FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended September 30, 2019

FDIC Insurance Cert. Number: 35095

TOWNEBANK

(Exact name of registrant as specified in its charter)

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

(757) 638-7500

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $1.667 per share	TOWN	The Nasdaq Global Select Market

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 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 number of shares of the Company's common stock outstanding as of October 31, 2019 was 72,632,756 shares.

TOWNEBANK

TABLE OF CONTENTS

Part I. Financial Information

Part II. Other Information

GLOSSARY OF ACRONYMS AND DEFINED TERMS

As used in this report, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries. The following list of acronyms and abbreviations are used in various sections of this Form 10-Q, including the Notes to Consolidated Financial Statements in Item 1 and Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of this Form 10-Q.

AFS	Available-for-Sale
ALCO	Asset/Liability Management Committee
ALLL	Allowance for Loan and Lease Losses
Angel	Angel Insurance and Financial Services, Inc.
AOCI	Accumulated Other Comprehensive Income (Loss)
ASC	Accounting Standard Codification
ASU	Accounting Standards Update
Basel III	Basel Committee on Banking Supervision’s Capital Guidelines for U.S. Banks
BOLI	Bank-Owned Life Insurance
bp	Basis Points
BSA	Bank Secrecy Act
CECL	Current Expected Credit Loss
CETI	Common Equity Tier I
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank of Atlanta
FHLMC	The Federal Home Loan Mortgage Corporation
FNMA	The Federal National Mortgage Association
FOMC	Federal Reserve Open Market Committee
FRB - Richmond	Federal Reserve Bank of Richmond
GAAP	Accounting Principles Generally Accepted in the United States of America
GNMA	Government National Mortgage Association
GSE	Government Sponsored Enterprise
HELOCs	Residential Home Equity Lines of Credit
HTM	Held-to-Maturity
LHFS	Loans Held for Sale
LIBOR	London InterBank Offered Rate
Monarch	Monarch Financial Holdings, Inc.
MBSs	Mortgage-backed Securities
OIS	Overnight Index Swap
OREO	Other Real Estate Owned
OTTI	Other Than Temporary Impairment
Paragon	Paragon Commercial Corporation
Paragon Bank	Paragon Commercial Bank
REPO	Retail Repurchase Agreement

RJFS	Raymond James Financial Services, Inc.
ROA	Annualized Return on Average Assets
ROE	Annualized Return on Average Equity
SCC	Virginia State Corporation Commission
SEC	Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
SIL	Straus, Itzkowitz & LeCompte Insurance Agency, Inc.
Tax Act	Tax Cuts and Jobs Act of 2017
TBA	To Be Announced
TDRs	Troubled Debt Restructurings
TIG	Towne Investment Group
TWM	Towne Wealth Management
U.S.	United States of America
VIE	Variable Interest Entity

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

(Dollars in thousands, except share data)	September 30, 2019 (unaudited)	December 31, 2018 (audited)
ASSETS		
Cash and due from banks	$ 124,439	$ 94,604
Interest-bearing deposits at FRB - Richmond	675,288	570,425
Interest-bearing deposits in financial institutions	21,663	21,667
Total Cash and Cash Equivalents	821,390	686,696
Securities available for sale, at fair value	1,337,395	1,095,339
Securities held to maturity, at amortized cost	44,494	50,598
Other equity securities	5,697	4,797
Federal Home Loan Bank stock	26,282	43,229
Total Securities	1,413,868	1,193,963
Mortgage loans held for sale	456,719	220,986
Loans, net of unearned income and deferred costs	8,182,829	8,018,233
Less: Allowance for loan losses	(55,428)	(52,094)
Net Loans	8,127,401	7,966,139
Premises and equipment, net	231,060	211,796
Goodwill	446,423	433,658
Other intangible assets, net	57,404	58,752
Bank-owned life insurance policies	241,652	237,371
Other assets	225,374	153,669
TOTAL ASSETS	$ 12,021,291	$ 11,163,030
LIABILITIES AND EQUITY		
Liabilities		
Deposits:		
Noninterest-bearing demand	$ 3,030,505	$ 2,622,761
Interest-bearing:		
Demand and money market accounts	3,534,252	3,223,215
Savings	280,552	286,684
Certificates of deposit	2,592,705	2,237,762
Total Deposits	9,438,014	8,370,422
Advances from the Federal Home Loan Bank	381,846	799,315
Subordinated debt, net	248,309	247,861
Repurchase agreements and other borrowings	42,971	47,156
Total Borrowings	673,126	1,094,332
Other liabilities	271,617	159,856
TOTAL LIABILITIES	10,382,757	9,624,610
Shareholders' Equity		
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, $1.667 par: 150,000,000 shares authorized 72,633,517 and 72,465,923 shares issued at September 30, 2019 and December 31, 2018, respectively	121,080	120,801
Capital surplus	1,039,156	1,034,676
Retained earnings	445,186	379,239
Common stock issued to deferred compensation trust, at cost 811,340 and 769,200 shares at September 30, 2019 and December 31, 2018, respectively	(15,317)	(13,955)
Deferred compensation trust	15,317	13,955
Accumulated other comprehensive income (loss)	19,958	(9,190)
TOTAL SHAREHOLDERS' EQUITY	1,625,380	1,525,526
Noncontrolling interests	13,154	12,894
TOTAL EQUITY	1,638,534	1,538,420
TOTAL LIABILITIES AND EQUITY	$ 12,021,291	$ 11,163,030

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share data)	2019	2018	2019	2018
INTEREST INCOME:				
Loans, including fees	$ 102,047	$ 97,215	$ 303,616	$ 271,897
Investment securities	9,889	7,019	27,010	19,001
Interest-bearing deposits in financial institutions and federal funds sold	3,745	2,148	11,758	6,670
Mortgage loans held for sale	3,956	4,012	8,966	9,948
Total interest income	119,637	110,394	351,350	307,516
INTEREST EXPENSE:				
Deposits	23,552	14,540	64,510	35,647
Advances from the Federal Home Loan Bank	1,935	4,153	9,288	10,755
Subordinated debt, net	2,962	2,962	8,885	9,105
Repurchase agreements and other borrowings	85	42	271	144
Total interest expense	28,534	21,697	82,954	55,651
Net interest income	91,103	88,697	268,396	251,865
PROVISION FOR LOAN LOSSES	1,508	1,241	5,770	6,249
Net interest income after provision for loan losses	89,595	87,456	262,626	245,616
NONINTEREST INCOME:				
Residential mortgage banking income, net	18,855	15,804	50,929	52,152
Insurance commissions and other title fees and income, net	16,681	14,493	49,477	42,952
Real estate brokerage and property management income, net	9,444	8,542	27,555	25,881
Service charges on deposit accounts	2,253	3,028	8,299	8,880
Credit card merchant fees, net	1,514	1,563	3,357	4,174
Bank-owned life insurance	2,117	1,657	5,350	4,822
Other income	3,981	4,130	11,754	10,520
Net gain (loss) on investment securities	(69)	—	(845)	3
Total noninterest income	54,776	49,217	155,876	149,384
NONINTEREST EXPENSE:				
Salaries and employee benefits	55,784	50,497	162,907	151,606
Occupancy expense	7,953	7,013	23,866	20,292
Furniture and equipment	3,805	3,646	10,753	10,890
Amortization - intangibles	3,059	2,996	9,364	8,587
Software expense	3,208	2,940	8,742	7,927
Outside data processing	2,533	2,917	9,316	7,898
Professional fees	3,566	1,908	9,952	6,295
Advertising and marketing	3,429	2,874	9,440	8,649
Other expenses	13,950	13,471	41,627	47,643
Total noninterest expense	97,287	88,262	285,967	269,787
Income before income tax expense and noncontrolling interest	47,084	48,411	132,535	125,213
Provision for income tax expense	7,684	9,159	24,810	23,879
Net income	$ 39,400	$ 39,252	$ 107,725	$ 101,334
Net income attributable to noncontrolling interest	(1,741)	(959)	(4,018)	(3,531)
Net income attributable to TowneBank	$ 37,659	$ 38,293	$ 103,707	$ 97,803
Per common share information				
Basic earnings	$ 0.52	$ 0.53	$ 1.44	$ 1.38
Diluted earnings	$ 0.52	$ 0.53	$ 1.44	$ 1.38

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

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

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	$ 39,400	$ 39,252	$ 107,725	$ 101,334
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	6,324	(5,625)	37,120	(19,824)
Deferred tax (expense) benefit	(1,377)	1,224	(8,083)	4,338
Realized losses (gains) reclassified into earnings	69	—	845	(3)
Deferred tax (expense) benefit	(14)	—	(177)	1
Net unrealized gains (losses)	5,002	(4,401)	29,705	(15,488)
Pension and postretirement benefit plans				
Prior service costs	(406)	—	(1,218)	
Deferred tax benefit	90	—	273	
Actuarial gain (loss)	204	(41)	613	(123)
Deferred tax (expense) benefit	(45)	9	(136)	27
Amortization of prior service costs	123	16	371	49
Deferred tax expense	(27)	(3)	(82)	(10)
Amortization of net actuarial (loss) gain	(162)	21	(487)	63
Deferred tax benefit (expense)	36	(5)	109	(14)
Change in retirement plans, net of tax	(187)	(3)	(557)	(8)
Other comprehensive income (loss), net of tax	4,815	(4,404)	29,148	(15,496)
Comprehensive income	$ 44,215	$ 34,848	$ 136,873	$ 85,838
Comprehensive income attributable to noncontrolling interest	(1,741)	(959)	(4,018)	(3,531)
Comprehensive income attributable to TowneBank	$ 42,474	$ 33,889	$ 132,855	$ 82,307

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOW (unaudited)

(Dollars in thousands)	Nine Months Ended September 30,	
OPERATING ACTIVITIES:	**2019**	**2018**
Net income	$ 107,725	$ 101,334
Adjustments to reconcile net income to net cash from operating activities:		
Net amortization of securities	1,847	2,334
Investment securities losses (gains)	845	(3)
Depreciation, amortization, and other intangible amortization	22,050	21,367
Amortization of debt issuance costs	448	516
Provision for loan losses	5,770	6,249
Bank-owned life insurance income	(5,350)	(4,822)
Deferred income tax expense (benefit)	6,441	(2,503)
Share-based compensation expense	3,771	2,077
Originations of mortgage loans held for sale	(2,307,608)	(2,394,119)
Proceeds from sales of mortgage loans held for sale	2,146,238	2,451,724
Gain on sales of mortgage loans held for sale	(74,363)	(77,704)
Loss (Gain) on sale and write-down of foreclosed assets	91	(362)
Changes in:		
Interest receivable	853	(11,447)
Other assets	(38,818)	9,710
Interest payable	(405)	609
Other liabilities	41,072	14,193
Net cash (used for) from operating activities	(89,393)	119,153
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(589,094)	(873,591)
Purchase of other securities	(905)	(514)
Purchase of held-to-maturity securities	(1,896)	—
Sale of available-for-sale securities	186,043	48,549
Sale of FHLB stock	16,947	3,551
Proceeds from maturities, calls, and prepayments of available-for-sale securities	212,132	794,397
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	7,924	9,181
Net increase in loans	(169,070)	(504,127)
Purchase of premises and equipment	(31,637)	(15,292)
Proceeds from sales of premises and equipment	401	357
Proceeds from sales of foreclosed assets	4,933	4,474
Proceeds from bank-owned life insurance	1,022	582
Acquisition of business, net of cash acquired	(19,747)	69,018
Net cash used for investing activities	(382,947)	(463,415)
FINANCING ACTIVITIES:		
Net change in deposit accounts	1,067,592	602,575
Net change in borrowings	(421,654)	(16,649)
Repayments of subordinated debt	—	(18,558)
Distribution of interest in joint ventures	(3,758)	(3,765)
Proceeds from issuance of common stock	988	2,131
Cash dividends paid	(36,134)	(33,167)
Net cash from financing activities	607,034	532,567
Change in cash and cash equivalents	134,694	188,305
Cash and cash equivalents at beginning of year	686,696	521,189
Cash and cash equivalents at end of period	$ 821,390	$ 709,494
Supplemental cash flow information:		
Cash paid for interest	$ 82,549	$ 36,493
Cash paid for income taxes	$ 20,094	$ 21,369
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	$ 2,038	$ 753
Sales of foreclosed assets financed by the Company	$ —	$ 1,111
Net unrealized gains (losses) on available-for-sale securities, net of tax	$ 29,705	$ (15,488)
Common stock issued in connection with business acquisitions	$ —	$ 295,057
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ —	$ 8
Right of use asset recognized upon adoption of ASC 842	$ 43,260	$ —

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

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

(Dollars in thousands, except per share data)	Common Shares	Common Stock	Capital Surplus	Retained Earnings	Deferred Compensation Trust	Common Stock Issued to Deferred Compensation Trust	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interests	Total
Balance, January 1, 2019	**72,465,923**	**$ 120,801**	**$ 1,034,676**	**$ 379,239**	**$ 13,955**	**$ (13,955)**	**$ (9,190)**	**$ 12,894**	**$ 1,538,420**
Net income	—	—	—	31,409	—	—	—	673	32,082
Other comprehensive loss, net of taxes	—	—	—	—	—	—	7,398	—	7,398
Cash dividends declared on common stock ($0.16 per share)	—	—	—	(11,618)	—	—	—	—	(11,618)
Directors’ deferred compensation	—	—	—	—	112	(112)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,759)	(1,759)
Issuance of common stock - net contingent consideration earned on acquisitions	7,447	12	199	—	—	—	—	—	211
Issuance of common stock - stock compensation plans	140,384	234	688	—	—	—	—	—	922
Balance, March 31, 2019	**72,613,754**	**$ 121,047**	**$ 1,035,563**	**$ 399,030**	**$ 14,067**	**$ (14,067)**	**$ (1,792)**	**$ 11,808**	**$ 1,565,656**
Net income	—	—	—	34,638	—	—	—	1,604	36,242
Other comprehensive income, net of taxes	—	—	—	—	—	—	16,935	—	16,935
Cash dividends declared on common stock ($0.18 per share)	—	—	—	(13,068)	—	—	—	—	(13,068)
Directors' deferred compensation	—	—	—	—	1,093	(1,093)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(723)	(723)
Issuance of common stock - stock compensation plans	(5,501)	(9)	1,419	—	—	—	—	—	1,410
Balance, June 30, 2019	**72,608,253**	**$ 121,038**	**$ 1,036,982**	**$ 420,600**	**$ 15,160**	**$ (15,160)**	**$ 15,143**	**$ 12,689**	**$ 1,606,452**
Net income	—	—	—	37,659	—	—	—	1,741	39,400
Other comprehensive income, net of taxes	—	—	—	—	—	—	4,815	—	4,815
Cash dividends declared on common stock ($0.18 per share)	—	—	—	(13,073)	—	—	—	—	(13,073)
Directors' deferred compensation	—	—	—	—	157	(157)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,276)	(1,276)
Issuance of common stock - contingent consideration earned on acquisitions	23,023	38	587	—	—	—	—	—	625
Issuance of common stock - stock compensation plans	2,241	4	1,587	—	—	—	—	—	1,591
Balance, September 30, 2019	**72,633,517**	**$ 121,080**	**$ 1,039,156**	**$ 445,186**	**$ 15,317**	**$ (15,317)**	**$ 19,958**	**$ 13,154**	**$ 1,638,534**

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

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

(Dollars in thousands, except per share data)	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, January 1, 2018	**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	—	—	—	24,705	—	—	—	1,238	25,943
Other comprehensive loss, net of taxes	—	—	—	—	—	—	(9,021)	—	(9,021)
Cash dividends declared on common stock ($0.14 per share)	—	—	—	(10,117)	—	—	—	—	(10,117)
Directors' deferred compensation	—	—	—	—	88	(88)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,633)	(1,633)
Conversion of convertible debt into common stock	207	1	3	—	—	—	—	—	4
Issuance of common stock - net contingent consideration earned on acquisitions	16,544	28	457	—	—	—	—	—	485
Issuance of common stock - acquisitions	9,425,213	15,711	278,356	—	—	—	—	—	294,067
Issuance of common stock - stock compensation plans	197,537	329	369	—	—	—	—	—	698
Balance, March 31, 2018	**72,268,502**	**$ 120,472**	**$ 1,028,985**	**$ 304,896**	**$ 12,612**	**$ (12,612)**	**$ (15,873)**	**$ 10,870**	**$ 1,449,350**
Net income	—	—	—	34,805	—	—	—	1,334	36,139
Other comprehensive loss, net of taxes	—	—	—	—	—	—	(2,071)	—	(2,071)
Cash dividends declared on common stock ($0.16 per share)	—	—	—	(11,576)	—	—	—	—	(11,576)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	2,823	2,823
Directors' deferred compensation	—	—	—	—	888	(888)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,002)	(1,002)
Issuance of common stock - net contingent consideration earned on acquisitions	34,325	57	1,086	—	—	—	—	—	1,143
Issuance of common stock - acquisitions	31,984	53	937	—	—	—	—	—	990
Issuance of common stock - stock compensation plans	19,693	33	957	—	—	—	—	—	990
Balance, June 30, 2018	**72,354,504**	**$ 120,615**	**$ 1,031,965**	**$ 328,125**	**$ 13,500**	**$ (13,500)**	**$ (17,944)**	**$ 14,025**	**$ 1,476,786**
Net income	—	—	—	38,293	—	—	—	959	39,252
Other comprehensive loss, net of taxes	—	—	—	—	—	—	(4,404)	—	(4,404)
Cash dividends declared on common stock ($0.16 per share)	—	—	—	(11,576)	—	—	—	—	(11,576)
Directors' deferred compensation	—	—	—	—	280	(280)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,130)	(1,130)
Conversion of convertible debt into common stock	277	—	4	—	—	—	—	—	4
Issuance of common stock - stock compensation plans	(1,647)	(2)	894	—	—	—	—	—	892
Balance, September 30, 2018	**72,353,134**	**$ 120,613**	**$ 1,032,863**	**$ 354,842**	**$ 13,780**	**$ (13,780)**	**$ (22,348)**	**$ 13,854**	**$ 1,499,824**

(1) Represents the impact of adopting ASU No. 2018-02 and ASU No. 2014-09.

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

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

Note 1. Basis of Presentation

The accompanying unaudited Consolidated Financial Statements of TowneBank have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes necessary for a complete presentation of financial position, results of operations, and cash flow activity required in accordance with GAAP. In the opinion of management, the financial statements reflect all adjustments of a normal, recurring nature that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01, of the SEC. These statements should be read in conjunction with the Company's 2018 audited Consolidated Financial Statements and the 2018 Annual Report on Form 10-K. Results of operations for the three- and nine- month periods ended September 30, 2019, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Recent accounting pronouncements:

Accounting standards adopted in current year		
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).	The Company adopted the standard effective April 1, 2019. We are applying the Standard on a prospective basis to all implementation costs incurred after the date of adoption. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.
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.	The Company adopted the standard effective January 1, 2019. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.

