

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, 2021

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, 2021, was 72,682,884 shares.

TOWNE BANK

TABLE OF CONTENTS

Part I. Financial Information

Item 1.	Financial Statements	
	Glossary of Acronyms and Defined Terms	3
	Consolidated Balance Sheets	5
	September 30, 2021 (unaudited)	
	December 31, 2020 (audited)	
	Consolidated Statements of Income	6
	Three and Nine Months Ended September 30, 2021 (unaudited)	
	Three and Nine Months Ended September 30, 2020 (unaudited)	
	Consolidated Statements of Comprehensive Income	7
	Three and Nine Months Ended September 30, 2021 (unaudited)	
	Three and Nine Months Ended September 30, 2020 (unaudited)	
	Consolidated Statements of Cash Flow	8
	Nine Months Ended September 30, 2021 (unaudited)	
	Nine Months Ended September 30, 2020 (unaudited)	
	Consolidated Statements of Equity	9
	Three and Nine Months Ended September 30, 2021 (unaudited)	
	Three and Nine Months Ended September 30, 2020 (unaudited)	
	Notes to Consolidated Financial Statements (unaudited)	11
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	52
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	82
Item 4.	Controls and Procedures	84

Part II. Other Information

Item 1.	Legal Proceedings	85
Item 1A.	Risk Factors	85
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	85
Item 3.	Defaults Upon Senior Securities	85
Item 4.	Mine Safety Disclosures	85
Item 5.	Other Information	85
Item 6.	Exhibits	85

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 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)
Appropriations Act	Consolidated Appropriations Act of 2021
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
CDARS	Certificate of Deposit Account Registry Service
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
G. Johnson	George Johnson Insurance, Inc.
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
N/M	Not Meaningful
OCI	Other Comprehensive Income
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
Red Sky	Red Sky Travel Insurance
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
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2021 (unaudited)	December 31, 2020 (audited)
ASSETS		
Cash and due from banks	\$ 75,370	\$ 41,514
Interest-bearing deposits at FRB - Richmond	3,155,039	1,795,241
Interest-bearing deposits in financial institutions	33,506	27,532
Total Cash and Cash Equivalents	3,263,915	1,864,287
Securities available for sale, at fair value (amortized cost of \$1,528,483 and \$1,310,250, and allowance for credit losses of \$142 and \$348 at September 30, 2021 and December 31, 2020, respectively.)	1,560,402	1,368,224
Securities held to maturity, at amortized cost (fair value \$16,489 and \$18,469 at September 30, 2021 and December 31, 2020, respectively.)	14,898	16,512
Less: Allowance for credit losses	(94)	(97)
Securities held to maturity, net of allowance for credit losses	14,804	16,415
Other equity securities	6,621	6,492
FHLB stock	13,146	30,135
Total Securities	1,594,973	1,421,266
Mortgage loans held for sale	431,846	540,798
Loans, net of unearned income and deferred costs:	9,297,565	9,629,068
Less: Allowance for credit losses on loans	(107,177)	(120,157)
Net Loans	9,190,388	9,508,911
Premises and equipment, net	270,810	260,242
Goodwill	457,187	452,328
Other intangible assets, net	50,839	45,533
BOLI	249,862	246,109
Other assets	301,552	286,970
TOTAL ASSETS	\$ 15,811,372	\$ 14,626,444
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 5,394,952	\$ 4,374,566
Interest-bearing:		
Demand and money market accounts	5,681,181	4,819,604
Savings	366,165	330,091
Certificates of deposit	1,571,752	2,048,905
Total Deposits	13,014,050	11,573,166
Advances from the FHLB	155,537	456,038
Subordinated debt, net	249,503	249,055
FRB PPP lending facility	—	182,852
Repurchase agreements and other borrowings	82,413	67,786
Total Borrowings	487,453	955,731
Other liabilities	409,435	313,719
TOTAL LIABILITIES	13,910,938	12,842,616
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, \$1.667 par: 150,000,000 shares authorized 72,683,529 and 72,667,541 shares issued at September 30, 2021 and December 31, 2020, respectively	121,163	121,132
Capital surplus	1,049,367	1,046,642
Retained earnings	690,960	557,889
Common stock issued to deferred compensation trust, at cost 905,484 and 873,486 shares at September 30, 2021 and December 31, 2020, respectively	(18,076)	(16,969)
Deferred compensation trust	18,076	16,969
Accumulated other comprehensive income	21,597	41,184
TOTAL SHAREHOLDERS' EQUITY	1,883,087	1,766,847
Noncontrolling interests	17,347	16,981
TOTAL EQUITY	1,900,434	1,783,828
TOTAL LIABILITIES AND EQUITY	\$ 15,811,372	\$ 14,626,444

