

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, 2020

FDIC Insurance Cert. Number: 35095

TOWNE BANK

(Exact name of registrant as specified in its charter)

VIRGINIA

(State or other jurisdiction of
incorporation or organization)

54-1910608

(I.R.S. Employer Identification No.)

5716 High Street, Portsmouth, Virginia

(Address of principal executive offices)

23703

(Zip Code)

(757) 638-7500

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
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, a 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 ☒ [X]

Non-accelerated filer ☐ []

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, 2020 was 72,654,823 shares.

TOWNE BANK

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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 defined terms 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.

ACL	Allowance for Credit Loss
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
C&I	Commercial and Industrial
CARES Act	Coronavirus Aid, Relief, and Economic Security Act
CDA	Collateral Dependent Asset
CECL	Current Expected Credit Loss
CETI	Common Equity Tier I
CRE	Commercial Real Estate
DCF	Discounted Cash Flow
EAD	Exposure at Default
ECL	Expected Credit Loss
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
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
FTE	Full-time Equivalent Employee
GAAP	Accounting Principles Generally Accepted in the United States of America
GNMA	Government National Mortgage Association
GSE	Government Sponsored Enterprise
HELOC	Residential Home Equity Lines of Credit
HTM	Held-to-Maturity
LGD	Loss Given Default

LHFS	Loans Held for Sale
LIBOR	London InterBank Offered Rate
LIHTC	Low Income Housing Tax Credits
MBS	Mortgage-backed Security
OIS	Overnight Index Swap
OREO	Other Real Estate Owned
OTTI	Other Than Temporary Impairment
PCD	Purchased Credit Deteriorated
PCI	Purchased Credit Impaired
PD	Probability of Default
PPP	Paycheck Protection Program
REPO	Retail Repurchase Agreement
Resi-Mort	Residential Mortgage
RJFS	Raymond James Financial Services, Inc.
ROA	Return on Average Assets
ROE	Return on Average Equity
SBA	U.S. Small Business Administration
SCC	Virginia State Corporation Commission
SEC	Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
SIL	Straus, Itzkowitz & LeCompte Insurance Agency, Inc.
TBA	To Be Announced
TDR	Troubled Debt Restructuring
TIG	Towne Investment Group
U.S.	United States of America
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2020	December 31, 2019
	(unaudited)	(audited)
ASSETS		
Cash and due from banks	\$ 114,604	\$ 97,593
Interest-bearing deposits at FRB - Richmond	1,670,186	322,505
Interest-bearing deposits in financial institutions	24,890	22,518
Total Cash and Cash Equivalents	1,809,680	442,616
Securities available for sale, at fair value (amortized cost of \$1,249,254 and \$1,421,573, and allowance for credit losses of \$4 and \$0 at September 30, 2020 and December 31, 2019, respectively)	1,310,683	1,441,308
Securities held to maturity, at amortized cost (fair value of \$19,102 and \$45,171 at September 30, 2020 and December 31, 2019, respectively)	17,131	43,688
Less: Allowance for credit losses	(90)	—
Securities held to maturity, net of allowance for credit losses	17,041	43,688
Other equity securities	6,497	6,462
FHLB stock	41,829	30,094
Total Securities	1,376,050	1,521,552
Mortgage loans held for sale	669,020	419,233
Loans, net of unearned income and deferred costs:	9,770,570	8,419,288
Less: Allowance for credit losses on loans	(119,058)	(58,234)
Net Loans	9,651,512	8,361,054
Premises and equipment, net	256,909	231,806
Goodwill	446,725	446,816
Other intangible assets, net	45,781	54,399
BOLI	244,103	243,062
Other assets	295,637	227,125
TOTAL ASSETS	\$ 14,795,417	\$ 11,947,663
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 4,464,178	\$ 2,951,225
Interest-bearing:		
Demand and money market accounts	4,642,482	3,586,364
Savings	312,444	276,205
Certificates of deposit	2,285,859	2,457,123
Total Deposits	11,704,963	9,270,917
Advances from the FHLB	731,202	471,687
Subordinated debt, net	248,906	248,458
FRB PPP lending facility	—	—
Repurchase agreements and other borrowings	58,061	52,391
Total Borrowings	1,038,169	772,536
Other liabilities	303,582	250,516
TOTAL LIABILITIES	13,046,714	10,293,969
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, \$1.667 par: 150,000,000 shares authorized		
72,656,729 and 72,649,682 shares issued at		
September 30, 2020 and December 31, 2019, respectively	121,115	121,107
Capital surplus	1,045,170	1,041,160
Retained earnings	520,888	467,186
Common stock issued to deferred compensation trust, at cost		
872,498 and 818,578 shares at		
September 30, 2020 and December 31, 2019, respectively	(16,951)	(15,555)
Deferred compensation trust	16,951	15,555
Accumulated other comprehensive income	44,569	11,302
TOTAL SHAREHOLDERS' EQUITY	1,731,742	1,640,755
Noncontrolling interests	16,961	12,939
TOTAL EQUITY	1,748,703	1,653,694
TOTAL LIABILITIES AND EQUITY	\$ 14,795,417	\$ 11,947,663

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,	
	2020	2019	2020	2019
<i>(Dollars in thousands, except per share data)</i>				
INTEREST INCOME:				
Loans, including fees	\$ 102,869	\$ 102,047	\$ 305,070	\$ 303,616
Investment securities	7,440	9,889	25,553	27,010
Interest-bearing deposits in financial institutions and federal funds sold	632	3,745	2,168	11,758
Mortgage loans held for sale	4,587	3,956	11,385	8,966
Total interest income	115,528	119,637	344,176	351,350
INTEREST EXPENSE:				
Deposits	12,966	23,552	47,099	64,510
Advances from the FHLB	1,901	1,935	6,990	9,288
Subordinated debt, net	2,962	2,962	8,885	8,885
Repurchase agreements and other borrowings	940	85	1,672	271
Total interest expense	18,769	28,534	64,646	82,954
Net interest income	96,759	91,103	279,530	268,396
PROVISION FOR CREDIT LOSSES	31,598	1,508	65,559	5,770
Net interest income after provision for credit losses	65,161	89,595	213,971	262,626
NONINTEREST INCOME:				
Residential mortgage banking income, net	37,531	18,855	74,662	50,929
Insurance commissions and other title fees and income, net	17,468	16,681	51,973	49,477
Real estate brokerage and property management income, net	11,301	9,444	29,020	27,555
Service charges on deposit accounts	1,986	2,253	6,314	8,299
Credit card merchant fees, net	1,506	1,514	3,793	3,357
BOLI	1,605	2,117	6,295	5,350
Other income	22,278	3,981	31,268	11,754
Net gain (loss) on investment securities	1,701	(69)	9,632	(845)
Total noninterest income	95,376	54,776	212,957	155,876
NONINTEREST EXPENSE:				
Salaries and employee benefits	61,408	55,784	174,201	162,907
Occupancy expense	8,396	7,953	23,124	23,866
Furniture and equipment	3,247	3,805	10,451	10,753
Amortization - intangibles	2,851	3,059	8,702	9,364
Software expense	3,572	3,208	10,556	8,742
Data processing	3,113	2,533	8,622	9,316
Professional fees	2,637	3,566	8,677	9,952
Advertising and marketing	1,870	3,429	7,440	9,440
Other expenses	14,887	13,950	38,121	41,627
Total noninterest expense	101,981	97,287	289,894	285,967
Income before income tax expense and noncontrolling interest	58,556	47,084	137,034	132,535
Provision for income tax expense	7,841	7,684	21,492	24,810
Net income	\$ 50,715	\$ 39,400	\$ 115,542	\$ 107,725
Net income attributable to noncontrolling interest	(16,251)	(1,741)	(20,089)	(4,018)
Net income attributable to TowneBank	\$ 34,464	\$ 37,659	\$ 95,453	\$ 103,707
Per common share information				
Basic earnings	\$ 0.48	\$ 0.52	\$ 1.32	\$ 1.44
Diluted earnings	\$ 0.48	\$ 0.52	\$ 1.32	\$ 1.44

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)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<i>(Dollars in thousands)</i>				
Net income	\$ 50,715	\$ 39,400	\$ 115,542	\$ 107,725
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	3,248	6,324	51,332	37,120
Deferred tax benefit (expense)	(887)	(1,377)	(11,289)	(8,083)
Realized (gains) losses reclassified into earnings	(1,701)	69	(9,632)	845
Deferred tax benefit (expense)	357	(14)	2,022	(177)
Net unrealized gains (losses)	1,017	5,002	32,433	29,705
Pension and postretirement benefit plans				
Prior service costs	(128)	(406)	(402)	(1,218)
Deferred tax benefit (expense)	28	90	92	273
Actuarial gain (loss)	277	204	634	613
Deferred tax benefit (expense)	(61)	(45)	(145)	(136)
Amortization of prior service costs	164	123	504	371
Deferred tax benefit (expense)	(36)	(27)	(116)	(82)
Amortization of net actuarial (gain) loss	115	(162)	345	(487)
Deferred tax benefit (expense)	(25)	36	(78)	109
Change in retirement plans, net of tax	334	(187)	834	(557)
Other comprehensive income (loss), net of tax	1,351	4,815	33,267	29,148
Comprehensive income	\$ 52,066	\$ 44,215	\$ 148,809	\$ 136,873
Comprehensive income attributable to noncontrolling interest	(16,251)	(1,741)	(20,089)	(4,018)
Comprehensive income attributable to TowneBank	\$ 35,815	\$ 42,474	\$ 128,720	\$ 132,855

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)

	Nine Months Ended September 30,	
	2020	2019
<i>(Dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$ 115,542	\$ 107,725
Adjustments to reconcile net income to net cash used for operating activities:		
Net amortization of securities	3,414	1,847
Investment securities (gains) losses	(9,632)	845
Depreciation, amortization, and other intangible amortization	21,786	22,050
Amortization of debt issuance costs	448	448
Provision for credit losses	65,559	5,770
Bank-owned life insurance income	(6,295)	(5,350)
Deferred income tax expense	(4,168)	6,441
Share-based compensation expense	3,585	3,771
Originations of mortgage loans held for sale	(4,184,511)	(2,307,608)
Proceeds from sales of mortgage loans held for sale	3,959,237	2,146,238
Gain on sales of mortgage loans held for sale	(24,513)	(74,363)
Gain on sale of Red Sky	(17,626)	—
Loss on sale and write-down of foreclosed assets	1,103	91
Changes in:		
Interest receivable	(1,877)	853
Other assets	(32,336)	(17,295)
Interest payable	(4,732)	(405)
Other liabilities	40,188	41,072
Net cash used for operating activities	(74,828)	(67,870)
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(318,020)	(589,094)
Purchase of other securities	(35)	(905)
Purchase of held-to-maturity securities	—	(1,896)
Sale of available-for-sale securities	347,757	186,043
(Purchase) sale of FHLB stock	(11,736)	16,947
Proceeds from maturities, calls, and prepayments of available-for-sale securities	148,524	212,132
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	26,836	7,924
Net increase in loans	(1,354,461)	(169,070)
Net change in investment in LIHTC	(32,902)	(21,523)
Purchase of premises and equipment	(38,143)	(31,637)
Proceeds from sales of premises and equipment	538	401
Proceeds from sales of foreclosed assets	6,735	4,933
Proceeds from sale of subsidiary Red Sky, net of cash disposed of	16,942	—
Proceeds from BOLI	5,483	1,022
Acquisition of business, net of cash acquired	—	(19,747)
Net cash used for investing activities	(1,202,482)	(404,470)
FINANCING ACTIVITIES:		
Net change in deposit accounts	2,434,046	1,067,592
Net change in borrowings	265,185	(421,654)
Distribution of interest in joint ventures	(16,067)	(3,758)
Proceeds from issuance of common stock	433	988
Cash dividends paid	(39,223)	(36,134)
Net cash from financing activities	2,644,374	607,034
Change in cash and cash equivalents	1,367,064	134,694
Cash and cash equivalents at beginning of year	442,616	686,696
Cash and cash equivalents at end of period	\$ 1,809,680	\$ 821,390
Supplemental cash flow information:		
Cash paid for interest	\$ 69,377	\$ 82,549
Cash paid for income taxes	\$ 20,975	\$ 20,094
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 4,482	\$ 2,038
Net unrealized gains on available-for-sale securities, net of tax	\$ 32,433	\$ 29,705
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

<i>(Dollars in thousands, except per share data)</i>	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, 2020	72,649,682	\$ 121,107	\$ 1,041,160	\$ 467,186	\$ 15,555	\$ (15,555)	\$ 11,302	\$ 12,939	\$ 1,653,694
Impact of adoption of new accounting standards (1)	—	—	—	(2,528)	—	—	—	—	(2,528)
Net income	—	—	—	26,384	—	—	—	1,221	27,605
Other comprehensive income, net of taxes	—	—	—	—	—	—	999	—	999
Cash dividends declared on common stock (\$0.18 per share)	—	—	—	(13,070)	—	—	—	—	(13,070)
Directors' deferred compensation	—	—	—	—	7	(7)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,728)	(1,728)
Conversion of convertible debt into common stock	69	—	1	—	—	—	—	—	1
Issuance of common stock - net contingent consideration earned on acquisitions	5,151	9	79	—	—	—	—	—	88
Issuance of common stock - stock compensation plans	(34,964)	(59)	630	—	—	—	—	—	571
Balance, March 31, 2020	72,619,938	\$ 121,057	\$ 1,041,870	\$ 477,972	\$ 15,562	\$ (15,562)	\$ 12,301	\$ 12,432	\$ 1,665,632
Net income	—	—	—	34,605	—	—	—	2,617	37,222
Other comprehensive income, net of taxes	—	—	—	—	—	—	30,917	—	30,917
Cash dividends declared on common stock (\$0.18 per share)	—	—	—	(13,075)	—	—	—	—	(13,075)
Directors' deferred compensation	—	—	—	—	1,214	(1,214)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,101)	(1,101)
Issuance of common stock - contingent consideration earned on acquisitions	30,181	51	590	—	—	—	—	—	641
Issuance of common stock - stock compensation plans	(4,132)	(7)	1,314	—	—	—	—	—	1,307
Balance, June 30, 2020	72,645,987	\$ 121,101	\$ 1,043,774	\$ 499,502	\$ 16,776	\$ (16,776)	\$ 43,218	\$ 13,948	\$ 1,721,543
Net income	—	—	—	34,464	—	—	—	16,251	50,715
Other comprehensive income, net of taxes	—	—	—	—	—	—	1,351	—	1,351
Cash dividends declared on common stock (\$0.18 per share)	—	—	—	(13,078)	—	—	—	—	(13,078)
Directors' deferred compensation	—	—	—	—	175	(175)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(13,238)	(13,238)
Issuance of common stock - stock compensation plans	10,742	14	1,396	—	—	—	—	—	1,410
Balance, September 30, 2020	72,656,729	\$ 121,115	\$ 1,045,170	\$ 520,888	\$ 16,951	\$ (16,951)	\$ 44,569	\$ 16,961	\$ 1,748,703

(1) Represents the impact of adopting ASU No. 2016-13.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENT OF EQUITY

<i>(Dollars in thousands, except per share data)</i>	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, 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 income, 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 loss, 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 loss, net of taxes	—	—	—	—	—	—	4,815	—	4,815
Cash dividends declared on common stock (\$0.18 per share)	—	—	—	(13,073)	—	—	—	—	(13,073)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	—	—
Directors' deferred compensation	—	—	—	—	157	(157)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,276)	(1,276)
Redemption of preferred stock	—	—	—	—	—	—	—	—	—
Conversion of convertible debt into common stock	—	—	—	—	—	—	—	—	—
Issuance of common stock - net contingent consideration earned on acquisitions	23,023	38	587	—	—	—	—	—	625
Issuance of common stock - acquisitions	—	—	—	—	—	—	—	—	—
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

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 2019 audited Consolidated Financial Statements and the 2019 Annual Report on Form 10-K. Results of operations for the three- and nine- month periods ended September 30, 2020, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Troubled Debt Restructuring Relief

On March 27, 2020, the CARES Act was signed into law. The provisions of the CARES Act included an election to not apply the guidance on accounting for TDRs to loan modifications related to the adverse effects of COVID-19 granted to borrowers that were current as of December 31, 2019. The relief applies to modifications made from March 1, 2020, until the earlier of December 31, 2020, or 60 days following the termination of the national emergency declared by the President of the United States. The Company elected to adopt these provisions of the CARES Act.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Recent accounting pronouncements:

Accounting standards adopted in current year		
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.	The Company adopted this standard January 1, 2020, applying the modified-retrospective method, which required a cumulative-effect adjustment to retained earnings. This cumulative-effect adjustment resulted in a decrease in retained earnings of \$2.56 million, net of tax. On January 1, 2020 the Company recorded an addition of \$1.65 million to our allowance for credit losses on loans related to PCD loans, a \$3.51 million liability for our allowance for credit losses on off-balance-sheet credit exposures, that was a partial reclassification from our allowance for credit losses on loans, and resulted in a net increase in our allowance for credit losses on loans of \$0.94 million. We also established an allowance for credit losses on HTM debt securities of \$0.15 million, and an allowance for credit losses on AFS debt securities of \$0.08 million.
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.	The Company adopted this standard, effective January 1, 2020. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.

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Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 470 - Debt and Topic 815 - Derivatives and Hedging Subtopics 470-20 - Debt with Conversion and Other Options and Subtopic 815-40 - Contracts in Entity's Own Equity ASU 2020 - 06 Issued August 2020	Simplifies an issuer's accounting for convertible debt instruments. Simplifies the settlement assessment that entities are required to perform to determine whether a contract qualifies for equity classification. Requires new disclosures about events that occur during the reporting period. Requires entities to use the if-converted method in the majority of diluted EPS calculations.	Effective for interim and annual periods beginning after December 15, 2021. Early adoption is permitted. The Company is 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.
Topic 740 - Income Taxes: Simplifying the Accounting for Income Taxes ASU 2019 - 12 Issued December 2019	Simplifies the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. Improves the consistent application and simplification of GAAP for other areas of Topic 740 by clarifying and amending existing guidance.	Effective for interim and annual periods beginning after December 15, 2020. 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.

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Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 848 - Reference Rate Reform - Facilitation of the Effects of Reference Rate Reform on Financial Reporting ASU 2020 - 04 Issued March 2020	Provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. In response to concerns about structural risks of interbank offered rates, and, particularly, the risk of cessation of the LIBOR, this ASU provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform, if certain criteria are met.	Effective for March 12, 2020, through December 31, 2022. An entity may elect to apply the amendments for contract modifications as of any date from the beginning of an interim period that includes, or is subsequent to March 12, 2020, or prospectively from a date within the interim period that includes, or is subsequent to March 12, 2020, up to the date that the financial statements are available to be issued. Once elected, the amendments in this Update must be applied prospectively for all eligible contract modifications. The Company is currently evaluating the impact the pronouncement will have on its Consolidated Financial Statements.

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.

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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,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Basic				
Net income available to common shareholders	\$ 34,464	\$ 37,659	\$ 95,453	\$ 103,707
Weighted-average common shares outstanding	72,339,413	72,091,221	72,272,368	72,043,158
Basic earnings per common share	\$ 0.48	\$ 0.52	\$ 1.32	\$ 1.44
Diluted				
Net income available to common shareholders, for diluted EPS	\$ 34,464	\$ 37,659	\$ 95,453	\$ 103,707
Weighted-average common shares outstanding	72,339,413	72,091,221	72,272,368	72,043,158
Effect of dilutive securities:				
Stock compensation plans (1)	36,323	131,713	45,723	109,485
Weighted-average diluted shares outstanding	72,375,736	72,222,934	72,318,091	72,152,643
Diluted earnings per common share	\$ 0.48	\$ 0.52	\$ 1.32	\$ 1.44

- (1) Shares underlying stock options and restricted stock totaling 36,323 and 1,565 were excluded from the computation of diluted EPS during the three months ended September 30, 2020 and 2019, respectively, and 45,723 and 9,091 shares were excluded from the computation of diluted EPS during the nine months ended September 30, 2020, and 2019, 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 were subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information was considered final, whichever was earlier. 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 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 were subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information was considered final, whichever was earlier. 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 January 1, 2019.

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Note 4. Investment Securities

AFS debt securities are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. HTM debt securities are carried at amortized cost. Interest income on debt securities includes the amortization of purchase premiums and discounts. Premiums and discounts on securities are generally amortized on the effective yield method without anticipating prepayments, except for MBSs where prepayments are anticipated. Premiums on callable debt securities are amortized to their earliest call date. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Debt securities are evaluated individually at each trade level. A debt security is placed on nonaccrual status at the time any principal or interest payments become 90 days delinquent. Interest accrued but not received for a security placed on nonaccrual is reversed against interest income on a timely basis. At a minimum, debt securities are evaluated for potential losses on a quarterly basis, and more frequently, if deemed necessary. We charge off any portion of an investment security we determine to be uncollectible. The amortized cost basis, excluding accrued interest, is charged off through the allowance for credit losses. Accrued interest is charged off as a reduction to interest income. Recoveries of previously charged-off principal amounts are recognized in our provision for credit losses when received.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. This ASC amends or supersedes subtopics within *Receivables (Topic 310)*, related to Financing Receivables, including AFS and HTM debt securities.

Available-for-sale debt securities

When the fair value of an individual AFS debt security has declined below its amortized cost basis, the Company is required to assess whether the decline is from a credit loss or other factor. If the decline in fair value is attributable to a credit loss, ASC 326 requires assessment of allowance for credit losses instead of other than temporary impairment. Through the use of an allowance, the Company is able to record credit losses in current period net income via a provision for credit loss expense rather than a direct write-down of the security's amortized cost basis. In addition, under ASC 326, the allowance is reduced for improvements in expected cash flows and reversals of previously recognized credit losses is permitted through net income in the period in which they occur. This change results in recognition and presentation of credit losses on the income statement.

In our assessment of whether the decline in fair value of AFS debt securities below the amortized cost is due to credit factors, all relevant information is considered at the individual security level. Specifically, the Company considers both qualitative and quantitative factors:

- Qualitative Factors
 - Market spread.
 - The extent to which the fair value is less than the amortized cost basis.
 - Adverse changes in the financial condition of the issuer.
 - Adverse conditions specifically related to the security, such as past due principal or interest.
 - Adverse changes in security ratings.
 - Economic conditions and demographics.
- Quantitative Factors

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- The present value of cash flows expected to be collected from the security compared with the amortized cost basis of the security.
- The likelihood the Company will be able to collect all amounts due in accordance with the contractual terms of the debt security.

If our assessment indicates that a credit loss exists, the Company records an allowance for credit losses for the excess of the amortized cost basis over the present value of cash flows expected to be collected, subject to the fair value floor. Subsequent changes in the allowance for credit losses are recorded as an addition to (or reversal of) the provision for credit loss expense.