Accounting standards adopted in current year		
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 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 LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate, and the Securities Industry and Financial Markets Association Municipal Swap Rate.	The Company adopted the standard effective January 1, 2019. The Company previously adopted the related ASU 2017-12, and the adoption of this guidance did not have a material impact on its Consolidated 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**	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.	The Company adopted this standard January 1, 2019, applying the alternative transition method whereby comparative periods were not restated, and any cumulative effect adjustment to the opening balance of retained earnings would be recognized as of January 1, 2019. There was no cumulative effect adjustment recognized. The Company elected the ASU's package of three practical expedients, which allowed 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. The January 1 impact of adopting this standard was to record right-of-use assets totaling $43.3 million and additional lease liabilities totaling $45.8 million, based on the present value of expected remaining lease payments.

Accounting standards adopted in current year		
Standard	**Summary of guidance**	**Effects on financial statements**
Topic 842 - Leases Continued **ASU 2016 - 02** **Issued February 2016** **Leases: Codification Improvements** **ASU 2018 - 10** **ASU 2018 - 11** **Issued July 2018** **ASU 2018 - 20** **Issued December 2018**	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.	

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 to one based on expected losses from one based on incurred losses. In addition, the ASU 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 third-party software solution to assist in the application of the standard, built a company-wide cross-discipline working group 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 policy development, control documentation, and implementation of key accounting and governance processes. The development of credit models was substantially completed during the second quarter of 2019. The Company has commenced comprehensive parallel testing of its CECL model and model implementation and validation will be completed during the fourth quarter of 2019. 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.

Accounting standards not yet adopted		
Standard	**Summary of guidance**	**Effects on 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.
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 who 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.

Note 2. Earnings per Share and Shareholders' Equity

Earnings per share

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

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

The following table summarizes basic and diluted EPS calculations for the periods indicated:

(Dollars in thousands, except per share data)	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Basic				
Net income available to common shareholders	$ 37,659	$ 38,293	$ 103,707	$ 97,803
Weighted-average common shares outstanding	72,091,221	71,875,085	72,043,158	70,892,879
Basic earnings per common share	$ 0.52	$ 0.53	$ 1.44	$ 1.38
Diluted				
Net income available to common shareholders, for diluted EPS	$ 37,659	$ 38,293	$ 103,707	$ 97,803
Weighted-average common shares outstanding	72,091,221	71,875,085	72,043,158	70,892,879
Effect of dilutive securities:				
Stock compensation plans (1)	131,713	169,270	109,485	150,160
Weighted-average diluted shares outstanding	72,222,934	72,044,355	72,152,643	71,043,039
Diluted earnings per common share	$ 0.52	$ 0.53	$ 1.44	$ 1.38

(1) Shares underlying stock options and restricted stock totaling 1,565 and 0 were excluded from the computation of diluted EPS during the third quarters of 2019 and 2018, respectively, and 9,091 and 15,996 shares were excluded from the computation of diluted EPS during the nine months ended September 30, 2019, and 2018, respectively, because their inclusion would be anti-dilutive.

Note 3. Mergers and Acquisitions

Angel Insurance and Financial Services, Inc.: Effective September 1, 2019, the Company acquired Angel, 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 becomes available and such information is considered final, whichever is earlier. 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 were included in the Company's Consolidated Statements of Income commencing September 1, 2019.

Straus, Itzkowitz & LeCompte Insurance Agency, Inc.: Effective January 1, 2019, the Company acquired SIL, 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 becomes available and such information is considered final, whichever is earlier. 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 were included in the Company's Consolidated Statements of Income commencing January 1, 2019.

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 becomes available and such information is considered final, whichever is earlier. 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 were 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 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. Primary areas of the allocation of the fair value of consideration transferred related to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business were 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 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 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 which 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.

The Paragon merger has been accounted for under the acquisition method of accounting. Under this guidance, an entity is required to recognize the assets acquired, liabilities assumed, and 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 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. The fair value of consideration exchanged exceeded the recognized amounts of the identifiable net assets and resulted in goodwill of $149.80 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, except per share data):

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		69,240
Total assets	$	1,801,790
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		144,270
Goodwill		149,800
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

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 purchased impaired loans receivable at the acquisition date, as adjusted (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

Note 4. Investment Securities

Available-for-sale securities

The following table summarizes amortized cost and fair values of AFS securities as of the dates indicated (in thousands):

September 30, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 151,812	$ 884	$ (115)	$ 152,581
U.S. Treasury notes	997	2	—	999
Municipal securities	166,159	7,364	(4)	173,519
Trust preferred and other corporate securities	50,797	1,281	(72)	52,006
Mortgage-backed securities issued by GSEs and GNMA	941,562	18,583	(1,855)	958,290
Total available-for-sale securities	$ 1,311,327	$ 28,114	$ (2,046)	$ 1,337,395

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 GSEs and GNMA	626,188	2,000	(10,937)	617,251
Total available-for-sale securities	$ 1,107,249	$ 3,423	$ (15,333)	$ 1,095,339

Held-to-maturity securities

The following table summarizes amortized cost and fair values of HTM investment securities as of the dates indicated (in thousands):

September 30, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust preferred corporate securities	$ 2,381	$ 228	$ —	$ 2,609
Municipal securities	29,166	1,359	—	30,525
Mortgage-backed securities issued by GSEs and GNMA	12,947	101	(5)	13,043
Total held-to-maturity securities	$ 44,494	$ 1,688	$ (5)	$ 46,177

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 GSEs and GNMA	15,610	42	(601)	15,051
Total held-to-maturity securities	$ 50,598	$ 1,271	$ (601)	$ 51,268

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 MBSs) as of September 30, 2019, and December 31, 2018, in the following table (in thousands):

	Available for Sale		Held to Maturity	
September 30, 2019	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 26,714	$ 26,714	$ —	$ —
Due after one year through five years	116,229	117,233	12,852	12,926
Due after five years through 10 years	435,463	445,943	21,675	22,291
Due after 10 years	732,921	747,505	9,967	10,960
	$ 1,311,327	$ 1,337,395	$ 44,494	$ 46,177
Other equity securities	5,697	5,697	—	—
Total	$ 1,317,024	$ 1,343,092	$ 44,494	$ 46,177

	Available for Sale		Held to Maturity	
December 31, 2018	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	—	—
Total	$ 1,112,046	$ 1,100,136	$ 50,598	$ 51,268

Pledged securities

At September 30, 2019 and 2018, the Company had investment securities with market values of $314.60 million and $259.64 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the FRB - Richmond at September 30, 2019 or 2018. The Company also had $68.40 million in investment securities pledged against repurchase agreements with commercial customers at September 30, 2019, compared to $66.24 million at December 31, 2018.

Unrealized losses

The following table shows the Company's gross unrealized losses and fair values of AFS and HTM securities, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019		Less than 12 months		12 months or more		Total	
Description of Securities	Number	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	5	$ —	$ —	$ 76,886	$ (115)	$ 76,886	$ (115)
Municipal securities	5	1,695	(1)	2,883	(3)	4,578	(4)
Mortgage-backed securities issued by GSE	41	160,188	(598)	85,584	(1,262)	245,772	(1,860)
Trust preferred and other corporate obligations	3	3,062	(21)	21,414	(51)	24,476	(72)
Total temporarily impaired securities	54	$ 164,945	$ (620)	$ 186,767	$ (1,431)	$ 351,712	$ (2,051)

December 31, 2018		Less than 12 months		12 months or more		Total	
Description of Securities	Number	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	18	$ 120,117	$ (1,100)	$ 227,833	$ (2,774)	$ 347,950	$ (3,874)
Municipal securities	40	22,758	(250)	11,672	(165)	34,430	(415)
Mortgage-backed securities issued by GSE	77	172,481	(1,987)	243,672	(9,551)	416,153	(11,538)
Trust preferred and other corporate obligations	3	6,001	(46)	20,548	(61)	26,549	(107)
Total temporarily impaired securities	138	$ 321,357	$ (3,383)	$ 503,725	$ (12,551)	$ 825,082	$ (15,934)

The Company continuously evaluates its investment securities for OTTI. This evaluation utilizes various qualitative and quantitative factors regarding each investment category, such as market conditions, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, and current analysts' evaluations. At September 30, 2019, unrealized losses on investment 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 credit quality of the issuers, and because the Company does not intend to sell, and it is not more likely than not that the Company will be required to sell the securities before the recovery of their amortized cost basis, which may be maturity, the Company does not consider these investments OTTI.

Federal Home Loan Bank of Atlanta stock

The Company is required to maintain an investment in the capital stock of the FHLB. FHLB stock is stated at cost, since this is a restricted security without a readily determinable fair value. The Company had $26.28 million and $43.23 million of FHLB stock at September 30, 2019, and December 31, 2018, respectively. Based on the Company's review of the credit quality of the institution, the institution's ability to repurchase shares, and the Company's carrying value in the shares, the Company does not consider this investment other than temporarily impaired.

Note 5. 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):

	September 30, 2019	December 31, 2018
Real estate loans		
1-4 family residential	$ 1,621,175	$ 1,626,896
Commercial	3,356,454	3,241,340
Construction and land development	1,142,225	1,067,239
Multifamily	219,901	260,987
Total real estate loans	6,339,755	6,196,462
Commercial and industrial business	1,527,515	1,510,364
Consumer loans and other	315,559	311,407
Loans, net of unearned income and deferred costs	$ 8,182,829	$ 8,018,233

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 $55.43 million adequate to cover estimated loan losses inherent in the loan portfolio at September 30, 2019.

The following table presents, by portfolio segment, changes in the allowance for loan losses for the three- and nine-month periods ended September 30, 2019 and 2018 (in thousands):

Three Months Ended September 30, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Allowance for loan losses:							
Balance, beginning of period	$ 6,555	$ 20,683	$ 1,115	$ 10,551	$ 9,069	$ 6,554	$ 54,527
Provision for loan losses	172	1,116	(295)	357	(388)	546	1,508
Losses charged off	(7)	(233)	—	(303)	—	(249)	(792)
Recoveries	—	22	—	62	26	75	185
Balance, end of period	$ 6,720	$ 21,588	$ 820	$ 10,667	$ 8,707	$ 6,926	$ 55,428

Nine Months Ended September 30, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Allowance for loan losses:							
Balance, beginning of period	$ 6,171	$ 19,488	$ 1,011	$ 10,245	$ 8,669	$ 6,510	$ 52,094
Provision for loan losses	463	3,367	(191)	508	701	922	5,770
Losses charged off	(50)	(1,298)	—	(517)	(763)	(712)	(3,340)
Recoveries	136	31	—	431	100	206	904
Balance, end of period	$ 6,720	$ 21,588	$ 820	$ 10,667	$ 8,707	$ 6,926	$ 55,428

Three Months Ended September 30, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Allowance for loan losses:							
Balance, beginning of period	$ 5,777	$ 18,187	$ 1,157	$ 9,846	$ 7,767	$ 6,801	$ 49,535
Provision for loan losses	151	664	(17)	196	714	(467)	1,241
Losses charged off	—	(22)	—	(134)	(467)	(173)	(796)
Recoveries	12	6	—	83	60	95	256
Balance, end of period	$ 5,940	$ 18,835	$ 1,140	$ 9,991	$ 8,074	$ 6,256	$ 50,236

Nine Months Ended September 30, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Allowance for loan losses:							
Balance, beginning of period	$ 5,753	$ 16,864	$ 1,075	$ 9,345	$ 6,596	$ 5,498	$ 45,131
Provision for loan losses	207	2,058	65	916	1,951	1,052	6,249
Losses charged off	(72)	(110)	—	(693)	(615)	(556)	(2,046)
Recoveries	52	23	—	423	142	262	902
Balance, end of period	$ 5,940	$ 18,835	$ 1,140	$ 9,991	$ 8,074	$ 6,256	$ 50,236

The following table presents, by portfolio segment, the allocation of the allowance for loan losses at September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	$ 14	$ 438	$ 40	$ 637	$ 74	$ 34	$ 1,237
Loans collectively evaluated for impairment	6,706	21,150	780	9,901	8,633	6,892	54,062
Loans acquired with deteriorated credit quality	—	—	—	129	—	—	129
Balance, end of period	$ 6,720	$ 21,588	$ 820	$ 10,667	$ 8,707	$ 6,926	$ 55,428

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	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

The following table presents, by portfolio segment, the Company's investment in loans at September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Ending balance: individually evaluated for impairment	$ 1,216	$ 15,320	$ 3,959	$ 13,076	$ 10,831	$ 1,091	$ 45,493
Ending balance: collectively evaluated for impairment	1,129,408	3,320,560	209,087	1,588,513	1,516,684	314,468	8,078,720
Ending balance: loans acquired with deteriorated credit quality	11,601	20,574	6,855	19,586	—	—	58,616
Ending Balance	$ 1,142,225	$ 3,356,454	$ 219,901	$ 1,621,175	$ 1,527,515	$ 315,559	$ 8,182,829

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	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

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 nine months ended September 30, 2019 and 2018 (in thousands):

	September 30,	
	2019	2018
Balance at beginning of period	$ 35,461	$ 38,542
Additions	—	1,857
Accretion	(5,513)	(8,685)
Reclassifications from nonaccretable balance, net	2,808	1,689
Other changes, net	(2,215)	(283)
Balance at end of period	$ 30,541	$ 33,120

Portfolio quality indicators

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

The Company's internally assigned grades are as follows:

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

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

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

The following table represents credit exposures by internally assigned grades as of September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	Commercial and Industrial Business	Consumer and Other Loans	Total
Pass	$ 1,121,777	$ 3,335,428	$ 215,942	$ 1,604,225	$ 1,502,362	$ 314,462	$ 8,094,196
Special Mention	19,497	8,495	696	3,867	12,228	—	44,783
Substandard	951	12,531	3,263	13,083	12,925	1,097	43,850
Doubtful	—	—	—	—	—	—	—
Total	$ 1,142,225	$ 3,356,454	$ 219,901	$ 1,621,175	$ 1,527,515	$ 315,559	$ 8,182,829

December 31, 2018	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi-Family	Real Estate Residential 1-4 Family	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

Age analysis of past-due financing receivables by class

The following table includes an aging analysis of the recorded investment of past-due financing receivables as of September 30, 2019, and 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 (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Purchased impaired loans are included in the aging schedule, but are excluded from the disclosure of accruing loans more than 90 days past due because they are considered to be accruing due to the existence of the accretable yield and not based on consideration given to contractual interest payments (in thousands):

September 30, 2019	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 land development	$ 1,070	$ 53	$ —	$ —	$ 1,123	$ 1,141,102	$ 1,142,225	$ —
Real estate - commercial	850	632	52	556	2,090	3,354,364	3,356,454	—
Real estate - multi-family	—	—	—	—	—	219,901	219,901	—
Real estate - residential 1-4 family	3,719	3,049	1,021	3,017	10,806	1,610,369	1,621,175	582
Commercial and industrial business	849	92	—	9,949	10,890	1,516,625	1,527,515	—
Consumer and other loans	1,209	262	54	494	2,019	313,540	315,559	54
Total	$ 7,697	$ 4,088	$ 1,127	$ 14,016	$ 26,928	$ 8,155,901	$ 8,182,829	$ 636

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 land 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

The following table provides an aging analysis of the recorded investment of purchased impaired loans as of September 30, 2019, and December 31, 2018, included in the table above (in thousands):

September 30, 2019	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
Real estate - construction and land development	$ —	$ —	$ —	$ —	$ 11,601	$ 11,601
Real estate - commercial	—	—	52	52	20,522	20,574
Real estate - multi-family	—	—	—	—	6,855	6,855
Real estate - residential 1-4 family	—	39	438	477	19,109	19,586
Commercial and industrial business	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	—	—
Total	$ —	$ 39	$ 490	$ 529	$ 58,087	$ 58,616

December 31, 2018	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
Real estate - construction and land 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

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. 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.

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

Unearned loan income was $8.10 million in excess of deferred loan costs at September 30, 2019, $6.46 million at September 30, 2018, and $7.06 million at December 31, 2018. There were $14.02 million, $6.93 million, and $4.75 million in nonaccrual loans at September 30, 2019, September 30, 2018, and December 31, 2018, respectively. The Company would have earned $77,000 in third quarter 2019 if interest on the loans had been accrued.

The following tables include the recorded investment and unpaid principal balances for impaired financing receivables, excluding purchased impaired loans, with the associated allowance amount, if applicable, as of September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Real estate - construction and land development	$ —	$ —	$ —	$ —	$ —
Real estate - commercial	1,654	1,654	—	1,670	82
Real estate - multi-family	2,852	2,852	—	2,852	96
Real estate - residential 1-4 family	4,003	4,003	—	4,025	111
Commercial and industrial business	9,168	8,736	—	9,431	387
Consumer and other loans	—	—	—	—	—
Total	$ 17,677	$ 17,245	$ —	$ 17,978	$ 676
Loans with a specific valuation allowance					
Real estate - construction and land development	$ 1,216	$ 1,216	$ 14	$ 1,439	$ 63
Real estate - commercial	13,814	13,665	438	14,125	591
Real estate - multi-family	1,108	1,108	40	1,132	55
Real estate - residential 1-4 family	9,373	9,073	637	9,456	373
Commercial and industrial business	2,196	2,095	74	2,302	95
Consumer and other loans	1,125	1,091	34	1,265	49
Total	$ 28,832	$ 28,248	$ 1,237	$ 29,719	$ 1,226
Total impaired loans					
Real estate - construction and land development	$ 1,216	$ 1,216	$ 14	$ 1,439	$ 63
Real estate - commercial	15,468	15,319	438	15,795	673
Real estate - multi-family	3,960	3,960	40	3,984	151
Real estate - residential 1-4 family	13,376	13,076	637	13,481	484
Commercial and industrial business	11,364	10,831	74	11,733	482
Consumer and other loans	1,125	1,091	34	1,265	49
Total	$ 46,509	$ 45,493	$ 1,237	$ 47,697	$ 1,902

Note: Included in the table above are accruing TDRs of $18.09 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled $1.04 million.

December 31, 2018	Unpaid Principal Balance	Recorded Balance	Specific Allowance	Average Recorded Investment	YTD Interest Income Recognized
Loans without a specific valuation allowance					
Real estate - construction and land 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 land 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 land 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

Note: 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.