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,	
	2021	2020	2021	2020
<i>(Dollars in thousands, except per share data)</i>				
INTEREST INCOME:				
Loans, including fees	\$ 98,258	\$ 102,869	\$ 300,268	\$ 305,070
Investment securities	7,000	7,440	20,987	25,553
Interest-bearing deposits in financial institutions and federal funds sold	1,182	632	2,218	2,168
Mortgage loans held for sale	3,405	4,587	10,477	11,385
Total interest income	109,845	115,528	333,950	344,176
INTEREST EXPENSE:				
Deposits	6,028	12,966	21,721	47,099
Advances from the FHLB	247	1,901	1,017	6,990
Subordinated debt, net	2,962	2,962	8,854	8,885
Repurchase agreements and other borrowings	165	940	781	1,672
Total interest expense	9,402	18,769	32,373	64,646
Net interest income	100,443	96,759	301,577	279,530
PROVISION FOR CREDIT LOSSES	(1,582)	31,598	(15,665)	65,559
Net interest income after provision for credit losses	102,025	65,161	317,242	213,971
NONINTEREST INCOME:				
Residential mortgage banking income, net	25,422	37,531	88,359	74,662
Insurance commissions and other title fees and income, net	17,398	17,468	52,055	51,973
Real estate brokerage and property management income, net	14,283	11,301	43,201	29,020
Service charges on deposit accounts	2,524	1,986	7,104	6,314
Credit card merchant fees, net	1,660	1,506	4,630	3,793
BOLI	2,301	1,605	5,361	6,295
Other income	6,045	22,278	16,367	31,268
Net gain (loss) on investment securities	—	1,701	1,252	9,632
Total noninterest income	69,633	95,376	218,329	212,957
NONINTEREST EXPENSE:				
Salaries and employee benefits	61,230	61,408	181,030	174,201
Occupancy expense	7,656	8,396	23,286	23,124
Furniture and equipment	3,513	3,247	10,647	10,451
Amortization - intangibles	2,750	2,851	8,192	8,702
Software expense	4,209	3,572	12,896	10,556
Data processing	3,603	3,113	10,255	8,622
Professional fees	2,227	2,637	6,826	8,677
Advertising and marketing	3,865	1,870	10,090	7,440
Other expenses	15,033	14,887	43,583	38,121
Total noninterest expense	104,086	101,981	306,805	289,894
Income before income tax expense and noncontrolling interest	67,572	58,556	228,766	137,034
Provision for income tax expense	14,829	7,841	45,388	21,492
Net income	\$ 52,743	\$ 50,715	\$ 183,378	\$ 115,542
Net income attributable to noncontrolling interest	(2,343)	(16,251)	(8,177)	(20,089)
Net income attributable to TowneBank	\$ 50,400	\$ 34,464	\$ 175,201	\$ 95,453
Per common share information				
Basic earnings	\$ 0.70	\$ 0.48	\$ 2.42	\$ 1.32
Diluted earnings	\$ 0.69	\$ 0.48	\$ 2.41	\$ 1.32

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,	
	2021	2020	2021	2020
<i>(Dollars in thousands)</i>				
Net income	\$ 52,743	\$ 50,715	\$ 183,378	\$ 115,542
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	(10,123)	3,248	(25,010)	51,332
Tax effect	2,227	(887)	5,556	(11,289)
Realized (gains) losses reclassified into earnings	—	(1,701)	(1,252)	(9,632)
Tax effect	—	357	263	2,022
Net unrealized gains (losses)	(7,896)	1,017	(20,443)	32,433
Pension and postretirement benefit plans				
Prior service costs	—	(128)	—	(402)
Tax effect	—	28	—	92
Actuarial gain (loss)	64	277	431	634
Tax effect	(15)	(61)	(88)	(145)
Amortization of prior service costs	171	164	513	504
Tax effect	(38)	(36)	(114)	(116)
Amortization of net actuarial (gain) loss	49	115	147	345
Tax effect	(11)	(25)	(33)	(78)
Change in retirement plans, net of tax	220	334	856	834
Other comprehensive income (loss), net of tax	(7,676)	1,351	(19,587)	33,267
Comprehensive income	\$ 45,067	\$ 52,066	\$ 163,791	\$ 148,809
Comprehensive income attributable to noncontrolling interest	(2,343)	(16,251)	(8,177)	(20,089)
Comprehensive income attributable to TowneBank	\$ 42,724	\$ 35,815	\$ 155,614	\$ 128,720