The Company elected not to measure an allowance for credit losses for accrued interest receivables as uncollectible accrued interest receivables are written off in a timely manner and, as such, the accrued interest receivable on AFS debt securities amounting to \$4.32 million as of September 30, 2020, was excluded from the estimate of expected credit loss and included in other assets.

As of September 30, 2020, we have recognized no credit losses on Company-held MBSs issued by GSEs, U.S. government sponsored agency securities, and U.S. treasury securities because these securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies, and have a long history of no credit losses. As such, the Company has excluded them, under the zero risk of loss exception, from the impairment analysis under ASC 326-30.

Held-to-maturity debt securities

For HTM debt securities, an allowance will be recognized when lifetime credit losses are expected, for an amount that reflects the expected contractual credit losses, even when the risk of credit losses is remote. As such, credit losses for HTM debt securities will generally be recognized earlier than credit losses for AFS debt securities, which are not recognized until there is evidential support of a potential loss.

As of September 30, 2020, no credit losses on Company-held MBSs issued by GSEs, U.S. government sponsored agency securities, and U.S. treasury securities have been recognized because these securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies, and have a long history of no credit losses. As such, the Company has excluded them under the zero risk of loss exception in the allowance for credit losses under ASC 326-20.

For the HTM debt securities not implicitly or explicitly guaranteed by the U.S. Government, the Company measures expected credit losses on a collective basis, by major security type with each type sharing similar characteristics, utilizing published statistical information from annual default and recovery tables. Accrued interest receivable on HTM debt securities totaling \$0.56 million, was included in other assets, as of September 30, 2020, and excluded from the estimate of expected credit losses. At September 30, 2020, all HTM debt securities are current for both principal and interest. There were no in-scope collateral-dependent HTM debt securities at September 30, 2020.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Available-for-sale debt securities

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

September 30, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 165,735	\$ 1,864	\$ (324)	\$ —	\$ 167,275
U.S. Treasury notes	1,001	5	—	—	1,006
Municipal securities	271,721	21,071	—	(4)	292,788
Trust preferred and other corporate securities	23,482	754	—	—	24,236
MBSs issued by GSEs and GNMA	787,315	38,512	(449)	—	825,378
Total available-for-sale securities	<u>\$ 1,249,254</u>	<u>\$ 62,206</u>	<u>\$ (773)</u>	<u>\$ (4)</u>	<u>\$ 1,310,683</u>

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 128,451	\$ 788	\$ (201)	n/a	\$ 129,038
U.S. Treasury notes	1,000	—	—	n/a	1,000
Municipal securities	217,911	6,032	(837)	n/a	223,106
Trust preferred and other corporate securities	51,724	1,668	(25)	n/a	53,367
MBSs issued by GSEs and GNMA	1,022,487	15,462	(3,152)	n/a	1,034,797
Total available-for-sale securities	<u>\$ 1,421,573</u>	<u>\$ 23,950</u>	<u>\$ (4,215)</u>	<u>n/a</u>	<u>\$ 1,441,308</u>

The following table summarizes realized gains and losses on the sale of AFS debt securities as of the dates indicated (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Gross gains	\$ 2,377	\$ 432	\$ 10,647	\$ 432
Gross (losses)	(676)	(501)	(1,015)	(1,277)
Net gains (losses)	<u>\$ 1,701</u>	<u>\$ (69)</u>	<u>\$ 9,632</u>	<u>\$ (845)</u>
Sales proceeds*	\$ 85,478	\$ 86,995	\$ 348,977	\$ 186,658

*Proceeds include interest on investment securities sold of \$0.75 million and \$0.26 million, in the third quarter of 2020 and 2019, respectively, and \$1.22 million and \$0.61 million in the first nine months of 2020 and 2019, respectively.

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Held-to-maturity debt securities

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

September 30, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
Trust preferred corporate securities	\$ 2,333	\$ 242	\$ —	\$ 2,575	\$ (78)
Municipal securities	4,992	1,212	—	6,204	(12)
MBSs issued by GSEs and GNMA	9,806	517	—	10,323	—
Total held-to-maturity securities	<u>\$ 17,131</u>	<u>\$ 1,971</u>	<u>\$ —</u>	<u>\$ 19,102</u>	<u>\$ (90)</u>

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
Trust preferred corporate securities	\$ 2,369	\$ 230	\$ —	\$ 2,599	n/a
Municipal securities	29,167	1,221	—	30,388	n/a
MBSs issued by GSEs and GNMA	12,152	69	(37)	12,184	n/a
Total held-to-maturity securities	<u>\$ 43,688</u>	<u>\$ 1,520</u>	<u>\$ (37)</u>	<u>\$ 45,171</u>	<u>n/a</u>

Maturities of debt 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 debt securities are shown by contractual maturity (including MBSs) as of September 30, 2020, and December 31, 2019, in the following table (dollars in thousands):

September 30, 2020	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 3,800	\$ 3,806	\$ —	\$ —
Due after one year through five years	68,310	71,671	3,438	3,496
Due after five years through 10 years	629,239	664,419	9,720	11,066
Due after 10 years	547,905	570,787	3,973	4,540
	<u>\$ 1,249,254</u>	<u>\$ 1,310,683</u>	<u>\$ 17,131</u>	<u>\$ 19,102</u>

December 31, 2019	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 60,390	\$ 60,390	\$ —	\$ —
Due after one year through five years	57,854	59,051	17,334	17,445
Due after five years through 10 years	661,270	668,119	16,407	16,824
Due after 10 years	642,059	653,748	9,947	10,902
	<u>\$ 1,421,573</u>	<u>\$ 1,441,308</u>	<u>\$ 43,688</u>	<u>\$ 45,171</u>

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The following table reflects the gross unrealized losses and fair values of AFS debt securities without an allowance for credit losses, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position as of September 30, 2020 and December 31, 2019 (dollars in thousands):

September 30, 2020		Less than 12 months		12 months or more		Total	
Description of Securities	Number	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	9	\$ 56,651	\$ (181)	\$ 25,982	\$ (143)	\$ 82,633	\$ (324)
MBSs issued by GSEs and GNMA	19	110,426	(260)	69,799	(189)	180,225	(449)
Total AFS securities	28	\$ 167,077	\$ (441)	\$ 95,781	\$ (332)	\$ 262,858	\$ (773)

December 31, 2019		Less than 12 months		12 months or more		Total	
Description of Securities	Number	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	4	\$ 29,035	\$ (193)	\$ 39,992	\$ (8)	\$ 69,027	\$ (201)
Municipal securities	14	62,153	(836)	503	(1)	62,656	(837)
Trust preferred and other corporate securities	1	3,052	(25)	—	—	3,052	(25)
MBSs issued by GSEs and GNMA	56	368,109	(2,364)	61,751	(788)	429,860	(3,152)
Total AFS securities	75	\$ 462,349	\$ (3,418)	\$ 102,246	\$ (797)	\$ 564,595	\$ (4,215)

The following table is a roll forward of our allowance for credit losses on AFS debt securities at September 30, 2020 (dollars in thousands):

Three Months Ended September 30, 2020	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Beginning balance	\$ —	\$ 140	\$ 140
Provision for (recovery of) credit losses	4	(140)	(136)
Reduction due to AFS securities sold	—	—	—
Ending balance	\$ 4	\$ —	\$ 4

Nine Months Ended September 30, 2020	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Beginning balance	\$ —	\$ —	\$ —
Impact of adopting ASC 326	76	—	76
Provision for (recovery of) credit losses	(68)	—	(68)
Reduction due to AFS securities sold	(4)	—	(4)
Ending balance	\$ 4	\$ —	\$ 4

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We monitor the credit quality of HTM debt securities through the use of credit ratings. These ratings are updated on a monthly basis, and were last updated September 30, 2020. The following table reflects the credit ratings aggregated by investment category for HTM debt securities at September 30, 2020 (dollars in thousands):

Description of Securities	Credit Ratings						Total
	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
Municipal securities	\$ 1,591	\$ 3,401	\$ —	\$ —	\$ —	\$ —	\$ 4,992
Trust preferred and other corporate securities	—	—	—	—	2,333	—	2,333
Mortgage-backed securities issued by GSEs and GNMA	9,806	—	—	—	—	—	9,806
Total	<u>\$ 11,397</u>	<u>\$ 3,401</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,333</u>	<u>\$ —</u>	<u>\$ 17,131</u>

The following table provides a breakdown, by major security type and year of origination, for our HTM debt securities at September 30, 2020 (dollars in thousands):

Description of Securities	2020	2019	2018	2017	2016	Prior	Total
Municipal securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 4,992	\$ 4,992
Trust preferred and other corporate securities	—	1,833	—	—	—	500	2,333
Mortgage-backed securities issued by GSEs and GNMA	—	—	—	—	5,819	3,987	9,806
Total	<u>\$ —</u>	<u>\$ 1,833</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,819</u>	<u>\$ 9,479</u>	<u>\$ 17,131</u>

The following table is a roll forward of our allowance for credit losses on HTM debt securities at September 30, 2020 (dollars in thousands):

Three Months Ended September 30, 2020	Trust Preferred and Other Corporate Securities		Total
	Municipal Securities	Trust Preferred and Other Corporate Securities	
Beginning balance	\$ 42	\$ 79	\$ 121
Provision for (recovery of) credit losses	(30)	(1)	(31)
Ending balance	<u>\$ 12</u>	<u>\$ 78</u>	<u>\$ 90</u>

Nine Months Ended September 30, 2020	Trust Preferred and Other Corporate Securities		Total
	Municipal Securities	Trust Preferred and Other Corporate Securities	
Beginning balance	\$ —	\$ —	\$ —
Impact of adopting ASC 326	63	91	154
Provision for (recovery of) credit losses	(51)	(13)	(64)
Ending balance	<u>\$ 12</u>	<u>\$ 78</u>	<u>\$ 90</u>

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Equity securities

We hold certain securities that do not have a readily determinable fair value and are recognized using cost or other measurement principles. These equity securities include FHLB stock, private equity, and tax credit investments. At September 30, 2020, FHLB stock totaled \$41.83 million and other equity securities totaled \$6.50 million. At December 31, 2019, FHLB stock totaled \$30.09 million and other equity securities totaled \$6.46 million. No impairments or adjustments have been recorded on these investments.

Debt Securities - Pre-ASC 326

Prior to the adoption of ASC 326, the disclosure for OTTI on AFS and HTM debt securities was combined. Unrealized losses were broken down between “less than 12 months” and “12 months or more.”

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

December 31, 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	4	\$ 29,035	\$ (192)	\$ 39,992	\$ (9)	\$ 69,027	\$ (201)
Municipal securities	14	62,153	(836)	502	(1)	62,655	(837)
Mortgage-backed securities issued by GSE	58	377,146	(2,401)	61,751	(788)	438,897	(3,189)
Trust preferred and other corporate obligations	1	3,052	(25)	—	—	3,052	(25)
Total temporarily impaired securities	77	\$ 471,386	\$ (3,454)	\$ 102,245	\$ (798)	\$ 573,631	\$ (4,252)

Pledged securities

At September 30, 2020 and December 31, 2019, the Company had investment securities with market values of \$234.36 million and \$306.25 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the FHLB or FRB -Richmond at September 30, 2020 or 2019. The Company also had \$70.11 million in investment securities pledged against repurchase agreements with commercial customers at September 30, 2020, compared to \$64.62 million at December 31, 2019.

Federal Home Loan Bank of Atlanta stock

The Company is required to maintain an investment in the capital stock of the FHLB. This stock is stated at cost, since it is a restricted security without a readily determinable fair value. The Company had \$41.83 million and \$30.09 million of FHLB stock at September 30, 2020, and December 31, 2019, respectively. Based on the Company's review of the credit quality of the institution, the institution's ability to repurchase shares, and the Company's carrying value in the shares, the Company does not consider this investment impaired.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Loans Held for Investment

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.

The following table presents loan balances by major classification as of the date indicated (in thousands):

	September 30, 2020 (1)	December 31, 2019 (2)
Commercial Real Estate		
Construction and land development	\$ 1,143,202	\$ 1,117,625
Owner occupied	1,378,443	1,330,344
Non-owner occupied	2,338,532	2,183,409
Multi-family	289,270	242,773
Total Commercial Real Estate	5,149,447	4,874,151
Residential 1- 4 family	1,229,732	1,192,090
HELOC	430,803	460,639
Commercial and industrial business	2,144,875	1,173,409
Government	354,926	325,123
Indirect	270,371	267,950
Consumer loans and other	190,416	125,926
Loans, net of unearned income and deferred costs	<u>\$ 9,770,570</u>	<u>\$ 8,419,288</u>

(1) Paycheck Protection Program loans totaling \$1.10 billion, primarily in C&I, are included in September 30, 2020 balances.

(2) The loan portfolio segments for December 31, 2019, were further segmented to reflect the new January 1, 2020, presentation due to the adoption of ASC 326.

Unearned loan income was \$31.35 million in excess of deferred loan costs at September 30, 2020, \$8.10 million at September 30, 2019, and \$8.98 million at December 31, 2019. PPP loans represented \$23.39 million of the increase from the previous periods. Unaccreted discounts on PCD loans were \$8.60 million and were \$7.83 million on non-PCD loans at September 30, 2020. There were \$16.30 million, \$14.02 million, and \$17.44 million in nonaccrual loans at September 30, 2020, September 30, 2019, and December 31, 2019, respectively. The Company would have earned \$0.21 million in third quarter 2020 if interest on the loans had been accrued.

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

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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 credit 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.

Troubled Debt Restructuring

A TDR loan is a loan that has been modified, for reasons related to a borrower's financial difficulties, that the Company would not otherwise consider modifying. A loan is a TDR if both of the following conditions are met: (1) a creditor has granted a concession to the debtor, and (2) the debtor is experiencing financial difficulty. Loan modifications may be utilized when there is a reasonable chance that an appropriate modification would allow a borrower to continue servicing their debt. Loan terms that may be modified or restructured due to a borrower's financial situation include, but are not limited to, a reduction in the stated interest rate, an extension of the maturity or renewal of the loan at an interest rate below current market, a reduction in the face amount of the debt, a reduction in the accrued interest, or deferral of interest payments.

If the value of a TDR is determined to be less than the recorded investment in the loan, a valuation allowance is created with a corresponding charge off. Measurement of the value of a TDR is generally based on the present value of expected future cash flows discounted at the loan's original effective interest rate before modification, or is based on the underlying collateral value less costs to sell, if repayment of the loan is collateral-dependent.

The Company determined that TDRs will continue to be pooled with other loans in the portfolio for purposes of estimating the ACL, as they share similar risk characteristics, unless the TDR no longer shares the common risk characteristics of its pool or if the concessions granted require a method for estimating expected credit losses that is inconsistent with the method applied to the pool. This method is used consistently for all segments of the portfolio.

At September 30, 2020, nonaccruing TDRs, which are included in nonperforming loans, totaled \$1.96 million and accruing TDRs totaled \$13.67 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.

For the three- and nine- months ended September 30, 2020, there were no loans modified as TDRs. For the three- and nine-months ended September 30, 2019, there were one and three loans, respectively, modified as TDRs. There were no loans restructured in the past 12 months that have subsequently defaulted. Restructured loans generally include terms to reduce the interest rate and extended payment terms.

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

Section 4013 of the CARES Act provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP, from the period beginning March 1, 2020 until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak declared by the President of the United States under the National Emergencies Act terminates. Accordingly, we have offered short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. Management continues to review risk grades and update credit risk when additional modifications are needed.

Note 6. Allowance For Credit Losses on Loans

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*. This ASC amends or supersedes subtopics within *Receivables (Topic 310)*, related to Financing Receivables. Specifically, ASC 326 replaces the prior incurred loss impairment methodology with an expected loss methodology, commonly referred to as CECL. The incurred loss methodology delayed the recognition of credit losses until it was probable a loss had been incurred. In contrast, the CECL methodology requires losses to be estimated over the life of the financial instrument and recorded at origination, or acquisition. Additionally, CECL requires consideration of a reasonable and supportable forecast to inform credit loss estimates while the prior standard did not allow the forecasting of losses.

ASC 326 also supersedes the guidance for PCI assets within the scope of ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Under ASC 326, PCD assets are acquired assets that, as of the date of acquisition, have experienced a more than insignificant deterioration in credit quality since origination. The entity is required to use its own judgment in this evaluation.

Unless excluded from the scope, the requirements of ASC 326 affect financial assets with the contractual right to receive cash, including loans, HTM debt securities, trade receivables, net investments in leases, and off-balance-sheet credit exposures. ASC 326 requires financial assets measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value and the amount expected to be collected on the financial asset. ASC 326 also made changes to the accounting for AFS debt securities, requiring credit losses be accounted for as an allowance rather than as a direct write-down of the AFS debt securities which management does not intend to sell or does not believe that it is more likely than not they will be required to sell.

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- For financial assets measured at amortized cost, the Company adopted the standard utilizing the modified-retrospective method, which required a cumulative-effect adjustment to retained earnings. That cumulative-effect adjustment resulted in a decrease in retained earnings of \$2.56 million, net of tax. This decrease is related to our existing balance sheet assets in scope, and off-balance-sheet exposures, at January 1, 2020, and due to the change in the timing of recognition of credit losses, from incurred loss methodology, to lifetime of expected losses methodology. Results for reporting periods beginning January 1, 2020, are presented under the new standard, while prior period allowance estimates have not been adjusted and continue to be reported in accordance with the Company's historic accounting under GAAP.
- For PCD financial assets that were previously classified as PCI, in accordance with ASC 326, management did not reassess whether PCI assets met the criteria of PCD assets as of the date of adoption. On January 1, 2020, in accordance with ASC 326, the amortized cost basis of the PCD assets were adjusted to reflect the addition of \$1.65 million to the allowance for credit losses. The remaining noncredit discount of \$10.02 million, based on the adjusted amortized cost basis, will be accreted into interest income over the contractual life using the effective interest rate as of January 1, 2020.

As stated previously, prior periods will continue to be presented under the prior incurred loss impairment methodology. As such, period-over-period presentations may differ in measurable ways. Such differences will be highlighted when presented. The most notable difference will be related to the concept of impairment, which does not exist under ASC 326. Previously, an impaired asset was specifically defined as an asset for which management did not expect to receive contractual payments in accordance with the original terms of the asset. However, unless it was probable a loss had occurred, no loss related to the asset's impairment could be recognized. For those assets in scope of ASC 326-20, the Company will be considering the lifetime ECLs at the point of origination and recording an allowance for that expectation, rather than waiting until a loss is probable to record an allowance, thus removing the need for consideration of impairment.

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The following table summarizes the impact to our allowance for credit losses with the adoption of ASC 326 as of the adoption date:

(dollars in thousands)	January 1, 2020		
	As Reported Under ASC 326	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption
ASSETS			
Allowance for credit losses on AFS securities	\$ 76	\$ —	\$ 76
Allowance for credit losses on HTM securities	\$ 154	\$ —	\$ 154
Loans			
Commercial real estate loans			
Construction and development	\$ 15,084	\$ 6,926	\$ 8,158
Owner occupied	7,164	9,356	(2,192)
Non-owner occupied	11,671	13,885	(2,214)
Multi-family	1,268	1,047	221
Total Commercial Real Estate	35,187	31,214	3,973
Residential 1-4 family	7,536	7,241	295
HELOC	9,116	3,382	5,734
Commercial and industrial	3,898	7,899	(4,001)
Government	1,371	1,937	(566)
Indirect	1,144	6,064	(4,920)
Consumer and other	920	497	423
Allowance for credit losses on loans	\$ 59,172	\$ 58,234	\$ 938
LIABILITIES			
Allowance for credit losses on off-balance-sheet credit exposures	\$ 3,507	\$ —	\$ 3,507

Several factors impacted changes in the distribution of the allowance for loan losses with the adoption of ASC 326. In addition to changes related to the transition from an incurred loss methodology to a day-one estimate of lifetime loss, new modeling techniques were adopted. These techniques rely on a robust statistical base in the form of multiple economic forecasts, to assist in identifying portfolio exposures and estimating areas of potential loss and replace the heavier reliance on qualitative adjustments, under the previous estimate methodology.

The following table presents a breakdown of the provision for credit losses included in our Consolidated Statements of Income for the applicable periods (in thousands):

	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2020
Provision for loan losses	\$ 28,263	\$ 60,015
Provision for off-balance-sheet exposures	3,502	5,680
Provision for (recovery of) HTM security losses	(31)	(64)
Provision for (recovery of) AFS security losses	(136)	(72)
Total provision for credit losses	\$ 31,598	\$ 65,559

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The allowance for loan credit losses is applied to amortized cost, which is defined as the amount at which a financing receivable is originated or acquired, adjusted for applicable accrued interest, accretion of discount, or amortization of premium, discount, and net of deferred fees and costs, collection of cash, and write-offs. ASC 326 allows a company to make a separate accounting policy election to exclude accrued interest receivable balances from the calculation of an allowance, contingent on the company having an accounting policy in place that results in the timely reversal, or write-off, of any unpaid accrued interest. The Company has such a policy in place, and has elected to exclude accrued interest from the calculation of its allowance for credit losses. As of September 30, 2020, \$29.62 million in accrued interest receivable on loans is excluded from the estimate of ECL and is included in other assets.

We charge off loans, or portions of loans, we determine to be uncollectible. The amortized cost basis, excluding interest, is charged off as a reduction to the allowance for credit losses. Accrued interest on loans determined to be uncollectible is reversed as a reduction of interest income. When received, recoveries of previously charged off amounts are recorded as an increase to the allowance for credit losses until prior charge offs have been fully recovered.

Credit risk is inherent in the business of extending loans to borrowers and is continuously monitored by management and reflected within the allowance for credit losses for loans. The allowance for credit losses is an estimate of expected losses inherent within the Company's loans held for investment portfolio. In estimating the allowance for credit losses, loans with similar risk characteristics are aggregated into pools and collectively assessed. Risk characteristics for pooling include, but are not limited to: loan purpose, underlying collateral, and similarities in performance and structure. Some loans are not sufficiently similar in risk characteristics to other loans. These loans are excluded from collective evaluation and evaluated on an individual basis. Loans identified for individual assessment include: substandard loans equal to or greater than \$1.0 million, PCD loans greater than \$100 thousand risk graded special mention or substandard, PCD loans with specific reserves, and/or loans identified as no longer sharing similar risk characteristics with other pooled loans. Individually assessed loans totaled \$32.93 million with specific reserves of \$1.87 million at September 30, 2020.