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 TDR if both of the following exist: (1) a creditor has granted a concession to the debtor, and (2) the debtor is experiencing financial difficulties. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or greater, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. 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 three and nine months ended September 30, 2019, there were one and three loans modified in TDRs, respectively. For the three and nine months ended September 30, 2018, there were no loans modified in TDRs. Two loans restructured in the last 12 months have subsequently defaulted. Restructured loans generally include terms to reduce the interest rate and extend payment terms. The following table shows the loans modified in TDRs for the three and nine months ended September 30, 2019 (in thousands, except number of loans):

	Three Months Ended September 30, 2019			Nine Months Ended September 30, 2019		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Construction and land development	1	$ 185	$ 185	2	$ 275	$ 275
1-4 family residential real estate	—	—	—	1	2,852	2,852
Total	1	$ 185	$ 185	3	$ 3,127	$ 3,127

The specific reserve portion of the allowance for loan losses on TDRs is determined by discounting the restructured cash flows at the original effective rate of the loan before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent. If the resulting amount is less than the recorded book value, the Company either establishes a valuation allowance as a component of the allowance for loan losses or charges off the impaired balance if it determines that such amount is a confirmed loss. This method is used consistently for all segments of the portfolio. At September 30, 2019, 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 as 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.

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

Note 6. Other Real Estate Owned

The table below presents a summary of activity related to OREO for the three- and nine-month periods ended September 30, 2019 and 2018 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Beginning balance	$ 16,027	$ 22,387	$ 19,416	$ 23,288
Additions and capital improvements	1,547	210	2,635	1,013
Paragon merger	—	(1,124)	—	1,330
Sales	(637)	(1,222)	(4,933)	(5,587)
Net change in valuation allowance	—	—	—	(57)
Gain (loss) on sale and write-downs, net	90	155	(91)	419
Ending balance	$ 17,027	$ 20,406	$ 17,027	$ 20,406

As of September 30, 2019, the Company's recorded investment in OREO collateralized by residential real estate was $2.67 million. As of September 30, 2019, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was $0.37 million.

Note 7. Leases

We lease certain office space, land, and equipment. These leases were all classified as operating leases. Leases with an initial term of 12 months or less are not recorded on our Consolidated Balance Sheets; we recognize lease expenses for these leases over the lease term. As most of our lease agreements do not provide for an implicit interest rate, we used the collateralized interest rate the Company would have to pay to borrow over a similar term to estimate our lease liability as of January 1, 2019. Certain leases include one or more options to renew, with renewal terms that can extend the lease term up to 15 years. The exercise of lease renewal options is at our sole discretion. When it is reasonably certain that we will exercise our option to renew or extend the lease term, that option is included in estimating the value of the right-of-use asset and lease liability.

At September 30, 2019, we did not have any leases that had not yet commenced for which we had created a right-of-use asset and a lease liability. For our operating leases we have elected the practical expedient of not separating lease components from non-lease components, and instead account for each separate lease component and the non-lease components associated with that lease as a single lease component. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants. Most of our lease agreements include periodic rate adjustments for inflation. The depreciable life of assets and leasehold improvements are limited to the expected lease term.

Leases

(In thousands)		September 30, 2019
Assets		
Operating lease assets included in other assets	$	49,656
Liabilities		
Accrued liability operating leases included in other liabilities	$	52,257

Lease Cost

	Three Months Ended September 30,				Nine Months Ended September 30,			
(In thousands)	2019		2018		2019		2018	
Operating lease cost (1) included in occupancy expense	$	3,359	$	3,127	$	11,066	$	9,130
Sublease income included in occupancy expense		—		(53)		(53)		(212)
Net lease cost	$	3,359	$	3,074	$	11,013	$	8,918

(1) Includes short-term leases, which are immaterial.

Maturity of Lease Liabilities

(In thousands)	Operating Leases (1)	
October 1 - December 31, 2019	$	2,872
2020		10,575
2021		8,182
2022		7,071
2023		5,787
After 2023		37,211
Total lease payments	$	71,698
Less: interest		19,441
Present value of lease liabilities	$	52,257

(1) Operating lease payments include $20.27 million related to options to extend lease terms that are reasonably certain of being exercised.
Note: Minimum lease payments exclude payments to landlords for real estate taxes and common area maintenance.

Lease Term and Discount Rate

Weighted - average remaining lease term - operating leases (in years)	11.96
Weighted - average discount rate - operating leases	4.55%

Other Information

(In thousands)	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating leases	$ 2,850	$ 8,708
Related Party Transactions (1)		
Rent expense included in occupancy expense	$ 648	$ 2,158

(1) The Company rents space for various financial centers from companies associated with its directors.

Note 8. 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, northeastern North Carolina, and the Greenville, 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 segments, 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 segments 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.

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

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

Three Months Ended September 30, 2019	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 89,490	$ 1,613	$ —	$ 91,103
Provision for loan losses	1,508	—	—	1,508
Net interest income after provision for loan losses	87,982	1,613	—	89,595
Residential mortgage banking income, net	(316)	19,171	—	18,855
Insurance commissions and other title fees and income, net	67	617	15,997	16,681
Real estate brokerage and property management income, net	—	9,444	—	9,444
Other noninterest income	9,099	457	240	9,796
Noninterest expense	59,877	24,427	12,983	97,287
Income before income tax, corporate allocation and noncontrolling interest	36,955	6,875	3,254	47,084
Corporate allocation	384	(208)	(176)	—
Income before income tax provision and noncontrolling interest	37,339	6,667	3,078	47,084
Provision for income tax expense	5,495	1,454	735	7,684
Net income	31,844	5,213	2,343	39,400
Noncontrolling interest	—	(1,496)	(245)	(1,741)
Net income attributable to TowneBank	$ 31,844	$ 3,717	$ 2,098	$ 37,659
Net income as percentage of total	84.56%	9.87%	5.57%	100.00%
Total assets	$ 11,000,325	$ 712,928	$ 308,038	$ 12,021,291

Three Months Ended September 30, 2018	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 85,423	$ 3,274	$ —	$ 88,697
Provision for loan losses	1,241	—	—	1,241
Net interest income after provision for loan losses	84,182	3,274	—	87,456
Residential mortgage banking income, net	(415)	16,219	—	15,804
Insurance commissions and other title fees and income, net	126	525	13,842	14,493
Real estate brokerage and property management income, net	—	8,542	—	8,542
Other noninterest income	9,180	958	240	10,378
Noninterest expense	51,431	26,113	10,718	88,262
Income before income tax, corporate allocation and noncontrolling interest	41,642	3,405	3,364	48,411
Corporate allocation	438	(270)	(168)	—
Income before income tax provision and noncontrolling interest	42,080	3,135	3,196	48,411
Provision for income tax expense	7,604	786	769	9,159
Net income	34,476	2,349	2,427	39,252
Noncontrolling interest	(4)	(756)	(199)	(959)
Net income attributable to TowneBank	$ 34,472	$ 1,593	$ 2,228	$ 38,293
Net income as percentage of total	90.02%	4.16%	5.82%	100.00%
Total assets	$ 10,328,425	$ 558,683	$ 234,124	$ 11,121,232

Nine Months Ended September 30, 2019	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 264,332	$ 4,064	$ —	$ 268,396
Provision for loan losses	5,770	—	—	5,770
Net interest income after provision for loan losses	258,562	4,064	—	262,626
Residential mortgage banking income, net	(897)	51,826	—	50,929
Insurance commissions and other title fees and income, net	183	1,581	47,713	49,477
Real estate brokerage and property management income, net	—	27,555	—	27,555
Other noninterest income	25,875	1,314	726	27,915
Noninterest expense	176,252	71,471	38,244	285,967
Income before income tax, corporate allocation and noncontrolling interest	107,471	14,869	10,195	132,535
Corporate allocation	1,383	(800)	(583)	—
Income before income tax provision and noncontrolling interest	108,854	14,069	9,612	132,535
Provision for income tax expense	19,337	3,292	2,181	24,810
Net income	89,517	10,777	7,431	107,725
Noncontrolling interest	4	(2,997)	(1,025)	(4,018)
Net income attributable to TowneBank	$ 89,521	$ 7,780	$ 6,406	$ 103,707
Net income as percentage of total	86.32%	7.50%	6.18%	100.00%
Total assets	$ 11,000,325	$ 712,928	$ 308,038	$ 12,021,291

Nine Months Ended September 30, 2018	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 243,151	$ 8,714	$ —	$ 251,865
Provision for loan losses	6,249	—	—	6,249
Net interest income after provision for loan losses	236,902	8,714	—	245,616
Residential mortgage banking income, net	(1,071)	53,223	—	52,152
Insurance commissions and other title fees and income, net	369	1,420	41,163	42,952
Real estate brokerage and property management income, net	—	25,881	—	25,881
Other noninterest income	26,077	1,601	721	28,399
Noninterest expense	161,648	76,863	31,276	269,787
Income before income tax, corporate allocation and noncontrolling interest	100,629	13,976	10,608	125,213
Corporate allocation	1,370	(853)	(517)	—
Income before income tax provision and noncontrolling interest	101,999	13,123	10,091	125,213
Provision for income tax expense	18,629	2,977	2,273	23,879
Net income	83,370	10,146	7,818	101,334
Noncontrolling interest	(12)	(2,268)	(1,251)	(3,531)
Net income attributable to TowneBank	$ 83,358	$ 7,878	$ 6,567	$ 97,803
Net income as percentage of total	85.23%	8.06%	6.71%	100.00%
Total assets	$ 10,328,425	$ 558,683	$ 234,124	$ 11,121,232

Note 9. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers, provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2019, the amounts of off-balance-sheet commitments to extend credit were $3.05 billion.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At September 30, 2019, standby letters of credit and financial guarantees were $135.40 million.

Additionally, the Company had $1.35 billion in mortgage loans sold to investors with estimated recourse and warranty provisions totaling $51.16 million as of September 30, 2019.

Note 10. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually, or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 1 – Summary of Significant Accounting Policies* and *Note 7 – Goodwill and Intangible Assets* of the 2018 Annual Report to Stockholders for more information on the Company's goodwill and other intangibles. The following table presents the gross carrying amount and accumulated amortization for the Company's intangible assets as of the dates indicated (in thousands):

	September 30, 2019		December 31, 2018	
	Carrying Amount	**Accumulated Amortization**	**Carrying Amount**	**Accumulated Amortization**
Core deposit intangible	$ 31,339	$ 13,719	$ 31,339	$ 9,773
Non-compete agreements	2,085	1,262	1,910	969
Customer lists	63,826	29,476	55,985	24,351
Total intangible assets subject to amortization	97,250	44,457	89,234	35,093
Trade name	1,380	—	1,380	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	4,611	—	4,611	—
Total intangible assets	$ 101,861	$ 44,457	$ 93,845	$ 35,093

Amortization expense for intangible assets was $3.06 million and $3.00 million for the three-month periods, and $9.36 million and $8.59 million for the nine-month periods, ended September 30, 2019 and 2018, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2018, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2018	$ 344,638	$ 27,688	$ 61,332	$ 433,658
Additions to goodwill	—	—	12,711	12,711
Other adjustments	75	(21)	—	54
Balance, September 30, 2019	$ 344,713	$ 27,667	$ 74,043	$ 446,423

Note 11. Bank-Owned Life Insurance Policies

The total carrying amount of BOLI as of September 30, 2019, and December 31, 2018, was $241.65 million and $237.37 million, respectively. The Company recognized BOLI income, included in other noninterest income, of $2.12 million and $1.66 million for the three-month periods, and $5.35 million and $4.82 million for the nine-month periods, ended September 30, 2019 and 2018, respectively.

Note 12. Postretirement Benefits

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

	SERP		Other Postretirement Benefits	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2019	2018	2019	2018
Service cost	$ 1,124	$ 1,260	$ —	$ —
Interest cost	435	354	15	15
Amortization of prior service costs	124	77	—	—
Amortization of actuarial (gain) loss	(170)	8	7	13
Net periodic postretirement benefit cost	$ 1,513	$ 1,699	$ 22	$ 28

	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Service cost	$ 3,372	$ 3,608	$ —	$ —
Interest cost	1,304	1,062	46	45
Amortization of prior service costs	375	230	—	—
Amortization of actuarial (gain) loss	(508)	24	23	39
Net periodic postretirement benefit cost	$ 4,543	$ 4,924	$ 69	$ 84

Postretirement benefit costs are included in our Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2019, and September 30, 2018. The service cost component of postretirement benefits is included in salaries and employee benefits. All other components of postretirement benefit costs are included in other expenses.

Note 13. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2019 and 2018 (in thousands), and changes in the nine months then ended. The amounts reclassified from AOCI for the securities available for sale are included in gain on investment securities, net on the Consolidated Statements of Income, while the amounts reclassified from AOCI for the pension and postretirement plans are a component of salaries and employee benefits expense on the Consolidated Statements of Income.

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2018	$ (9,317)	$ 127	$ (9,190)
Other comprehensive income before reclassifications	29,037	(468)	28,569
Amounts reclassified from AOCI	668	(89)	579
Other comprehensive income, net	29,705	(557)	29,148
Balance, September 30, 2019	$ 20,388	$ (430)	$ 19,958

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2017	$ (4,177)	$ (1,515)	$ (5,692)
Impact from adoption of new accounting standards	(851)	(309)	(1,160)
Other comprehensive income before reclassifications	(15,486)	(11)	(15,497)
Amounts reclassified from AOCI	(2)	3	1
Other comprehensive income, net	(15,488)	(8)	(15,496)
Balance, September 30, 2018	$ (20,516)	$ (1,832)	$ (22,348)

(a) For additional information about securities, refer to Note 4.
(b) For additional information about retirement plans, refer to Note 12.

Note 14. Variable Interest Entities

A VIE is an entity that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns as generated by its operations. If any of these characteristics are present, the entity is subject to a variable interest consolidation model, and consolidation is based on variable interests, not on ownership of the entity's outstanding voting stock. Variable interests are defined as contractual, ownership, or other monetary interests in an entity that change with fluctuations in the entity's net asset value. The primary beneficiary consolidates the VIE. The primary beneficiary is the entity that has (1) the power to direct the activities of a VIE which most significantly impact the entity's economic performance, and (2) the obligation to absorb losses of the entity which could potentially be significant to the VIE, or the right to receive benefits from the entity which could potentially be significant to the VIE. The Company reviews all significant interests in the VIEs it is involved with, including the amounts and types of financial and other support, including equity investments, debt financing, and guarantees. The Company also considers the activities of the VIEs that most significantly impact the VIEs' economic performance and whether it has control over those activities.

Low income housing tax credit partnerships

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

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because the general partner of each limited partnership has both the power to direct the activities that most significantly affect the performance of each partnership and the obligation to absorb losses or the right to receive benefits that could be significant to the entities. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $200.21 million and $151.84 million were not included in the Consolidated Balance Sheets at September 30, 2019, and December 31, 2018, respectively. These limited partner interests had carrying values of $54.56 million and $33.03 million at September 30, 2019, and December 31, 2018, 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 $59.33 million, $40.47 million, and $42.34 million at September 30, 2019, September 30, 2018, and December 31, 2018, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments, along with $4.78 million of loans to the entities at September 30, 2019. As of September 30, 2019, the Company had $54.33 million in funding commitments that are dependent on certain contractual milestones and $25.72 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the three- and nine-month periods ended September 30, 2019, tax benefits totaling $0.63 million and $0.97 million, net of amortization expenses of $2.19 million and $4.88 million, respectively, were recognized as a component of income tax expense.

Note 15. Fair Value Disclosures

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principle 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 Valuation is based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Valuation is based on observable inputs, other than Level 1 prices, that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and which are significant to the fair value of the assets or liabilities.

Following is a description of 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.

Loans held for sale - mandatory delivery: Effective 07/01/2019, TowneBank elected to carry mortgages it intends to sell in the mandatory delivery program at fair value. Intent is established for these residential real estate mortgage loans when TowneBank enters into a loan commitment or interest rate lock with the customer. As of this effective date, any loan closed and held for sale within the mandatory program will be carried at fair value. For additional information about loans held for sale refer to Note 16.

Derivative financial instruments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three-month periods ended September 30, 2019 and 2018, and the year ended December 31, 2018, the Company used a weighted average fall-out rate of 14.90%.

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.

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2019, and December 31, 2018 (in thousands):

	September 30, 2019			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	$ —	$ 152,581	$ —	$ 152,581
U.S. Treasury notes	—	999	—	999
Municipal securities	—	173,519	—	173,519
Mortgage-backed securities issued by GSEs	—	958,290	—	958,290
Trust preferred and other corporate securities	—	52,006	—	52,006
Other equity securities	—	5,697	—	5,697
Loans held for sale - mandatory delivery	—	360,320	—	360,320
Derivative assets	—	740	3,343	4,083
Derivative liabilities	—	1,159	294	1,453

	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 GSEs	—	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

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at September 30, 2019, and December 31, 2018 (in thousands):

September 30, 2019	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ —	$ —	$ 3,969	$ 3,969
Other real estate owned and other nonperforming assets	—	—	17,027	17,027

December 31, 2018	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ —	$ —	$ 5,896	$ 5,896
Other real estate owned and other nonperforming assets	—	—	19,416	19,416

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

Loans: Impaired loans for which repayment of the loan is expected to be provided solely by the value of the underlying collateral are considered collateral-dependent and are valued based on the fair value of such collateral. Collateral values are estimated using inputs based on observable market data or inputs based on customized discounting criteria. In cases where such inputs were unobservable, specifically, discounts applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 7.19% to 15.26%, with a weighted average of 12.85%.

Loans held for sale - best efforts: Loans closed and held for sale within the mandatory program are carried at fair value. Loans held for sale within the best efforts program are carried at the lower of cost or 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. For additional information about loans held for sale refer to Note 16.