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,	
	2021	2020
<i>(Dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$ 183,378	\$ 115,542
Adjustments to reconcile net income to net cash used for operating activities:		
Net amortization of securities	6,777	3,414
Investment securities gains	(1,252)	(9,632)
Depreciation, amortization, and other intangible amortization	21,423	21,786
Amortization of debt issuance costs	448	448
Provision for credit losses	(15,665)	65,559
Bank-owned life insurance income	(5,361)	(6,295)
Deferred income tax benefit	(5,382)	(4,168)
Share-based compensation expense	5,099	3,585
Originations of mortgage loans held for sale	(4,377,451)	(4,184,511)
Proceeds from sales of mortgage loans held for sale (1)	4,643,871	4,068,254
(Gain) loss on sales of mortgage loans held for sale (1)	(157,468)	(133,530)
Gain on sale of Red Sky	—	(17,626)
(Gain) loss on sale and write-down of foreclosed assets	(235)	1,103
Changes in:		
Interest receivable	5,050	(1,877)
Other assets	3,889	(32,336)
Interest payable	(5,942)	(4,732)
Other liabilities	106,161	40,188
Net cash from (used for) operating activities	407,340	(74,828)
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(359,461)	(318,020)
Purchase of other securities	(305)	(35)
Sale of available-for-sale securities	18,819	347,757
Redemption (purchase) of FHLB stock	16,989	(11,736)
Proceeds from maturities, calls, and prepayments of available-for-sale securities	116,838	148,524
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	1,659	26,836
Proceeds from maturities, calls, and prepayments of other securities	177	—
Net decrease (increase) in loans	328,988	(1,354,461)
Net change in investment in LIHTC	(9,764)	(32,902)
Purchase of premises and equipment	(23,549)	(38,143)
Proceeds from sales of premises and equipment	265	538
Proceeds from sales of foreclosed assets	2,478	6,735
Proceeds from sale of subsidiary Red Sky, net of cash disposed of	—	16,942
Proceeds from BOLI	1,665	5,483
Acquisition of business, net of cash acquired	(26,078)	—
Net cash from (used for) investing activities	68,721	(1,202,482)
FINANCING ACTIVITIES:		
Net change in deposit accounts	1,440,885	2,434,046
Net change in borrowings	(468,726)	265,185
Distribution of interest in joint ventures	(7,811)	(16,067)
Proceeds from issuance of common stock	—	433
Cash dividends paid	(40,781)	(39,223)
Net cash from financing activities	923,567	2,644,374
Change in cash and cash equivalents	1,399,628	1,367,064
Cash and cash equivalents at beginning of year	1,864,287	442,616
Cash and cash equivalents at end of period	\$ 3,263,915	\$ 1,809,680
(1) Restated prior year to correct misclassification between proceeds from sales of mortgage loans held for sale and gain on sales of mortgage loans held for sale.		
Supplemental cash flow information:		
Cash paid for interest	\$ 38,316	\$ 69,377
Cash paid (refunded) for income taxes	\$ 44,601	\$ 20,975
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 2,626	\$ 4,482
Sales of foreclosed assets financed by the Company	\$ 475	\$ —
Net unrealized (losses) gains on available-for-sale securities, net of tax	\$ (20,443)	\$ 32,433

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, 2021	72,667,541	\$ 121,132	\$ 1,046,642	\$ 557,889	\$ 16,969	\$ (16,969)	\$ 41,184	\$ 16,981	\$ 1,783,828
Net income	—	—	—	68,996	—	—	—	3,636	72,632
Other comprehensive income, net of taxes	—	—	—	—	—	—	(23,215)	—	(23,215)
Cash dividends declared on common stock (\$0.18 per share)	—	—	—	(13,058)	—	—	—	—	(13,058)
Directors' deferred compensation	—	—	—	—	94	(94)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(4,526)	(4,526)
Issuance of common stock - stock compensation plans	(13,871)	(24)	670	—	—	—	—	—	646
Balance, March 31, 2021	72,653,670	\$ 121,108	\$ 1,047,312	\$ 613,827	\$ 17,063	\$ (17,063)	\$ 17,969	\$ 16,091	\$ 1,816,307
Net income	—	—	—	55,803	—	—	—	2,199	58,002
Other comprehensive income, net of taxes	—	—	—	—	—	—	11,304	—	11,304
Cash dividends declared on common stock (\$0.20 per share)	—	—	—	(14,535)	—	—	—	—	(14,535)
Directors' deferred compensation	—	—	—	—	1,013	(1,013)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(2,278)	(2,278)
Issuance of common stock - stock compensation plans	18,221	36	1,020	—	—	—	—	—	1,056
Balance, June 30, 2021	72,671,891	\$ 121,144	\$ 1,048,332	\$ 655,095	\$ 18,076	\$ (18,076)	\$ 29,273	\$ 16,012	\$ 1,869,856
Net income	—	—	—	50,400	—	—	—	2,343	52,743
Other comprehensive income, net of taxes	—	—	—	—	—	—	(7,676)	—	(7,676)
Cash dividends declared on common stock (\$0.20 per share)	—	—	—	(14,535)	—	—	—	—	(14,535)
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(1,008)	(1,008)
Issuance of common stock - stock compensation plans	11,638	19	1,035	—	—	—	—	—	1,054
Balance, September 30, 2021	72,683,529	\$ 121,163	\$ 1,049,367	\$ 690,960	\$ 18,076	\$ (18,076)	\$ 21,597	\$ 17,347	\$ 1,900,434

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 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 loss, 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 - net 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 loss, 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.

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 2020 audited Consolidated Financial Statements and the 2020 Annual Report on Form 10-K. Results of operations for the three- and nine-month periods ended September 30, 2021, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Reclassifications

Within our Realty segment, certain refinance transactions related to residential mortgage banking entitle the borrower a three-day right of rescission, which allows the borrower to nullify the transaction during the rescission period. The Company holds the funds for these transactions in a suspense account until the completion of the rescission period. In first quarter 2021, the Company determined the balance should be reclassified to other liabilities at period end. At September 30, 2021, the balance associated with these funds in other liabilities was \$44.88 million. If the Company had reclassified these funds at December 31, 2020, it would have resulted in an increase in mortgage loans held for sale and a corresponding increase in other liabilities of \$33.60 million. There was no income statement impact associated with the reclassification.