Our loan portfolio is divided into modeling segments, which are further broken down into portfolios:

Modeling Segment	Portfolio
CRE	Construction and development
	Commercial owner occupied
	Commercial non-owner occupied
	Multi-family
Resi-Mort	1 - 4 family mortgage and subordinated mortgage
HELOC	HELOC
C&I	Commercial and industrial
	Dealer floorplans
Government	Municipal loans / bonds
Indirect	Indirect auto
Consumer	Consumer and other loans

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In determining the allowance for credit losses, the Company utilized two approaches:

- Risk parameter - PD, LGD, EAD
- Qualitative adjustment

For Government and Dealer floorplans, which have limited data history and limited history of defaults, baseline ECL estimates are adjusted quantitatively to determine the allowance for credit losses. Baseline ECL is defined as the most likely scenario for financial outcome based on the current conditions of U.S. monetary policy, fiscal policy, U.S. dollar strength, and energy prices as provided through widely published macroeconomic modeling tools. For all other segments/portfolios, the Company builds an estimate of ECLs using an expected loss methodology that incorporates risk parameters which are derived from various vendor models, internally developed statistical models, or non-statistical estimation approaches.

- PD - estimates the frequency of loss events by assigning probabilities of default within each period to each account;
- LGD - calculates the loss severity for defaulted accounts relative to their exposure at the point of default;
- EAD - calculates the exposure the account faces at default.

PD is projected in these models or estimation approaches using loan level and macroeconomic variables. Loan level variables can include structural, performance, and credit variables such as amortization terms, balance, and credit scores, including age groupings. Macroeconomic variables are sourced from third parties. Outcomes are weighted based on the Company's economic outlook and incorporate relevant information about past events, current conditions, and reasonable and supportable forecasts. The Company's PD models share a common definition of default, which include loans that are 90 days past due, on nonaccrual status, and/or have a write-off or obligor bankruptcy. All of the Company's models utilize an eight-quarter reasonable and supportable period followed by a four-quarter input reversion period. The Company's loan segments' LGD was developed from actual cumulative loss history. Based on model development results, the Company applies an average net charge-off rate for each modeling segment utilizing internal loss historical observations. For off-balance-sheet commitments, EAD includes estimates of amounts available to draw for loans considered not unconditionally cancellable. Calculations for EAD utilize a flat-rate assumption methodology based on median over time for C&I, Consumer, and HELOC loans, and average utilization at default for CRE loans. No allowance for credit losses has been recognized for PPP loans as the loans are fully guaranteed by the SBA.

For most of the Company's loan segments, prepayment rate assumptions are based on prepayment patterns of pools with shared risk characteristics. Prepayment trends are sensitive to interest rates, and the macroeconomic environment. While both fixed-rate and variable-rate loans are influenced by interest rates, variable rate loans are more heavily influenced by the macroeconomic environment. After the quantitative expected loss estimates are calculated, management then adjusts these estimates to incorporate considerations of current trends and conditions that are not captured in the quantitative loss estimates, through the use of qualitative and/or environmental factors.

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The following table presents a roll forward of the allowance for our on-balance-sheet credit losses on our loans held for investment, at amortized cost, for the three- and nine- months ended September 30, 2020 (in thousands):

Three Months Ended September 30, 2020	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 18,487	\$ 12,413	\$ 17,830	\$ 2,171	\$ 12,083	\$ 11,874
Provision for credit losses	5,293	5,110	6,499	755	1,110	1,739
Write-offs	—	—	(35)	—	—	—
Recoveries	11	5	8	—	74	247
Net (write-offs) recoveries	11	5	(27)	—	74	247
Balance, end of period	23,791	17,528	24,302	2,926	13,267	13,860

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 7,348	\$ 2,009	\$ 2,953	\$ 3,299	\$ 90,467
Provision for credit losses	2,295	308	1,630	3,524	28,263
Write-offs	(5)	—	(165)	—	(205)
Recoveries	90	—	73	25	533
Net (write-offs) recoveries	85	—	(92)	25	328
Balance, end of period	9,728	2,317	4,491	6,848	\$ 119,058

Nine Months Ended September 30, 2020	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Beginning balance, prior to adoption of ASC 326	\$ 6,926	\$ 9,356	\$ 13,885	\$ 1,047	\$ 7,241	\$ 3,382
Impact of adopting ASC 326	8,158	(2,192)	(2,214)	221	295	5,734
Provision for credit losses	8,711	10,362	12,642	1,658	5,837	4,455
Write-offs	(28)	—	(35)	—	(241)	(141)
Recoveries	24	2	24	—	135	430
Net (write-offs) recoveries	(4)	2	(11)	—	(106)	289
Balance, end of period	23,791	17,528	24,302	2,926	13,267	13,860

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Beginning balance, prior to adoption of ASC 326	\$ 7,899	\$ 1,937	\$ 6,064	\$ 497	\$ 58,234
Impact of adopting ASC 326	(4,001)	(566)	(4,920)	423	938
Provision for credit losses	5,689	946	3,781	5,934	60,015
Write-offs	(156)	—	(675)	(52)	(1,328)
Recoveries	297	—	241	46	1,199
Net (write-offs) recoveries	141	—	(434)	(6)	(129)
Balance, end of period	9,728	2,317	4,491	6,848	\$ 119,058

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The following table presents a roll forward of the allowance for off-balance-sheet exposure for the three- and nine- months ended September 30, 2020, related to loans held for investment, which is carried in other liabilities on our Consolidated Balance Sheets (in thousands):

Three Months Ended September 30, 2020	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 675	\$ 227	\$ 506	\$ 28	\$ —	\$ 2,095
Provision for credit losses	365	42	31	(8)	—	350
Balance, end of period	\$ 1,040	\$ 269	\$ 537	\$ 20	\$ —	\$ 2,445

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 987	\$ —	\$ —	\$ 1,166	\$ 5,684
Provision for credit losses	1,642	—	—	1,080	3,502
Balance, end of period	\$ 2,629	\$ —	\$ —	\$ 2,246	\$ 9,186

Nine Months Ended September 30, 2020	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Beginning balance, prior to adoption of ASC 326	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Impact of adopting ASC 326	313	205	190	144	43	1,547
Provision for credit losses	727	64	347	(124)	(43)	898
Ending balance	\$ 1,040	\$ 269	\$ 537	\$ 20	\$ —	\$ 2,445

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Beginning balance, prior to adoption of ASC 326	\$ —	\$ —	\$ —	\$ —	\$ —
Impact of adopting ASC 326	683	—	—	382	3,507
Provision for credit losses	1,946	—	—	1,864	5,679
Ending balance	\$ 2,629	\$ —	\$ —	\$ 2,246	\$ 9,186

Our provision for credit losses on funded and unfunded loan exposures was \$31.77 million in the quarter compared to \$27.08 million in the linked quarter, an increase of \$4.69 million, or 17.32%. This increase is primarily attributable to a heavier weighting given to adverse economic forecasts in our credit loss models due to expectation of continued economic weakness driven by a number of uncertainties impacting the local and national economy. Macroeconomic forecasts were impacted by the notable weakening of small businesses in the wake of the extended COVID-19 pandemic, major layoff announcements, and the deterioration in the U.S. trade relationship with China. Our provision could change significantly in future quarters as more information on the impacts of these uncertainties becomes available.

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Credit quality indicators

For commercial credits, the Company's internal credit risk grading analysis assesses 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 is inherent in the business of extending loans and leases to borrowers and is monitored by management and reflected within the allowance for credit losses for loans. The allowance for credit losses is an estimate of expected losses inherent within the Company's loans held for investment portfolio.

Credit risk grades, which were last affirmed in June 2020, are refreshed semi-annually. No risk grades were automatically adjusted based on requesting an initial modification due to COVID-19. At affirmation, management analyzes the resulting scores, as well as external statistics and factors to track loan performance. On an as needed basis, credit risk grades may be updated between review periods if new information arises related to the customer's ability to repay the loan. The Company differentiates its loan segments based on shared risk characteristics for which expected credit loss is measured on a pool basis.

The Company's internally assigned risk 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 a more than normal level of monitoring.

Special Mention - These assets are characterized by well-defined credit weaknesses and carry the distinct possibility that the Company will sustain some loss if such weakness or deficiency is not corrected.

Substandard - The borrower's ability to repay is threatened by a clearly defined weakness, related to the capacity of the obligor, which jeopardizes ultimate repayment of the loan according to terms.

Doubtful - The borrower's ability to repay in full, on the basis of currently existing facts, conditions, and values, is highly questionable and improbable. Some loss of principal and income is likely; however, the total amount of such loss cannot be determined at the present time. Loans in this category are immediately placed on nonaccrual status with all payments applied to principal until such time as the potential loss exposure is eliminated.

For consumer-related credits, the Company utilizes credit scores calculated and maintained by one of three credit bureaus. Credit scores range between 300 and 850, with a lower score indicating a potentially higher risk. Credit scores are updated semi-annually, with the last update in May 2020.

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The following table provides a breakdown of the Company's loans held for investment by credit score or risk grade and year of origination at September 30, 2020 (in thousands):

	Term Loans By Origination								Revolving Loans Converted to Term	Total
	2020	2019	2018	2017	2016	Prior	Revolving Loans			
CRE - Construction and Development										
Pass	\$ 521,920	\$ 384,916	\$ 137,030	\$ 15,004	\$ 7,513	\$ 16,783	\$ 26,959	\$ 186	\$ 1,110,311	
Special Mention	18,219	1,261	1,594	4,539	237	672	5,558	—	32,080	
Substandard	—	263	101	—	447	—	—	—	811	
Doubtful	—	—	—	—	—	—	—	—	—	
	\$ 540,139	\$ 386,440	\$ 138,725	\$ 19,543	\$ 8,197	\$ 17,455	\$ 32,517	\$ 186	\$ 1,143,202	
CRE - Owner Occupied										
Pass	\$ 246,552	\$ 271,250	\$ 217,571	\$ 134,013	\$ 135,075	\$ 282,426	\$ 19,969	\$ 172	\$ 1,307,028	
Special Mention	4,478	3,909	17,237	5,832	9,397	14,187	1,824	200	57,064	
Substandard	1,145	442	1,349	2,248	3,150	5,726	291	—	14,351	
Doubtful	—	—	—	—	—	—	—	—	—	
	\$ 252,175	\$ 275,601	\$ 236,157	\$ 142,093	\$ 147,622	\$ 302,339	\$ 22,084	\$ 372	\$ 1,378,443	
CRE - Non-Owner Occupied										
Pass	\$ 457,724	\$ 550,850	\$ 417,728	\$ 273,958	\$ 216,492	\$ 345,482	\$ 20,233	\$ 1,691	\$ 2,284,158	
Special Mention	17,462	551	18,609	3,909	2,988	5,620	942	—	50,081	
Substandard	735	—	404	394	—	2,760	—	—	4,293	
Doubtful	—	—	—	—	—	—	—	—	—	
	\$ 475,921	\$ 551,401	\$ 436,741	\$ 278,261	\$ 219,480	\$ 353,862	\$ 21,175	\$ 1,691	\$ 2,338,532	
CRE - Multi-Family										
Pass	\$ 74,340	\$ 91,807	\$ 24,420	\$ 19,968	\$ 11,382	\$ 54,732	\$ 3,673	\$ 97	\$ 280,419	
Special Mention	578	—	4,121	679	—	232	—	—	5,610	
Substandard	—	—	—	—	2,892	349	—	—	3,241	
Doubtful	—	—	—	—	—	—	—	—	—	
	\$ 74,918	\$ 91,807	\$ 28,541	\$ 20,647	\$ 14,274	\$ 55,313	\$ 3,673	\$ 97	\$ 289,270	
Commercial and Industrial										
Pass	\$ 1,247,806	\$ 170,726	\$ 104,632	\$ 45,546	\$ 19,790	\$ 21,347	\$ 448,772	\$ 2,118	\$ 2,060,737	
Special Mention	14,312	17,808	6,678	3,943	380	304	29,913	248	73,586	
Substandard	746	2,949	416	4,775	238	429	999	—	10,552	
Doubtful	—	—	—	—	—	—	—	—	—	
	\$ 1,262,864	\$ 191,483	\$ 111,726	\$ 54,264	\$ 20,408	\$ 22,080	\$ 479,684	\$ 2,366	\$ 2,144,875	

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Term Loans By Origination									
	2020	2019	2018	2017	2016	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
Government									
Pass	\$ 64,628	\$ 37,527	\$ 48,871	\$ 14,019	\$ 51,060	\$ 129,372	\$ 768	\$ —	\$ 346,245
Special Mention	474	—	—	1,848	—	6,359	—	—	8,681
Substandard	—	—	—	—	—	—	—	—	—
Doubtful	—	—	—	—	—	—	—	—	—
	<u>\$ 65,102</u>	<u>\$ 37,527</u>	<u>\$ 48,871</u>	<u>\$ 15,867</u>	<u>\$ 51,060</u>	<u>\$ 135,731</u>	<u>\$ 768</u>	<u>\$ —</u>	<u>\$ 354,926</u>
Residential 1 - 4 Family									
Credit Score:									
>= 750	\$ 221,013	\$ 208,075	\$ 134,982	\$ 113,079	\$ 115,355	\$ 162,953	\$ —	\$ 649	\$ 956,106
650 - 749	61,161	41,387	42,578	19,475	33,955	43,553	—	—	242,109
300 - 649	5,599	2,910	5,585	4,851	1,015	11,557	—	—	31,517
	<u>\$ 287,773</u>	<u>\$ 252,372</u>	<u>\$ 183,145</u>	<u>\$ 137,405</u>	<u>\$ 150,325</u>	<u>\$ 218,063</u>	<u>\$ —</u>	<u>\$ 649</u>	<u>\$ 1,229,732</u>
HELOC									
Credit Score:									
>= 750	\$ 498	\$ 1,157	\$ 463	\$ 430	\$ 635	\$ 1,854	\$ 311,502	\$ 450	\$ 316,989
650 - 749	832	31	264	737	28	1,549	94,079	—	97,520
300 - 649	312	198	74	159	377	3,578	11,596	—	16,294
	<u>\$ 1,642</u>	<u>\$ 1,386</u>	<u>\$ 801</u>	<u>\$ 1,326</u>	<u>\$ 1,040</u>	<u>\$ 6,981</u>	<u>\$ 417,177</u>	<u>\$ 450</u>	<u>\$ 430,803</u>
Indirect									
Credit Score:									
>= 750	\$ 33,557	\$ 28,887	\$ 33,368	\$ 15,821	\$ 4,846	\$ 2,007	\$ —	\$ —	\$ 118,486
650 - 749	43,528	31,303	27,870	8,571	5,149	1,967	—	—	118,388
300 - 649	4,333	9,305	11,402	3,985	3,230	1,242	—	—	33,497
	<u>\$ 81,418</u>	<u>\$ 69,495</u>	<u>\$ 72,640</u>	<u>\$ 28,377</u>	<u>\$ 13,225</u>	<u>\$ 5,216</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 270,371</u>
Consumer and Other									
Credit Score:									
>= 750	\$ 90,992	\$ 23,353	\$ 9,915	\$ 3,673	\$ 4,227	\$ 7,948	\$ 34,462	\$ 29	\$ 174,599
650 - 749	3,366	2,348	2,381	477	425	356	3,871	—	13,224
300 - 649	606	363	123	154	627	52	668	—	2,593
	<u>\$ 94,964</u>	<u>\$ 26,064</u>	<u>\$ 12,419</u>	<u>\$ 4,304</u>	<u>\$ 5,279</u>	<u>\$ 8,356</u>	<u>\$ 39,001</u>	<u>\$ 29</u>	<u>\$ 190,416</u>
Grand Total	<u>\$ 3,136,916</u>	<u>\$ 1,883,576</u>	<u>\$ 1,269,766</u>	<u>\$ 702,087</u>	<u>\$ 630,910</u>	<u>\$ 1,125,396</u>	<u>\$ 1,016,079</u>	<u>\$ 5,840</u>	<u>\$ 9,770,570</u>

Through our loan portfolio evaluation process, we have identified certain loans for which the primary source of loan repayment is no longer a viable option, necessitating identifying these loans as CDAs. In most cases these are loans in which the borrower is experiencing financial difficulty, which may or may not be classified as TDRs, but we believe will necessitate the operation or sale of the underlying collateral to provide substantially all of the repayment.

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In estimating ECL, ASC 326 prescribes that if foreclosure is probable, a CDA is required to be measured at the fair value of collateral, but as a practical expedient, if foreclosure is not probable, fair value measurement is optional. For those CDA loans measured at the fair value of collateral, a credit loss expense is recorded for loan amounts in excess of fair value.

The following table provides a breakdown between loans identified as CDAs and non-CDAs, by type and securing collateral, as well as collateral coverage for those loans at September 30, 2020 (in thousands):

	Type of Collateral and Extent to Which Collateral Secures Financial Assets				Financial Assets Not Considered Collateral Dependent	Total
	Residential Property	Investment Property	Commercial Property	Business Assets		
Commercial Real Estate						
Construction and development	\$ 1,678	\$ 4,000	\$ —	\$ —	\$ 1,137,524	\$ 1,143,202
Owner occupied	—	—	2,157	—	1,376,286	1,378,443
Non-owner Occupied	—	8,410	—	—	2,330,122	2,338,532
Multi-family	—	8,041	—	—	281,229	289,270
Residential 1-4 Family	6,218	—	—	—	1,223,514	1,229,732
HELOC	863	—	—	—	429,940	430,803
Commercial and industrial	—	—	—	6,686	2,138,189	2,144,875
Government	—	—	—	—	354,926	354,926
Indirect	—	—	—	—	270,371	270,371
Consumer and other	—	—	—	—	190,416	190,416
Total, amortized cost	\$ 8,759	\$ 20,451	\$ 2,157	\$ 6,686	\$ 9,732,517	\$ 9,770,570
Collateral value	\$ 33,365	\$ 50,650	\$ 4,478	\$ 25,191		

Nonaccrual and Past Due Loans

Loans are placed on nonaccrual status when management determines that the full repayment of principal and collection of interest according to contractual terms is no longer likely, generally when the loan becomes 90 days or more past due. However, some loans that are 90 days or more past due as to interest and principal are 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.

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The following table is an aging analysis at amortized cost of the Company's loans held for investment portfolio at September 30, 2020 (in thousands):

	Days Past Due				Total Past Due	Total Loans	Accruing Loans Over 90 Days Past Due
	Current	30-59	60-89	Over 90			
Commercial Real Estate							
Construction and development	\$ 1,143,158	\$ —	\$ —	\$ 44	\$ 44	\$ 1,143,202	\$ —
Owner occupied	1,377,274	118	—	1,051	1,169	1,378,443	—
Non-owner occupied	2,337,489	245	—	798	1,043	2,338,532	—
Multi-family	289,270	—	—	—	—	289,270	—
Residential 1-4 family	1,225,737	1,039	460	2,496	3,995	1,229,732	—
HELOC	429,444	644	15	700	1,359	430,803	—
Commercial and industrial	2,139,539	143	191	5,002	5,336	2,144,875	—
Government	354,926	—	—	—	—	354,926	—
Indirect	268,763	906	96	606	1,608	270,371	19
Consumer and other	190,373	23	18	2	43	190,416	—
Total	\$ 9,755,973	\$ 3,118	\$ 780	\$ 10,699	\$ 14,597	\$ 9,770,570	\$ 19

The following table presents the amortized cost basis of loans on nonaccrual status as of the beginning of the reporting period and the end of the reporting period and the amortized cost basis of nonaccrual loans without specific reserves. Nonaccrual loans without specific reserves are included in collectively evaluated pools for which an ACL has been recorded. It also shows interest income recognized on nonaccrual loans (in thousands):

	Nonaccrual Financial Assets		Financial Assets 90 Days or More Past Due, Not on Nonaccrual Status	Nonaccrual Financial Assets With No Specific Reserve as of 09/30/2020	Interest Income Recognized
	As of 06/30/2020	As of 09/30/2020			
Commercial Real Estate					
Construction and development	\$ 47	\$ 43	\$ —	\$ 43	15
Owner occupied	1,352	1,149	—	—	17
Non-owner occupied	753	798	—	—	42
Multi-family	—	—	—	—	—
Residential 1-4 Family	4,058	4,366	—	507	294
HELOC	1,664	1,510	—	72	90
Commercial and industrial	8,250	7,720	—	7,302	497
Government	—	—	—	—	—
Indirect	809	708	19	—	83
Consumer and other	2	1	—	—	24
Total	\$ 16,935	\$ 16,295	\$ 19	\$ 7,924	\$ 1,062

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Off-Balance-Sheet Credit Exposure

The Company maintains a separate allowance for credit losses from off-balance-sheet credit exposures, including unfunded loan commitments, which is included in other liabilities on the Consolidated Balance Sheets. The allowance for credit losses on off-balance-sheet credit exposures is adjusted as a provision for credit loss expense and included with the provision for credit loss expense on funded loans in the consolidated statements of income. The estimate includes consideration of the likelihood that funding will occur and an estimate of ECLs on commitments expected to be funded over its estimated life, utilizing the same models and approaches for the Company's other loan portfolio segments described above, as these unfunded commitments share similar risk characteristics as our loan portfolio segments. The Company has identified the unfunded portion of certain lines of credit as unconditionally cancellable credit exposures, meaning the Company can cancel the unfunded commitment at any time. No credit loss estimate is reported for off-balance-sheet credit exposures that are unconditionally cancellable by the Company or for undrawn amounts under such arrangements that may be drawn prior to the cancellation of the arrangement. At September 30, 2020, the allowance for credit losses from off-balance-sheet credit exposures included in other liabilities was \$9.19 million.

Loans - Pre ASC 326

Under the prior incurred loss methodology, loss contingencies were evaluated as: probable, reasonably possible, or remote. If, at the date of financial statement presentation, information was available that indicated an asset had been impaired and the amount of loss could be reasonably estimated, then an allowance for that loss could be recorded. Recording an allowance for a loss that was considered reasonably possible or remote, was not permitted. With the adoption of ASC 326, the Company considers the lifetime potential for losses at the point of origination and records an allowance for that potential, at that point in time, removing the necessity of differentiation between the three loss contingency concepts and impairment. The following disclosures are presented under previously applicable GAAP.