Other real estate owned and other nonperforming assets: 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, OREO 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 levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of September 30, 2019, and December 31, 2018, are as follows (in thousands):

September 30, 2019	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 124,439	$ 124,439	$ 124,439	$ —	$ —
Interest-bearing deposits at FRB - Richmond	675,288	675,288	675,288	—	—
Interest-bearing deposits in financial institutions	21,663	21,663	21,663	—	—
Securities available for sale	1,337,395	1,337,395	—	1,337,395	—
Securities held to maturity	44,494	46,177	—	46,177	—
Other equity securities	5,697	5,697	—	5,697	—
Mortgage loans held for sale	456,719	456,784	—	456,784	—
Net loans	8,182,829	8,108,571	—	—	8,108,571
Interest receivable	32,227	32,227	—	32,227	—
Non-maturity deposits	6,736,982	6,700,475	—	6,700,475	—
Time deposits	2,701,032	2,713,820	—	2,713,820	—
Advances from the Federal Home Loan Bank of Atlanta	381,846	381,939	—	381,939	—
Subordinated debt	248,309	250,613	—	250,613	—
Repurchase agreements and other borrowings	42,971	40,763	—	40,763	—
Interest payable	12,093	12,093	—	12,093	—

December 31, 2018	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	$ 94,604	$ 94,604	$ 94,604	$ —	$ —
Interest-bearing deposits at FRB - Richmond	570,425	570,425	570,425	—	—
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	—
Net loans	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 debt	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	—

Fair Value Option

Effective 07/01/2019, TowneBank elected the fair value option for loans held for sale within the mandatory delivery program. This elections allow for a more effective offset of the changes in fair values of the loans and the derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting. TowneBank has not elected the fair value option for other loans held for sale primarily because they are not actively hedged. Fair values of loans held for sale are recorded in mortgage loans held for sale in the consolidated balance sheets.

The following table summarizes the difference between the aggregate fair value and the aggregate unpaid principal balance for mortgage loans held for sale measured at fair value at September 30, 2019 (in thousands):

September 30, 2019	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value less Aggregate Unpaid Principal
Mortgage loans held for sale, at fair value	$ 360,320	$ 359,364	$ 956

Interest income on mortgage loans held for sale is recognized based on contractual rates and is reflected in interest income on mortgage loans held for sale in the consolidated statements of income. The following table details net gains and losses resulting from changes in fair value of these loans, which were recorded in residential mortgage banking income, net in the consolidated statements of income for the periods presented.

Net Gains (Losses) Resulting from Changes in Fair Value		
(in thousands)	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Mortgage loans held for sale, at fair value	$ 956	$ 956

Note 16. Derivative Instruments and Hedging Activities

The Company enters into rate lock commitments with its mortgage customers. The Company is also a party to forward mortgage loan sales contracts to sell loans servicing-released and sales of TBA MBSs. 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 sell mortgage loans under both "mandatory" and "best efforts" delivery programs. Under the mandatory delivery system, loans with interest rate locks with respective borrowers are paired with the sales of TBA MBSs bearing similar attributes. We commit to deliver loans to an investor at an agreed-upon price upon the closing of such loans. This differs from "best efforts" delivery transactions, which set 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 dates indicated (in thousands):

	September 30, 2019		December 31, 2018	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	$ 727,764	$ 4,083	$ 397,240	$ 3,196
Interest rate contracts included in other liabilities	$ 381,704	$ 1,453	$ 181,262	$ 1,507

Gains and losses from mortgage banking derivatives are included in Residential mortgage banking income, net on the Consolidated Statements of Income. For the three and nine months ended September 30, 2019, the Company recognized $0.15 million in losses and $2.88 million in gains, respectively. For the three and nine months ended September 30, 2018, the Company recognized $0.66 million in losses and $1.20 million in gains, respectively.

Note 17. Revenue from Contracts with Customers

ASC 606 - *Revenue from Contracts with Customers,* 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, and (7) sales channels. The Company disaggregates revenue from contracts by major product line, a type of good or service.

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

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

Revenue from Contracts with Customers:	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Investment management income				
Investment commissions, net	$ 1,779	$ 1,665	$ 4,958	$ 4,654
Total	$ 1,779	$ 1,665	$ 4,958	$ 4,654
Insurance income				
Property and casualty insurance income, net	$ 12,511	$ 10,276	$ 36,132	$ 29,263
Benefit insurance income, net	2,652	2,695	8,289	7,871
Travel insurance commissions, net	834	871	3,292	4,028
Total	$ 15,997	$ 13,842	$ 47,713	$ 41,162
Real estate and property management income				
Real estate sales commissions, net	$ 2,882	$ 2,758	$ 7,315	$ 7,275
Real estate property management income, net	6,562	5,784	20,240	18,606
Total	$ 9,444	$ 8,542	$ 27,555	$ 25,881

The Company had no material contract assets or contract liabilities recorded on the Consolidated Balance Sheets as of September 30, 2019.

This disclosure includes only revenue from contracts with third-party customers. See Note 8 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 18. Borrowings

The Company has short-term borrowings for terms under one year consisting of REPOs and FHLB advances. FHLB advances are for various terms and are secured by a blanket lien on residential mortgages and other real estate secured loans. All REPOs are overnight short-term investments and are not insured by the FDIC. Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and, therefore, are 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.

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 September 30, 2019, the carrying value of the notes totaled $248.31 million, compared with $247.86 million at December 31, 2018.

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	Third Quarter 2019	Second Quarter 2019	First Quarter 2019	Fourth Quarter 2018	Third Quarter 2018
Results of Operations:					
Interest income	$ 119,637	$ 117,883	$ 113,830	$ 114,307	$ 110,394
Interest expense	28,534	28,064	26,357	25,099	21,697
Net interest income	91,103	89,819	87,473	89,208	88,697
Provision for loan losses	1,508	2,824	1,438	2,292	1,241
Net interest income after provision for loan losses	89,595	86,995	86,035	86,916	87,456
Noninterest income:					
Residential mortgage banking income, net	18,855	18,565	13,508	12,951	15,804
Insurance commissions and other title fees and income, net	16,681	17,213	15,582	13,212	14,493
Real estate brokerage and property management income, net	9,444	8,843	9,268	5,982	8,542
Service charges on deposit accounts	2,253	3,185	2,861	2,928	3,028
Credit card merchant fees, net	1,514	660	1,183	1,298	1,563
Bank-owned life insurance	2,117	1,635	1,598	2,014	1,657
Other income	3,981	4,617	3,157	3,824	4,130
Loss on investment securities	(69)	—	(776)	—	—
Total noninterest income	54,776	54,718	46,381	42,209	49,217
Noninterest expense:					
Salaries and benefits	55,784	54,263	52,860	50,233	50,497
Occupancy expense	7,953	7,662	8,251	7,352	7,013
Furniture and equipment	3,805	3,578	3,371	3,587	3,646
Amortization - intangibles	3,059	3,113	3,192	3,123	2,996
Software expense	3,208	2,788	2,745	2,694	2,940
Outside data processing	2,533	3,616	3,166	2,466	2,917
Professional fees	3,566	3,707	2,679	2,028	1,908
Advertising and marketing	3,429	3,182	2,829	2,546	2,874
Other expenses	13,950	14,647	13,030	8,308	13,471
Total noninterest expense	97,287	96,556	92,123	82,337	88,262
Income before noncontrolling interest and income tax	47,084	45,157	40,293	46,788	48,411
Provision for income tax expense	7,684	8,915	8,211	10,348	9,159
Net income	$ 39,400	$ 36,242	$ 32,082	$ 36,440	$ 39,252
Net income attributable to noncontrolling interest	(1,741)	(1,604)	(673)	(450)	(959)
Net income attributable to TowneBank	$ 37,659	$ 34,638	$ 31,409	$ 35,990	$ 38,293

Selected Quarterly Information (unaudited)
TOWNEBANK

(Dollars in thousands, except per share data)	**Third Quarter 2019**	**Second Quarter 2019**	**First Quarter 2019**	**Fourth Quarter 2018**	**Third Quarter 2018**
Per Share Data:					
Net income:					
Basic	$ 0.52	$ 0.48	$ 0.44	$ 0.50	$ 0.53
Diluted	0.52	0.48	0.44	0.50	0.53
Book value at period end	22.38	21.95	21.40	21.05	20.54
Tangible book value at period end (non-GAAP)	15.44	15.05	14.46	14.26	13.83
Cash dividends declared	0.18	0.18	0.16	0.16	0.16
Selected Financial Ratios (annualized):					
Return on average assets	1.26%	1.20%	1.14%	1.28%	1.40%
Return on average tangible assets (non-GAAP)	1.40%	1.35%	1.29%	1.43%	1.56%
Return on average equity	9.22%	8.83%	8.24%	9.44%	10.21%
Return on average tangible equity (non-GAAP)	14.20%	13.90%	13.24%	14.91%	16.08%
Net interest margin (tax-equivalent basis) (non-GAAP)	3.43%	3.52%	3.57%	3.55%	3.64%
Daily Averages:					
Total assets	$ 11,845,282	$ 11,532,278	$ 11,194,753	$ 11,149,960	$ 10,844,570
Total tangible assets (non-GAAP)	11,345,036	11,029,058	10,688,484	10,661,020	10,359,353
Loans, net of unearned income, excluding nonaccrual loans	8,096,908	8,075,054	8,030,994	7,923,978	7,825,065
Total earning assets	10,604,500	10,316,635	10,018,789	10,024,715	9,726,612
Total deposits	9,239,987	8,815,609	8,380,525	8,312,642	8,021,632
FHLB advances	440,089	623,972	775,915	872,605	873,558
Total equity	1,620,070	1,573,855	1,545,899	1,511,922	1,488,368
Tangible equity (non-GAAP)	1,119,824	1,070,635	1,039,630	1,022,982	1,003,151
Basic weighted average shares outstanding	72,091,221	72,044,817	71,992,330	71,905,956	71,875,085
Diluted weighted average shares outstanding	72,222,934	72,145,600	72,099,558	72,043,369	72,044,355

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2018 audited Consolidated Financial Statements included in our 2018 Annual Report to Stockholders and our 2018 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by Dixon Hughes Goodman LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts, but instead represent only the beliefs, expectations, or opinions of TowneBank and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward-looking statements may be identified by the use of such words as: "believe," "expect," "anticipate," "intend," "plan," "estimate," or words of similar meaning, or future or conditional terms, such as "will," "would,""should," "could," "may," "likely," "probably," or "possibly." These statements may address issues that involve significant risks, uncertainties, estimates, and assumptions made by management. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include competitive pressures in the banking industry that may increase significantly; changes in the interest rate environment that may reduce margins and/or the volumes and values of loans made or held as well as the value of other financial assets held; changes in the creditworthiness of customers and the possible impairment of the collectability of loans; general economic conditions, either nationally or regionally, that may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit or other services; changes in the legislative or regulatory environment, including changes in accounting standards and tax laws, that may adversely affect our business; costs or difficulties related to the integration of the 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; cybersecurity threats or attacks, the implementation of new technologies, and the ability to develop and maintain reliable electronic systems; our competitors may have greater financial resources and develop products that enable them to compete more successfully; changes in business conditions; changes in the securities market; and changes in our local economy with regard to our market area. Any forward-looking statements made by us or on our behalf speak only as of the date they are made or as of the date indicated, and we do not undertake any obligation to update forward-looking statements as a result of new information, future events, or otherwise. For additional information on factors that could materially influence forward-looking statements included in this report, see the risk factors in "Item 1A. Risk Factors" in the Company's Form 10-K for the year ended December 31, 2018.*

Non-GAAP Financial Measures

This document contains GAAP financial measures and non-GAAP financial measures where management believes it to be helpful in understanding Towne's results of operations or financial position. We encourage readers to consider the Unaudited Consolidated Financial Statements and other financial information contained in this Form 10-Q in their entirety, and not to rely on any single financial measure.

Fully-Taxable Equivalent Basis. Interest income, yields, and ratios on a fully taxable equivalent basis are considered non-GAAP financial measures. Management believes net interest income on a fully taxable equivalent basis provides an insightful picture of the interest margin for comparison purposes. The fully taxable equivalent basis also allows management to assess the comparability of revenue arising from both taxable and tax-exempt sources. The fully taxable equivalent basis assumes a federal statutory tax rate of 21 percent.

Regulatory Capital Ratios. Financial measures related to regulatory capital under Basel III are utilized by banking regulators as a basis for assessing a bank's capital adequacy. Management believes these ratios provide insight into the Company's financial condition, asset quality, and capital adequacy These ratios include:

- Common equity tier I to risk-based assets
- Tier I capital to risk-based assets
- Total risk-based capital to risk-based assets
- Tier I capital to average quarterly assets (Tier I leverage)

Non-Regulatory Capital Ratios. In addition to capital ratios defined by banking regulators, the Company considers various other measures when evaluating capital utilization and adequacy, including:

- Return on average tangible assets
- Return on average tangible equity

These non-regulatory capital ratios are viewed by management as useful additional methods of reflecting the level of capital available to withstand unexpected market conditions. Additionally, presentation of these ratios allows readers to compare the Company’s capitalization to other financial services companies. These ratios differ from capital ratios defined by banking regulators principally in that the numerator excludes goodwill and other intangible assets, the nature and extent of which varies among different financial services companies. These ratios are not defined in GAAP or federal banking regulations. As a result, these non-regulatory capital ratios disclosed by the Company are considered non-GAAP financial measures. Because there are no standardized definitions for these non-regulatory capital ratios, the Company’s calculation methods may differ from those used by other financial services companies. Also, there may be limits in the usefulness of these measures to investors.

Where non-GAAP financial measures are used, the comparable GAAP financial measure, as well as the reconciliation to the comparable GAAP financial measure, can be found herein this Form 10-Q.

Overview

TowneBank is a retail and commercial banking business that places 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.

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

The following discussion and analysis presents the significant factors affecting the Company’s financial performance in the three and nine months ended September 30, 2019. This discussion should be read in conjunction with our Consolidated Financial Statements and notes to the financial statements appearing elsewhere in this report.

- Net income for the three months ended September 30, 2019, was $37.66 million, or $0.52 per common diluted share, compared to $38.29 million, or $0.53 per common diluted share, for the same period in 2018. Net income for the nine months ended September 30, 2019, was $103.71 million, or $1.44 per common diluted share, compared to $97.80 million, or $1.38 per common diluted share, for the same period in 2018.

- Net interest income increased $2.41 million, or 2.71%, in third quarter 2019 from the comparable period in 2018. Net interest income increased $16.53 million, or 6.56%, in the first nine months of 2019 compared to 2018. These increases were primarily due to a rise in average earning assets driven by loan and investment securities growth combined with higher yields.

- Provision for loan losses increased $0.27 million in the third quarter of 2019, when compared to the provision of $1.24 million for the quarter ended September 30, 2018, and decreased $0.48 million in the nine-month period ended September 30, 2019, compared to the nine-month period ended September 30, 2018. The allowance for loan losses was 0.68% of period-end loans at September 30, 2019, as compared to 0.67% at June 30, 2019, and 0.64% at September 30, 2018. The increase in the provision for loan losses in the third quarter of 2019 compared to prior year was driven by a higher level of non-performing loans. The decline in the provision expense in the first nine months of 2019, was driven by a lower level of loan growth in 2019 when compared to the prior year period. The allowance for loan losses, as a percentage of total loans, excluding purchased loans, held steady at 0.81% at September 30, 2019, compared to June 30, 2019, but declined from 0.82% at September 30, 2018.

- Noninterest income for the three-month period ended September 30, 2019, increased by $5.56 million, or 11.29%, compared to the same period in 2018. Noninterest income increased $6.49 million, or 4.35%, for the nine-month period ended September 30, 2019, from the comparative period ended September 30, 2018. The increase in noninterest income in the third quarter of 2019 compared to 2018 was due to growth in mortgage banking income, insurance commissions, and property management income. In the first nine months of 2019, noninterest income growth was attributable to growth in insurance commissions and property management income.

- Noninterest expense increased $9.03 million, or 10.23%, in the quarterly comparison, and increased $16.18 million, or 6.00%, compared to the first nine months of 2018. The increase in both the three- and nine-month comparisons was driven by higher salaries and benefits expenses, professional fees, and occupancy expense. Additionally, for the nine month comparison, growth in outside data processing expense was a contributing factor.

- Our effective tax rate was 16.95% for the third quarter of 2019, a decrease from 19.30% in the comparative period of 2018 and 20.47% in the second quarter of 2019. The lower effective tax rate in the third quarter of 2019 was related to a revision in deferred taxes.

Critical Accounting Policies

Preparation of financial statements and related disclosures in conformity with GAAP requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the Consolidated Financial Statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, other real estate owned, deferred income taxes, estimates of fair value of financial instruments, mergers and acquisitions, and goodwill and other intangibles to be critical accounting policies. Refer to our 2018 Annual Report to Stockholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized ROA was 1.26% for third quarter 2019, compared to 1.40% for third quarter 2018, and 1.20% for second quarter 2019. The annualized return on average tangible assets (non-GAAP) was 1.40%, 1.56%, and 1.35% for the same respective periods. ROA for the nine-month period ended September 30, 2019, was 1.20% compared to 1.26% for the nine-month period ended September 30, 2018. Tangible ROA (non-GAAP) was 1.35% and 1.41% for the same respective periods.

Annualized ROE was 9.22% for third quarter 2019, 10.21% for third quarter 2018, and 8.83% for second quarter 2019, while the annualized return on average tangible equity (non-GAAP) was 14.20%, 16.08%, and 13.90% for the same respective periods. ROE for the nine-month period ended September 30, 2019, was 8.77%, compared to 9.11% for the nine-month period ended September 30, 2018. Tangible ROE (non-GAAP) was 13.79% and 14.38% for the same respective periods.

Operating income, calculated as net interest income and noninterest income less gains on investment securities, was $145.95 million for the quarter ended September 30, 2019, which increased $8.03 million, or 5.83%, compared to the quarter ended September 30, 2018. For the nine-month period ended September 30, 2019, operating income was $425.12 million, an increase of $23.87 million, or 5.95%, over comparative 2018.

Basic and diluted EPS were $0.52 for the three months ended September 30, 2019, compared to basic and diluted EPS of $0.53 in third quarter 2018. For the nine-month period ended September 30, 2019, basic and diluted EPS were $1.44, compared to $1.38 in the first nine months of 2018.

Net Interest Income. Net interest income, the major source of our earnings, is the income generated by interest-earning assets reduced by the total interest cost of the funds incurred to carry them. It is affected by market interest rates and the volume and mix 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 (non-GAAP) using a 21% federal marginal tax rate.

TowneBank reported net interest income, on a tax-equivalent basis, of $91.75 million for the quarter ended September 30, 2019, which was $2.41 million, or 2.70%, higher than the third quarter 2018 total of $89.34 million. On a linked-quarter basis, tax-equivalent net interest income increased by $1.32 million, or

1.46%, from $90.43 million. Net interest income, on a tax equivalent basis, was $270.26 million, or $16.74 million, higher in the first nine months of 2019 than comparative 2018.