Recent accounting pronouncements:

Accounting standards adopted in current year		
Standard	Summary of guidance	Effects on financial statements
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.	The Company adopted this standard January 1, 2021. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.
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.	The Company adopted this standard January 1, 2021. The adoption of the accounting standard did not have a material impact on the Company's Consolidated Financial Statements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 848 - Reference Rate Reform - Facilitation of the Effects of Reference Rate Reform on Financial Reporting ASU 2020 - 04 Issued March 2020 ASU 2021-01 Issued January 2021	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, these ASUs provide 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 these updates 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
<i>(Dollars in thousands, except per share data)</i>				
Basic				
Net income available to common shareholders	\$ 50,400	\$ 34,464	\$ 175,201	\$ 95,453
Weighted-average common shares outstanding	72,506,877	72,339,413	72,463,644	72,272,368
Basic earnings per common share	\$ 0.70	\$ 0.48	\$ 2.42	\$ 1.32
Diluted				
Net income available to common shareholders, for diluted EPS	\$ 50,400	\$ 34,464	\$ 175,201	\$ 95,453
Weighted-average common shares outstanding	72,506,877	72,339,413	72,463,644	72,272,368
Effect of dilutive securities:				
Stock compensation plans (1)	84,404	36,323	83,834	45,723
Weighted-average diluted shares outstanding	72,591,281	72,375,736	72,547,478	72,318,091
Diluted earnings per common share	\$ 0.69	\$ 0.48	\$ 2.41	\$ 1.32

- (1) There were no shares excluded from the computation of diluted shares for the three and nine months ended September 30, 2021. Shares underlying stock options and restricted stock totaling 37,433 and 58,396 were excluded from the computation of diluted EPS during the three and nine months ended September 30, 2020, respectively, because their inclusion would be anti-dilutive.

Note 3. Mergers and Acquisitions

Venture Resorts, Inc.: Effective July 1, 2021, the Company acquired Venture Resorts, Inc., an independent resort property management company that was merged with the operations of Towne Vacations Venture Resorts, LLC, a division of TowneBank's Realty segment. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. Such fair values were preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values became available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of certain intangible assets acquired and the residual goodwill. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing July 1, 2021.

George Johnson Insurance, Inc.: Effective December 31, 2020, the Company acquired G. Johnson, an independent insurance agency, which was merged into the operations of Towne Insurance Agency, LLC, a wholly owned subsidiary of TowneBank. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. Such fair values were preliminary estimates and are subject to adjustment for up to one year after the merger date, or when the additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. Primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized 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 December 31, 2020.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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.

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. 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. In addition, the allowance is reduced for improvements in expected cash flows, and reversals of previously recognized credit losses are permitted through net income in the period in which they occur.

The Company elected not to measure an allowance for credit losses for accrued interest receivables because uncollectible accrued interest receivables are written off in a timely manner and, as such, the accrued interest receivable on AFS debt securities amounting to \$5.60 million as of September 30, 2021, was excluded from the estimate of expected credit loss and included in other assets.

As of September 30, 2021, 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.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2021, 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.

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 \$0.06 million was included in other assets as of September 30, 2021, and excluded from the estimate of expected credit losses. At September 30, 2021, all HTM debt securities are current for both principal and interest. There are no collateral-dependent HTM debt securities at September 30, 2021.

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, 2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 207,795	\$ 1,779	\$ (1,625)	\$ —	\$ 207,949
U.S. Treasury notes	1,007	—	—	—	1,007
Municipal securities	338,661	14,251	(1,932)	(28)	350,952
Trust preferred and other corporate securities	30,984	777	(170)	(114)	31,477
MBSs issued by GSEs and GNMA	950,036	24,099	(5,118)	—	969,017
Total available-for-sale securities	<u>\$ 1,528,483</u>	<u>\$ 40,906</u>	<u>\$ (8,845)</u>	<u>\$ (142)</u>	<u>\$ 1,560,402</u>

December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 183,514	\$ 1,797	\$ (654)	\$ —	\$ 184,657
U.S. Treasury notes	1,000	—	—	—	1,000
Municipal securities	331,850	21,952	(151)	(10)	353,641
Trust preferred and other corporate securities	30,983	692	(176)	(338)	31,161
MBSs issued by GSEs and GNMA	762,903	35,584	(722)	—	797,765
Total available-for-sale securities	<u>\$ 1,310,250</u>	<u>\$ 60,025</u>	<u>\$ (1,703)</u>	<u>\$ (348)</u>	<u>\$ 1,368,224</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2021	2020	2021	2020
Gross gains	\$ —	\$ 2,377	\$ 1,252	\$ 10,647
Gross (losses)	—	(676)	—	(1,015)
Net gains	<u>\$ —</u>	<u>\$ 1,701</u>	<u>\$ 1,252</u>	<u>\$ 9,632</u>
Sales proceeds	\$ —	\$ 84,734	\$ 18,819	\$ 347,757

