2019	/s/ J. Morgan Davis
Date	J. Morgan Davis President/Chief Executive Officer

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, William B. Littreal, Senior Executive Vice President and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of TowneBank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

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

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

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

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

TOWNEBANK

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

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

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

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

March 1, 2019	/s/ William B. Littreal
Date	William B. Littreal Senior Executive Vice President/CFO

Exhibit (32)

Certification Pursuant to 18 U.S.C. Section 1350,
As Adopted By
Section 906 of The Sarbanes-Oxley Act of 2002

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

1. Our Annual Report on Form 10-K for the year ended December 31, 2018 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

March 1, 2019	/s/ J. Morgan Davis
Date	J. Morgan Davis President/Chief Executive Officer

March 1, 2019	/s/ William B. Littreal
Date	William B. Littreal Senior Executive Vice President/CFO

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