In the three months comparison to prior year, net interest income rose due to increased asset volume coupled with higher yields in all earning asset categories. The income benefit achieved through these increases was partially offset by higher liability costs on interest bearing deposits due to both rate and volume increases. A decline in average borrowings also contributed to the increase in net interest income. Comparing third quarter 2019 to the linked-quarter, interest income increased due to growth in our earning assets, including loans held for investment, and loans held for sale. Lower earning asset yield, coupled with higher interest-bearing deposit volume and higher interest-bearing deposit rates absorbed the majority of the increase in interest income. A decline in average borrowings between quarters coupled with lower rates on those borrowings contributed to the increase in net interest income compared to the linked quarter. In the nine months comparison to prior year, net interest income increased due to higher asset volumes and rates, in most categories, which were partially absorbed through increased interest bearing deposit volumes and rates. Lower average borrowings contributed to the improvement in net interest income. Accretion of purchase accounting marks added $2.65 million, or 11 bp, to margin in the current quarter compared to $2.34 million, or 11 bp, in the linked-quarter and $4.12 million, or 18 bp, in third quarter 2018.

Interest income, on a tax-equivalent basis, was $120.28 million for the quarter ended September 30, 2019, which was $9.25 million, or 8.33%, higher than the $111.03 million reported for the quarter ended September 30, 2018. On a linked-quarter basis, tax-equivalent interest income increased $1.79 million, or 1.51%, from $118.49 million in second quarter 2019. Average earning assets grew to $10.60 billion in the quarter ended September 30, 2019, from $9.73 billion in the comparative prior year quarter, an increase of $0.88 billion, or 9.03%. In the linked-quarter comparison, average earning assets increased by $0.29 billion, or 2.79%, from $10.32 billion in second quarter 2019. The yield on earning assets was 4.50% in the quarter ended September 30, 2019, which compared to 4.53% in the prior year and 4.61% in the linked quarter. Average loan balances, excluding nonaccrual loans, of $8.10 billion, were $0.27 billion, or 3.47%, higher in third quarter 2019 than in the same period one year ago, while loan yields increased by 7 bp. In the linked quarter, average loans increased by $0.02 billion, or 0.27%, and loan yields decreased by 6 bp.

Interest income, on a tax-equivalent basis, was $353.21 million for the nine months ended September 30, 2019, which was $44.04 million, or 14.25%, higher than the $309.17 million reported for the nine months ended September 30, 2018. Average earning assets grew by $0.99 billion in the first nine months of 2019, from $9.32 billion in the prior year. The yield on earning assets was 4.58% in the nine months ended September 30, 2019, or 15 bp higher than 4.43% in 2018. Average loan balances, excluding nonaccrual loans, of $8.07 billion were $620.43 million, or 8.33%, higher in the first nine months of 2019 than one year ago, while loan yields increased by 15 bp. Taxable investment securities increased $187.49 million and interest-bearing deposits grew by $179.48 million, year over year, while yields increased 51 bp and 53 bp, respectively.

Interest expense for the quarter ended September 30, 2019, was $28.53 million, which was $6.84 million, or 31.51%, higher than interest expense of $21.70 million for third quarter 2018. Average interest-bearing liabilities increased to $7.03 billion in third quarter 2019 from $6.57 billion in the comparative prior year quarter, an increase of 7.01%. On a linked quarter basis, interest expense increased 1.67% from $28.06 million in second quarter 2019. Average interest-bearing liabilities increased $80.60 million, or 1.16%, from $6.95 billion in the linked quarter. The cost of interest-bearing liabilities was 1.61% in the third quarter of 2019, compared to 1.31% in third quarter 2018, and 1.62% in the linked quarter. This represents a 30 bp increase over prior year and a 1 bp decrease from the linked quarter.

Interest expense for the nine months ended September 30, 2019, was $82.95 million, which was $27.30 million, or 49.06%, higher than interest expense of $55.65 million for the first nine months of 2018. Average interest-bearing liabilities increased by $597.54 million in the first nine months of 2019 from $6.34 billion in the comparative prior year, an increase of 9.43%. Average interest-bearing deposits increased $830.37 million, or 15.98%, while borrowings declined $228.67 million, or 25.70%, in the first nine months of 2019 compared to 2018. The cost of interest-bearing liabilities increased 43 bp to 1.60% in the first nine months of 2019 compared to 2018.

Tax-equivalent net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.43% or 21 bp lower, for the quarter ended September 30, 2019, than the September 30, 2018, quarter margin of 3.64%, and 9 bp lower than the quarter ended June 30, 2019, margin of 3.52%. Net interest margin for the first nine months of 2019 declined 14 bp to 3.50% when compared to the prior year. Continued pressure from rising deposit costs resulted in margin compression. Accretion in the third quarter of 2019 was 11 bp, compared to accretion of 18 bp in third quarter 2018 and 11 bp for the linked quarter. Net interest margin will continue to be impacted by future changes in short-term and long-term interest rate levels, as well as from the competitive environment.

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

	Discount Accretion (Premium Amortization)
	For the Three Months Ended December 31, 2019
Assets:	
Investment Securities	$ (74)
Loans	1,403
Liabilities:	
Deposits	47
Total estimated effect on net interest income	$ 1,282

Note: This information is intended for informational purposes only and is not necessarily indicative of future results. Actual results may differ due to factors such as changes in estimated prepayment speeds or projected credit loss rates. We are unable to quantify the impact the January 1, 2020, adoption of ASU 2016-13 will have on this discount accretion. Therefore, we are not disclosing an estimate beyond December 31, 2019.

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

	Three Months Ended September 30, 2019			Three Months Ended June 30, 2019			Three Months Ended September 30, 2018		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 8,096,908	$ 102,495	5.02%	$ 8,075,054	$ 102,366	5.08%	$ 7,825,065	$ 97,705	4.95%
Taxable investment securities	1,266,447	9,087	2.87%	1,170,215	8,346	2.85%	1,022,051	6,402	2.51%
Tax-exempt investment securities	121,738	997	3.28%	90,942	756	3.33%	82,235	766	3.73%
Total securities	1,388,185	10,084	2.91%	1,261,157	9,102	2.89%	1,104,286	7,168	2.60%
Interest-bearing deposits	711,030	3,745	2.09%	698,649	4,016	2.31%	450,455	2,148	1.89%
Loans held for sale	408,377	3,956	3.87%	281,775	3,007	4.27%	346,806	4,012	4.63%
Total earning assets	10,604,500	120,280	4.50%	10,316,635	118,491	4.61%	9,726,612	111,033	4.53%
Less: allowance for loan losses	(54,858)			(53,386)			(50,144)		
Total nonearning assets	1,295,640			1,269,029			1,168,102		
Total assets	$ 11,845,282			$11,532,278			$10,844,570		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 3,379,888	$ 7,223	0.85%	$ 3,312,313	$ 7,025	0.85%	$ 2,957,037	$ 4,217	0.57%
Savings	278,048	702	1.00%	281,221	929	1.33%	301,311	984	1.30%
Certificates of deposit	2,641,681	15,627	2.35%	2,433,479	13,830	2.28%	2,147,338	9,339	1.73%
Total interest-bearing deposits	6,299,617	23,552	1.48%	6,027,013	21,784	1.45%	5,405,686	14,540	1.07%
Borrowings	486,644	2,020	1.62%	678,799	3,318	1.93%	920,380	4,195	1.78%
Subordinated debt, net	248,210	2,962	4.77%	248,064	2,962	4.78%	247,615	2,962	4.78%
Total interest-bearing liabilities	7,034,471	28,534	1.61%	6,953,876	28,064	1.62%	6,573,681	21,697	1.31%
Demand deposits	2,940,370			2,788,596			2,615,946		
Other noninterest-bearing liabilities	250,371			215,951			166,575		
Total liabilities	10,225,212			9,958,423			9,356,202		
Shareholders' equity	1,620,070			1,573,855			1,488,368		
Total liabilities and equity	$ 11,845,282			$11,532,278			$10,844,570		
Net interest income (tax-equivalent basis)		$ 91,746			$ 90,427			$ 89,336	
Reconcilement of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(643)			(608)			(639)	
Net interest income (GAAP)		$ 91,103			$ 89,819			$ 88,697	
Interest rate spread (1)(3)			2.89%			2.99%			3.22%
Interest expense as a percent of average earning assets			1.07%			1.09%			0.89%
Net interest margin (tax equivalent basis) (2)(3)			3.43%			3.52%			3.64%
Total cost of deposits			1.01%			0.99%			0.72%

(1) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Fully tax equivalent.
(2) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.
(3) Non-GAAP.

	Increase/(Decrease) Three Months Ended September 30, 2019 Compared to Three Months Ended June 30, 2019			Increase/(Decrease) Three Months Ended September 30, 2019 Compared to Three Months Ended September 30, 2018		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 482	$ (353)	$ 129	$ 3,428	$ 1,363	$ 4,791
Taxable investment securities	690	51	741	1,670	1,015	2,685
Tax-exempt investment securities	252	(11)	241	332	(101)	231
Total securities	942	40	982	2,002	914	2,916
Interest-bearing deposits	78	(349)	(271)	1,353	244	1,597
Loans held for sale	1,248	(299)	949	652	(708)	(56)
Total earning assets	2,750	(961)	1,789	7,435	1,813	9,248
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	211	(13)	198	670	2,336	3,006
Savings	(10)	(217)	(227)	(72)	(211)	(283)
Certificates of deposit	1,335	462	1,797	2,452	3,836	6,288
Total interest-bearing deposits	1,536	232	1,768	3,050	5,961	9,011
Borrowings	(829)	(469)	(1,298)	(1,828)	(346)	(2,174)
Subordinated capital debentures	—	—	—	—	—	—
Total interest-bearing liabilities	707	(237)	470	1,222	5,615	6,837
Net interest income	$ 2,043	$ (724)	$ 1,319	$ 6,213	$ (3,802)	$ 2,411

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

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended September 30, 2019			Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2019 Compared with 2018		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change Due to Rate	Change Due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 8,067,894	$ 305,007	5.05%	$ 7,447,463	$ 273,162	4.90%	$ 31,845	$ 8,578	$ 23,267
Taxable investment securities	1,158,611	24,962	2.87%	971,117	17,214	2.36%	7,748	4,086	3,662
Tax-exempt investment securities	97,485	2,519	3.45%	79,404	2,174	3.65%	345	(128)	473
Total securities	1,256,096	27,481	2.92%	1,050,521	19,388	2.46%	8,093	3,958	4,135
Interest-bearing deposits	700,840	11,758	2.24%	521,361	6,670	1.71%	5,088	2,416	2,672
Loans held for sale	290,384	8,966	4.12%	302,102	9,948	4.39%	(982)	(605)	(377)
Total earning assets	10,315,214	353,212	4.58%	9,321,447	309,168	4.43%	44,044	14,347	29,697
Less: allowance for loan losses	(53,703)			(48,044)					
Total nonearning assets	$ 1,264,976			$ 1,140,173					
Total assets	$11,526,487			$10,413,576					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 3,289,539	$ 20,488	0.83%	$ 2,893,096	$ 10,788	0.50%	$ 9,700	$ 8,053	$ 1,647
Savings	281,562	2,658	1.26%	305,570	2,802	1.23%	(144)	81	(225)
Certificates of deposit	2,456,360	41,364	2.25%	1,998,427	22,057	1.48%	19,307	13,447	5,860
Total interest-bearing deposits	6,027,461	64,510	1.43%	5,197,093	35,647	0.92%	28,863	21,581	7,282
Borrowings	661,216	9,559	1.91%	889,885	10,899	1.62%	(1,340)	1,757	(3,097)
Subordinated debt, net	248,064	8,885	4.78%	252,220	9,105	4.81%	(220)	(71)	(149)
Total interest-bearing liabilities	6,936,741	82,954	1.60%	6,339,198	55,651	1.17%	27,303	23,267	4,036
Demand deposits	2,787,727			2,471,906					
Other noninterest-bearing liabilities	221,806			166,928					
Total liabilities	9,946,274			8,978,032					
Shareholders' equity	1,580,213			1,435,544					
Total liabilities and equity	$11,526,487			$10,413,576					
Net interest income (tax-equivalent basis)		$ 270,258			$ 253,517		$ 16,741	$(8,920)	$ 25,661
Reconcilement of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(1,862)			(1,652)		(210)		
Net interest income (GAAP)		$ 268,396			$ 251,865		$ 16,531		
Interest rate spread (1)(3)			2.98%			3.26%			
Interest expense as a percent of average earning assets			1.08%			0.80%			
Net interest margin (tax equivalent basis) (2)(3)			3.50%			3.64%			
Total cost of deposits			0.98%			0.62%			

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

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

(3) Non-GAAP.

Noninterest Income. Total noninterest income for the quarter ended September 30, 2019, was $54.78 million, an increase of $5.56 million, or 11.29%, compared to the same period in 2018. Total noninterest income increased $0.06 million, or 0.11%, over the linked quarter. As a percentage of total operating income, noninterest income for third quarter 2019 was 37.53%, compared with 35.69% for comparative 2018, and 37.86% for the quarter ended June 30, 2019. There were $69 thousand in net losses on investment securities in the third quarter of 2019 included in noninterest income. There were no gains or losses on investment securities in comparative periods. Total noninterest income was $155.88 million for the nine months ended September 30, 2019, compared to $149.38 million in 2018. For the first nine months of 2019, total noninterest income included losses on investment securities totaling $845 thousand, compared to gains on investment securities of $3 thousand for the same period in 2018.

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

	Three Months Ended September 30,		Increase/(Decrease) 2019 over 2018	
	2019	2018	Amount	Percent
Residential mortgage banking income, net	$ 18,855	$ 15,804	$ 3,051	19.31 %
Insurance commissions and other title fees and income, net	16,681	14,493	2,188	15.10 %
Real estate brokerage and property management, net	9,444	8,542	902	10.56 %
Service charges on deposit accounts	2,253	3,028	(775)	(25.59)%
Credit card merchant fees, net	1,514	1,563	(49)	(3.13)%
Bank-owned life insurance	2,117	1,657	460	27.76 %
Other income	3,981	4,130	(149)	(3.61)%
Subtotal before loss on investment securities	54,845	49,217	5,628	11.44 %
Net gain (loss) on investment securities	(69)	—	(69)	N/M
Total noninterest income	$ 54,776	$ 49,217	$ 5,559	11.29 %

	Three Months Ended		Increase/(Decrease) Third Quarter 2019 over Second Quarter 2019	
	September 30, 2019	June 30, 2019	Amount	Percent
Residential mortgage banking income, net	$ 18,855	$ 18,565	$ 290	1.56 %
Insurance commissions and other title fees and income, net	16,681	17,213	(532)	(3.09)%
Real estate brokerage and property management, net	9,444	8,843	601	6.80 %
Service charges on deposit accounts	2,253	3,185	(932)	(29.26)%
Credit card merchant fees, net	1,514	660	854	129.39 %
Bank-owned life insurance	2,117	1,635	482	29.48 %
Other income	3,981	4,617	(636)	(13.78)%
Subtotal before gain on investment securities	54,845	54,718	127	0.23 %
Net gain (loss) on investment securities	(69)	—	(69)	N/M
Total noninterest income	$ 54,776	$ 54,718	$ 58	0.11 %

	Nine Months Ended September 30,		Increase/(Decrease) 2019 over 2018	
	2019	2018	Amount	Percent
Residential mortgage banking income, net	$ 50,929	$ 52,152	$ (1,223)	(2.35)%
Insurance commissions and other title fees and income, net	49,477	42,952	6,525	15.19 %
Real estate brokerage and property management, net	27,555	25,881	1,674	6.47 %
Service charges on deposit accounts	8,299	8,880	(581)	(6.54)%
Credit card merchant fees, net	3,357	4,174	(817)	(19.57)%
Bank-owned life insurance	5,350	4,822	528	10.95 %
Other income	11,754	10,520	1,234	11.73 %
Subtotal before gain (loss) on investment securities	156,721	149,381	7,340	4.91 %
Net gain (loss) on investment securities	(845)	3	(848)	N/M
Total noninterest income	$ 155,876	$ 149,384	$ 6,492	4.35 %

For the third quarter of 2019, residential mortgage banking income, net of commission expense, was $18.86 million, an increase of $3.05 million, or 19.31%, compared to third quarter 2018, and an increase of $0.29 million, or 1.56%, compared to second quarter 2019. For the nine-month period ended September 30, 2019, residential mortgage banking income, net of commission expense, was $50.93 million reflecting a decrease of $1.22 million, or 2.35%, compared to the same period in 2018. Quarterly changes in mortgage banking income were driven by changes in production volumes, rate lock commitments, and forward sales contracts. The increase from second quarter 2019 was driven by income on higher volumes. Changes in income from rate lock commitments, net of changes in forward sales contracts resulted in a decline in income of $0.49 million. The increase from third quarter 2018 was driven by higher production income and a net increase in income from rate lock commitments and forward sales contracts of $1.46 million. Mortgage loan production volume was $963.66 million in the third quarter of 2019, compared to $821.13 million in the linked quarter, and $811.50 million in the third quarter of 2018. Purchase volume as a percentage of total production was 68.83%, 84.97%, and 89.72% for the same respective periods. Total mortgage loan production for the first nine months of 2019 compared to 2018 was $2.30 billion and $2.43 billion, respectively.

For the third quarter of 2019, insurance commissions and other title income, net of commission expense, was $16.68 million, which was $2.19 million, or 15.10%, higher than comparative 2018, and $0.53 million, or 3.09%, lower than second quarter 2019. For the nine-month period ended September 30, 2019, insurance commissions and other title income, net of commission expense, was $6.53 million, or 15.19%, higher than comparative 2018. The increase from third quarter 2018 was primarily a result of additional commission income from insurance agency acquisitions that occurred in November 2018 and January 2019. Towne Insurance Agency, LLC also acquired an insurance agency on September 1, 2019.

Real estate brokerage and property management income, net of commission expense, for third quarter 2019 was $9.44 million, which was $0.90 million, or 10.56%, higher than comparative 2018, and $0.60 million, or 6.80%, higher than second quarter 2019. Real estate brokerage and property management income, net of commission expense increased $1.67 million, or 6.47%, for the nine-month period ended September 30, 2019, compared to the same period in 2018. The majority of the income from this line of business is related to vacation property commissions and associated fees. The income is seasonally affected because a large percentage of renters typically reserve vacation homes in the winter months in anticipation of their summer occupancy. Income from these reservations is recognized at the time of reservation. As compared to the third quarter of 2018, reservations were higher due to an increase in the number of properties being managed. The increase in the third quarter of 2019 compared to the linked quarter was driven by higher fees and advance reservations.