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, 2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
Trust preferred corporate securities	\$ 2,285	\$ 250	\$ —	\$ 2,535	\$ (84)
Municipal securities	5,074	1,067	—	6,141	(10)
MBSs issued by GSEs and GNMA	7,539	274	—	7,813	—
Total held-to-maturity securities	<u>\$ 14,898</u>	<u>\$ 1,591</u>	<u>\$ —</u>	<u>\$ 16,489</u>	<u>\$ (94)</u>
December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
Trust preferred corporate securities	\$ 2,321	\$ 231	\$ —	\$ 2,552	\$ (85)
Municipal securities	5,012	1,235	—	6,247	(12)
MBSs issued by GSEs and GNMA	9,179	491	—	9,670	—
Total held-to-maturity securities	<u>\$ 16,512</u>	<u>\$ 1,957</u>	<u>\$ —</u>	<u>\$ 18,469</u>	<u>\$ (97)</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 the dates indicated, in the following table (dollars in thousands):

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
September 30, 2021				
Due in one year or less	\$ 1,931	\$ 1,935	\$ 87	\$ 87
Due after one year through five years	151,810	157,280	1,314	1,328
Due after five years through 10 years	911,017	929,285	11,271	12,831
Due after 10 years	463,725	471,902	2,226	2,243
	<u>\$ 1,528,483</u>	<u>\$ 1,560,402</u>	<u>\$ 14,898</u>	<u>\$ 16,489</u>
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2020				
Due in one year or less	\$ 6,254	\$ 6,331	\$ —	\$ —
Due after one year through five years	64,839	67,814	2,850	2,890
Due after five years through 10 years	693,699	726,808	9,693	11,031
Due after 10 years	545,458	567,271	3,969	4,548
	<u>\$ 1,310,250</u>	<u>\$ 1,368,224</u>	<u>\$ 16,512</u>	<u>\$ 18,469</u>

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 the dates indicated (dollars in thousands):

		Less than 12 months		12 months or more		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2021							
Description of Securities	Number						
U.S. agency securities	12	\$ 55,721	\$ (615)	\$ 40,079	\$ (1,010)	\$ 95,800	\$ (1,625)
Municipal securities	23	81,348	(1,285)	—	—	81,348	(1,285)
MBSs issued by GSEs and GNMA	47	330,773	(4,003)	47,325	(1,115)	378,098	(5,118)
Total AFS securities	82	<u>\$ 467,842</u>	<u>\$ (5,903)</u>	<u>\$ 87,404</u>	<u>\$ (2,125)</u>	<u>\$ 555,246</u>	<u>\$ (8,028)</u>
		Less than 12 months		12 months or more		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2020							
Description of Securities	Number						
U.S. agency securities	13	\$ 82,573	\$ (533)	\$ 24,628	\$ (121)	\$ 107,201	\$ (654)
Municipal securities	12	35,279	(125)	—	—	35,279	(125)
MBSs issued by GSEs and GNMA	18	115,664	(704)	1,905	(18)	117,569	(722)
Total AFS securities	43	<u>\$ 233,516</u>	<u>\$ (1,362)</u>	<u>\$ 26,533</u>	<u>\$ (139)</u>	<u>\$ 260,049</u>	<u>\$ (1,501)</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table is a roll forward of our allowance for credit losses on AFS debt securities for the periods indicated (dollars in thousands):

Three Months Ended September 30, 2021	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 20	\$ 114	\$ 134
Provision for credit losses	8	—	8
Balance, end of period	\$ 28	\$ 114	\$ 142

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

Nine Months Ended September 30, 2021	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 10	\$ 338	\$ 348
Provision for credit losses	18	(224)	(206)
Balance, end of period	\$ 28	\$ 114	\$ 142

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

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, 2021. The following table reflects the credit ratings aggregated by investment category for HTM debt securities as of the dates indicated (dollars in thousands):

September 30, 2021	Credit Ratings					Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
Description of Securities						
Municipal securities	\$ 1,659	\$ 3,415	\$ —	\$ —	\$ —	\$ 5,074
Trust preferred and other corporate securities	—	—	—	2,285	—	2,285
Mortgage-backed securities issued by GSEs and GNMA	7,539	—	—	—	—	7,539
Total	\$ 9,198	\$ 3,415	\$ —	\$ 2,285	\$ —	\$ 14,898

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2020

Description of Securities	Credit Ratings						Total
	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
Municipal securities	\$ 1,608	\$ 3,404	\$ —	\$ —	\$ —	\$ —	\$ 5,012
Trust preferred and other corporate securities	—	—	—	—	2,321	—	2,321
Mortgage-backed securities issued by GSEs and GNMA	9,179	—	—	—	—	—	9,179
Total	<u>\$ 10,787</u>	<u>\$ 3,404</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,321</u>	<u>\$ —</u>	<u>\$ 16,512</u>

The following table provides a breakdown, by major security type and year of origination, for our HTM debt securities as of the dates indicated (dollars in thousands):

September 30, 2021

Description of Securities	2021	2020	2019	2018	2017	Prior	Total
Municipal securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 5,074	\$ 5,074
Trust preferred and other corporate securities	—	—	1,785	—	—	500	2,285
Mortgage-backed securities issued by GSEs and GNMA	—	—	—	—	—	7,539	7,539
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,785</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 13,113</u>	<u>\$ 14,898</u>