The following table presents, by portfolio segment, the allowance for loan losses at December 31, 2019 (in thousands):

Year Ended	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi- family	Real Estate Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
December 31, 2019							
Allowance for loan losses:							
Balance, beginning of period	\$ 6,171	\$ 19,488	\$ 1,011	\$ 10,245	\$ 8,669	\$ 6,510	\$ 52,094
Provision charged to expense	654	5,013	36	841	2,003	824	9,371
Losses charged off	(43)	(1,298)	—	(1,098)	(984)	(1,068)	(4,491)
Recoveries	144	38	—	635	148	295	1,260
Balance, end of period	<u>\$ 6,926</u>	<u>\$ 23,241</u>	<u>\$ 1,047</u>	<u>\$ 10,623</u>	<u>\$ 9,836</u>	<u>\$ 6,561</u>	<u>\$ 58,234</u>

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

December 31, 2019	Real Estate Construction and Land Development	Real Estate Commercial	Real Estate Multi- family	Real Estate Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Period-end balance allocated to:							
Loans individually evaluated for impairment	\$ 16	\$ 472	\$ 39	\$ 427	\$ 267	\$ 41	\$ 1,262
Loans collectively evaluated for impairment	6,910	22,769	1,008	10,068	9,484	6,520	56,759
Loans acquired with deteriorated credit quality	—	—	—	128	85	—	213
Balance, end of year	<u>\$ 6,926</u>	<u>\$ 23,241</u>	<u>\$ 1,047</u>	<u>\$ 10,623</u>	<u>\$ 9,836</u>	<u>\$ 6,561</u>	<u>\$ 58,234</u>

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

December 31, 2019	Real estate Construction and Land Development	Real estate Commercial	Real estate Multi- family	Real estate Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Ending balance: individually evaluated for impairment	\$ 1,415	\$ 21,123	\$ 3,941	\$ 15,105	\$ 5,383	\$ 1,296	\$ 48,263
Ending balance: collectively evaluated for impairment	1,118,463	3,464,328	233,254	1,619,314	1,568,892	314,683	8,318,934
Ending balance: loans acquired with deteriorated credit quality	655	26,925	5,846	18,665	—	—	52,091
Ending Balance	<u>\$ 1,120,533</u>	<u>\$ 3,512,376</u>	<u>\$ 243,041</u>	<u>\$ 1,653,084</u>	<u>\$ 1,574,275</u>	<u>\$ 315,979</u>	<u>\$ 8,419,288</u>

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

December 31, 2019	Real estate Construction and Land Development	Real estate Commercial	Real estate Multi- family	Real estate Residential	Commercial and Industrial Business	Consumer and Other Loans	Total
Pass	\$ 1,106,773	\$ 3,478,967	\$ 239,099	\$ 1,633,695	\$ 1,560,041	\$ 314,683	\$ 8,333,258
Special Mention	12,613	15,155	692	4,295	6,752	—	39,507
Substandard	1,147	18,254	3,250	15,094	7,482	1,296	46,523
Doubtful	—	—	—	—	—	—	—
Total	<u>\$ 1,120,533</u>	<u>\$ 3,512,376</u>	<u>\$ 243,041</u>	<u>\$ 1,653,084</u>	<u>\$ 1,574,275</u>	<u>\$ 315,979</u>	<u>\$ 8,419,288</u>

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The following table includes an aging analysis of the recorded investment of past-due financing receivables as of December 31, 2019 (in thousands):

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Nonaccrual Loans	Total Past Due and Nonaccruing	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
December 31, 2019								
Real estate construction and land development	\$ 240	\$ 323	\$ —	\$ 43	\$ 606	\$ 1,119,927	\$ 1,120,533	\$ —
Real estate commercial	1,238	199	45	7,513	8,995	3,503,381	3,512,376	—
Real estate multi-family	—	—	—	—	—	243,041	243,041	—
Real estate residential	6,470	326	505	5,973	13,274	1,639,810	1,653,084	244
Commercial and industrial business loans	347	55	—	3,284	3,686	1,570,589	1,574,275	—
Consumer loans and other	1,289	148	65	624	2,126	313,853	315,979	65
Total	<u>\$ 9,584</u>	<u>\$ 1,051</u>	<u>\$ 615</u>	<u>\$ 17,437</u>	<u>\$ 28,687</u>	<u>\$ 8,390,601</u>	<u>\$ 8,419,288</u>	<u>\$ 309</u>

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

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable
December 31, 2019						
Real estate construction and land development	\$ 13	\$ —	\$ —	\$ 13	\$ 642	\$ 655
Real estate commercial	—	—	45	45	26,880	26,925
Real estate multi-family	—	—	—	—	5,846	5,846
Real estate residential	313	129	260	702	17,963	18,665
Total	<u>\$ 326</u>	<u>\$ 129</u>	<u>\$ 305</u>	<u>\$ 760</u>	<u>\$ 51,331</u>	<u>\$ 52,091</u>

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Impaired Loans

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 December 31, 2019 (in thousands):

December 31, 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	\$ 43	\$ 43	\$ —	\$ 48	\$ 2
Real estate - commercial	8,226	8,058	—	8,500	396
Real estate - multi-family	2,852	2,852	—	2,852	127
Real estate - residential 1-4 family	7,211	6,999	—	7,029	322
Commercial and industrial business	3,500	3,213	—	3,255	206
Consumer and other loans	—	—	—	—	—
Total	\$ 21,832	\$ 21,165	\$ —	\$ 21,684	\$ 1,053
Loans with a specific valuation allowance					
Real estate - construction and land development	\$ 1,372	\$ 1,372	\$ 16	\$ 1,386	\$ 71
Real estate - commercial	13,216	13,065	472	13,395	737
Real estate - multi-family	1,089	1,089	39	1,124	71
Real estate - residential 1-4 family	8,423	8,106	427	9,114	509
Commercial and industrial business	2,277	2,170	267	2,293	131
Consumer and other loans	1,335	1,296	41	1,418	79
Total	\$ 27,712	\$ 27,098	\$ 1,262	\$ 28,730	\$ 1,598
Total impaired loans					
Real estate - construction and land development	\$ 1,415	\$ 1,415	\$ 16	\$ 1,434	\$ 73
Real estate - commercial	21,442	21,123	472	21,895	1,133
Real estate - multi-family	3,941	3,941	39	3,976	198
Real estate - residential 1-4 family	15,634	15,105	427	16,143	831
Commercial and industrial business	5,777	5,383	267	5,548	337
Consumer and other loans	1,335	1,296	41	1,418	79
Total	\$ 49,544	\$ 48,263	\$ 1,262	\$ 50,414	\$ 2,651
Included in the table above are accruing TDRs of \$15.02 million, which the Company has designated as performing loans, while nonaccruing TDRs, which are also included in the above table of impaired loans, totaled \$2.27 million.					

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Note 7. 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, 2020 and 2019 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Beginning balance	\$ 12,315	\$ 16,027	\$ 15,360	\$ 19,416
Additions and capital improvements	1,947	1,547	4,922	2,635
Sales	(827)	(637)	(6,735)	(4,933)
Net change in valuation allowance	—	—	(471)	—
Gain (loss) on sale and write-downs, net	(991)	90	(632)	(91)
Ending balance	<u>\$ 12,444</u>	<u>\$ 17,027</u>	<u>\$ 12,444</u>	<u>\$ 17,027</u>

As of September 30, 2020, the Company's recorded investment in OREO collateralized by residential real estate was \$3.25 million. As of September 30, 2020, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was \$0.32 million.

Note 8. 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 use the collateralized interest rate the Company would have to pay to borrow over a similar term to estimate our lease liability. 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, 2020, we did not have any significant 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.

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The following table presents a summary of the lease assets and liabilities as of the dates indicated (in thousands):

	Leases	
	September 30, 2020	December 31, 2019
Assets		
Operating lease assets included in other assets	\$ 58,498	\$ 47,515
Liabilities		
Accrued liability operating leases included in other liabilities	\$ 62,300	\$ 50,246

The following table presents a summary of activity related to leases for the three- and nine- month periods ended September 30, 2020 and 2019 (in thousands):

	Lease Cost			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Operating lease cost (1) included in occupancy expense	\$ 3,960	\$ 3,359	\$ 10,520	\$ 11,066
Variable lease cost included in occupancy expense	151	156	493	477
Sublease income included in occupancy expense	(18)	(3)	(61)	(61)
Net lease cost	\$ 4,093	\$ 3,512	\$ 10,952	\$ 11,482

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

The following table presents lease liability maturities, by year, as of September 30, 2020 (in thousands):

Maturity of Lease Liabilities		Operating Leases (1)
October 1 - December 31, 2020	\$	11,748
2021		9,659
2022		8,007
2023		6,162
2024		5,229
After 2024		49,219
Total lease payments	\$	90,024
Less: interest		27,724
Present value of lease liabilities	\$	62,300

(1) Operating lease payments include \$30.09 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.

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The following table presents the lease term and discount rate as of the dates indicated:

Lease Term and Discount Rate		
	September 30, 2020	September 30, 2019
Weighted - average remaining lease term - operating leases (in years)	13.55	11.96
Weighted - average discount rate - operating leases	4.87%	4.55%

The following table presents other information with regard to leases as of the dates indicated (in thousands):

	Other Information			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from operating leases	\$ 2,888	\$ 2,850	\$ 8,526	8,708
Related Party Transactions (1)				
Rent expense included in occupancy expense	\$ 655	\$ 648	\$ 1,965	2,158

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

Note 9. 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 Greensboro, 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.

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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, 2020	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 92,869	\$ 3,890	\$ —	\$ 96,759
Provision for credit losses	31,070	528	—	31,598
Net interest income after provision for credit losses	61,799	3,362	—	65,161
Residential mortgage banking income, net	(543)	38,074	—	37,531
Insurance commissions and other title fees and income, net	61	654	16,753	17,468
Real estate brokerage and property management income, net	—	11,301	—	11,301
Other noninterest income	10,551	662	17,863	29,076
Noninterest expense	61,644	28,154	12,183	101,981
Income before income tax, corporate allocation and noncontrolling interest	10,224	25,899	22,433	58,556
Corporate allocation	595	(356)	(239)	—
Income before income tax provision and noncontrolling interest	10,819	25,543	22,194	58,556
Provision for income tax expense	474	4,780	2,587	7,841
Net income	10,345	20,763	19,607	50,715
Noncontrolling interest	(2)	(4,790)	(11,459)	(16,251)
Net income attributable to TowneBank	\$ 10,343	\$ 15,973	\$ 8,148	\$ 34,464
Net income as percentage of total	30.01 %	46.35 %	23.64 %	100.00 %
Total assets	\$ 13,481,711	\$ 942,791	\$ 370,915	\$ 14,795,417

Three Months Ended September 30, 2019	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 89,490	\$ 1,613	\$ —	\$ 91,103
Provision for credit losses	1,508	—	—	1,508
Net interest income after provision for credit 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

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Nine Months Ended September 30, 2020				Consolidated
	Banking	Realty	Insurance	Totals
Net interest income	\$ 269,941	\$ 9,589	\$ —	\$ 279,530
Provision for credit losses	64,170	1,389	—	65,559
Net interest income after provision for loan losses	205,771	8,200	—	213,971
Residential mortgage banking income, net	(1,887)	76,549	—	74,662
Insurance commissions and other title fees and income, net	157	1,728	50,088	51,973
Real estate brokerage and property management income, net	—	29,020	—	29,020
Other noninterest income	37,296	1,611	18,395	57,302
Noninterest expense	176,882	76,036	36,976	289,894
Income before income tax, corporate allocation and noncontrolling interest	64,455	41,072	31,507	137,034
Corporate allocation	1,891	(1,119)	(772)	—
Income before income tax provision and noncontrolling interest	66,346	39,953	30,735	137,034
Provision for income tax expense	9,304	7,614	4,574	21,492
Net income	57,042	32,339	26,161	115,542
Noncontrolling interest	2	(7,996)	(12,095)	(20,089)
Net income attributable to TowneBank	\$ 57,044	\$ 24,343	\$ 14,066	\$ 95,453
Net income as percentage of total	59.76 %	25.50 %	14.74 %	100.00 %
Total assets	\$ 13,481,711	\$ 942,791	\$ 370,915	\$ 14,795,417

Nine Months Ended September 30, 2019				Consolidated
	Banking	Realty	Insurance	Totals
Net interest income	\$ 264,332	\$ 4,064	\$ —	\$ 268,396
Provision for credit 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

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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 utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2020, the amounts of off-balance-sheet commitments to extend credit were \$3.58 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, 2020, standby letters of credit and financial guarantees were \$145.78 million.

Additionally, the Company had \$1.63 billion in mortgage loans sold to investors with estimated recourse and warranty provisions totaling \$58.02 million as of September 30, 2020.

Note 11. 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 8 – Goodwill and Intangible Assets* of the 2019 Annual Report to Shareholders 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, 2020		December 31, 2019	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 31,339	\$ 18,274	\$ 31,339	\$ 14,933
Non-compete agreements	2,085	1,487	2,085	1,320
Customer lists	63,911	36,404	63,826	31,209
Total intangible assets subject to amortization	97,335	56,165	97,250	47,462
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	\$ 101,946	\$ 56,165	\$ 101,861	\$ 47,462

Amortization expense for intangible assets was \$2.85 million and \$3.06 million for the three-month periods, and \$8.70 million and \$9.36 million for the nine-month periods, ended September 30, 2020 and 2019, respectively.

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Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2019, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2019	\$ 344,713	\$ 27,667	\$ 74,436	\$ 446,816
Additions to goodwill	—	—	—	—
Other adjustments	—	—	(91)	(91)
Balance, September 30, 2020	\$ 344,713	\$ 27,667	\$ 74,345	\$ 446,725

Note 12. Bank-Owned Life Insurance Policies

The total carrying amount of BOLI as of September 30, 2020, and December 31, 2019, was \$244.10 million and \$243.06 million, respectively. The Company recognized BOLI income, included in other noninterest income, of \$1.61 million and \$2.12 million for the three-month periods, and \$6.30 million and \$5.35 million for the nine-month periods, ended September 30, 2020 and 2019, respectively.

Note 13. 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,	
	2020	2019	2020	2019
Service cost	\$ 1,100	\$ 1,124	\$ —	\$ —
Interest cost	375	435	11	15
Amortization of prior service costs	164	124	—	—
Amortization of actuarial (gain) loss	106	(170)	9	7
Net periodic postretirement benefit cost	<u>\$ 1,745</u>	<u>\$ 1,513</u>	<u>\$ 20</u>	<u>\$ 22</u>
	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Service cost	\$ 3,335	\$ 3,372	\$ —	\$ —
Interest cost	1,139	1,304	33	46
Amortization of prior service costs	504	375	—	—
Amortization of actuarial (gain) loss	316	(508)	29	23
Net periodic postretirement benefit cost	<u>\$ 5,294</u>	<u>\$ 4,543</u>	<u>\$ 62</u>	<u>\$ 69</u>

Postretirement benefit costs are included in our Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2020, and September 30, 2019. 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.

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Note 14. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2020 and 2019 (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 and other expenses 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, 2019	\$ 15,441	\$ (4,139)	\$ 11,302
Other comprehensive income before reclassifications	40,043	179	40,222
Amounts reclassified from AOCI	(7,610)	655	(6,955)
Other comprehensive income, net	32,433	834	33,267
Balance, September 30, 2020	<u>\$ 47,874</u>	<u>\$ (3,305)</u>	<u>\$ 44,569</u>

	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	<u>\$ 20,388</u>	<u>\$ (430)</u>	<u>\$ 19,958</u>

(a) For additional information about securities, refer to Note 4.

(b) For additional information about retirement plans, refer to Note 13.

Note 15. 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

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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 \$270.22 million and \$229.01 million were not included in the Consolidated Balance Sheets at September 30, 2020, and December 31, 2019, respectively. These limited partner interests had carrying values of \$92.28 million and \$59.38 million at September 30, 2020, and December 31, 2019, 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 \$94.22 million, \$59.33 million, and \$62.24 million at September 30, 2020, September 30, 2019, and December 31, 2019, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments, along with \$1.94 million of loans to the entities at September 30, 2020. As of September 30, 2020, the Company had \$55.11 million in funding commitments that are dependent on certain contractual milestones and \$28.56 million in loans, unfunded short-term construction loans, or letters of credit commitments. For the three- and nine-month periods ended September 30, 2020, tax benefits totaling \$0.50 million and \$1.30 million, net of amortization expenses of \$2.31 million and \$6.44 million, were recognized as a component of income tax expense.

Note 16. 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.

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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: 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. Effective July 1, 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. At September 30, 2020, the Company was temporarily not participating in the mandatory delivery program. For additional information about loans held for sale, refer to Note 17.

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, 2020 and September 30, 2019, the Company used weighted average fall-out rates of 13.27% and 14.90%, respectively. For the year ended December 31, 2019, the Company used a fall-out rate of 13.16%.

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. At September 30, 2020, because the Company was not participating in the mandatory delivery program, we did not have any TBA mortgage-backed securities.

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The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2020, and December 31, 2019 (in thousands):

	September 30, 2020			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 167,275	\$ —	\$ 167,275
U.S. Treasury notes	—	1,006	—	1,006
Municipal securities	—	292,792	—	292,792
Mortgage-backed securities issued by GSEs	—	825,378	—	825,378
Trust preferred and other corporate securities	—	24,236	—	24,236
Other equity securities	—	6,497	—	6,497
Loans held for sale - mandatory delivery	—	—	—	—
Derivative assets	—	—	10,480	10,480
Derivative liabilities	—	—	—	—
	December 31, 2019			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 129,038	\$ —	\$ 129,038
U.S. Treasury notes	—	1,000	—	1,000
Municipal securities	—	223,106	—	223,106
Mortgage-backed securities issued by GSEs	—	1,034,797	—	1,034,797
Trust preferred and other corporate securities	—	53,367	—	53,367
Other equity securities	—	6,462	—	6,462
Loans held for sale - mandatory delivery	—	340,915	—	340,915
Derivative assets	—	439	1,525	1,964
Derivative liabilities	—	940	—	940

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, 2020, and December 31, 2019 (in thousands):

September 30, 2020	Level 1	Level 2	Level 3	Fair Value
Collateral dependent assets with specific reserves	\$ —	\$ —	\$ 38,053	\$ 38,053
Other real estate owned and other nonperforming assets	—	—	12,444	12,444
December 31, 2019	Level 1	Level 2	Level 3	Fair Value
Impaired loans - Pre-ASC 326	\$ —	\$ —	\$ 3,204	\$ 3,204
Other real estate owned and other nonperforming assets	—	—	15,360	15,360

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

Loans: 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 loan balance is reflected within Level 3 of the hierarchy. These discounts ranged from 2.34% to 100.00%, with a weighted average of 14.06%.

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 17.

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, 2020, and December 31, 2019, are as follows (in thousands):

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
September 30, 2020					
Cash and due from banks	\$ 114,604	\$ 114,604	\$ 114,604	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,670,186	1,670,186	1,670,186	—	—
Interest-bearing deposits in financial institutions	24,890	24,890	24,890	—	—
Securities available for sale, net	1,310,683	1,310,683	—	1,310,683	—
Securities held to maturity, net	17,131	19,102	—	19,102	—
Other equity securities	6,497	6,497	—	6,497	—
Mortgage loans held for sale	669,020	669,477	—	669,477	—
Net loans	9,770,570	9,690,168	—	—	9,690,168
Interest receivable	35,152	35,152	—	35,152	—
Non-maturity deposits	9,419,104	9,777,133	—	9,777,133	—
Time deposits	2,285,859	2,305,246	—	2,305,246	—
Advances from the FHLB	731,202	735,477	—	735,477	—
Subordinated debt	248,906	254,730	—	254,730	—
Repurchase agreements and other borrowings	58,061	59,668	—	59,668	—
Interest payable	8,980	8,980	—	8,980	—

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December 31, 2019	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	\$ 97,593	\$ 97,593	\$ 97,593	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	322,505	322,505	322,505	—	—
Interest-bearing deposits in financial institutions	22,518	22,518	22,518	—	—
Securities available for sale	1,441,308	1,441,308	—	1,441,308	—
Securities held to maturity	43,688	46,177	—	46,177	—
Other equity securities	6,462	6,462	—	6,462	—
Mortgage loans held for sale	419,233	419,420	—	419,420	—
Net loans	8,361,054	8,365,959	—	—	8,365,959
Interest receivable	33,126	33,126	—	33,126	—
Non-maturity deposits	6,813,794	6,732,178	—	6,732,178	—
Time deposits	2,457,123	2,468,979	—	2,468,979	—
Advances from the FHLB	471,687	472,029	—	472,029	—
Subordinated debt	248,458	254,993	—	254,993	—
Repurchase agreements and other borrowings	52,391	49,958	—	49,958	—
Interest payable	13,563	13,563	—	13,563	—

Note 17. 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.

When the market is favorable, 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. At September 30, 2020, we were temporarily not participating in the mandatory delivery system and had no sales of TBA MBSs outstanding.

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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, 2020		December 31, 2019	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	\$ 828,388	\$ 10,480	\$ 367,073	\$ 1,964
Interest rate contracts included in other liabilities	\$ —	\$ —	\$ 315,912	\$ 940

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, 2020, the Company recognized \$3.33 million in gains and \$1.12 million in losses, respectively. 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.

Note 18. 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.

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

Revenue from Contracts with Customers:	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Investment management income				
Investment commissions, net	\$ 2,006	\$ 1,779	\$ 5,556	\$ 4,958
Total	\$ 2,006	\$ 1,779	\$ 5,556	\$ 4,958
Insurance income				
Property and casualty insurance income, net	\$ 12,581	\$ 12,511	\$ 37,789	\$ 36,132
Benefit insurance income, net	2,774	2,652	8,773	8,289
Travel insurance commissions, net	1,399	834	3,526	3,292
Total	\$ 16,754	\$ 15,997	\$ 50,088	\$ 47,713
Real estate and property management income				
Real estate sales commissions, net	\$ 3,688	\$ 2,882	\$ 8,212	\$ 7,315
Real estate property management income, net	7,613	6,562	20,808	20,240
Total	\$ 11,301	\$ 9,444	\$ 29,020	\$ 27,555

In the first nine months of 2020, the Company recorded a provision for credit losses related to future reservations of resort properties recorded in real estate property management income and a provision for credit losses related to property and casualty insurance receivables of \$0.22 million and \$0.51 million, respectively. The Company sold Red Sky, a travel insurance joint venture, in third quarter 2020, at a pre-tax

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gain of \$6.52 million, after distributions to noncontrolling interests. Red Sky was our only source of travel insurance commission, and we do not anticipate a future income stream from this line of insurance.

The Company had no material contract assets or contract liabilities recorded on the Consolidated Balance Sheets as of September 30, 2020.

This disclosure includes only revenue from contracts with third-party customers. See Note 9 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 19. 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, 2020, the carrying value of the notes totaled \$248.91 million, compared with \$248.46 million at December 31, 2019.

On March 27, 2020, the CARES Act was enacted, which temporarily added a new product, titled the Paycheck Protection Program to the SBA's 7(a) Loan Program. The CARES Act provides for forgiveness of up to the full principal amount of qualifying loans guaranteed. TowneBank has repaid the \$1.11 billion in borrowings during the quarter under the Federal Reserve PPP lending facility, which had been used to facilitate funding of the PPP loans.