Service charges on deposit accounts were $2.25 million for third quarter 2019, compared with $3.03 million for the comparative 2018 period, and $3.19 million for second quarter 2019. For the nine-month period ended September 30, 2019, service charges on deposit accounts were $8.30 million, which was $0.58 million, or 6.54%, lower than comparative 2018. In 2018, the Company exceeded $10 billion in assets, which made us subject, in the third quarter of 2019, to the Durbin Amendment promulgated under the Dodd-Frank Act. This rule limits certain fees the Company is allowed to charge for interchange activities. The Company had anticipated a decline in service charges beginning in this quarter.

For the third quarter of 2019, credit card merchant fees totaled $1.51 million, which was $0.05 million, or 3.13%, below comparative 2018, and $0.85 million, or 129.39%, above second quarter 2019. For the nine-month period ended September 30, 2019, credit card merchant fees totaled $3.36 million, which was $0.82 million, or 19.57%, below comparative 2018. The impact of converting to a new processing platform in 2019 that will allow us to provide additional services and capabilities has had a short-term adverse impact on credit card merchant fees, primarily affecting second quarter 2019.

Income from BOLI was $2.12 million in third quarter 2019, compared to $1.63 million in third quarter 2018, and $1.60 million in second quarter 2019. For the nine-month period ended September 30, 2019, BOLI totaled $5.35 million, which was $0.53 million, or 10.95%, higher than comparative 2018. Average BOLI balances have increased, year over year.

Other noninterest income for the three months ended September 30, 2019, was $3.98 million, a decrease of $0.15 million, or 3.61%, as compared to $4.13 million for third quarter 2018. For the first nine months of 2019, other noninterest income increased $1.23 million, to $11.75 million, from $10.52 million in the prior year. Growth in the first nine months of 2019, as compared to 2018, was primarily attributable to increases in service charges on loans, commercial mortgage commissions, and gains on sale of OREO properties.

There were five investment securities sold in the third quarter of 2019 and no investments sold in the third quarter of 2018. We recorded losses on the sale of AFS securities of $69 thousand in the third quarter of 2019 and $845 thousand in the first nine months of 2019. We reported zero gains or losses in the third quarter of 2018 and gains of $3 thousand in the first nine months of 2018. We sold securities with a carrying value of $87.00 million in the third quarter of 2019 and $187.08 million in the first nine months of 2019. We sold securities with a carrying value of $48.50 million in first nine months of 2018. All securities sales were transacted to position ourselves for better yield, going forward.

Noninterest Expense. For the quarter ended September 30, 2019, total noninterest expense was $97.29 million, which was $9.03 million, or 10.23%, higher than comparative 2018, and $0.73 million, or 0.76%, higher than the quarter ended June 30, 2019. For the nine-month period ended September 30, 2019, total noninterest expense increased $16.18 million, or 6.00%, from comparative 2018 to $285.97 million.

As a percentage of operating income, noninterest expense was 66.66% for the third quarter of 2019, 64.00% for comparative 2018, and 66.80% for the quarter ended June 30, 2019. Primary components of noninterest expense in third quarter 2019 were salaries and employee benefits of $55.78 million, occupancy expenses of $7.95 million, professional fees of $3.57 million, outside data processing expenses of $2.53 million, furniture and equipment expenses of $3.81 million, advertising and marketing expenses of $3.43 million, amortization expense of $3.06 million, and software expenses of $3.21 million.

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

	Three Months Ended			Increase/(Decrease) September 30, 2019 over September 30, 2018		Increase/(Decrease) September 30, 2019 over June 30, 2019	
	September 30,		June 30,				
	2019	2018	2019	Amount	Percent	Amount	Percent
Salaries and employee benefits	$ 55,784	$ 50,497	$ 54,263	$ 5,287	10.47 %	$ 1,521	2.80 %
Occupancy expense	7,953	7,013	7,662	940	13.40 %	291	3.80 %
Furniture and equipment	3,805	3,646	3,578	159	4.36 %	227	6.34 %
Amortization - intangibles	3,059	2,996	3,113	63	2.10 %	(54)	(1.73)%
Software expense	3,208	2,940	2,788	268	9.12 %	420	15.06 %
Outside data processing	2,533	2,917	3,616	(384)	(13.16)%	(1,083)	(29.95)%
Professional fees	3,566	1,908	3,707	1,658	86.90 %	(141)	(3.80)%
Advertising and marketing	3,429	2,874	3,182	555	19.31 %	247	7.76 %
Other noninterest expenses:							
Acquisition-related expenses	207	424	20	(217)	(51.18)%	187	935.00 %
Bank franchise tax/SCC fees	1,982	1,403	1,660	579	41.27 %	322	19.40 %
Charitable contributions	2,175	1,878	2,763	297	15.81 %	(588)	(21.28)%
Directors fees and expenses	542	547	576	(5)	(0.91)%	(34)	(5.90)%
FDIC and other insurance	699	1,284	1,369	(585)	(45.56)%	(670)	(48.94)%
Foreclosed property expenses	52	200	430	(148)	(74.00)%	(378)	(87.91)%
Other	5,031	4,295	4,432	736	17.14 %	599	13.52 %
Stationery and supplies	807	840	655	(33)	(3.93)%	152	23.21 %
Telephone and postage	1,636	1,743	1,684	(107)	(6.14)%	(48)	(2.85)%
Travel/meals/entertainment	819	857	1,058	(38)	(4.43)%	(239)	(22.59)%
Total other noninterest expenses	13,950	13,471	14,647	479	3.56 %	(697)	(4.76)%
Total noninterest expense	$ 97,287	$ 88,262	$ 96,556	$ 9,025	10.23 %	$ 731	0.76 %

	Nine Months Ended September 30,		Increase/(Decrease) 2019 over 2018	
	2019	2018	Amount	Percent
Salaries and benefits	$ 162,907	$ 151,606	$ 11,301	7.45 %
Occupancy expense	23,866	20,292	3,574	17.61 %
Furniture and equipment	10,753	10,890	(137)	(1.26)%
Amortization - intangibles	9,364	8,587	777	12.77 %
Software expense	8,742	7,927	815	10.93 %
Outside data processing	9,316	7,898	1,418	10.93 %
Professional fees	9,952	6,295	3,657	58.09 %
Advertising and marketing	9,440	8,649	791	9.15 %
Other noninterest expenses:				
Acquisition-related expenses	638	9,947	(9,309)	(93.59)%
Bank franchise tax/SCC fees	5,302	4,244	1,058	24.93 %
Charitable contributions	7,337	5,865	1,472	25.10 %
Directors fees and expenses	1,560	1,462	98	6.70 %
FDIC and other insurance	3,422	3,658	(236)	(6.45)%
Foreclosed property expenses	654	623	31	4.98 %
Other	12,673	11,853	820	6.92 %
Stationery and supplies	2,233	2,396	(163)	(6.80)%
Telephone and postage	4,935	5,034	(99)	(1.97)%
Travel/meals/entertainment	2,873	2,561	312	12.18 %
Total other noninterest expenses	41,627	47,643	(6,016)	(12.63)%
Total noninterest expense	$ 285,967	$ 269,787	$ 16,180	6.00 %

Salary and benefits expense was $55.78 million, representing 57.34% of total noninterest expense for the quarter ended September 30, 2019, and $162.91 million, or 56.97%, of total noninterest expense for the nine months ended September 30, 2019. Salary and benefits expense increased $5.29 million, or 10.47%, and $11.30 million, or 7.45%, over the comparative three- and nine-month periods in 2018. Salaries and benefits increased $1.52 million, or 2.80%, from second quarter 2019. The increase in salary and benefits expense in the first nine months of 2019 compared to 2018 was attributable to expansion that enables us to enhance Company infrastructure and meet increased regulatory expectations related to exceeding $10 billion in assets, as well as keeping pace with our growth and changing industry standards. Specific areas of enhancement were information technology, risk and compliance, accounting and internal audit. We also established two new banking groups, located in Greenville and Greensboro, North Carolina, and opened a full-service banking office in Greenville, in the first quarter of 2019. We anticipate opening a full-service banking office in Greensboro, North Carolina, in mid - November.

In our Banking segment, we had a total of 1,117 full-time equivalent employees ("FTE") at September 30, 2019, as compared to 1,026 at September 30, 2018, and 1,134 at June 30, 2019. In our non-Banking segments at September 30, 2019, we had a total of 1,327 FTEs, excluding real estate sales agents, compared to 1,509 at September 30, 2018, and 1,370 at June 30, 2019. Real estate sales agents are independent contractors and, therefore, not included as our employees. The headcount in the linked quarter, for both Banking and non-Banking, was marginally higher due to the Company hiring temporary summer interns. The year-over-year decline in non-Banking segment FTEs included both salaried and commission-based employees. Total operating income per FTE was $59,000 for the quarter ended September 30, 2019, increasing from $58,000 in the linked quarter and $54,000 for the quarter ended September 30, 2018.

Occupancy expense for the third quarter of 2019 increased $0.94 million, or 13.40%, from the comparative quarter of 2018, and $0.29 million, or 3.80%, from second quarter 2019. Occupancy expense for the first nine months of 2019 increased $3.57 million, or 17.61%, from comparative 2018. Increases from the prior-year quarters were primarily related to a higher level of expenses for maintenance and cleaning services, as well as increases in rent expense and depreciation of leasehold improvements. Additionally, we performed a comprehensive review of all lease agreements in conjunction with our adoption of ASU 842. This review led to a correction of several lease schedules, resulting in a one-time increase to rent expense $1.08 million year-to-date. For further financial details, see *Note 7 – Leases* of the Notes to Consolidated Financial Statements in this report.

For the three month period ended September 30, 2019, professional fees increased by $1.66 million compared to the same period in 2018 but decreased $0.14 million from second quarter 2019. Professional fees increased $3.66 million in the first nine months of 2019 compared to 2018. Outside data processing expense decreased $0.38 million in the third quarter of 2019 compared to 2018, and $1.08 million compared to the linked quarter. Outside data processing expense increased $1.42 million in the first nine months of 2019 compared to 2018. Infrastructure costs associated with more robust fraud/BSA monitoring, adoption of new accounting standards, security surrounding information technology, plus costs associated with contract cancellations associated with the re-branding of Paragon, were the primary drivers of year-over-year increases.

Other noninterest expenses for the third quarter of 2019 were $13.95 million, an increase of $0.48 million, or 3.56%, compared to the same period in 2018, and a decrease of $0.70 million, or 4.76%, compared to the linked quarter. For the third quarter of 2019 compared to 2018, increases were attributable to higher charitable contributions of $0.30 million and bank franchise tax/SCC fees of $0.58 million. FDIC and other insurance expense declined $0.59 million. For the third quarter of 2019 compared to the linked quarter, bank franchise tax/SCC fees increased $0.32 million while charitable contributions declined $0.59 million and FDIC and other insurance expense declined $0.67 million.

Provision for Income Taxes. We reported a provision for income tax expense of $7.68 million, representing an effective tax rate of 16.95%, in third quarter 2019. The provision for income tax expense was $9.16 million for third quarter 2018, with an effective rate of 19.30%, and $8.92 million, with an effective rate of 20.47%, for the second quarter of 2019. The lower effective tax rate in the third quarter of 2019 was related to a revision in deferred taxes.

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 8 – Segment Reporting* of the Notes to Consolidated Financial Statements in this report.

Banking Segment. For the three months ended September 30, 2019, the Banking segment represented 84.56%, or $31.84 million, of our total consolidated net income, compared to 90.02%, or $34.47 million, for the three months ended September 30, 2018. For the nine months ended September 30, 2019, the Banking segment represented 86.32%, or $89.52 million, of our consolidated income compared to 85.23%, or $83.36 million, for comparative 2018.

Income before tax provision and noncontrolling interest for the Banking segment was $37.34 million for the quarter ended September 30, 2019, decreasing $4.74 million from comparative 2018. This decrease in earnings was driven by growth in noninterest expenses outpacing increases in total revenue. Overall revenue increased $4.10 million, primarily driven by an increase in net interest income of $4.07 million due to organic growth. Noninterest income decreased $0.03 million due to decreases in service charges on deposit accounts of $0.78 million and credit card merchant fees of $0.05 million, net of increases in other income of $0.85 million. Noninterest expenses increased $8.45 million compared to third quarter 2018, driven by increases in salaries and employee benefits of $5.20 million. Occupancy expense increased $0.88 million. The provision for loan loss increased $0.27 million in the third quarter of 2019 compared to 2018.

Income before tax provision and noncontrolling interest increased by $2.19 million compared to the linked quarter ended June 30, 2019. The increase in earnings was driven by net interest income growth, lower noninterest expenses and a decline in the provision for loan losses, when compared to the linked quarter. Net interest income increased $1.05 million, driven by growth in earning assets. Noninterest expenses decreased from the linked quarter, despite increased salaries and employee benefits, due to a $1.14 million decline in outside data processing expense and $0.68 million decline in FDIC and other insurance expense. The provision for loan losses decreased $1.32 million.

Income before tax provision and noncontrolling interest was $108.85 million, an increase of $6.86 million, or 6.72%, for the nine months ended September 30, 2019, compared to the same period in 2018. The increase in earnings was driven by an increase in net interest income of $21.18 million due to a higher volume in earning assets partially reduced by a $0.21 million decrease in noninterest income. The increase in earnings was partially offset by an increase in total noninterest expenses of $14.60 million, which includes an increase in salaries and benefits costs of $10.59 million and occupancy expense of $2.84 million. There was also a decrease in the provision for loan losses of $0.48 million.

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

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2019 September 30, 2018		September 30, 2019 June 30, 2019	
	2019	2018	2019	Amount	Percent	Amount	Percent
Net interest income	$ 89,490	$ 85,423	$ 88,442	$ 4,067	4.76 %	$ 1,048	1.18 %
Service charges on deposit accounts	2,253	3,028	3,185	(775)	(25.59)%	(932)	(29.26)%
Credit card merchant fees	1,514	1,563	660	(49)	(3.13)%	854	129.39 %
Other income	5,152	4,300	5,273	852	19.81 %	(121)	(2.29)%
Net loss on investment securities	(69)	—	—	(69)	— %	(69)	N/M
Total noninterest income	8,850	8,891	9,118	(41)	(0.46)%	(268)	(2.94)%
Total revenue	98,340	94,314	97,560	4,026	4.27 %	780	0.80 %
Provision for loan losses	1,508	1,241	2,824	267	21.51 %	(1,316)	(46.60)%
Salaries and employee benefits	33,526	28,329	32,353	5,197	18.35 %	1,173	3.63 %
Occupancy expense	5,209	4,331	5,007	878	20.27 %	202	4.03 %
Furniture and equipment	2,779	2,463	2,517	316	12.83 %	262	10.41 %
Amortization of intangible assets	1,265	1,479	1,315	(214)	(14.47)%	(50)	(3.80)%
Other expenses	17,098	14,829	18,938	2,269	15.30 %	(1,840)	(9.72)%
Total noninterest expenses	59,877	51,431	60,130	8,446	16.42 %	(253)	(0.42)%
Income before income tax and corporate allocation	36,955	41,642	34,606	(4,687)	(11.26)%	2,349	6.79 %
Corporate allocation	384	438	546	(54)	(12.33)%	(162)	(29.67)%
Income before income tax provision and noncontrolling interest	37,339	42,080	35,152	(4,741)	(11.27)%	2,187	6.22 %
Provision for income tax expense	5,495	7,604	6,650	(2,109)	(27.74)%	(1,155)	(17.37)%
Net income	31,844	34,476	28,502	(2,632)	(7.63)%	3,342	11.73 %
Noncontrolling interest	—	(4)	1	4	N/M	(1)	(100.00)%
Net income attributable to TowneBank	$ 31,844	$ 34,472	$ 28,503	$ (2,628)	(7.62)%	$ 3,341	11.72 %
Efficiency ratio	60.85%	54.53%	61.63%	6.32%	11.59 %	(0.78)%	(1.27)%

	Nine Months Ended September 30,		Increase/(Decrease) 2019 over 2018	
	2019	2018	Amount	Percent
Net interest income	$ 264,332	$ 243,151	$ 21,181	8.71 %
Service charges on deposit accounts	8,299	8,880	(581)	(6.54)%
Credit card merchant fees	3,357	4,174	(817)	(19.57)%
Other income	14,350	12,318	2,032	16.50 %
Net (loss) gain on investment securities	(845)	3	(848)	N/M
Total noninterest income	25,161	25,375	(214)	(0.84)%
Total revenue	289,493	268,526	20,967	7.81 %
Provision for loan losses	5,770	6,249	(479)	(7.67)%
Salaries and employee benefits	96,966	86,372	10,594	12.27 %
Occupancy expense	15,460	12,621	2,839	22.49 %
Furniture and equipment	7,662	7,485	177	2.36 %
Amortization of intangibles	3,946	4,230	(284)	(6.71)%
Other expenses	52,218	50,940	1,278	2.51 %
Total noninterest expenses	176,252	161,648	14,604	9.03 %
Income before income tax and corporate allocation	107,471	100,629	6,842	6.80 %
Corporate allocation	1,383	1,370	13	0.95 %
Income before income tax provision and noncontrolling interest	108,854	101,999	6,855	6.72 %
Provision for income tax expense	19,337	18,629	708	3.80 %
Net income	89,517	83,370	6,147	7.37 %
Noncontrolling interest	4	(12)	16	N/M
Net income attributable to TowneBank	$ 89,521	$ 83,358	$ 6,163	7.39 %
Efficiency ratio	60.71%	60.20%	0.51%	0.85 %

Realty Segment. For the three months ended September 30, 2019, the Realty segment had income before income tax provision and noncontrolling interest of $6.67 million, as compared to $3.14 million, for third quarter 2018, and $5.78 million for the linked quarter ended June 30, 2019. Income before income tax provision and noncontrolling interest increased $0.95 million in the first nine months of 2019 compared to 2018. Total revenue increased to $31.30 million in third quarter 2019 from $29.52 million in third quarter 2018, and increased from $30.17 million in the quarter ended June 30, 2019. Total expenses declined $1.69 million in third quarter 2019 compared to 2018, but increased $0.36 million compared to the linked quarter. Total revenue decreased $4.50 million, or 4.95%, in the first nine months of 2019 compared to 2018, while total expenses declined $5.39 million, or 7.02%, for the same comparative periods.

The increase in total revenue in third quarter 2019 from comparative 2018 is the result of an increase in net residential mortgage banking income of $2.95 million driven by higher production volume, offset by a reduction in net interest and other income of $2.23 million. Net property management fees increased $0.78 million compared to prior year. Residential mortgage banking income included increases in income from rate lock commitments and forward sales contracts of $1.46 million for the quarter ended September 30, 2019, compared to the same period of 2018. Net property management fees, which are primarily commissions on vacation homes managed by the Company, increased as a result of higher reservation levels in third quarter 2019, compared to 2018. Salaries and employee benefits declined $1.39 million on lower FTEs when compared to third quarter 2018. In addition to the decrease in salaries and employee benefits, general expense levels declined $0.30 million, quarter over quarter.