December 31, 2020

Description of Securities	2020	2019	2018	2017	2016	Prior	Total
Municipal securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 5,012	\$ 5,012
Trust preferred and other corporate securities	—	1,821	—	—	—	500	2,321
Mortgage-backed securities issued by GSEs and GNMA	—	—	—	—	5,788	3,391	9,179
Total	<u>\$ —</u>	<u>\$ 1,821</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,788</u>	<u>\$ 8,903</u>	<u>\$ 16,512</u>

The following table is a roll forward of our allowance for credit losses on HTM debt securities for the periods indicated (dollars in thousands):

Three Months Ended September 30, 2021	Municipal Securities	Trust Preferred and Other Corporate Securities	
			Total
Balance, beginning of period	\$ 10	\$ 87	\$ 97
Provision for credit losses	—	(3)	(3)
Balance, end of period	<u>\$ 10</u>	<u>\$ 84</u>	<u>\$ 94</u>

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine Months Ended September 30, 2021	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 12	\$ 85	\$ 97
Provision for credit losses	(2)	(1)	(3)
Balance, end of period	\$ 10	\$ 84	\$ 94

Nine Months Ended September 30, 2020	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ —	\$ —	\$ —
Impact of adopting ASC 326	63	91	154
Provision for credit losses	(51)	(13)	(64)
Balance, end of period	\$ 12	\$ 78	\$ 90

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, 2021, FHLB stock totaled \$13.15 million and other equity securities totaled \$6.62 million. At December 31, 2020, FHLB stock totaled \$30.13 million and other equity securities totaled \$6.49 million. No impairments or adjustments have been recorded on these investments.

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. 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.

Pledged securities

At September 30, 2021, and December 31, 2020, the Company had investment securities with market values of \$334.61 million and \$288.06 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, 2021 or 2020. The Company also had \$93.95 million in investment securities pledged against repurchase agreements with commercial customers at September 30, 2021, compared to \$80.21 million at December 31, 2020.

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2021 (1)	December 31, 2020 (1)
Commercial Real Estate		
Construction and land development	\$ 1,005,592	\$ 1,199,772
Owner occupied	1,463,000	1,380,516
Non-owner occupied	2,647,625	2,335,235
Multi-family	363,733	295,488
Total Commercial Real Estate	5,479,950	5,211,011
Residential 1-4 family	1,233,125	1,216,629
HELOC	389,974	412,476
Commercial and industrial business	1,253,972	1,990,808
Government	471,037	379,243
Indirect	348,864	271,459
Consumer loans and other	120,643	147,442
Loans, net of unearned income and deferred costs	<u>\$ 9,297,565</u>	<u>\$ 9,629,068</u>

(1) Paycheck Protection Program loans totaling \$0.25 billion and \$0.86 billion, primarily in C&I, are included in the September 30, 2021 and December 31, 2020 balances, respectively.

Unearned loan income was \$9.04 million in excess of deferred loan costs at September 30, 2021, \$31.35 million at September 30, 2020, and \$18.20 million at December 31, 2020. Unearned loan income on PPP totaled \$7.50 million at September 30, 2021, \$23.39 million at September 30, 2020, and \$14.79 million at December 31, 2020. Unaccrued discounts on PCD loans were \$6.28 million at September 30, 2021, \$8.60 million at September 30, 2020, and \$8.02 million at December 31, 2020. Unaccrued discounts on non-PCD loans were \$4.42 million at September 30, 2021, \$7.83 million at September 30, 2020, and \$6.91 million at December 31, 2020. There were \$8.45 million and \$11.19 million in nonaccrual loans at September 30, 2021 and December 31, 2020, respectively. The Company would have earned \$0.12 million in third quarter 2021 and \$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 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Troubled debt restructuring

A TDR loan is a loan that has been modified, for reasons related to a borrower's financial difficulties, which 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 and a corresponding charge-off is processed, if needed. 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 because 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, 2021, nonaccruing TDRs, which are included in nonperforming loans, totaled \$3.06 million, and accruing TDRs totaled \$9.90 million. At December 31, 2020, nonaccruing TDRs, which are included in nonperforming loans, totaled \$0.71 million, and accruing TDRs totaled \$13.86 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, 2021 and September 30, 2020, there were no loans 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.

Section 4013 of the CARES Act provided 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. The Appropriations Act, passed December 27, 2020, extended TDR relief to the earlier of January 1, 2022, or 60 days after the national emergency 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. The Company had 10 and 210 qualified loan modifications with outstanding balances of \$50.95 million and \$340.81 million, at September 30, 2021 and December 31, 2020, respectively.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. Allowance For Credit Losses

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		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Provision for loan losses	\$ (1,597)	\$ 28,263	\$ (13,092)	\$ 60,015
Provision for off-balance-sheet exposures	10	3,502	(2,364)	5,680
Provision for HTM security losses	(3)	(31)	(3)	(64)
Provision for AFS security losses	8	(136)	(206)	(72)
Total provision for credit losses	<u>\$ (1,582)</u>	<u>\$ 31,598</u>	<u>\$ (15,665)</u>	<u>\$ 65,559</u>

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, 2021, \$20.59 million in accrued interest receivable on loans is excluded from the estimate of ECL and is included in other assets, compared to \$29.62 million as of September 30, 2020.