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

Selected Quarterly Information (unaudited) TOWNEBANK

<i>(Dollars in thousands, except per share data)</i>	Third Quarter 2020	Second Quarter 2020	First Quarter 2020	Fourth Quarter 2019	Third Quarter 2019
Results of Operations:					
Interest income	\$ 115,528	\$ 114,546	\$ 114,101	\$ 116,475	\$ 119,637
Interest expense	18,769	21,272	24,605	26,516	28,534
Net interest income	96,759	93,274	89,496	89,959	91,103
Provision for credit losses	31,598	26,945	7,016	3,601	1,508
Net interest income after provision for credit losses	65,161	66,329	82,480	86,358	89,595
Noninterest income:					
Residential mortgage banking income, net	37,531	29,715	7,416	15,884	18,855
Insurance commissions and other title fees and income, net	17,468	17,612	16,893	15,001	16,681
Real estate brokerage and property management income, net	11,301	10,781	6,938	6,737	9,444
Service charges on deposit accounts	1,986	1,888	2,440	2,245	2,253
Credit card merchant fees, net	1,506	1,109	1,179	1,389	1,514
Bank-owned life insurance	1,605	1,584	3,105	3,865	2,117
Other income	22,278	3,763	5,227	4,591	3,981
Gain (loss) on investment securities	1,701	2,930	5,002	—	(69)
Total noninterest income	95,376	69,382	48,200	49,712	54,776
Noninterest expense:					
Salaries and benefits	61,408	56,926	55,867	56,013	55,784
Occupancy expense	8,396	7,227	7,502	7,516	7,953
Furniture and equipment	3,247	3,564	3,640	3,598	3,805
Amortization - intangibles	2,851	2,901	2,950	3,005	3,059
Software expense	3,572	3,492	3,492	2,976	3,208
Outside data processing	3,113	2,718	2,791	2,510	2,533
Professional fees	2,637	2,972	3,067	2,990	3,566
Advertising and marketing	1,870	1,986	3,584	2,839	3,429
Other expenses	14,887	9,239	13,995	10,889	13,950
Total noninterest expense	101,981	91,025	96,888	92,336	97,287
Income before noncontrolling interest and income tax	58,556	44,686	33,792	43,734	47,084
Provision for income tax expense	7,841	7,464	6,187	7,786	7,684
Net income	\$ 50,715	\$ 37,222	\$ 27,605	\$ 35,948	\$ 39,400
Net income attributable to noncontrolling interest	(16,251)	(2,617)	(1,221)	(873)	(1,741)
Net income attributable to TowneBank	<u>\$ 34,464</u>	<u>\$ 34,605</u>	<u>\$ 26,384</u>	<u>\$ 35,075</u>	<u>\$ 37,659</u>

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Selected Quarterly Information (unaudited)

TOWNEBANK

<i>(Dollars in thousands, except per share data)</i>	Third Quarter 2020	Second Quarter 2020	First Quarter 2020	Fourth Quarter 2019	Third Quarter 2019
Per Share Data:					
Net income:					
Basic	\$ 0.48	\$ 0.48	\$ 0.37	\$ 0.49	\$ 0.52
Diluted	0.48	0.48	0.36	0.49	0.52
Book value at period end	23.83	23.50	22.77	22.58	22.38
Tangible book value at period end ^(non-GAAP)	17.06	16.68	15.91	15.69	15.44
Cash dividends declared	0.18	0.18	0.18	0.18	0.18
Selected Financial Ratios (annualized):					
Return on average assets	0.89 %	0.97 %	0.88 %	1.16 %	1.26 %
Return on average tangible assets ^(non-GAAP)	0.97 %	1.07 %	1.00 %	1.30 %	1.40 %
Return on average equity	7.85 %	8.18 %	6.37 %	8.44 %	9.22 %
Return on average tangible equity ^(non-GAAP)	11.66 %	12.32 %	9.91 %	12.97 %	14.20 %
Net interest margin (tax-equivalent basis) ^(non-GAAP)	2.72 %	2.87 %	3.37 %	3.35 %	3.43 %
Daily Averages:					
Total assets	\$15,487,152	\$14,409,468	\$12,049,323	\$11,970,593	\$11,845,282
Total tangible assets ^(non-GAAP)	14,992,914	13,912,391	11,549,200	11,467,826	11,345,036
Loans, net of unearned income, excluding nonaccrual loans	9,752,746	9,619,931	8,550,216	8,283,388	8,096,908
Total earning assets	14,262,377	13,160,132	10,741,885	10,722,323	10,604,500
Total deposits	11,302,888	10,478,045	9,194,862	9,369,355	9,239,987
FHLB advances	831,296	963,819	614,478	404,061	440,089
Total equity	1,747,033	1,701,777	1,665,706	1,647,929	1,620,070
Tangible equity ^(non-GAAP)	1,252,795	1,204,700	1,165,583	1,145,162	1,119,824
Basic weighted average shares outstanding	72,339,413	72,280,555	72,206,228	72,122,476	72,091,221
Diluted weighted average shares outstanding	72,375,736	72,317,988	72,299,721	72,302,414	72,222,934

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2019 audited Consolidated Financial Statements included in our 2019 Annual Report to Shareholders and our 2019 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 the impact of the COVID-19 pandemic and the associated efforts to limit its spread; 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 Part III of this report, in the Company's Form 10-K for the year ended December 31, 2019, and related disclosures in other filings that have been, or will be, filed by TowneBank with the FDIC.*

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

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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%.

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 (CETI)
- 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)

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 in 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, 2020. 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, 2020, was \$34.46 million, or \$0.48 per common diluted share, compared to \$37.66 million, or \$0.52 per common diluted share, for the same period in 2019. Net income for the nine months ended September 30, 2020, was \$95.45 million, or \$1.32 per common diluted share, compared to \$103.71 million, or \$1.44 per common diluted share, for the same period in 2019.
- Net interest income increased \$5.66 million, or 6.21%, in third quarter 2020 from the comparable period in 2019. Net interest income increased \$11.13 million, or 4.15%, in the first nine months of 2020 compared to 2019. These increases were primarily attributable to a decline in interest expense due to lower rates on interest-bearing deposits.
- With the adoption of ASC 326, loss recognition on financial instruments changed from an incurred loss, to an expected loss, methodology which requires the immediate recognition of life of financial

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instrument credit losses at origination or acquisition. The provision for credit losses on loans increased \$30.09 million in third quarter 2020, when compared to the provision for loan losses of \$1.51 million for the quarter ended September 30, 2019. The provision for credit losses on loans increased \$59.79 million in the first nine months of 2020 compared to 2019. This increase is primarily attributable to a heavier weighting given to adverse economic forecasts in our credit loss models due to management's expectation of continued economic weakness driven by the impact of the COVID-19 pandemic and uncertainties with regard to the current U.S. geopolitical landscape. The allowance for credit losses on loans was 1.22% of period-end loans at September 30, 2020, as compared to 0.92% at June 30, 2020, and 0.68% at September 30, 2019. Additionally, the provision for credit losses on unfunded commitments was \$3.50 million for the quarter and \$5.68 million for the first nine months of 2020, compared to \$0 for the same respective periods ended September 30, 2019.

- Noninterest income for the three-month period ended September 30, 2020, increased by \$40.60 million, or 74.12%, compared to the same period in 2019. The increase was largely due to growth in residential mortgage banking income, property management income, a gross gain on sale of a joint venture, and net gains on investment securities sales. Noninterest income for the first nine months of 2020 increased \$57.08 million, or 36.62%, compared to the first nine months of 2019, driven by growth in residential mortgage banking income, insurance commissions, gross gain on sale of a joint venture, and net gains on investment securities sales.
- Noninterest expense increased \$4.69 million, or 4.82%, in the quarterly comparison and \$3.93 million, or 1.37%, in the first nine months of 2020 compared to 2019. This reflects increases in salaries and data processing which outpaced decreases in advertising and marketing, travel and meals expense, professional fees, and other expenses.

COVID-19 Impact

In first quarter 2020, the outbreak of the global COVID-19 pandemic and related preventative measures taken across the U.S. and worldwide resulted in an extended economic downturn, driven by the domino effect of business and production interruptions, supply-chain disruptions, volatility in the equity and debt markets, widespread sickness, nationwide health industry stress, changes in workforce dynamics, quarantines, and record unemployment claims. In late third quarter 2020, the state of global health is still unclear due to an uptick in the number of COVID-19 cases in areas not previously impacted, in addition to prior COVID-19 hotspots. Additionally, weaknesses in the small business sector have become apparent and widespread layoffs by major U.S. companies have been announced. With the duration and magnitude of the effects of COVID-19 still unknown, the questions regarding the financial impact and recovery period remain unanswered.

Events surrounding the COVID-19 pandemic have had an impact on both the timing and recognition of Company financial results. Although travel related noninterest income streams were initially impacted by forced closures, they have since rebounded and increased compared to third quarter of prior year. The continued low rate environment has positively impacted mortgage production and real estate brokerage income. On the downside, concerns over the financial health of our members in the wake of the pandemic remain paramount. Our provision for credit losses has increased significantly due to management's expectation of continued economic weakness driven by the impact of the pandemic. We have experienced margin compression due to changes in our earning assets and liabilities mix and actions taken by the FOMC to lower benchmark rates. With the significant slowdown of the local economies in the markets we serve,

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organic loan growth has slowed with the exception of the origination of PPP loans. PPP loans carry rates well below market, driving down loan yield.

On March 27, 2020, the CARES Act was enacted, which provided temporary relief from TDR accounting for eligible loan modifications in addition to temporarily adding a new product, titled the Paycheck Protection Program to the SBA's 7(a) Loan Program. As of September 30, 2020 the Company had 168 eligible loan modifications with outstanding balances of \$120.36 million. The number of modifications have decreased in the last quarter; however, the seasonal needs of our borrowers may result in future increases. The Company also had 6,705 PPP loans with an outstanding balance of \$1.10 billion as of September 30, 2020. The CARES Act provides for forgiveness of up to the full principal amount of qualifying loans guaranteed under the PPP.

Although we preemptively borrowed short term funds from the Federal Reserve early in the crisis, we repaid all funds late in third quarter 2020. In second quarter 2020, we established a PPP credit facility with the FHLB. The jump in loan levels due to our participation in the PPP led to a rise in deposit levels as borrowers wait to deploy those borrowings. In the third quarter we reduced a portion of the excess liquidity created by the Federal Reserve PPP credit facility and deposit growth with the repayment mentioned previously. Because of its short-term nature, excess liquidity has been deployed primarily in low yielding overnight investments.

The Company performed our required annual goodwill impairment tests as of August 31, 2020 and determined there was no impairment. No events or circumstances since the August 31, 2020 annual impairment test were noted that would indicate it was more likely than not a goodwill impairment exists.

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 credit 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 2019 Annual Report to Shareholders for further discussion of these policies.

Allowance for Credit Losses

Accounting policies related to the allowance for credit losses are considered to be critical as these policies involve considerable subjective judgment and estimation by management. As discussed in Note 1 - Summary of Significant Accounting Policies, our policies related to allowances for credit losses changed on January 1, 2020 in connection with the adoption of a new accounting standard update as codified in ASC 326. In the case of loans, the allowance for credit losses is a contra-asset valuation account, calculated in accordance with ASC 326, that is deducted from the amortized cost basis of loans to present the net amount expected to be collected. In the case of off-balance-sheet credit exposures, the allowance for credit losses is a liability account, calculated in accordance with ASC 326, reported as a component of other liabilities in our consolidated balance sheets. The amount of each allowance account represents

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management's best estimate of current expected credit losses on these financial instruments considering available information, from internal and external sources, relevant to assessing exposure to credit loss over the contractual term of the instrument. Relevant available information includes historical credit loss experience, current conditions and reasonable and supportable forecasts. While historical credit loss experience provides the basis for the estimation of expected credit losses, adjustments to historical loss information may be made for differences in current portfolio-specific risk characteristics, environmental conditions or other relevant factors. While management utilizes its best judgment and information available, the ultimate adequacy of our allowance accounts is dependent upon a variety of factors beyond our control, including the performance of our portfolios, the economy, changes in interest rates and the view of the regulatory authorities toward classification of assets. For additional information regarding critical accounting policies, refer to Note 1, Note 4, and Note 6 in the notes to consolidated financial statements.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized ROA was 0.89% for third quarter 2020, compared to 1.26% for third quarter 2019, and 0.97% for second quarter 2020. The annualized return on average tangible assets (non-GAAP) was 0.97%, 1.40%, and 1.07% for the same respective periods. ROA for the nine-month period ended September 30, 2020, was 0.91% compared to 1.17% for the nine-month period ended September 30, 2019.

Annualized ROE was 7.85% for third quarter 2020, 9.22% for third quarter 2019, and 8.18% for second quarter 2020, while the annualized return on average tangible equity (non-GAAP) was 11.66%, 14.20%, and 12.32% for the same respective periods. ROE for the nine-month period ended September 30, 2020, was 7.48% compared to 8.54% for the nine-month period ended September 30, 2019.

Operating income (non-GAAP), calculated as net interest income and noninterest income less gains on investment securities, was \$190.43 million for the quarter ended September 30, 2020, which was an increase of \$44.49 million, or 30.48%, compared to the quarter ended September 30, 2019. Operating income for the first nine months of 2020 was \$482.86 million, an increase of \$57.74 million, or 13.58%, compared to the first nine months of 2019.

Basic and diluted EPS were \$0.48, for the three months ended September 30, 2020, and \$0.52 for the three months ended September 30, 2019. For the nine-month period ended September 30, 2020, basic and diluted EPS were \$1.32, compared to \$1.44 for the nine-month period ended September 30, 2019.

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 ("net interest income, tax-equivalent"), of \$97.36 million for the quarter ended September 30, 2020, which was \$5.61 million, or 6.12%, higher than the third quarter 2019 total of \$91.75 million. On a linked-quarter basis, net interest income, tax-equivalent, increased by \$3.53 million, or 3.76%, from \$93.83 million. Net interest income, tax-equivalent, was

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\$281.31 million, for the first nine months of 2020, an increase of 4.09%, or \$11.05 million, over the same period in 2019.

Net interest income, tax-equivalent, increased \$5.61 million in the quarter, compared to the prior year quarter, driven by increased volume that was partially offset by lower rates. Average earning assets increased \$3.66 billion, in the three-months' comparison to prior year while yields on earning assets declined 126 bp, for a decrease in interest income of \$4.16 million. Average loan growth was \$1.66 billion in the quarter, driven by growth in average PPP loans of \$1.10 billion. Related interest and fee income on PPP loans was \$9.82 million. As a provision of the CARES Act, these loans carry below-market rates. Excluding the impact of PPP loans, the yield on our loan portfolio was 4.30% in the third quarter of 2020. Average interest bearing liabilities increased \$2.18 billion compared to third quarter 2019 but lower interest costs resulted in a \$10.59 million decline in interest expense compared to the prior year quarter. Borrowings increased an average of \$1.44 billion in the quarter, driven by average borrowings related to the Federal Reserve PPP lending facility of \$1.03 billion, that was paid off in September 2020.

Comparing third quarter 2020 to the linked quarter, net interest income, tax-equivalent, increased, driven by a combination of volume increases in earning assets and lower liability costs. Growth in our earning assets, partially offset by lower asset yield, resulted in a \$1.02 million increase in interest income. Declines in interest costs on interest-bearing deposits and borrowings, net of volume increases, resulted in a \$2.50 million decline in interest expense. Accretion of purchase accounting marks added \$1.68 million, or 5 bp, to margin in the current quarter compared to \$2.30 million, or 8 bp, in the linked-quarter and \$2.65 million, or 11 bp, in third quarter 2019.

Net interest income, tax-equivalent, increased \$11.13 million in the first nine months of 2020, compared to 2019, driven by lower interest expense. Interest income declined due to reduced rates, despite volume increases on interest earning assets. However, the decrease in interest expense related to our interest bearing liabilities was much higher, for an overall increase in tax-equivalent net interest income.

Interest income, on a tax-equivalent basis, was \$116.13 million for the quarter ended September 30, 2020, which was \$4.16 million, or 3.45%, lower than the \$120.28 million reported for the quarter ended September 30, 2019. On a linked-quarter basis, tax-equivalent interest income increased \$1.02 million, or 0.89%, from \$115.10 million in second quarter 2020. Average earning assets grew to \$14.26 billion in the quarter ended September 30, 2020, from \$10.60 billion in the comparative prior year quarter, an increase of \$3.66 billion, or 34.49%. In the linked-quarter comparison, average earning assets increased by \$1.10 billion, or 8.38%, from \$13.16 billion in second quarter 2020. The yield on earning assets was 3.24% in the quarter ended September 30, 2020, down compared to 4.50% in the prior year and 3.52% in the linked quarter. Average loan balances, excluding nonaccrual loans, of \$9.75 billion, were \$1.66 billion, or 20.45%, higher in third quarter 2020 than in the same period one year ago, while loan yields decreased by 80 bp. In the linked quarter, average loans increased by \$0.13 billion, or 1.38%, and loan yields decreased by 7 bp.

Interest income, on a tax-equivalent basis, was \$345.96 million for the nine months ended September 30, 2020, which was \$7.26 million, or 2.05%, lower than the \$353.21 million reported for the nine months ended September 30, 2019. Average earning assets grew to \$11.80 billion in the nine months ended September 30, 2020, from \$10.32 billion in the comparative prior year, an increase of \$1.48 billion, or 14.36%. The yield on earning assets was 3.92% in the nine-month period ended September 30, 2020, 66 bp below the 4.58% in prior year. Average loan balances, excluding nonaccrual loans, of \$9.31 billion, were \$1.24 billion, or 15.39%, higher in the first nine months of 2020 than in the same period one year ago, while loan yields

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decreased by 65 bp. Excluding average PPP loans of \$0.64 billion and related interest and fees of \$15.65 million in the first nine months of 2020, loan yield would have been 4.48%, or 8 bp higher.

Interest expense for the quarter ended September 30, 2020, was \$18.77 million, which was \$9.77 million, or 34.23%, lower than interest expense of \$28.53 million for third quarter 2019. Average interest-bearing liabilities increased to \$9.21 billion in third quarter 2020 from \$7.03 billion in the comparative prior year quarter, an increase of 30.99%. On a linked-quarter basis, interest expense decreased 11.77% from \$21.27 million in second quarter 2020. Average interest-bearing liabilities increased \$0.57 billion, or 6.62%, from \$8.64 billion in the linked quarter. The cost of interest-bearing liabilities was 0.81% in third quarter 2020, compared to 1.61% in third quarter 2019, and 0.99% in the linked quarter. This represents an 80 bp decrease from prior year and 18 bp decrease from the linked quarter.

Interest expense for the nine months ended September 30, 2020, was \$64.65 million, which was \$18.31 million, or 22.07%, lower than interest expense of \$82.95 million for same period in 2019. Average interest-bearing liabilities increased \$1.41 billion in the first nine months of 2020 an increase of 20.26% from the same period in 2019. The cost of interest-bearing liabilities was 1.04% in the first nine months of 2020, compared to 1.60% in the first nine months of 2019. This represents a 56 bp decrease from prior year.

Tax-equivalent net interest margin, which is net interest income, tax-equivalent, expressed as a percentage of average earning assets, was 2.72%, or 71 bp lower, for the quarter ended September 30, 2020, than the September 30, 2019, quarter margin of 3.43%, and 15 bp lower than the quarter ended June 30, 2020, margin of 2.87%. Tax-equivalent net interest margin for the nine months ended September 30, 2020, was 3.19%, or 31 bp lower, than the September 30, 2019, margin of 3.50%. Interest rates remained at historic lows during third quarter 2020 after the Federal Reserve decreased rates 150 basis points in first quarter 2020 due to the COVID-19 pandemic. The Federal Reserve's Federal Funds range is currently 0.00% to 0.25%, with the Effective Fed Funds Rate in the 0.05% to 0.10% range. The decline in benchmark rates impacted our earning assets at a quicker pace than our interest-bearing liabilities, resulting in year-over-year margin compression. Our net interest margin may be impacted by future changes in short-term and long-term interest rate levels.

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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:

	Three Months Ended September 30, 2020			Three Months Ended June 30, 2020			Three Months Ended September 30, 2019		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
<i>(dollars in thousands)</i>									
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans (1)	\$ 9,752,746	\$ 103,401	4.22 %	\$ 9,619,931	\$ 102,656	4.29 %	\$ 8,096,908	\$ 102,495	5.02 %
Taxable investment securities	1,206,679	6,726	2.23 %	1,198,776	7,367	2.46 %	1,266,447	9,087	2.87 %
Tax-exempt investment securities	144,999	779	2.15 %	147,489	836	2.27 %	121,738	997	3.28 %
Total securities	1,351,678	7,505	2.22 %	1,346,265	8,203	2.44 %	1,388,185	10,084	2.91 %
Interest-bearing deposits	2,523,644	632	0.10 %	1,729,140	433	0.10 %	711,030	3,745	2.09 %
Loans held for sale	634,309	4,587	2.89 %	464,796	3,811	3.28 %	408,377	3,956	3.87 %
Total earning assets	14,262,377	116,125	3.24 %	13,160,132	115,103	3.52 %	10,604,500	120,280	4.50 %
Less: allowance for credit losses	(95,594)			(69,451)			(54,858)		
Total nonearning assets	1,320,369			1,318,787			1,295,640		
Total assets	<u>\$15,487,152</u>			<u>\$14,409,468</u>			<u>\$11,845,282</u>		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 4,311,920	\$ 2,663	0.25 %	\$ 3,857,757	\$ 2,491	0.26 %	\$ 3,379,888	\$ 7,223	0.85 %
Savings	304,753	555	0.72 %	290,201	554	0.77 %	278,048	702	1.00 %
Certificates of deposit	2,417,772	9,747	1.60 %	2,503,648	12,027	1.93 %	2,641,681	15,627	2.35 %
Total interest-bearing deposits	7,034,445	12,965	0.73 %	6,651,606	15,072	0.91 %	6,299,617	23,552	1.48 %
Borrowings	1,931,120	2,841	0.58 %	1,741,832	3,238	0.74 %	486,644	2,020	1.62 %
Subordinated debt, net	248,807	2,962	4.76 %	248,660	2,962	4.76 %	248,210	2,962	4.77 %
Total interest-bearing liabilities	9,214,372	18,768	0.81 %	8,642,098	21,272	0.99 %	7,034,471	28,534	1.61 %
Demand deposits	4,268,443			3,826,439			2,940,370		
Other noninterest-bearing liabilities	257,304			239,154			250,371		
Total liabilities	13,740,119			12,707,691			10,225,212		
Shareholders' equity	1,747,033			1,701,777			1,620,070		
Total liabilities and equity	<u>\$15,487,152</u>			<u>\$14,409,468</u>			<u>\$11,845,282</u>		
Net interest income (tax-equivalent basis)		\$ 97,357			\$ 93,831			\$ 91,746	
Reconciliation of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(598)			(557)			(643)	
Net interest income (GAAP)		<u>\$ 96,759</u>			<u>\$ 93,274</u>			<u>\$ 91,103</u>	
Interest rate spread (2)(4)			2.43 %			2.53 %			2.89 %
Interest expense as a percent of average earning assets			0.52 %			0.65 %			1.07 %
Net interest margin (tax equivalent basis) (3)(4)			2.72 %			2.87 %			3.43 %
Total cost of deposits			0.46 %			0.58 %			1.01 %

- (1) September 30, and June 30, 2020 balances include average PPP balances of \$1.10 billion and \$0.81 billion, and related interest and fees of \$9.82 million and \$5.80 million, respectively. There were no PPP balances at September 30, 2019.
- (2) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Fully tax equivalent.
- (3) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.
- (4) Non-GAAP.