The increase in total revenue in third quarter 2019 from second quarter 2019 was driven by a $0.27 million increase in net residential mortgage banking income and a $0.01 million increase in net real estate brokerage income, and a $0.59 million increase in net property management fees. Net residential mortgage income increased on higher volumes. Forward sales contracts, net of the value of rate lock commitments declined $0.49 million compared to the prior quarter. Net real estate brokerage income increased on a higher number of units sold. Net property management fees declined based on the timing of reservations and recognition of related revenue. Income related to net property management fees is typically highest in the first quarter, when the majority of reservations are made. Total expenses increased $0.36 million in the third quarter of 2019, compared to the linked quarter. These increases were primarily due to salaries and employee benefits and other expenses.

Income before tax provision and noncontrolling interest was up $0.95 million for the nine months ended September 30, 2019, compared to the same period in 2018. The increase in earnings was driven by a decrease in total expenses of $5.39 million which outpaced the decline in total revenue of $4.50 million. Declines in residential mortgage banking income of $1.40 million were due to lower year-over-year volume, and a decrease in net interest and other income of $5.06 million were partially offset by an increase in net property management fee income of $1.63 million. Total expenses declined $5.39 million, driven by a $4.46 million decline in salaries and employee benefits and a $1.04 million decline in other expenses.

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2019 September 30, 2018		September 30, 2019 June 30, 2019	
	2019	2018	2019	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	$ 19,171	$ 16,219	$ 18,898	$ 2,952	18.20 %	$ 273	1.44 %
Real estate brokerage income, net	2,882	2,758	2,873	124	4.50 %	9	0.31 %
Title insurance and settlement fees	617	525	594	92	17.52 %	23	3.87 %
Property management fees, net	6,562	5,783	5,970	779	13.47 %	592	9.92 %
Income from unconsolidated subsidiary	185	122	162	63	51.64 %	23	14.20 %
Net interest and other income	1,885	4,111	1,677	(2,226)	(54.15)%	208	12.40 %
Total revenue	31,302	29,518	30,174	1,784	6.04 %	1,128	3.74 %
Salaries and employee benefits	13,474	14,862	13,309	(1,388)	(9.34)%	165	1.24 %
Occupancy expense	2,055	2,084	2,028	(29)	(1.39)%	27	1.33 %
Furniture and equipment	754	952	803	(198)	(20.80)%	(49)	(6.10)%
Amortization of intangible assets	666	672	695	(6)	(0.89)%	(29)	(4.17)%
Other expenses	7,478	7,543	7,234	(65)	(0.86)%	244	3.37 %
Total expenses	24,427	26,113	24,069	(1,686)	(6.46)%	358	1.49 %
Income before income tax, corporate allocation, and noncontrolling interest	6,875	3,405	6,105	3,470	101.91 %	770	12.61 %
Corporate allocation	(208)	(270)	(328)	62	22.96 %	120	36.59 %
Income before income tax provision and noncontrolling interest	6,667	3,135	5,777	3,532	112.66 %	890	15.41 %
Provision for income tax	1,454	786	1,287	668	84.99 %	167	12.98 %
Net income	5,213	2,349	4,490	2,864	121.92 %	723	16.10 %
Noncontrolling interest	(1,496)	(756)	(1,248)	(740)	(97.88)%	(248)	(19.87)%
Net income attributable to TowneBank	$ 3,717	$ 1,593	$ 3,242	$ 2,124	133.33 %	$ 475	14.65 %

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

	Three Months Ended			Increase/(Decrease)			
	September 30,		June 30,	September 30, 2019 September 30, 2018		September 30, 2019 June 30, 2019	
	2019	2018	2019	Amount	Percent	Amount	Percent
Key data:							
Efficiency ratio	78.04%	88.46%	79.77%	(10.42)%	(11.78)%	(1.73)%	(2.17)%
Number of units sold	1,368	1,510	1,369	(142)	(9.40)%	(1)	(0.07)%
Volume of units sold	$ 485,328	$ 459,286	$ 447,280	$ 26,042	5.67 %	$ 38,048	8.51 %
Number of real estate agents	404	415	415	(11)	(2.65)%	(11)	(2.65)%
Loans originated, mortgage	$ 703,922	$ 561,543	$ 574,638	$ 142,379	25.35 %	$ 129,284	22.50 %
Loans originated, joint venture	259,742	249,956	246,491	9,786	3.92 %	13,251	5.38 %
Total loans originated	$ 963,664	$ 811,499	$ 821,129	$ 152,165	18.75 %	$ 142,535	17.36 %
Number of loans, mortgage	2,300	1,971	2,059	329	16.69 %	241	11.70 %
Number of loans, joint venture	1,060	1,097	1,062	(37)	(3.37)%	(2)	(0.19)%
Total number of loans	3,360	3,068	3,121	292	9.52 %	239	7.66 %
Average loan amount, mortgage	$ 306	$ 285	$ 279	$ 21	7.37 %	$ 27	9.68 %
Average loan amount, joint venture	245	228	232	17	7.46 %	13	5.60 %
Average loan amount	$ 287	$ 265	$ 263	$ 22	8.30 %	$ 24	9.13 %
Number of originators, mortgage	154	222	159	(68)	(30.63)%	(5)	(3.14)%
Number of originators, joint venture	71	81	70	(10)	(12.35)%	1	1.43 %
Total number of originators	225	303	229	(78)	(25.74)%	(4)	(1.75)%

	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018	Increase/(Decrease) 2019 over 2018 Amount	Increase/(Decrease) 2019 over 2018 Percent
Residential mortgage banking income, net	$ 51,826	$ 53,223	$ (1,397)	(2.62)%
Real estate brokerage income, net	7,315	7,275	40	0.55 %
Title insurance and settlement fees	1,581	1,420	161	11.34 %
Property management fees, net	20,240	18,606	1,634	8.78 %
Income from unconsolidated subsidiary	441	316	125	39.56 %
Net interest and other income	4,937	9,999	(5,062)	(50.63)%
Total revenue	86,340	90,839	(4,499)	(4.95)%
Salaries and employee benefits	39,678	44,142	(4,464)	(10.11)%
Occupancy expense	6,428	5,942	486	8.18 %
Furniture and equipment	2,326	2,768	(442)	(15.97)%
Amortization of intangible assets	2,086	2,015	71	3.52 %
Other expenses	20,953	21,996	(1,043)	(4.74)%
Total expenses	71,471	76,863	(5,392)	(7.02)%
Income before income tax, corporate allocation, and noncontrolling interest	14,869	13,976	893	6.39 %
Corporate allocation	(800)	(853)	53	6.21 %
Income before income tax provision and noncontrolling interest	14,069	13,123	946	7.21 %
Provision for income tax	3,292	2,977	315	10.58 %
Net income	10,777	10,146	631	6.22 %
Noncontrolling interest	(2,997)	(2,268)	(729)	(32.14)%
Net income attributable to TowneBank	$ 7,780	$ 7,878	$ (98)	(1.24)%
Key data:				
Efficiency ratio	82.78%	84.61%	(1.83)%	(2.16)%
Number of units sold	3,552	3,739	(187)	(5.00)%
Volume of units sold	$ 1,169,062	$ 1,128,038	$ 41,024	3.64 %
Number of real estate agents	404	415	(11)	(2.65)%
Loans originated, mortgage	$ 1,645,204	$ 1,705,880	$ (60,676)	(3.56)%
Loans originated, joint venture	653,118	719,195	(66,077)	(9.19)%
Total loans originated	$ 2,298,322	$ 2,425,075	$(126,753)	(5.23)%
Number of loans, mortgage	5,696	6,220	(524)	(8.42)%
Number of loans, joint venture	2,762	3,136	(374)	(11.93)%
Total number of loans	8,458	9,356	(898)	(9.60)%
Average loan amount, mortgage	$ 289	$ 274	$ 15	5.47 %
Average loan amount, joint venture	236	230	6	2.61 %
Average loan amount	$ 272	$ 259	$ 13	5.02 %
Number of originators, mortgage	154	222	(68)	(30.63)%
Number of originators, joint venture	71	81	(10)	(12.35)%
Number of originators	225	303	(78)	(25.74)%

Mortgage. Loan volume for the combined mortgage operations increased in the quarter ended September 30, 2019, as compared to the same period in 2018. Total loans originated in the third quarter of 2019 were $963.66 million, an 18.75%, or $152.17 million, increase from $811.50 million in the comparative period of 2018, and a $142.54 million, or 17.36% increase compared to the volume for the quarter ended June 30, 2019. Refinance activity comprised 31.17% of loan volume for the quarter ended September 30, 2019, compared to 10.28% for the quarter ended September 30, 2018, and 15.03% for the quarter ended June 30, 2019. Loan volume for the combined mortgage operations in the first nine months of 2019 was $2.3 billion, a 5.2% decline from $2.4 billion the comparative period in 2018. Refinance activity comprised 21.5% of loan volume in the first nine months of 2019, compared to 12.23% in the first nine months of 2018.

Insurance Segment. The Insurance segment includes property and casualty and group benefit divisions, as well as travel insurance. The Insurance segment represented 5.57%, or $2.10 million, of total consolidated net income at September 30, 2019, and 5.82%, or $2.23 million, at September 30, 2018.

Earnings before income taxes and noncontrolling interest for the three months ended September 30, 2019, were $3.08 million, decreasing $0.12 million, or 3.69%, from comparative 2018, and $1.15 million from the linked quarter ended June 30, 2019. Increases in revenue, net of commissions were outpaced by growth in total operating expenses, when comparing third quarter 2019 to the same period in 2018. Declines in revenue, net of commissions, due to seasonality, coupled with increases in total operating expenses resulted in the linked quarter decrease. Earnings before income taxes and noncontrolling interest for the nine months ended September 30, 2019, were $10.20 million, decreasing 3.89%, or $0.41 million, from the comparative period in 2018. Increases in operating expenses of $6.97 million outpaced the growth in revenue, net of commissions.

Net revenues for the third quarter of 2019 increased $2.16 million, or 15.30%, when compared to the same quarterly period in 2018 but declined $0.57 million, or 3.37%, when compared to the linked quarter. Net revenues for the first nine months of 2019 increased $6.56 million, or 15.65%, when compared to the nine months ended September 30, 2018. Theses increases were driven by commissions on property and casualty insurance related to acquisitions. Towne Insurance Agency, LLC acquired insurance agencies in November 2018, January 2019 and September 2019. Travel insurance revenue declined in the third quarter, compared to second quarter, due to seasonality.

Total operating expenses for the third quarter of 2019 increased $2.27 million, or 21.13%, when compared to the same period in 2018, and $0.63 million, or 5.07%, when compared to the linked quarter. Total operating expenses increased $6.97 million, or 22.28%, for the nine months ended September 30, 2019 compared to September 30, 2018. The largest factor in the increase from comparative prior year periods was salaries and employee benefits expense, which increased $1.48 million, or 20.23%, and $5.17 million, or 24.52%, when comparing the three- and nine-month periods ended September 30, 2019, to the same periods for 2018. Salaries and employee benefits expense increased $0.18 million when compared to the linked quarter. Insurance agency acquisitions in third quarter 2018, first quarter 2019, and third quarter 2019 resulted in additional salaries and employee benefits expenses in the third quarter and first nine months of 2019, when compared to the same periods in 2018. In second quarter 2019, the Insurance segment began consolidating teams to reduce overhead and realize more income benefits from their acquisitions, which management anticipates will have a positive impact on operating results in future periods.

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

	Three Months Ended			Increase/(Decrease)			
				September 30, 2019		September 30, 2019	
	September 30,		June 30,	September 30, 2018		June 30, 2019	
	2019	2018	2019	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 13,481	$ 10,762	$ 13,067	$ 2,719	25.26 %	$ 414	3.17 %
Employee benefits	3,629	3,813	3,833	(184)	(4.83)%	(204)	(5.32)%
Travel insurance	834	871	1,169	(37)	(4.25)%	(335)	(28.66)%
Specialized benefit services	166	166	163	—	— %	3	1.84 %
Total net commissions and fees	18,110	15,612	18,232	2,498	16.00 %	(122)	(0.67)%
Contingency and bonus revenue	1,431	1,137	1,893	294	25.86 %	(462)	(24.41)%
Other income	74	75	79	(1)	(1.33)%	(5)	(6.33)%
Total revenues	19,615	16,824	20,204	2,791	16.59 %	(589)	(2.92)%
Employee commission expense	3,378	2,742	3,401	636	23.19 %	(23)	(0.68)%
Revenue, net of commission expense	16,237	14,082	16,803	2,155	15.30 %	(566)	(3.37)%
Salaries and employee benefits	8,784	7,306	8,601	1,478	20.23 %	183	2.13 %
Occupancy expense	689	598	627	91	15.22 %	62	9.89 %
Furniture and equipment	272	232	258	40	17.24 %	14	5.43 %
Amortization of intangible assets	1,128	845	1,103	283	33.49 %	25	2.27 %
Other expenses	2,110	1,737	1,768	373	21.47 %	342	19.34 %
Total operating expenses	12,983	10,718	12,357	2,265	21.13 %	626	5.07 %
Income before income tax, corporate allocation, and noncontrolling interest	3,254	3,364	4,446	(110)	(3.27)%	(1,192)	(26.81)%
Corporate allocation	(176)	(168)	(218)	(8)	4.76 %	42	(19.27)%
Income before income tax provision and noncontrolling interest	3,078	3,196	4,228	(118)	(3.69)%	(1,150)	(27.20)%
Provision for income tax	735	769	978	(34)	(4.42)%	(243)	(24.85)%
Net income	2,343	2,427	3,250	(84)	(3.46)%	(907)	(27.91)%
Noncontrolling interest	(245)	(199)	(357)	(46)	23.12 %	112	(31.37)%
Net income attributable to TowneBank	$ 2,098	$ 2,228	$ 2,893	$ (130)	(5.83)%	$ (795)	(27.48)%
Efficiency ratio	79.96%	76.11%	73.54%	3.85%	5.06 %	6.42%	8.73 %

	Nine Months Ended September 30,		Increase/(Decrease) 2019 over 2018	
	2019	2018	Amount	Percent
Net commission and fee income				
Property and casualty	$ 38,421	$ 31,178	$ 7,243	23.23 %
Employee benefits	10,968	10,463	505	4.83 %
Travel insurance	3,292	4,028	(736)	(18.27)%
Specialized benefit services	499	506	(7)	(1.38)%
Total net commissions and fees	53,180	46,175	7,005	15.17 %
Contingency and bonus revenue	4,910	3,703	1,207	32.60 %
Other income	227	215	12	5.58 %
Total revenues	58,317	50,093	8,224	16.42 %
Employee commission expense	9,878	8,209	1,669	20.33 %
Revenue, net of commission expense	48,439	41,884	6,555	15.65 %
Salaries and employee benefits	26,263	21,092	5,171	24.52 %
Occupancy expense	1,978	1,729	249	14.40 %
Furniture and equipment	765	637	128	20.09 %
Amortization of intangible assets	3,332	2,342	990	42.27 %
Other expenses	5,906	5,476	430	7.85 %
Total operating expenses	38,244	31,276	6,968	22.28 %
Income before income tax, corporate allocation, and noncontrolling interest	10,195	10,608	(413)	(3.89)%
Corporate allocation	(583)	(517)	(66)	12.77 %
Income before income tax provision and noncontrolling interest	9,612	10,091	(479)	(4.75)%
Provision for income tax	2,181	2,273	(92)	(4.05)%
Net income	7,431	7,818	(387)	(4.95)%
Noncontrolling interest	(1,025)	(1,251)	226	(18.07)%
Net income attributable to TowneBank	$ 6,406	$ 6,567	$ (161)	(2.45)%
Efficiency ratio	78.95%	74.67%	4.28%	5.73 %

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2019, total assets were $12.02 billion, which is $0.86 billion, or 7.69%, higher than total assets at December 31, 2018. Our loan portfolio, less unearned income and deferred costs, made up 68.07% of our period-end assets and totaled $8.18 billion at September 30, 2019. Average assets for the quarter ended September 30, 2019, were $11.85 billion, up $0.70 billion, or 6.24%, from the year ended December 31, 2018.

Average earning assets for the third quarter of 2019 increased $0.58 billion from fourth quarter 2018 to $10.60 billion. Our average total deposits were $9.24 billion for third quarter 2019, reflecting growth of $0.93 billion, or 11.16%, compared to fourth quarter 2018. Average noninterest-bearing deposits at September 30, 2019, increased $0.29 billion, or 10.89%, from December 31, 2018.

Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks, at the FRB - Richmond, and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. At September 30, 2019, these balances were $696.95 million and consisted mainly of deposits in other banks and overnight deposits with the FRB - Richmond.

The average balance of interest-bearing deposits in other banks, at the FRB - Richmond, and federal funds sold during the third quarter of 2019 was $711.03 million, or 6.70%, of average total earning assets, compared with $652.13 million, or 6.51%, of average total earning assets for the fourth quarter of 2018.

Securities Available for Sale. Our AFS securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The AFS securities portfolio was $1.34 billion at September 30, 2019, compared with $1.10 billion at December 31, 2018. The average balance during the third quarter of 2019 was $1.34 billion, compared to $1.08 billion at December 31, 2018. The average AFS securities portfolio represented 13.53% and 10.77% of average earning assets in third quarter 2019 and fourth quarter 2018, respectively. During the three and nine months ended September 30, 2019, we had sales, maturities, and calls totaling $242.87 million and $398.12 million in investment securities that were classified as AFS, respectively.

The securities are held primarily for earnings, liquidity, and asset/liability management purposes and reviewed quarterly for possible other-than-temporary impairments. During this review, we analyze the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer, whether we intend to sell the security, and whether it is more likely than not that the Company will be required to sell the security before the recovery of the amortized cost basis, which may be maturity. These factors are analyzed on an individual basis.

Securities Held to Maturity. HTM securities are valued at amortized cost. Securities HTM were $44.49 million at September 30, 2019, and $50.60 million at December 31, 2018. The average balance during the third quarter of 2019 was $46.06 million, compared with $51.58 million in fourth quarter 2018, representing 0.47% and 0.51% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. Similar to AFS securities, HTM securities are reviewed quarterly for possible OTTI.