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 with specific reserves, and/or loans identified as no longer sharing similar risk characteristics with other pooled loans. Individually assessed loans totaled \$21.05 million with specific reserves of \$1.06 million at September 30, 2021 and \$26.50 million with specific reserves of \$1.84 million at December 31, 2020.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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-month periods ended September 30, 2021 and 2020 (in thousands):

Three Months Ended September 30, 2021	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 18,235	\$ 14,385	\$ 27,866	\$ 2,449	\$ 15,021	\$ 16,636
Provision for credit losses	(926)	(682)	(1,898)	340	1,118	104
Write-offs	—	(21)	—	—	(73)	(24)
Recoveries	45	27	39	—	295	275
Net (write-offs) recoveries	45	6	39	—	222	251
Balance, end of period	17,354	13,709	26,007	2,789	16,361	16,991

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 6,848	\$ 2,880	\$ 1,449	\$ 2,361	\$ 108,130
Provision for credit losses	(86)	6	315	112	(1,597)
Write-offs	(3)	—	(73)	(33)	(227)
Recoveries	110	—	63	17	871
Net (write-offs) recoveries	107	—	(10)	(16)	644
Balance, end of period	6,869	2,886	1,754	2,457	107,177

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine Months Ended September 30, 2021	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 23,681	\$ 16,158	\$ 27,567	\$ 2,054	\$ 13,779	\$ 15,240
Provision for credit losses	(6,206)	(2,462)	(1,145)	735	2,308	1,297
Write-offs	(173)	(21)	(469)	—	(132)	(36)
Recoveries	52	34	54	—	406	490
Net (write-offs) recoveries	(121)	13	(415)	—	274	454
Balance, end of period	17,354	13,709	26,007	2,789	16,361	16,991

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 11,056	\$ 2,334	\$ 2,901	\$ 5,387	\$ 120,157
Provision for credit losses	(4,229)	552	(998)	(2,944)	(13,092)
Write-offs	(143)	—	(440)	(37)	(1,451)
Recoveries	185	—	291	51	1,563
Net (write-offs) recoveries	42	—	(149)	14	112
Balance, end of period	6,869	2,886	1,754	2,457	\$ 107,177

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents a roll forward of the allowance for off-balance-sheet exposure for the three and nine months ended September 30, 2021 and 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, 2021	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 1,234	\$ 282	\$ 313	\$ 63	\$ —	\$ 2,936
Provision for credit losses	(608)	(49)	41	(4)	—	63
Balance, end of period	\$ 626	\$ 233	\$ 354	\$ 59	\$ —	\$ 2,999

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 724	\$ —	\$ —	\$ 1,319	\$ 6,871
Provision for credit losses	464	—	—	103	10
Balance, end of period	\$ 1,188	\$ —	\$ —	\$ 1,422	\$ 6,881

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, 2021	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 1,535	\$ 212	\$ 265	\$ 40	\$ —	\$ 2,686
Provision for credit losses	(909)	21	89	19	—	313
Ending balance	\$ 626	\$ 233	\$ 354	\$ 59	\$ —	\$ 2,999

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 2,903	\$ —	\$ —	\$ 1,603	\$ 9,244
Provision for credit losses	(1,715)	—	—	(181)	(2,363)
Ending balance	\$ 1,188	\$ —	\$ —	\$ 1,422	\$ 6,881

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 a net benefit of \$1.59 million in the third quarter of 2021 compared to a net benefit of \$9.98 million in the linked quarter, and a provision expense of \$31.77 million in the prior year quarter. The negative provision was driven by a combination of net recoveries in the quarter and slight improvements in the economic forecast, offset by modest core loan growth. Expected loss estimates are subject to change based on continuing review of models and assumptions, portfolio performance, changes in forecasted macroeconomic conditions, and loan mix, which could result in material changes to the reserve in future periods. No allowance for credit losses has been recognized for PPP loans because the loans are fully guaranteed by the SBA.

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 March 2021, are refreshed semi-annually. 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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 most recent update in August 2021.

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, 2021 and December 31, 2020 (in thousands):