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	Increase/(Decrease) Three Months Ended September 30, 2020 Compared to Three Months Ended June 30, 2020			Increase/(Decrease) Three Months Ended September 30, 2020 Compared to Three Months Ended September 30, 2019		
(dollars in thousands)	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	\$ 1,923	\$ (1,178)	\$ 745	\$ 18,869	\$ (17,963)	\$ 906
Taxable investment securities	48	(689)	(641)	(412)	(1,949)	(2,361)
Tax-exempt investment securities	(14)	(43)	(57)	167	(385)	(218)
Total securities	34	(732)	(698)	(245)	(2,334)	(2,579)
Interest-bearing deposits	204	(5)	199	2,912	(6,025)	(3,113)
Loans held for sale	1,266	(490)	776	1,808	(1,177)	631
Total earning assets	3,427	(2,405)	1,022	23,344	(27,499)	(4,155)
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	304	(132)	172	1,586	(6,146)	(4,560)
Savings	30	(29)	1	62	(209)	(147)
Certificates of deposit	(383)	(1,897)	(2,280)	(1,242)	(4,638)	(5,880)
Total interest-bearing deposits	(49)	(2,058)	(2,107)	406	(10,993)	(10,587)
Borrowings	342	(739)	(397)	2,816	(1,995)	821
Subordinated capital debentures	—	—	—	—	—	—
Total interest-bearing liabilities	293	(2,797)	(2,504)	3,222	(12,988)	(9,766)
Net interest income	\$ 3,134	\$ 392	\$ 3,526	\$ 20,122	\$ (14,511)	\$ 5,611

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

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	Nine Months Ended September 30, 2020			Nine Months Ended September 30, 2019			Nine Months Ended September 30, 2020 Compared with 2019		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change Due to Rate	Volume
<i>(dollars in thousands)</i>									
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans (1)	\$ 9,309,256	\$306,622	4.40 %	\$ 8,067,894	\$305,007	5.05 %	\$ 1,615	\$(42,206)	\$ 43,822
Taxable investment securities	1,253,783	23,304	2.48 %	1,158,611	24,962	2.87 %	(1,658)	(3,603)	1,945
Tax-exempt investment securities	140,248	2,476	2.35 %	97,485	2,519	3.45 %	(43)	(944)	902
Total securities	1,394,031	25,780	2.47 %	1,256,096	27,481	2.92 %	(1,701)	(4,547)	2,847
Interest-bearing deposits	615,466	2,168	0.47 %	700,840	11,758	2.24 %	(9,590)	(8,309)	(1,281)
Loans held for sale	477,964	11,386	3.18 %	290,384	8,966	4.12 %	2,420	(2,394)	4,814
Total earning assets	11,796,717	345,956	3.92 %	10,315,214	353,212	4.58 %	(7,256)	(57,456)	50,202
Less: allowance for loan losses	(73,538)			(53,703)					
Total nonearning assets	2,264,295			1,264,976					
Total assets	<u>\$ 13,987,474</u>			<u>\$ 11,526,487</u>					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 3,898,642	\$ 10,472	0.36 %	\$ 3,289,539	\$ 20,488	0.83 %	\$ (10,016)	\$(13,287)	\$ 3,271
Savings	290,684	1,702	0.78 %	281,562	2,658	1.26 %	(956)	(1,040)	84
Certificates of deposit	2,451,715	34,925	1.90 %	2,456,360	41,364	2.25 %	(6,439)	(6,362)	(78)
Total interest-bearing deposits	6,641,041	47,099	0.95 %	6,027,461	64,510	1.43 %	(17,411)	(20,689)	3,277
Borrowings	1,452,652	8,661	0.78 %	661,216	9,559	1.91 %	(898)	(7,871)	6,973
Subordinated debt, net	248,660	8,885	4.76 %	248,064	8,885	4.78 %	—	(22)	21
Total interest-bearing liabilities	8,342,353	64,645	1.04 %	6,936,741	82,954	1.60 %	(18,309)	(28,582)	10,271
Demand deposits	3,687,791			2,787,727					
Other noninterest-bearing liabilities	252,337			221,806					
Total liabilities	12,282,481			9,946,274					
Shareholders' equity	1,704,993			1,580,213					
Total liabilities and equity	<u>\$ 13,987,474</u>			<u>\$ 11,526,487</u>					
Net interest income (tax-equivalent basis)		\$281,311			\$270,258		\$ 11,053	\$(28,874)	\$ 39,931
Reconciliation of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(1,781)			(1,862)		81		
Net interest income (GAAP)		<u>\$279,530</u>			<u>\$268,396</u>		<u>\$ 11,134</u>		
Interest rate spread (2)(4)			2.88 %			2.98 %			
Interest expense as a percent of average earning assets			0.73 %			1.08 %			
Net interest margin (tax equivalent basis) (3)(4)			3.19 %			3.50 %			
Total cost of deposits			0.61 %			0.98 %			

(1) 2020 balance includes average PPP balances of \$0.64 billion and related interest and fees of \$15.65 million.

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

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

(4) Non-GAAP.

Noninterest Income. Total noninterest income for the quarter ended September 30, 2020, was \$95.38 million, an increase of \$40.60 million, or 74.12%, compared to the same period in 2019. As a percentage of total operating income (non-GAAP), noninterest income for third quarter 2020 was 50.08%,

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compared with 37.53% for comparative 2019. There were \$1.70 million in net gains on investment securities in third quarter 2020 included in noninterest income and net losses on investment securities of \$0.07 million in third quarter 2019. Total noninterest income in the nine months ended September 30, 2020, was \$212.96 million, an increase of \$57.08 million, or 36.62%, compared to the first nine months of 2019. There were \$9.63 million in net gains on investment securities in the first nine months of 2020 compared to net losses of \$0.85 million in the prior year. Included in other income in the third quarter and nine months ended September 30, 2020, was a gross gain on the sale of Red Sky Travel Insurance ("Red Sky") of \$17.63 million.

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:

	Increase/(Decrease)							
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,		September 30,		2020 over 2019		2020 over 2019	
(dollars in thousands)	2020	2019	2020	2019	Amount	Percent	Amount	Percent
Residential mortgage banking, net	\$37,531	\$18,855	\$74,662	\$50,929	\$18,676	99.05 %	\$23,733	46.60 %
Insurance commissions and other title fees and income, net	17,468	16,681	51,973	49,477	787	4.72 %	2,496	5.04 %
Real estate brokerage and property management, net	11,301	9,444	29,020	27,555	1,857	19.66 %	1,465	5.32 %
Service charges on deposit accounts	1,986	2,253	6,314	8,299	(267)	(11.85)%	(1,985)	(23.92)%
Credit card merchant fees, net	1,506	1,514	3,793	3,357	(8)	(0.53)%	436	12.99 %
Bank-owned life insurance	1,605	2,117	6,295	5,350	(512)	(24.19)%	945	17.66 %
Other income	22,278	3,981	31,268	11,754	18,297	459.61 %	19,514	166.02 %
Subtotal before gain (loss) on investment securities	93,675	54,845	203,325	156,721	38,830	70.80 %	46,604	29.74 %
Net gain (loss) on investment securities	1,701	(69)	9,632	(845)	1,770	N/M	10,477	N/M
Total noninterest income	<u>\$95,376</u>	<u>\$54,776</u>	<u>\$212,957</u>	<u>\$155,876</u>	<u>\$40,600</u>	<u>74.12 %</u>	<u>\$57,081</u>	<u>36.62 %</u>

For third quarter 2020, residential mortgage banking income, net of commission expense, was \$37.53 million, an increase of \$18.68 million, or 99.05%, compared to third quarter 2019, and an increase of \$23.73 million, or 46.60%, in the first nine months of 2020 compared to 2019. The third quarter and first nine months of 2020 increase in mortgage banking income, compared to prior year was primarily driven by an increase in production volume. Production volumes in third quarter 2020, were \$1.79 billion, an increase of \$0.83 billion, or 85.84% over third quarter 2019. Production volumes in the first nine months of 2020, were \$4.19 billion, an increase of \$1.89 billion, or 82.25% over the same period in 2019. Purchase volume as a percentage of total production was 61.21% and 57.33% in the third quarter and first nine months of 2020, respectively, compared to 68.83% and 78.45% in 2019, for the same respective periods. Refinance activities have increased significantly in 2020, driven by historic low rates. We expect production volumes to remain elevated through fourth quarter 2020. In third quarter 2020, net gains from rate lock commitments were \$3.28 million and net income from forward sales contracts were \$0.01 million. In the first nine months of 2020, net gains of \$8.96 million on income from rate lock commitments, were offset by net losses in forward sales contracts of \$10.08 million.

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For third quarter 2020, insurance commissions and other title income, net of commission expense, was \$17.47 million, which was \$0.79 million, or 4.72%, higher than comparative 2019. Year-to-date insurance commissions and other title income, net of commission expense was \$51.97 million compared to \$49.48 million in 2019, an increase of \$2.50 million, or 5.04%, over the prior year. These increases were driven by organic growth and additional commission income from an insurance agency acquisition that occurred in September 2019.

Real estate brokerage and property management income, net of commission expense, for third quarter 2020 was \$11.30 million, which was \$1.86 million, or 19.66%, higher than comparative 2019. In the first nine months of 2020, real estate brokerage and property management income, net of commission expense, was \$29.02 million, a \$1.47 million, or 5.32%, increase from prior year. The majority of the income from this line of business is related to vacation property commissions and associated fees. Although reservations were down significantly in first quarter 2020, due to COVID-19 travel restrictions, the lifting of local travel restrictions in the areas of our vacation rental companies, along with businesses and schools continuing to operate remotely, have resulted in an extended vacation season and increased reservation activity during the quarter and year-to-date.

Service charges on deposit accounts were \$1.99 million for third quarter 2020, compared with \$2.25 million for the comparative 2019 period due to lower transaction volumes and fees waived for members experiencing financial hardships. For the third quarter and first nine months of 2020, credit card merchant fees totaled \$1.51 million and \$3.79 million, respectively, and were higher than comparative periods in 2019. In second quarter 2019, we converted to a new processing platform that had a temporary impact of reducing 2019 income from credit card merchant fees.

Income from BOLI was \$1.61 million in third quarter 2020, compared to \$2.12 million in third quarter 2019. Income from BOLI in the first nine months of 2020 was \$6.30 million, compared to \$5.35 million in 2019. Income from life insurance claims in first quarter 2020 was the primary source of the higher levels year-to-date.

Other noninterest income for the three months ended September 30, 2020, was \$22.28 million, an increase of \$18.30 million, or 459.61%, compared to third quarter 2019, driven by the gross gain on sale of Red Sky. Other noninterest income was \$31.27 million in the first nine months of 2020, an increase of \$19.51 million, or 166.02%, compared to 2019. In third quarter 2020, the Company sold Red Sky, a travel insurance joint venture, and recorded a gross gain on sale of \$17.63 million, in other income. After distributions to noncontrolling interests, the Company retained \$6.52 million of the pre-tax gain on sale of Red Sky. Net gains on OREO sales in the third quarter and first nine months of 2020 were \$0.42 million and \$0.89 million, respectively, compared to \$0.09 million and \$0.35 million for the same periods in 2019.

We sold 22 investment securities with a carrying value of \$81.80 million in the third quarter and 47 investment securities with a carrying value of \$333.51 million in the first nine months of 2020. We sold five investment securities with a carrying value of \$87.00 million in third quarter 2019 and nine investment securities with a carrying value of \$187.08 million in the first nine months of 2019. We recorded net gains on the sale of AFS securities of \$1.70 million in third quarter 2020 compared to net losses of \$0.07 million in 2019. Year-to-date 2020, we recorded net gains of \$9.63 million compared to net losses of \$0.85 million in 2019. We sold investment securities in third quarter 2020 to reposition our portfolio for future periods.

Noninterest Expense. For the quarter ended September 30, 2020, total noninterest expense was \$101.98 million, which was \$4.69 million, or 4.82%, higher than comparative 2019. Noninterest expense

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was \$289.89 million for the first nine months of 2020, compared to \$285.97 million for the same period in 2019.

As a percentage of operating income (non-GAAP), noninterest expense was 53.55% for third quarter 2020 and 66.66% for comparative 2019. Primary components of noninterest expense in third quarter 2020 were salaries and employee benefits of \$61.41 million, occupancy expenses of \$8.40 million, software expenses of \$3.57 million, furniture and equipment expenses of \$3.25 million, data processing expenses of \$3.11 million, amortization expense of \$2.85 million, professional fees of \$2.64 million, and advertising and marketing expenses of \$1.87 million.

The following table provides an analysis of quarterly total noninterest expense by line item for the periods presented:

	Three Months Ended		Nine Months Ended		Increase/(Decrease)			
					Three Months Ended		Nine Months Ended	
	September 30,		September 30,		2020 over 2019		2020 over 2019	
(dollars in thousands)	2020	2019	2020	2019	Amount	Percent	Amount	Percent
Salaries and employee benefits	\$61,408	\$55,784	\$174,201	\$162,907	\$ 5,624	10.08 %	\$ 11,294	6.93 %
Occupancy expense	8,396	7,953	23,124	23,866	443	5.57 %	(742)	(3.11)%
Furniture and equipment	3,247	3,805	10,451	10,753	(558)	(14.66)%	(302)	(2.81)%
Amortization - intangibles	2,851	3,059	8,702	9,364	(208)	(6.80)%	(662)	(7.07)%
Software expense	3,572	3,208	10,556	8,742	364	11.35 %	1,814	20.75 %
Data processing	3,113	2,533	8,622	9,316	580	22.90 %	(694)	(7.45)%
Professional fees	2,637	3,566	8,677	9,952	(929)	(26.05)%	(1,275)	(12.81)%
Advertising and marketing	1,870	3,429	7,440	9,440	(1,559)	(45.47)%	(2,000)	(21.19)%
Other noninterest expenses:								
Acquisition-related expenses	—	207	(134)	638	(207)	(100.00)%	(772)	(121.00)%
Bank franchise tax/SCC fees	2,066	1,982	6,540	5,302	84	4.24 %	1,238	23.35 %
Charitable contributions	2,214	2,175	6,185	7,337	39	1.79 %	(1,152)	(15.70)%
Directors fees and expenses	498	542	1,373	1,560	(44)	(8.12)%	(187)	(11.99)%
FDIC and other insurance	1,522	699	4,576	3,422	823	117.74 %	1,154	33.72 %
Foreclosed property expenses	1,379	52	1,576	654	1,327	2,551.92 %	922	140.98 %
Other	4,719	5,031	9,342	12,673	(312)	(6.20)%	(3,331)	(26.28)%
Stationery and supplies	603	807	1,919	2,233	(204)	(25.28)%	(314)	(14.06)%
Telephone and postage	1,677	1,636	5,209	4,935	41	2.51 %	274	5.55 %
Travel/meals/entertainment	209	819	1,535	2,873	(610)	(74.48)%	(1,338)	(46.57)%
Total other noninterest expenses	14,887	13,950	38,121	41,627	937	6.72 %	(3,506)	(8.42)%
Total noninterest expense	<u>\$101,981</u>	<u>\$97,287</u>	<u>\$289,894</u>	<u>\$285,967</u>	<u>\$ 4,694</u>	<u>4.82 %</u>	<u>\$ 3,927</u>	<u>1.37 %</u>

Salary and benefits expense was \$61.41 million and \$174.20 million, respectively, for the third quarter and nine months ended September 30, 2020, representing 60.22% and 60.09% of total noninterest expense. Salary and benefits expense increased \$5.62 million, or 10.08%, over the comparative quarter and \$11.29 million, or 6.93%, over the first nine months in 2019. During the first nine months of 2020, the Company has been focused on its Towne 20.20 initiative which centered around our early October 2020 core conversion. This core conversion will allow the Company to provide a greater variety of financial services

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to our members through new technologies and enhanced digital solutions. Preparation for this conversion began in 2019 and necessitated long hours and dedication from team members, which the Company chose to recognize in third quarter 2020 through one-time bonuses and vacation carry-overs of approximately \$2.84 million. The high volume of mortgage activities and PPP loan processing has also resulted in a notable amount of overtime in the quarter and year-to-date. In the first nine months of 2020, in addition to core conversion and production driven overtime, the Company also paid second quarter bonuses related to PPP loan processing and frontline bonuses. Salary increases that occurred in the latter portion of 2019 are in full effect in 2020. These increases included an across the board cost of living increase, expansion to enhance our infrastructure and meet increased regulatory requirements, as well as keep pace with our growth and changing industry standards and entry into a new market. Specific areas of enhancement in personnel levels were information technology, risk and compliance, accounting, and internal audit. We also established a new banking group, located in Greensboro, North Carolina, and opened a full-service banking office in Greensboro in November 2019.

In our Banking segment, we had a total of 1,131 full-time equivalent employees at September 30, 2020, as compared to 1,117 at September 30, 2019. In our non-Banking segments at September 30, 2020, we had a total of 1,319 FTEs, excluding real estate sales agents, compared to 1,327 at September 30, 2019. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total operating income per FTE (non-GAAP), excluding the gross gain on the sale of Red Sky, per FTE was \$70,000 for the quarter ended September 30, 2020, increasing from \$59,000 for the quarter ended September 30, 2019.

Occupancy expense for third quarter 2020 increased \$0.44 million, or 5.57%, from the comparative quarter in 2019, but decreased \$0.74 million, or 3.11%, in the first nine months of 2020 compared to 2019. The third quarter increase was related to a one-time rent adjustment for a new location. Decreases in the year-over-year comparison were primarily related to our adoption of ASU 842 in the first quarter of 2019 and related one-time increases in that year. Upon adoption, we performed a comprehensive review of our leases, which led to a correction of several lease schedules, resulting in a one-time increase to rent expense of \$1.08 million year-to-date in 2019.

Data processing and software expenses increased \$0.58 million and \$0.36 million in third quarter 2020 compared to 2019. Software expense increased \$1.81 million, while data processing declined \$0.69 million, in the first nine months of 2020 compared to 2019. For the three- and nine-month periods ended September 30, 2020, professional fees decreased by \$0.93 million and \$1.28 million, respectively, compared to the same periods in 2019. In addition to costs associated with the core conversion, these fluctuations were driven by the timing of, preparation for, and adoption of, ASC 326 on January 1, 2020. In 2019, the Company engaged a nationally recognized accounting firm and began the preparation necessary to acquire a more robust system for analyzing finance receivables carried at amortized cost, leading to higher professional fees and data processing expense. The Company placed a third-party software solution for this purpose in service in 2020 which resulted in higher software expense.

Advertising and marketing expense decreased \$1.56 million in the third quarter and \$2.00 million in the first nine months of 2020 compared to the same periods in 2019, driven primarily by COVID-19 quarantines and the temporary cessation in public venues of sporting and entertainment activities.

For third quarter 2020, other noninterest expenses were \$14.89 million, an increase of 6.72%, or \$0.94 million, compared to the same period in 2019. Other noninterest expenses declined \$3.51 million, or 8.42%, in the first nine months of 2020, compared to 2019. Write-downs related to a Company-owned

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building and lots in North Carolina are included in foreclosed property expenses for the quarter. Expense levels declined in many categories in the quarter primarily driven by the impact of COVID-19.

Provision for Income Taxes. We reported a provision for income tax expense of \$7.84 million, representing an effective tax rate of 18.53%, in third quarter 2020. The provision for income tax expense was \$7.68 million for third quarter 2019, with an effective rate of 16.95%. A revision in deferred taxes in third quarter 2019 resulted in a lower effective rate in that quarter. We reported a provision for income tax expense of \$21.49 million in the first nine months of 2020 and \$24.81 million for the first nine months of 2019. The decrease in the effective tax rate is largely due to an increase in benefit from low income housing tax credit partnerships, an increase in tax advantaged income, along with a decrease in non-deductible expenses.

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

Banking Segment. For the three months ended September 30, 2020, the Banking segment represented 30.01%, or \$10.34 million, of our total consolidated net income, compared to 84.56%, or \$31.84 million, for the three months ended September 30, 2019. For the nine months ended September 30, 2020, the Banking segment represented 59.76%, or \$57.04 million, of our consolidated income compared to 86.32%, or \$89.52 million, for comparative 2019. This decline in contribution level was driven by a significant increase in our provision for credit losses coupled with high mortgage volume, in the Realty segment, and the sale of Red Sky, in the Insurance segment.

Income before income tax provision and noncontrolling interest for the Banking segment was \$10.82 million for the quarter ended September 30, 2020, decreasing \$26.52 million from comparative 2019. This decrease in earnings was driven by a \$29.56 million, or 1,960.34%, increase in our provision for credit losses in the quarter. This increase was primarily attributable to a heavier weighting given to adverse economic forecasts in our credit loss model due to expectations of continued economic weaknesses driven by a number of uncertainties in the local and national economy. Total revenue increased \$4.60 million, due to an increase in net interest income of \$3.38 million related to lower deposit costs, partially offset by lower yields on earning assets, combined with net gains on the sale of investment securities of \$1.70 million. Noninterest expenses increased \$1.77 million compared to third quarter 2019, driven by increases in salaries and employee benefits and occupancy, as discussed previously.

For the nine months ended September 30, 2020, income before income tax provision and noncontrolling interest was \$66.35 million, a decrease of \$42.51 million, or 39.05%, compared to the same period in 2019. The decrease in earnings was driven by an increase in our provision for credit losses in the period of \$58.40 million. Net interest income increased \$5.61 million due to lower interest cost. Total noninterest expenses were \$0.63 million higher than prior year as a general decrease across most expense categories offset an \$8.00 million increase in salaries and benefits costs.