Loans Held for Sale. At September 30, 2019, we held $456.72 million in mortgage loans originated and intended for sale in the secondary market, as compared with $220.99 million at December 31, 2018. Average loans held for sale were 3.85% of average earning assets for the quarter ended September 30, 2019, and 2.65% of average earning assets for the quarter ended December 31, 2018. The majority of mortgage loans held for sale have been precommitted to investors, which minimizes our interest rate risk.

Loan Portfolio. Loans, net of unearned income and deferred costs, were $8.18 billion at September 30, 2019, which was $0.16 billion, or 2.05%, above the $8.02 billion at December 31, 2018. As a percentage of total average earning assets, average loans were 76.35% for the quarter ended September 30, 2019, compared with 79.04% for the quarter ended December 31, 2018. Management reforecasts on a quarterly basis and anticipates annualized loan portfolio growth will be in the low-to-mid single digits for the remainder of 2019.

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

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

It is our policy to recommend internal risk grades on 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 on a sample basis to determine if any changes in the circumstances of the loan require a different risk grade. To determine the most appropriate risk grade classification for each loan, the credit officers examine the borrower's liquidity level, asset quality, the amount of the borrower's other indebtedness, cash flow, earnings, sources of financing, and existing lending relationships. The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans.

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

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

The allowance for loan losses at September 30, 2019, and December 31, 2018, was $55.43 million and $52.09 million, respectively. The allowance was equal to 0.68% of total loans outstanding at September 30, 2019, compared with 0.65% at December 31, 2018. Excluding purchased loans, the allowance was equal to 0.81% of loans outstanding at September 30, 2019, down marginally from 0.82% at December 31, 2018. We believe the slight decline in the ratio from the prior year, excluding purchased loans, is appropriate given the risk profile of our loan portfolio and the level of diversification therein. Reflective of strong credit quality, classified loans, defined as loans in the substandard and doubtful categories, remained low at 0.54% of total loans at September 30, 2019, down slightly from 0.57% at December 31, 2018. Loans 30 to 89 days past due were $11.79 million, including purchased impaired loans of $0.04 million at September 30, 2019, as compared to $14.33 million at December 31, 2018. Total past due and nonaccruing loans were $26.93 million, including purchased impaired past-due loans of $0.53 million at September 30, 2019, compared to $20.20 million, including purchased impaired past due loans of $1.56 million, at December 31, 2018. The increase in past due loans at September 30, 2019, compared to December 31, 2018, was driven by a single commercial relationship of approximately $10 million. The allowance was equal to 3.95x of nonperforming loans at September 30, 2019, compared with 10.97x at December 31, 2018. This decrease is largely attributable to the addition of one large relationship that was placed on nonaccrual during the second quarter. Overall, economic conditions have been in flux in recent months. Domestic economic news has been mixed, while labor market conditions have continued to show relative strength in the form of low jobless claims. Despite the mixed economic news, we believe the continued strength and quality of our loan portfolio supports the level of our allowance for loan losses and is adequate to cover loan losses inherent in the loan portfolio at September 30, 2019.

For additional financial details regarding the analysis of the allowance for loan losses, see *Note 5 – Loans and Allowance for Loan Losses* of the Notes to Consolidated Financial Statements in this report. The following table provides information on the allowance for loan losses and nonperforming assets for the periods presented (dollars in thousands):

	Three Months Ended			Nine Months Ended	
	September 30,		June 30,	September 30,	
	2019	2018	2019	2019	2018
Nonperforming Assets					
Nonperforming loans	$ 14,016	$ 6,926	$ 18,202	$ 14,016	$ 6,926
Former bank premises	1,510	2,253	1,510	1,510	2,253
Foreclosed property	15,517	18,153	14,517	15,517	18,153
Total nonperforming assets	$ 31,043	$ 27,332	$ 34,229	$ 31,043	$ 27,332
Loans past due 90 days and still accruing interest	$ 636	$ 153	$ 415	$ 636	$ 153
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	3.95x	7.25x	3.00x	3.95x	7.25x
Allowance for loan losses to period-end loans	0.68%	0.64%	0.67%	0.68%	0.64%
Allowance for loan losses to period-end loans excluding purchased loans	0.81%	0.82%	0.81%	0.81%	0.82%
Nonperforming loans to period-end loans	0.17%	0.09%	0.22%	0.17%	0.09%
Nonperforming assets to period-end assets	0.26%	0.25%	0.29%	0.26%	0.25%
Net charge-offs to average loans (annualized)	0.03%	0.03%	0.08%	0.06%	0.02%

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

At September 30, 2019, we had $31.04 million in nonperforming assets, which amounted to 0.26% of total assets. Additionally, there were $0.64 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of $14.02 million in nonperforming loans, $1.51 million in former bank premises related to the merger with Monarch, as well as $15.52 million in foreclosed property. Nonperforming loans decreased by $4.19 million from June 30, 2019, as transfers to OREO, charge-offs, and payments in the commercial real estate, residential 1-4 family, and commercial and industrial categories during the third quarter of 2019 exceeded additions to nonaccrual loans. Foreclosed property increased from $14.52 million at June 30, 2019, and decreased from $18.15 million at September 30, 2018. The five largest foreclosed property developments represented approximately 94.06% of total foreclosed property at September 30, 2019, with the largest development representing approximately 48.59%. Foreclosed property consists of five residential properties, 12 construction and development properties, and two commercial properties.

At September 30, 2019, loans 60-89 days past due, excluding nonperforming loans, totaled $4.09 million. Additionally, there are other performing loans in the substandard category, totaling $15.16 million, which are current but have certain documentation deficiencies or other potential weaknesses that management has determined warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis.

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

At September 30, 2019, nonaccruing TDRs, which are included in nonperforming loans, totaled $1.04 million and accruing TDRs totaled $18.09 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current, there is a sustained repayment performance of six months or longer, and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement. All restructured loans are considered impaired in the calendar year of restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and has performed according to the modified terms for at least six months.

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

	September 30, 2019	December 31, 2018
Real estate - commercial	556	538
Real estate - residential 1-4 family	3,017	1,954
Commercial and industrial business loans	9,949	1,820
Consumer and other loans	494	437
Total nonperforming loans	$ 14,016	$ 4,749

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

	September 30,		December 31,
	2019	2018	2018
Real estate loans:			
Real estate - construction and land development	$ 6,720	$ 5,940	$ 6,171
Real estate - commercial	21,588	18,835	19,488
Real estate - multi-family	820	1,140	1,011
Real estate - residential 1-4 family	10,667	9,991	10,245
Total real estate loans	39,795	35,906	36,915
Commercial and industrial business loans	8,707	8,074	8,669
Consumer and other loans	6,926	6,256	6,510
Total	$ 55,428	$ 50,236	$ 52,094

Deposits. Total deposits at September 30, 2019, were $9.44 billion, representing an increase of $1.07 billion, or 12.75%, compared to December 31, 2018. Total average deposits were $9.24 billion during the third quarter of 2019, compared to $8.02 billion during third quarter 2018 and $8.31 billion during fourth quarter 2018.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 31.82% during third quarter 2019 and 32.61% during the same period in 2018. Average noninterest-bearing demand deposits were 31.90% of average total deposits for fourth quarter 2018. The cost of interest-bearing deposits was 1.48% for third quarter 2019, compared with 1.07% for third quarter 2018 and 1.23% for fourth quarter 2018.

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

	Average Balance/Cost Rate Three Months Ended							
	September 30, 2019		September 30, 2018		June 30, 2019		December 31, 2018	
Interest-bearing demand and money market accounts	$ 3,379,888	0.85%	$ 2,957,037	0.57%	$ 3,312,313	0.85%	$ 3,122,973	0.72%
Regular savings	278,048	1.00%	301,311	1.30%	281,221	1.33%	293,135	1.38%
Certificates of deposit	2,641,681	2.35%	2,147,338	1.73%	2,433,479	2.28%	2,245,039	1.91%
Total interest-bearing	6,299,617	1.48%	5,405,686	1.07%	6,027,013	1.45%	5,661,147	1.23%
Noninterest-bearing demand	2,940,370		2,615,946		2,788,596		2,651,495	
Total	$ 9,239,987	1.01%	$ 8,021,632	0.72%	$ 8,815,609	0.99%	$ 8,312,642	0.83%

	Average Balance/Cost Rate Nine Months Ended			
	September 30, 2019		September 30, 2018	
Interest-bearing demand and money market accounts	$ 3,289,539	0.83%	$ 2,893,096	0.50%
Regular savings	281,562	1.26%	305,570	1.23%
Certificates of deposit	2,456,360	2.25%	1,998,427	1.48%
Total interest-bearing	6,027,461	1.43%	5,197,093	0.92%
Noninterest-bearing	2,787,727		2,471,906	
Total	$ 8,815,188	0.98%	$ 7,668,999	0.62%

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

	Average Balance and Composition Three Months Ended							
	September 30, 2019		September 30, 2018		June 30, 2019		December 31, 2018	
Interest-bearing demand and money market accounts	$ 3,379,888	36.58%	$ 2,957,037	36.86%	$ 3,312,313	37.57%	$ 3,122,973	37.57%
Regular savings	278,048	3.01%	301,311	3.76%	281,221	3.19%	293,135	3.53%
Certificates of deposit	2,641,681	28.59%	2,147,338	26.77%	2,433,479	27.60%	2,245,039	27.00%
Total interest-bearing	6,299,617	68.18%	5,405,686	67.39%	6,027,013	68.61%	5,661,147	68.10%
Noninterest-bearing	2,940,370	31.82%	2,615,946	32.61%	2,788,596	31.63%	2,651,495	31.90%
Total	$ 9,239,987	100.00%	$ 8,021,632	100.00%	$ 8,815,609	100.00%	$ 8,312,642	100.00%

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2019, were $381.8 million, compared to $799.32 million at December 31, 2018. The average borrowing cost for third quarter 2019 was 1.58% and 2.11% in fourth quarter 2018.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2019, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
11/15/2028	3.43%	—	$ 3,996
12/01/2028	2.83%	—	2,850
11/04/2019	1.26%	—	260,000
04/09/2020	2.22%	10/09/2019	115,000
		Total FHLB Loans	**$ 381,846**

At September 30, 2019, certain residential HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of $1.48 billion collateralized the advances from the FHLB. At December 31, 2018, certain residential HELOCs, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of $1.59 billion collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of September 30, 2019, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during third quarter 2019 were $486.64 million, compared with $920.39 million for fourth quarter 2018, while the average cost of these funds was 1.62% and 1.97%, respectively.

Subordinated Debt, net. 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 September 30, 2019, the carrying value of the subordinated notes totaled $248.31 million, compared with $247.86 million at December 31, 2018. Average subordinated debt during third quarter 2019 was $248.21 million, compared to $247.77 million during fourth quarter 2018, while the average cost of the debentures was 4.77% for both quarters.

Common Stock and Dividends. Our common stock is listed on the Nasdaq Global Select Market under the symbol TOWN.

On February 27, 2019, we declared a quarterly shareholder cash dividend of $0.16 per common share. The dividend was paid April 10, 2019, to shareholders of record on March 29, 2019.

On May 22, 2019, we declared a quarterly shareholder cash dividend of $0.18 per common share. The dividend was paid on July 10, 2019, to shareholders of record on June 28, 2019.

On August 29, 2019, we declared a quarterly shareholder cash dividend of $0.18 per common share. The dividend was paid on October 10, 2019, to shareholders of record on September 30, 2019.

All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

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

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

In July 2013, the FDIC and the other federal banking agencies approved the final rules implementing 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, until it was fully implemented on January 1, 2019.

Risk-based capital ratios, which include CETI, 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. Under the FDIC rules, we are considered "well capitalized" as of September 30, 2019.

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

	September 30, 2019	September 30, 2018	June 30, 2019
Tier I Capital:			
Shareholders' equity	$ 1,638,534	$ 1,499,824	$ 1,606,452
Less: goodwill and disallowed intangible assets, net of deferred tax	496,114	477,154	493,559
AOCI-related adjustments	19,959	(22,348)	15,143
Noncontrolling interests	13,154	13,854	12,689
Total common equity tier I capital	1,109,307	1,031,164	1,085,061
Included noncontrolling interests	3,221	3,337	3,219
Total tier I capital	1,112,528	1,034,501	1,088,280
Tier II Capital:			
Qualifying allowance for loan losses (1)	55,428	50,236	54,527
Qualifying subordinated debt	248,309	247,712	248,160
Total tier II capital	303,737	297,948	302,687
Total Risk-Based Capital	$ 1,416,265	$ 1,332,449	$ 1,390,967
Total assets	$ 12,021,291	$ 11,121,232	$ 11,942,480
Total risk-weighted assets (2)	9,631,537	8,942,084	9,366,379
Average assets for leverage capital purposes	11,326,611	10,367,415	11,039,388
Risk-weighted assets to total assets	80.12%	80.41%	78.43%
Risk-based capital ratios:			
Common equity tier I (7.0% minimum requirement)	11.52%	11.53%	11.58%
Tier I (8.5% minimum requirement)	11.55%	11.57%	11.62%
Total (10.5% minimum requirement)	14.70%	14.90%	14.85%
Tier I leverage ratio (5.0% minimum requirement)	9.82%	9.98%	9.86%

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

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

(dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Average assets (GAAP)	$ 11,845,282	$ 10,844,570	$ 11,526,487	$ 10,413,575
Less: average goodwill	442,919	425,725	442,890	405,726
Less: average intangible assets	57,327	59,492	60,333	57,251
Average tangible assets (non-GAAP)	$ 11,345,036	$ 10,359,353	$ 11,023,264	$ 9,950,598
Average equity (GAAP)	$ 1,620,070	$ 1,488,368	$ 1,580,213	$ 1,435,544
Less: average goodwill	442,919	425,725	442,890	405,726
Less: average intangible assets	57,327	59,492	60,333	57,251
Average tangible equity (non-GAAP)	$ 1,119,824	$ 1,003,151	$ 1,076,990	$ 972,567
Average common equity (GAAP)	$ 1,607,853	$ 1,474,833	$ 1,568,336	$ 1,423,787
Less: average goodwill	442,919	425,725	442,890	405,726
Less: average intangible assets	57,327	59,492	60,333	57,251
Average tangible common equity (non-GAAP)	$ 1,107,607	$ 989,616	$ 1,065,113	$ 960,810

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Return on average assets (GAAP basis)	1.26%	1.40%	1.20%	1.26%
Impact of excluding average goodwill and other intangibles and amortization	0.14%	0.16%	0.15%	0.15%
Return on average tangible assets	1.40%	1.56%	1.35%	1.41%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Return on average equity (GAAP basis)	9.22%	10.21%	8.77%	9.11%
Impact of excluding average goodwill and other intangibles and amortization	4.98%	5.87%	5.02%	5.27%
Return on average tangible equity	14.20%	16.08%	13.79%	14.38%

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

	Three Months Ended September 30,	
	2019	2018
Book value (GAAP basis)	$ 22.38	$ 20.54
Impact of excluding goodwill and other intangibles and amortization	(6.71)	(6.71)
Tangible book value	$ 15.44	$ 13.83

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

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

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

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

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

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

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

At September 30, 2019, we had $0.60 billion more assets than liabilities subject to repricing within one year and, therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

Earnings Simulation Analysis: Management uses simulation analysis to measure the sensitivity of net interest income to changes in interest rates. The model calculates an earnings estimate based on current and projected balances and rates. This method is subject to the accuracy of the assumptions that underlie the process, but it provides an additional analysis of the sensitivity of earnings to changes in interest rates to static gap analysis. Assumptions used in the model rates are derived from historical trends, peer analysis, and management's outlook, and include loans and deposit growth rates and projected yields and rates. All maturities, calls, and prepayments in the securities portfolio are assumed to be reinvested in like instruments. Mortgage loans and mortgage-backed securities prepayment assumptions are based on industry estimates of prepayment speeds for portfolios with similar coupon ranges and seasoning. Different interest rate scenarios and yield curves are used to measure the sensitivity of earnings to changing interest rates. Interest rates on different asset and liability accounts move differently when the prime rate changes and are 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	14.45 %
+ 200 basis points	10.17 %
+ 100 basis points	5.65 %
- 100 basis points	(8.86)%
- 200 basis points	(15.50)%

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	$	66,638
+ 200 basis points	$	60,550
+ 100 basis points	$	50,591
- 100 basis points	$	(179,019)
- 200 basis points	$	(376,467)

PART I. FINANCIAL INFORMATION
Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2019, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2019. There were no changes that occurred during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

For information regarding factors that could affect the Company's results of operations, financial condition, or liquidity, see the risk factors discussed in Part I, Item 1A, of TowneBank's 2018 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2, of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2018 Annual Report on Form 10-K.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No.	Description
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
(99)	Report of Independent Registered Public Accounting Firm dated November 8, 2019.

Signatures

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

TOWNEBANK

November 8, 2019	By: /s/ J. Morgan Davis
Date	J. Morgan Davis President/Chief Executive Officer
November 8, 2019	By: /s/ William B. Littreal
Date	William B. Littreal Senior Executive Vice President/Chief Financial Officer

Exhibit (31.1)

CERTIFICATIONS

I, J. Morgan Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2019, of TowneBank;

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

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

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

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

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

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

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

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

continued

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

November 8, 2019	/s/ J. Morgan Davis
Date	J. Morgan Davis
	President/Chief Executive Officer

Exhibit (31.2)

CERTIFICATIONS

I, William B. Littreal, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2019, of TowneBank;

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

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

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

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

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

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

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

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

Exhibit (31.2)

continued

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

November 8, 2019	/s/ William B. Littreal
Date	William B. Littreal Senior Executive Vice President/Chief Financial Officer

Exhibit (32)

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

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

1. Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

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

November 8, 2019	/s/ J. Morgan Davis
Date	J. Morgan Davis President/Chief Executive Officer
November 8, 2019	/s/ William B. Littreal
Date	William B. Littreal Senior Executive Vice President/Chief Financial Officer

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

DIXON HUGHES GOODMAN LLP

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of *TowneBank*

Results of Review of Interim Financial Statements

We have reviewed the consolidated balance sheets of TowneBank and subsidiaries (the "Company") as of September 30, 2019 and 2018, the related consolidated statements of income, comprehensive income, cash flow and equity for the three and nine-month periods ended September 30, 2019 and 2018, and the related notes (collectively referred to as the "interim financial statements"). Based on our reviews, we are not aware of any material modifications that should be made to the interim financial statements referred for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheet of TowneBank and subsidiaries as of December 31, 2018, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated March 1, 2019, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2018, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

These interim financial statements are the responsibility of the Company's management. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

We are a public accounting firm registered with the 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.

Dixon Hughes Goodman LLP

Norfolk, Virginia
November 8, 2019