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The following charts present revenue and expenses for the Banking segment for the periods presented, as well as changes between periods:

	Three Months Ended		Increase/(Decrease)	
	September 30,		September 30, 2020	September 30, 2019
	2020	2019	Amount	Percent
<i>(dollars in thousands)</i>				
Net interest income	\$ 92,869	\$ 89,490	\$ 3,379	3.78 %
Service charges on deposit accounts	1,986	2,253	(267)	(11.85)%
Credit card merchant fees	1,506	1,514	(8)	(0.53)%
Other income	4,876	5,152	(276)	(5.36)%
Net gain (loss) on investment securities	1,701	(69)	1,770	N/M
Total noninterest income	10,069	8,850	1,219	13.77 %
Total revenue	102,938	98,340	4,598	4.68 %
Provision for credit losses	31,070	1,508	29,562	1,960.34 %
Salaries and employee benefits	36,535	33,526	3,009	8.98 %
Occupancy expense	5,829	5,209	620	11.90 %
Furniture and equipment	2,424	2,779	(355)	(12.77)%
Amortization of intangible assets	1,063	1,265	(202)	(15.97)%
Other expenses	15,793	17,098	(1,305)	(7.63)%
Total noninterest expenses	61,644	59,877	1,767	2.95 %
Income before income tax and corporate allocation	10,224	36,955	(26,731)	(72.33)%
Corporate allocation	595	384	211	54.95 %
Income before income tax provision and noncontrolling interest	10,819	37,339	(26,520)	(71.02)%
Provision for income tax expense	474	5,495	(5,021)	(91.37)%
Net income	10,345	31,844	(21,499)	(67.51)%
Noncontrolling interest	(2)	—	(2)	N/M
Net income attributable to TowneBank	\$ 10,343	\$ 31,844	\$ (21,501)	(67.52)%
Efficiency ratio	60.89 %	60.85 %		

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	Nine Months Ended		Increase/(Decrease)	
	September 30,		2020 over 2019	
	2020	2019	Amount	Percent
Net interest income	\$ 269,941	\$ 264,332	\$ 5,609	2.12 %
Service charges on deposit accounts	6,315	8,299	(1,984)	(23.91)%
Credit card merchant fees	3,793	3,357	436	12.99 %
Other income	15,826	14,350	1,476	10.29 %
Net (loss) gain on investment securities	9,632	(845)	10,477	N/M
Total noninterest income	35,566	25,161	10,405	41.35 %
Total revenue	305,507	289,493	16,014	5.53 %
Provision for credit losses	64,170	5,770	58,400	1,012.13 %
Salaries and employee benefits	104,970	96,966	8,004	8.25 %
Occupancy expense	15,557	15,460	97	0.63 %
Furniture and equipment	7,800	7,662	138	1.80 %
Amortization of intangibles	3,341	3,946	(605)	(15.33)%
Other expenses	45,214	52,218	(7,004)	(13.41)%
Total noninterest expenses	176,882	176,252	630	0.36 %
Income before income tax and corporate allocation	64,455	107,471	(43,016)	(40.03)%
Corporate allocation	1,891	1,383	508	36.73 %
Income before income tax provision and noncontrolling interest	66,346	108,854	(42,508)	(39.05)%
Provision for income tax expense	9,304	19,337	(10,033)	(51.88)%
Net income	57,042	89,517	(32,475)	(36.28)%
Noncontrolling interest	2	4	(2)	(50.00)%
Net income attributable to TowneBank	\$ 57,044	\$ 89,521	\$ (32,477)	(36.28)%
Efficiency ratio	59.78 %	60.71 %		

Realty Segment. For the three months ended September 30, 2020, the Realty segment had income before income tax provision and noncontrolling interest of \$25.54 million, as compared to \$6.67 million, in third quarter 2019. For the nine months ended September 30, 2020, the Realty segment had income before income tax provision and noncontrolling interest of \$39.95 million, as compared to \$14.07 million, in 2019. This represented an increase in income of \$18.88 million in the third quarter, and \$25.88 million in the first nine months, of 2020 compared to 2019. Total revenue was \$54.58 million in third quarter 2020, increasing from \$31.30 million in third quarter 2019. Total revenue increased \$32.16 million, or 37.24%, in the first nine months of 2020 compared to 2019. Total expenses increased \$3.73 million in third quarter 2020 compared to 2019, and \$4.57 million in the first nine months of 2020, compared to 2019.

The increase in total revenue in the third quarter and first nine months of 2020 compared to 2019 was driven by higher levels of residential mortgage brokerage income. Real estate brokerage income, net and property management fees, net also increased in both the quarter and first nine months, compared to 2019.

Real estate brokerage income, net increased \$0.81 million in the quarter and \$0.90 million in the first nine months of 2020, compared to 2019. Sales volume increased 18.25% in the quarter and 7.40% in the first nine months of 2020, when compared to prior year. Home sales increased in the quarter due to lower rates, but were also hampered by low inventory levels. Low inventory levels continue to be a challenge in our footprint. The low mortgage rate environment has spurred many individuals to want to buy, but uncertainties in the economic environment has made existing home owners reluctant to sell. This trend is expected to continue for the remainder of the year.

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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 2020, compared to 2019. Typically, first quarter is the highest for reservations because travelers reserve for their summer vacations. However, in first quarter 2020, COVID-19 quarantines resulted in commissions significantly below normal due to the uncertainty of future travel. In second quarter 2020, as local travel restrictions lifted in the areas of our vacation rental companies, commission levels rebounded. In third quarter 2020, with the flexibility of many businesses and schools operating remotely, the typical vacation season was extended. Property management fees increased \$1.05 million in the third quarter and \$0.57 million in the first nine months of 2020, compared to 2019.

With the January 1, 2020 adoption of ASC 326, the Realty segment recorded an allowance of \$2.37 million with an offset to retained earnings, for their on-balance-sheet loans. The Realty segment recorded an additional provision for credit losses of \$0.53 million and \$1.39 million for the three and nine months ended September 30, 2020.

Salaries and employee benefits increased \$2.27 million when compared to third quarter and \$2.42 million in the first nine months of 2020, compared to 2019. Overtime and retention bonuses related to mortgage production were the primary drivers of the increases. Occupancy expense declined \$0.15 million, compared to third quarter 2019, and \$0.83 million, compared to the first nine months of 2019, due to one-time increases related to the adoption of the leasing standard in 2019, as previously discussed.

Mortgage. Loan volume for the combined mortgage operations increased in the quarter and nine months ended September 30, 2020, as compared to the same periods in 2019. Total loans originated in third quarter 2020 were \$1.79 billion, an 85.84%, or \$827.24 million, increase from \$963.66 million in the comparative period of 2019. Year-to-date, loan volume for the combined mortgage operation was \$4.19 billion, a 82.25%, or \$1.89 billion, increase from \$2.30 billion in the prior year. Refinance activity increased to 38.79% of loan volume, due to lower market rates, for the quarter ended September 30, 2020, compared to 31.17% for the quarter ended September 30, 2019. In third quarter 2020, net gains from rate lock commitments were \$3.28 million and net income from forward sales contracts were \$0.01 million. In the first nine months of 2020, net gains of \$8.96 million on income from rate lock commitments, were offset by net losses in forward sales contracts of \$10.08 million.

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The following charts present revenue and expenses for the Realty segment for the periods presented:

	Three Months Ended		Increase/(Decrease)	
	September 30,		September 30, 2020	
	2020	2019	Amount	Percent
<i>(dollars in thousands)</i>				
Residential mortgage banking income, net	\$ 38,074	\$ 19,171	\$ 18,903	98.60 %
Real estate brokerage income, net	3,688	2,882	806	27.97 %
Title insurance and settlement fees	654	617	37	6.00 %
Property management fees, net	7,613	6,562	1,051	16.02 %
Income from unconsolidated subsidiary	451	185	266	143.78 %
Net interest and other income	4,101	1,885	2,216	117.56 %
Total revenue	54,581	31,302	23,279	74.37 %
Provision for credit losses	528	—	528	N/M
Salaries and employee benefits	15,744	13,474	2,270	16.85 %
Occupancy expense	1,906	2,055	(149)	(7.25)%
Furniture and equipment	620	754	(134)	(17.77)%
Amortization of intangible assets	658	666	(8)	(1.20)%
Other expenses	9,226	7,478	1,748	23.38 %
Total expenses	28,154	24,427	3,727	15.26 %
Income (loss) before income tax, corporate allocation, and noncontrolling interest	25,899	6,875	19,024	276.71 %
Corporate allocation	(356)	(208)	(148)	(71.15)%
Income (loss) before income tax provision and noncontrolling interest	25,543	6,667	18,876	283.13 %
Provision for income tax	4,780	1,454	3,326	228.75 %
Net income (loss)	20,763	5,213	15,550	298.29 %
Noncontrolling interest	(4,790)	(1,496)	(3,294)	(220.19)%
Net income (loss) attributable to TowneBank	\$ 15,973	\$ 3,717	\$ 12,256	329.73 %
Key data:				
Efficiency ratio	51.58 %	78.04 %		
Number of units sold	1,518	1,368	150	10.96 %
Volume of units sold	\$ 573,923	\$ 485,328	\$ 88,595	18.25 %
Number of real estate agents	407	404	3	0.74 %
Loans originated, mortgage	\$ 1,292,801	\$ 703,922	\$ 588,879	83.66 %
Loans originated, joint venture	498,100	259,742	238,358	91.77 %
Total loans originated	\$ 1,790,901	\$ 963,664	\$ 827,237	85.84 %
Number of loans, mortgage	3,964	2,300	1,664	72.35 %
Number of loans, joint venture	1,853	1,060	793	74.81 %
Total number of loans	5,817	3,360	2,457	73.13 %
Average loan amount, mortgage	\$ 326	\$ 306	\$ 20	6.54 %
Average loan amount, joint venture	269	245	24	9.80 %
Average loan amount	\$ 308	\$ 287	\$ 21	7.32 %
Number of originators, mortgage	161	154	7	4.55 %
Number of originators, joint venture	63	71	(8)	(11.27)%
Total number of originators	224	225	(1)	(0.44)%

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	Nine Months Ended September 30,		Increase/(Decrease) 2020 over 2019	
	2020	2019	Amount	Percent
<i>(dollars in thousands)</i>				
Residential mortgage banking income, net	\$ 76,549	\$ 51,826	\$ 24,723	47.70 %
Real estate brokerage income, net	8,212	7,315	897	12.26 %
Title insurance and settlement fees	1,728	1,581	147	9.30 %
Property management fees, net	20,808	20,240	568	2.81 %
Income from unconsolidated subsidiary	938	441	497	112.70 %
Net interest and other income	10,262	4,937	5,325	107.86 %
Total revenue	118,497	86,340	32,157	37.24 %
Provision for credit losses	1,389	—	1,389	N/M
Salaries and employee benefits	42,095	39,678	2,417	6.09 %
Occupancy expense	5,595	6,428	(833)	(12.96)%
Furniture and equipment	2,007	2,326	(319)	(13.71)%
Amortization of intangible assets	1,973	2,086	(113)	(5.42)%
Other expenses	24,366	20,953	3,413	16.29 %
Total expenses	76,036	71,471	4,565	6.39 %
Income before income tax, corporate allocation, and noncontrolling interest	41,072	14,869	26,203	176.23 %
Corporate allocation	(1,119)	(800)	(319)	(39.88)%
Income before income tax provision and noncontrolling interest	39,953	14,069	25,884	183.98 %
Provision for income tax	7,614	3,292	4,322	131.29 %
Net income	32,339	10,777	21,562	200.07 %
Noncontrolling interest	(7,996)	(2,997)	(4,999)	(166.80)%
Net income attributable to TowneBank	\$ 24,343	\$ 7,780	\$ 16,563	212.89 %
Key data:				
Efficiency ratio	64.17 %	82.78 %		
Number of units sold	3,630	3,552	78	2.20 %
Volume of units sold	\$ 1,255,629	\$ 1,169,062	\$ 86,567	7.40 %
Number of real estate agents	407	404	3	0.74 %
Loans originated, mortgage	\$ 3,128,264	\$ 1,645,204	\$ 1,483,060	90.14 %
Loans originated, joint venture	1,060,437	653,118	407,319	62.37 %
Total loans originated	\$ 4,188,701	\$ 2,298,322	\$ 1,890,379	82.25 %
Number of loans, mortgage	9,584	5,696	3,888	68.26 %
Number of loans, joint venture	4,076	2,762	1,314	47.57 %
Total number of loans	13,660	8,458	5,202	61.50 %
Average loan amount, mortgage	\$ 326	\$ 289	\$ 37	12.80 %
Average loan amount, joint venture	260	236	24	10.17 %
Average loan amount	\$ 307	\$ 272	\$ 35	12.87 %
Number of originators, mortgage	161	154	7	4.55 %
Number of originators, joint venture	63	71	(8)	(11.27)%
Number of originators	224	225	(1)	(0.44)%

Insurance Segment. The Insurance segment includes property and casualty and group benefit divisions, as well as travel insurance. The Insurance segment represented 23.64%, or \$8.15 million, of total consolidated net income for the three months ended September 30, 2020, and 5.57%, or \$2.10 million, for the three months ended September 30, 2019. For the nine months ended September 30, 2020, the Insurance segment

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represented 14.74%, or \$14.07 million, of our consolidated income compared to 6.18%, or \$6.41 million, for comparative 2019.

Earnings before income taxes and noncontrolling interest for the three months ended September 30, 2020, were \$22.19 million, increasing \$19.12 million, or 621.05%, from comparative 2019. Net revenues for the first nine months of 2020 increased \$20.04 million, or 41.38%, when compared to the nine months ended September 30, 2019. These increases are primarily attributable to the gross gain of \$17.63 million on the sale of Red Sky, the company's travel insurance joint venture recorded in the third quarter. Commissions on property and casualty insurance and employee benefits increased due to organic growth. Excluding the gain, travel insurance revenue increased in both the quarter, and year to date 2020, compared to prior year.

Total operating expenses for the third quarter of 2020 decreased \$0.80 million, or 6.16%, when compared to the same period in 2019. Total operating expenses decreased \$1.27 million, or 3.32%, for the nine months ended September 30, 2020 compared to September 30, 2019. With the exception of salaries and employee benefits, general expense levels decreased in the third quarter and first nine months of 2020.

After distributions to noncontrolling interests, the Company retained \$6.52 million of the pre-tax gain on sale of Red Sky. In 2019, Red Sky contributed \$4.09 million to insurance revenue, with an annual net income after noncontrolling interests of \$0.94 million.

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The following chart presents revenue and expenses as well as changes for the Insurance segment for the periods presented:

	Three Months Ended		Increase/(Decrease)	
	September 30,		September 30, 2020	
	2020	2019	Amount	Percent
<i>(dollars in thousands)</i>				
Net commission and fee income				
Property and casualty	\$ 14,072	\$ 13,481	\$ 591	4.38 %
Employee benefits	3,825	3,629	196	5.40 %
Travel insurance	1,399	834	565	67.75 %
Specialized benefit services	165	166	(1)	(0.60)%
Total net commissions and fees	19,461	18,110	1,351	7.46 %
Contingency and bonus revenue	1,112	1,431	(319)	(22.29)%
Other income	17,697	74	17,623	N/M
Total revenues	38,270	19,615	18,655	95.11 %
Employee commission expense	3,654	3,378	276	8.17 %
Revenue, net of commission expense	34,616	16,237	18,379	113.19 %
Salaries and employee benefits	9,129	8,784	345	3.93 %
Occupancy expense	661	689	(28)	(4.06)%
Furniture and equipment	203	272	(69)	(25.37)%
Amortization of intangible assets	1,130	1,128	2	0.18 %
Other expenses	1,060	2,110	(1,050)	(49.76)%
Total operating expenses	12,183	12,983	(800)	(6.16)%
Income before income tax, corporate allocation, and noncontrolling interest	22,433	3,254	19,179	589.40 %
Corporate allocation	(239)	(176)	(63)	35.80 %
Income before income tax provision and noncontrolling interest	22,194	3,078	19,116	621.05 %
Provision for income tax	2,587	735	1,852	251.97 %
Net income	19,607	2,343	17,264	736.83 %
Noncontrolling interest	(11,459)	(245)	(11,214)	4,577.14 %
Net income attributable to TowneBank	\$ 8,148	\$ 2,098	\$ 6,050	288.37 %
Efficiency ratio	35.19 %	79.96 %		
Included in other income is the gross gain on the sale of a joint venture	\$ 17,626			
Efficiency ratio excluding gain	71.71 %			

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	Nine Months Ended		Increase/(Decrease)	
	September 30,		2020 over 2019	
	2020	2019	Amount	Percent
<i>(dollars in thousands)</i>				
Net commission and fee income				
Property and casualty	\$ 40,784	\$ 38,421	\$ 2,363	6.15 %
Employee benefits	11,534	10,968	566	5.16 %
Travel insurance	3,526	3,292	234	7.11 %
Specialized benefit services	489	499	(10)	(2.00)%
Total net commissions and fees	56,333	53,180	3,153	5.93 %
Contingency and bonus revenue	5,144	4,910	234	4.77 %
Other income	17,906	227	17,679	7,788.11 %
Total revenues	79,383	58,317	21,066	36.12 %
Employee commission expense	10,900	9,878	1,022	10.35 %
Revenue, net of commission expense	68,483	48,439	20,044	41.38 %
Salaries and employee benefits	27,136	26,263	873	3.32 %
Occupancy expense	1,972	1,978	(6)	(0.30)%
Furniture and equipment	644	765	(121)	(15.82)%
Amortization of intangible assets	3,388	3,332	56	1.68 %
Other expenses	3,836	5,906	(2,070)	(35.05)%
Total operating expenses	36,976	38,244	(1,268)	(3.32)%
Income before income tax, corporate allocation, and noncontrolling interest	31,507	10,195	21,312	209.04 %
Corporate allocation	(772)	(583)	(189)	32.42 %
Income before income tax provision and noncontrolling interest	30,735	9,612	21,123	219.76 %
Provision for income tax	4,574	2,181	2,393	109.72 %
Net income	26,161	7,431	18,730	252.05 %
Noncontrolling interest	(12,095)	(1,025)	(11,070)	1,080.00 %
Net income attributable to TowneBank	\$ 14,066	\$ 6,406	\$ 7,660	119.58 %
Efficiency ratio	53.99 %	78.95 %		
Included in other income is the gross gain on the sale of a joint venture	\$ 17,626			
Efficiency ratio excluding gain	72.71 %			

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2020, total assets were \$14.80 billion, which is \$2.85 billion, or 23.84%, higher than total assets at December 31, 2019. Our loan portfolio, less unearned income and deferred costs, made up 66.04% of our period-end assets and totaled \$9.77 billion at September 30, 2020. Average assets for the quarter ended September 30, 2020, were \$15.49 billion, up \$3.52 billion, or 29.38%, from the quarter ended December 31, 2019.

Average earning assets for the third quarter of 2020 increased \$3.54 billion from fourth quarter 2019 to \$14.26 billion. Our average total deposits were \$11.30 billion for third quarter 2020, an increase of \$1.93 billion, or 20.64%, compared to fourth quarter 2019. Average noninterest-bearing deposits at September 30, 2020, increased \$1.26 billion, or 41.73%, from December 31, 2019.

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, 2020, these balances were \$1.70 billion and consisted mainly of deposits in other banks and overnight deposits with the FRB - Richmond.

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The average balance of interest-bearing deposits in other banks, at the FRB - Richmond, and federal funds sold during third quarter 2020, was \$2.52 billion, or 17.69%, of average total earning assets, compared with \$0.52 billion, or 4.85%, of average total earning assets for the fourth quarter of 2019.

Securities Available for Sale. Our AFS debt securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. The AFS debt securities portfolio was \$1.31 billion at September 30, 2020, compared with \$1.44 billion at December 31, 2019. The average balance during the third quarter of 2020 was \$1.27 billion, compared to \$1.41 billion at December 31, 2019. The average AFS securities portfolio represented 8.93% and 12.80% of average earning assets in third quarter 2020 and fourth quarter 2019, respectively. During the three- and nine-months ended September 30, 2020, we had sales, maturities, and calls totaling \$117.14 million and \$496.25 million in investment securities that were classified as AFS.

With the adoption of ASU 326 on January 1, 2020, we began recording an allowance for credit losses on our AFS debt securities. AFS debt securities are reviewed quarterly to assess whether an allowance for credit losses is required. An allowance for credit losses on impaired AFS debt securities is recorded when the present value of expected future cash flows of the investment security is less than its amortized cost basis, limited to the amount by which the security's amortized cost basis exceeds the fair value. At September 30, 2020, the allowance for credit losses on AFS debt securities was \$4 thousand. For further financial details, see *Note 4 - Investment Securities* and *Note 6 - Allowance for Credit Losses on Loans* of the Notes to Consolidated Financial Statements in this report.

Securities Held to Maturity. HTM debt securities are valued at amortized cost, and totaled \$17.13 million at September 30, 2020, and \$43.69 million at December 31, 2019. The average balance during the third quarter of 2020 was \$25.20 million, compared with \$44.07 million in fourth quarter 2019, representing 0.02% and 0.41% 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 potential credit losses. With the adoption of ASU 326 on January 1, 2020, we began recording an allowance for credit losses on our HTM debt securities. At September 30, 2020, the allowance for credit losses on HTM debt securities was \$90 thousand. During the three- and nine-months ended September 30, 2020, we had maturities, and calls totaling \$24.76 million and \$26.84 million in investment securities that were classified as HTM. For further financial details, see *Note 4 - Investment Securities* and *Note 6 - Allowance for Credit Losses on Loans* of the Notes to Consolidated Financial Statements in this report.

Loans Held for Sale. At September 30, 2020, we held \$669.02 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$419.23 million at December 31, 2019. Average loans held for sale were 4.45% of average earning assets for the quarter ended September 30, 2020, and 4.38% of average earning assets for the quarter ended December 31, 2019. 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 \$9.77 billion at September 30, 2020, which was \$1.35 billion, or 16.05%, over \$8.42 billion at December 31, 2019. As a percentage of total average earning assets, average loans were 68.38% for the quarter ended September 30, 2020, compared with 77.25% for the quarter ended December 31, 2019.

Allowance for Credit Losses and Asset Quality. Effective January 1, 2020, with the adoption of ASU 326, losses are required to be estimated over the life of the loan and recorded at origination or acquisition. The

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allowance for credit losses on funded loans is established through a provision for credit losses charged against earnings. Additionally, with the adoption of ASU 326, the Company increased the allowance for credit losses on unfunded commitments, in other liabilities, with a provision for credit losses charged against earnings. The level of the allowance for loan losses is an estimate of expected losses inherent in the Company's portfolio at September 30, 2020.

The allowance for credit losses on funded loans at September 30, 2020, and December 31, 2019, was \$119.06 million and \$58.23 million, respectively. This increase is primarily attributable to a heavier weighting given to adverse economic forecasts in our credit loss models due to expectation of continued economic weakness driven by a number of uncertainties impacting the local and national economy. These macroeconomic forecasts were impacted by the notable weakening of small businesses in the wake of the extended COVID-19 pandemic, major layoff announcements, and the deterioration in the U.S. trade relationship with China. Expected loss estimates consider various factors including the impacts of the decreased economic activity and higher unemployment rates, customer specific credit information, and the potential mitigating benefits of government stimulus and industry wide loan modification efforts. The allowance was equal to 1.22% of total loans outstanding at September 30, 2020, compared with 0.69% at December 31, 2019. PPP loans, which totaled \$1.10 billion at September 30, 2020, are included in our loan portfolio. Consistent with regulatory guidance, because the PPP loans are fully guaranteed by the SBA, there is no associated allowance for credit losses. Excluding PPP loans, the allowance for credit losses on loans was 1.37% of total loans outstanding at September 30, 2020.

Classified loans, defined as loans in the substandard and doubtful categories, represented 0.51% of total loans at September 30, 2020, down from 0.55% at December 31, 2019. Loans 30 to 89 days past due were \$3.90 million, at September 30, 2020, as compared to \$10.64 million at December 31, 2019. Total past due and nonaccruing loans were \$19.62 million at September 30, 2020, compared to \$28.69 million at December 31, 2019. The allowance for credit losses on funded loans was equal to 7.31x of nonperforming loans at September 30, 2020, compared with 3.34x at December 31, 2019. Our allowance for credit losses, for both funded loans and unfunded commitments, was determined by evaluating numerous variables, many of which are interrelated or dependent on other assumptions and estimates, and considered past events, current conditions, and reasonable and supportable forecasts. We believe the quality of our loan portfolio supports the level of our allowance for credit losses and that it is adequate to cover estimated lifetime credit losses expected in the loan portfolio based on our reasonable and supportable forecasts at that date. There is still a great deal of uncertainty with regard to the future economic impact of COVID-19, which may result in material changes to our allowance in the coming quarters.

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The following table provides a breakdown of the allowance for credit losses among the various loan types as of the dates indicated (dollars in thousands):

	September 30, 2020	January 1, * 2020	December 31, 2019
Real estate - construction and development	\$ 23,791	\$ 15,084	\$ 6,926
Real estate - commercial owner occupied	17,528	7,164	9,356
Real estate - commercial non-owner occupied	24,302	11,671	13,885
Real estate - multi-family	2,926	1,268	1,047
Real estate - residential 1-4 family	13,267	7,536	7,241
HELOC	13,860	9,116	3,382
Commercial and industrial business loans	9,728	3,898	7,899
Government	2,317	1,371	1,937
Indirect	4,491	1,144	6,064
Consumer and other loans	6,848	920	497
Total	\$ 119,058	\$ 59,172	\$ 58,234

*Post-adoption of ASU 326.

The following table provides information on the allowance for loan losses and nonperforming assets for the periods presented:

	Periods Ended September 30,	
(dollars in thousands)	2020	2019
Nonperforming Assets		
Nonperforming loans	\$ 16,295	\$ 14,016
Former bank premises	750	1,510
Foreclosed property	11,695	15,517
Total nonperforming assets	\$ 28,740	\$ 31,043
 Loans past due 90 days and still accruing interest	 \$ 19	 \$ 636
Asset Quality Ratios		
Allowance for credit losses to nonperforming loans	7.31x	3.95x
Allowance for credit losses to period-end loans	1.22%	0.68%
Allowance for credit losses on loans to period end loans excluding PPP loans (non-GAAP)	1.37%	0.81%
Nonperforming loans to period-end loans	0.17%	0.17%
Nonperforming assets to period-end assets	0.19%	0.26%
Net charge-offs (recoveries) to average loans (annualized)	(0.01)%	0.03%

For the nine months ended September 30, 2020 and 2019, annualized net charge-offs to average loans were 0.01% and 0.06%, respectively. For additional financial details regarding the analysis of the allowance for loan losses, see *Note 6 – Allowance for Credit Losses on Loans* of the Notes to Consolidated Financial Statements in this report.

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

	September 30, 2020	December 31, 2019
CRE - Construction and development	\$ 43	\$ 43
CRE - Owner occupied	1,149	7,291
CRE - Non-owner occupied	798	221
CRE - Multi-family	—	—
Residential 1-4 family	4,366	4,760
HELOC	1,510	1,214
Commercial and industrial business	7,720	3,284
Government	—	—
Indirect	708	620
Consumer and other loans	1	4
Total nonperforming loans	<u>\$ 16,295</u>	<u>\$ 17,437</u>

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, 2020, we had \$28.74 million in nonperforming assets, which amounted to 0.19% of total assets. Additionally, there were \$0.02 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of \$16.30 million in nonperforming loans, as well as \$11.70 million in foreclosed property. Nonperforming loans decreased by \$1.14 million from December 31, 2019. Foreclosed property decreased from \$13.84 million at December 31, 2019. The five largest foreclosed property developments represented approximately 90.17% of total foreclosed property at September 30, 2020, with the largest development representing approximately 34.09%. Foreclosed property consists of five residential properties and 7 construction and development properties.

At September 30, 2020, loans 60-89 days past due, excluding nonperforming loans, totaled \$0.51 million. Additionally, there are other performing loans in the substandard category, totaling \$25.25 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.

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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 credit losses estimate.

At September 30, 2020, nonaccruing TDRs, which are included in nonperforming loans, totaled \$1.96 million and accruing TDRs totaled \$13.67 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.

Section 4013 of the CARES Act provides that a qualified loan modification is exempt by law from classification as a TDR as defined by GAAP from the period beginning March 1, 2020, until the earlier of December 31, 2020 or the date that is 60 days after the date on which the national emergency concerning the COVID-19 outbreak was declared by the President of the United States under the National Emergencies Act terminates. Accordingly, we are offering short-term modifications made in response to COVID-19 to borrowers who are current and otherwise not past due. These generally include short-term, 180 days or less, modifications in the form of payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant. As of September 30, 2020, we had 168 loans with modifications under on Section 4013 with total outstanding balances of \$120.36 million.

Deposits. Total deposits at September 30, 2020, were \$11.70 billion, representing an increase of \$2.43 billion, or 26.25%, compared to December 31, 2019. Total average deposits were \$11.30 billion during the third quarter of 2020, compared to \$9.24 billion during third quarter 2019 and \$9.37 billion during fourth quarter 2019. The increase was primarily due to PPP loan proceeds deposited into business customer accounts combined with the liquidity added to the economy through other government stimulus programs.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 37.76% during third quarter 2020 and 31.82% during the same period in 2019. Average noninterest-bearing demand deposits were 32.14% of average total deposits for fourth quarter 2019. The cost of interest-bearing deposits was 0.73% for third quarter 2020, compared with 1.48% for third quarter 2019 and 1.36% for fourth quarter 2019.

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,			December 31,		
	2020		2019		2019	
Interest-bearing demand and money market accounts	\$ 4,311,920	0.25 %	\$ 3,379,888	0.85 %	\$3,533,912	0.72 %
Regular savings	304,753	0.72 %	278,048	1.00 %	278,910	0.91 %
Certificates of deposit	2,417,772	1.60 %	2,641,681	2.35 %	2,544,845	2.29 %
Total interest-bearing	7,034,445	0.73 %	6,299,617	1.48 %	6,357,667	1.36 %
Noninterest-bearing demand	4,268,443		2,940,370		3,011,688	
Total	<u>\$ 11,302,888</u>	0.46 %	<u>\$ 9,239,987</u>	1.01 %	<u>\$9,369,355</u>	0.92 %

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	Average Balance/Cost Rate			
	Nine Months Ended			
	September 30,		September 30,	
	2020		2019	
Interest-bearing demand and money market accounts	\$ 3,898,642	0.36 %	\$ 3,289,539	0.83 %
Regular savings	290,684	0.78 %	281,562	1.26 %
Certificates of deposit	2,451,715	1.90 %	2,456,360	2.25 %
Total interest-bearing	6,641,041	0.95 %	6,027,461	1.43 %
Noninterest-bearing	3,687,791		2,787,727	
Total	<u>\$ 10,328,832</u>	0.61 %	<u>\$ 8,815,188</u>	0.98 %

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,			December 31,		
	2020		2019		2019	
Interest-bearing demand and money market accounts	\$ 4,311,920	38.15 %	\$ 3,379,888	36.58 %	\$ 3,533,912	37.72 %
Regular savings	304,753	2.70 %	278,048	3.01 %	278,910	2.98 %
Certificates of deposit	2,417,772	21.39 %	2,641,681	28.59 %	2,544,845	27.16 %
Total interest-bearing	7,034,445	62.24 %	6,299,617	68.18 %	6,357,667	67.86 %
Noninterest-bearing	4,268,443	37.76 %	2,940,370	31.82 %	3,011,688	32.14 %
Total	<u>\$11,302,888</u>	100.00 %	<u>\$9,239,987</u>	100.00 %	<u>\$9,369,355</u>	100.00 %

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2020, were \$731.20 million, compared to \$471.69 million at December 31, 2019. The average borrowing cost for third quarter 2020 was 0.69% and 2.11% in fourth quarter 2019.

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The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2020, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
11/15/2028	3.43%	—	\$ 3,624
12/01/2028	2.83%	—	\$ 2,578
11/12/2020	0.25%	—	\$ 100,000
11/14/2022	—%	11/16/2020	\$ 100,000
01/07/2021	1.75%	—	\$ 100,000
02/12/2021	1.67%	—	\$ 100,000
10/09/2020	0.37%	—	\$ 75,000
08/13/2021	0.27%	—	\$ 75,000
09/20/2021	0.26%	—	\$ 25,000
09/20/2022	0.33%	—	\$ 25,000
03/20/2023	0.37%	—	\$ 25,000
09/20/2023	0.40%	—	\$ 25,000
03/20/2024	0.43%	—	\$ 25,000
09/20/2024	0.46%	—	\$ 25,000
03/20/2025	0.54%	—	\$ 25,000
Total FHLB Loans			\$ 731,202

At September 30, 2020, certain residential HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of \$3.34 billion collateralized the advances from the FHLB. At December 31, 2019, certain residential HELOCs, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of \$1.48 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, 2020, we had no outstanding balances on these borrowing agreements with other financial institutions. To facilitate the funding of PPP loans, the Federal Reserve offered a PPP lending facility. The Company had no borrowings under this facility at September 30, 2020, compared to \$1.11 billion in borrowings under this facility at June 30, 2020, at an average cost of 0.35%. Average total borrowings, including FHLB advances and PPPLF, during third quarter 2020 were \$1.93 billion, compared with \$454.62 million for fourth quarter 2019, while the average cost of these funds was 0.58% and 1.56%, 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, 2020, the carrying value of the subordinated notes totaled \$248.91 million, compared with \$248.46 million at December 31, 2019. Average subordinated debt during third quarter 2020 was \$248.81 million, compared to \$248.36 million during fourth quarter 2019, while the average cost of the debentures was 4.76% and 4.77%, respectively.

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

On February 27, 2020, we declared a quarterly shareholder cash dividend of \$0.18 per common share. The dividend was paid April 10, 2020, to shareholders of record on March 30, 2020.

On May 27, 2020, we declared a quarterly shareholder cash dividend of \$0.18 per common share. The dividend was paid July 10, 2020, to shareholders of record on June 30, 2020.

On August 26, 2020, we declared a quarterly shareholder cash dividend of \$0.18 per common share. The dividend was paid October 9, 2020, to shareholders of record on September 30, 2020.

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. We monitor liquidity through regular reviews of asset and liability maturities, funding sources, and loan and deposit forecasts.

In the first quarter of 2020 we increased our liquid assets to ensure that we have the balance sheet strength to serve our clients through the COVID-19 pandemic and we will continue to closely monitor liquidity as economic conditions change. The following table provides summarized information on our availability of liquid funds and borrowings as of September 30, 2020 (in thousands):

	September 30, 2020
Available Liquid Funds:	
Cash and cash equivalents	\$ 1,809,680
Unencumbered investment securities	969,214
Availability of Borrowings:	
Amount available from FHLB	1,402,826
Amount available from unsecured lines of credit with correspondent banks	155,000
Amount available from Federal Reserve discount window	454,947
Amount available from Federal Reserve PPP liquidity facility	1,126,531

Risk-based capital guidelines for United States banking organizations have been issued by 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 response to COVID-19, the joint federal bank regulatory agencies issued an interim final rule that allows banking organizations that adopt CECL in 2020 to mitigate the effects of the standard in their regulatory capital for two years. This two-year delay is in addition to the three-year transition period the agencies had

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already made available. The Company has elected to adopt the option provided by the interim final rule, which will largely delay the effects of CECL on its regulatory capital for the next two years, after which time the effects will be phased in over a three-year period from January 1, 2022, through December 31, 2024. Under the interim final rule, the amount of the adjustments to regulatory capital deferred until the phase-in period will include both the initial impact of the adoption of CECL at January 1, 2020, and 25% of subsequent changes in the allowance for credit losses during each quarter of the two-year period ended December 31, 2021.

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 FDIC rules, we are considered "well capitalized" as of September 30, 2020.

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

	September 30,		June 30,
	2020	2019	2020
Tier I Capital:			
Shareholders' equity	\$ 1,748,703	\$ 1,638,534	\$ 1,721,543
Add: modified CECL transitional amount	18,904	—	10,888
Less: goodwill and disallowed intangible assets, net of deferred tax	485,227	496,114	488,130
AOCI-related adjustments	44,569	19,959	43,218
Noncontrolling interests	16,961	13,154	13,948
Total common equity tier I capital	1,220,850	1,109,307	1,187,135
Included noncontrolling interests	16,961	3,221	13,948
Total tier I capital	1,237,811	1,112,528	1,201,083
Tier II Capital:			
Qualifying allowance for loan losses (1)	127,423	55,428	95,394
Less: modified adjusted allowance for credit losses (ACL)	19,328	—	11,313
Qualifying subordinated debt	248,906	248,309	248,756
Total tier II capital	357,001	303,737	332,837
Total Risk-Based Capital	\$ 1,594,812	\$ 1,416,265	\$ 1,533,920
Total assets	\$ 14,795,417	\$ 12,021,291	\$ 15,580,258
Total risk-weighted assets (2)	10,389,372	9,631,537	10,291,054
Average assets for leverage capital purposes	13,922,857	11,326,611	13,278,630
Risk-weighted assets to total assets	70.22 %	80.12 %	66.05 %
Risk-based capital ratios:			
Common equity tier I (7.0% minimum requirement)	11.75 %	11.52 %	11.54 %
Tier I (8.5% minimum requirement)	11.91 %	11.55 %	11.67 %
Total (10.5% minimum requirement)	15.35 %	14.70 %	14.91 %
Tier I leverage ratio (5.0% minimum requirement)	8.89 %	9.82 %	9.05 %

(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.

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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.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<i>(dollars in thousands)</i>				
Average assets (GAAP)	\$ 15,487,152	\$ 11,845,282	\$ 13,987,474	\$ 11,526,487
Less: average goodwill	446,725	442,919	446,762	442,890
Less: average intangible assets	47,513	57,327	50,373	60,333
Average tangible assets (non-GAAP)	\$ 14,992,914	\$ 11,345,036	\$ 13,490,339	\$ 11,023,264
Average equity (GAAP)	\$ 1,747,033	\$ 1,620,070	\$ 1,704,993	\$ 1,580,213
Less: average goodwill	446,725	442,919	446,762	442,890
Less: average intangible assets	47,513	57,327	50,373	60,333
Average tangible equity (non-GAAP)	\$ 1,252,795	\$ 1,119,824	\$ 1,207,858	\$ 1,076,990
Average common equity (GAAP)	\$ 1,732,881	\$ 1,607,853	\$ 1,692,202	\$ 1,568,336
Less: average goodwill	446,725	442,919	446,762	442,890
Less: average intangible assets	47,513	57,327	50,373	60,333
Average tangible common equity (non-GAAP)	\$ 1,238,643	\$ 1,107,607	\$ 1,195,067	\$ 1,065,113
Net Income (GAAP)	\$ 34,464	\$ 37,659	\$ 95,453	\$ 103,707
Amortization of Intangibles, net of tax	2,252	2,417	6,875	7,398
Tangible net income (non-GAAP)	\$ 36,716	\$ 40,076	\$ 102,328	\$ 111,105
Total Revenue (GAAP)	\$ 192,135	\$ 162,656	\$ 492,487	\$ 424,272
Net (gain)/loss on investment securities	\$ (1,701)	\$ (2,930)	\$ (9,632)	\$ 845
Operating Income (non-GAAP)	\$ 190,434	\$ 159,726	\$ 482,855	\$ 425,117
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Return on average assets (GAAP basis)	0.89 %	1.26 %	0.91 %	1.20 %
Impact of excluding average goodwill and other intangibles and amortization	0.08 %	0.14 %	0.10 %	0.15 %
Return on average tangible assets	0.97 %	1.40 %	1.01 %	1.35 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Return on average equity (GAAP basis)	7.85 %	9.22 %	7.48 %	8.77 %
Impact of excluding average goodwill and other intangibles and amortization	3.81 %	4.98 %	3.84 %	5.02 %
Return on average tangible equity	11.66 %	14.20 %	11.32 %	13.79 %

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Efficiency ratio (GAAP)	53.08 %	55.96 %	58.86 %	67.40 %
Impact of excluding gain/loss on investments	(0.47)%	(1.03)%	(1.18)%	0.13 %
Efficiency ratio (non-GAAP)	53.55 %	56.99 %	60.04 %	67.27 %

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

	Period Ended September 30,	
	2020	2019
Book value per share (GAAP basis)	\$ 23.83	\$ 22.38
Impact of excluding goodwill and other intangibles and amortization	(6.77)	(6.94)
Tangible book value per share	\$ 17.06	\$ 15.44

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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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

At September 30, 2020, we had \$1.27 billion more liabilities than assets subject to repricing within one year. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time.

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:

<u>Change in Prime Rate</u>	<u>% Change in Net Interest Income</u>
+ 300 basis points	16.98 %
+ 200 basis points	11.29 %
+ 100 basis points	5.22 %
- 100 basis points	(2.96)%

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:

<u>Change in Prime Rate</u>	<u>Change in Net Market Value (dollars in thousands)</u>
+ 300 basis points	\$ 161,525
+ 200 basis points	\$ 114,490
+ 100 basis points	\$ 56,031
- 100 basis points	\$ (138,100)

PART I. FINANCIAL INFORMATION

Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2020, 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, 2020. 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

In addition to the other information contained in this Quarterly Report on Form 10-Q, the following risk factors update and supplement, and should be read together with, the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations. See also “Forward-Looking Statements,” included in Part 1, Item 2, of this Quarterly Report on Form 10-Q.

The ongoing COVID-19 pandemic and measures intended to prevent its spread may adversely affect our business, financial condition and operations; the extent of such impacts are highly uncertain and difficult to predict.

Global health and economic concerns relating to the COVID-19 outbreak and government actions taken to reduce the spread of the virus have had a material adverse impact on the macroeconomic environment, and the outbreak has significantly increased economic uncertainty. The pandemic has resulted in federal, state and local authorities, including those who govern the markets in which we operate, implementing numerous measures to try to contain the virus. These measures, including shelter in place orders and business limitations and shutdowns, have significantly contributed to rising unemployment and negatively impacted consumer and business spending.

The COVID-19 outbreak has adversely impacted and is likely to continue to adversely impact our workforce and operations and the operations of our customers and business partners. In particular, we may experience adverse effects due to a number of operational factors impacting us or our customers or business partners, including but not limited to:

- credit losses resulting from financial stress experienced by our borrowers, especially those operating in industries hardest hit by government measures to contain the spread of the virus;
- collateral for loans, especially real estate, may decline in value, which could cause loan losses to increase;
- as a result of the decline in the FOMC’s target federal funds rate, the yield on our assets may decline to a greater extent than the decline in our cost of interest-bearing liabilities, reducing our net interest margin and spread, and reducing net income;
- operational failures, disruptions or inefficiencies due to changes in our normal business practices necessitated by our internal measures to protect our employees and government-mandated measures intended to slow the spread of the virus;
- possible business disruptions experienced by our vendors and business partners in carrying out work that supports our operations;
- decreased demand for our products and services due to economic uncertainty, volatile market conditions and temporary business closures;
- material declines in income from our Realty segment due to prolonged travel restrictions;
- potential financial liability, credit losses, litigation costs or reputational damage resulting from our origination of PPP loans; and

PART II. OTHER INFORMATION

- heightened levels of cyber and payment fraud, as cyber criminals try to take advantage of the disruption and increased online activity brought about by the pandemic.

The extent to which the pandemic impacts our business, liquidity, financial condition and operations will depend on future developments, which are highly uncertain and are difficult to predict, including, but not limited to, its duration and severity, the actions to contain it or treat its impact, and how quickly and to what extent normal economic and operating conditions can resume. In addition, the rapidly changing and unprecedented nature of COVID-19 heightens the inherent uncertainty of forecasting future economic conditions and their impact on our loan portfolio, thereby increasing the risk that the assumptions, judgments and estimates used to determine the allowance for credit losses and other estimates are incorrect. Further, our loan deferral program could delay or make it difficult to identify the extent of asset quality deterioration during the deferral period. As a result of these and other conditions, the ultimate impact of the pandemic is highly uncertain and subject to change, and we cannot predict the full extent of the impacts on our business, our operations or the global economy as a whole. To the extent any of the foregoing risks or other factors that develop as a result of COVID-19 materialize, it could exacerbate the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2019, or otherwise materially and adversely affect our business, liquidity, financial condition and results of operations.

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

<u>Exhibit No.</u>	<u>Description</u>
(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 6, 2020.

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 6, 2020

Date

By: /s/ J. Morgan Davis

J. Morgan Davis

President/Chief Executive Officer

November 6, 2020

Date

By: /s/ William B. Littreal

William B. Littreal

Senior Executive Vice President/Chief
Financial Officer

CERTIFICATIONS

I, J. Morgan Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2020, 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
 - (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 6, 2020

Date

/s/ J. Morgan Davis

J. Morgan Davis

President/Chief Executive Officer

CERTIFICATIONS

I, William B. Littreal, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2020, 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
 - (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 6, 2020

Date

/s/ William B. Littreal

William B. Littreal

Senior Executive Vice President/Chief Financial Officer

**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, 2020 (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 6, 2020

Date

/s/ J. Morgan Davis

J. Morgan Davis

President/Chief Executive Officer

November 6, 2020

Date

/s/ William B. Littreal

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.



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, 2020 and 2019, the related consolidated statements of income, comprehensive income, cash flow and equity for the three and nine-month periods ended September 30, 2020 and 2019, 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, 2019, 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, 2020, we expressed an unqualified opinion on those consolidated financial statements.

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

Charlotte, North Carolina
November 6, 2020