September 30, 2021

Term Loans By Origination									
	2021	2020	2019	2018	2017	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
CRE - Construction and Development									
Pass	\$ 541,283	\$ 333,645	\$ 57,965	\$ 16,329	\$ 5,894	\$ 12,267	\$ 33,937	\$ 1,761	\$ 1,003,081
Special Mention	—	—	—	—	—	530	1,381	—	1,911
Substandard	88	—	41	—	86	385	—	—	600
	<u>\$ 541,371</u>	<u>\$ 333,645</u>	<u>\$ 58,006</u>	<u>\$ 16,329</u>	<u>\$ 5,980</u>	<u>\$ 13,182</u>	<u>\$ 35,318</u>	<u>\$ 1,761</u>	<u>\$ 1,005,592</u>
CRE - Owner Occupied									
Pass	\$ 318,853	\$ 350,586	\$ 233,395	\$ 138,833	\$ 105,443	\$ 276,105	\$ 14,950	\$ 2,234	\$ 1,440,399
Special Mention	193	131	61	—	2,060	5,429	1,751	—	9,625
Substandard	—	—	8,090	286	294	4,306	—	—	12,976
	<u>\$ 319,046</u>	<u>\$ 350,717</u>	<u>\$ 241,546</u>	<u>\$ 139,119</u>	<u>\$ 107,797</u>	<u>\$ 285,840</u>	<u>\$ 16,701</u>	<u>\$ 2,234</u>	<u>\$ 1,463,000</u>
CRE - Non-Owner Occupied									
Pass	\$ 765,326	\$ 568,113	\$ 476,359	\$ 247,312	\$ 210,657	\$ 334,379	\$ 17,550	—	\$ 2,619,696
Special Mention	777	—	2,690	12,601	2,302	5,398	800	—	24,568
Substandard	—	3,154	—	—	—	207	—	—	3,361
	<u>\$ 766,103</u>	<u>\$ 571,267</u>	<u>\$ 479,049</u>	<u>\$ 259,913</u>	<u>\$ 212,959</u>	<u>\$ 339,984</u>	<u>\$ 18,350</u>	<u>\$ —</u>	<u>\$ 2,647,625</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Term Loans By Origination									
	2021	2020	2019	2018	2017	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
CRE - Multi-Family									
Pass	\$ 105,413	\$ 85,385	\$ 61,149	\$ 45,013	\$ 13,558	\$ 46,924	\$ 3,166	\$ —	\$ 360,608
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	2,839	—	—	—	286	—	—	3,125
	<u>\$ 105,413</u>	<u>\$ 88,224</u>	<u>\$ 61,149</u>	<u>\$ 45,013</u>	<u>\$ 13,558</u>	<u>\$ 47,210</u>	<u>\$ 3,166</u>	<u>\$ —</u>	<u>\$ 363,733</u>
Commercial and Industrial									
Pass	\$ 413,962	\$ 207,009	\$ 106,613	\$ 61,031	\$ 25,680	\$ 24,085	\$ 397,374	\$ 1,579	\$ 1,237,333
Special Mention	794	4,560	2,200	1,380	1,560	12	1,485	—	11,991
Substandard	3,089	316	187	371	13	22	650	—	4,648
	<u>\$ 417,845</u>	<u>\$ 211,885</u>	<u>\$ 109,000</u>	<u>\$ 62,782</u>	<u>\$ 27,253</u>	<u>\$ 24,119</u>	<u>\$ 399,509</u>	<u>\$ 1,579</u>	<u>\$ 1,253,972</u>
Government									
Pass	\$ 15,447	\$ 191,492	\$ 23,376	\$ 46,677	\$ 14,884	\$ 174,348	\$ 3,105	\$ —	\$ 469,329
Special Mention	—	1,708	—	—	—	—	—	—	1,708
Substandard	—	—	—	—	—	—	—	—	—
	<u>\$ 15,447</u>	<u>\$ 193,200</u>	<u>\$ 23,376</u>	<u>\$ 46,677</u>	<u>\$ 14,884</u>	<u>\$ 174,348</u>	<u>\$ 3,105</u>	<u>\$ —</u>	<u>\$ 471,037</u>
Residential 1 - 4 Family									
Credit Score:									
> = 750	\$ 268,512	\$ 256,358	\$ 145,126	\$ 70,446	\$ 82,199	\$ 166,549	\$ 3,521	\$ 1,005	\$ 993,716
650-749	61,615	59,747	19,863	30,930	12,589	43,465	—	—	228,209
450-649	1,285	1,049	619	1,182	1,349	5,716	—	—	11,200
300-449	—	—	—	—	—	—	—	—	—
	<u>\$ 331,412</u>	<u>\$ 317,154</u>	<u>\$ 165,608</u>	<u>\$ 102,558</u>	<u>\$ 96,137</u>	<u>\$ 215,730</u>	<u>\$ 3,521</u>	<u>\$ 1,005</u>	<u>\$ 1,233,125</u>
HELOC									
Credit Score:									
> = 750	\$ 3,734	\$ 938	\$ 475	\$ 216	\$ 576	\$ 1,426	\$ 294,020	\$ 606	\$ 301,991
650-749	402	111	1,094	275	333	2,856	75,497	522	81,090
450-649	266	529	121	99	245	1,066	4,502	65	6,893
300-449	—	—	—	—	—	—	—	—	—
	<u>\$ 4,402</u>	<u>\$ 1,578</u>	<u>\$ 1,690</u>	<u>\$ 590</u>	<u>\$ 1,154</u>	<u>\$ 5,348</u>	<u>\$ 374,019</u>	<u>\$ 1,193</u>	<u>\$ 389,974</u>
Indirect									
Credit Score:									
> = 750	\$ 80,082	\$ 30,497	\$ 19,639	\$ 19,068	\$ 7,613	\$ 1,856	\$ —	\$ —	\$ 158,755
650-749	81,475	40,935	17,629	15,354	4,048	2,418	—	—	161,859
450-649	4,870	8,369	5,402	5,943	1,958	1,678	—	—	28,220
300-449	—	—	30	—	—	—	—	—	30
	<u>\$ 166,427</u>	<u>\$ 79,801</u>	<u>\$ 42,700</u>	<u>\$ 40,365</u>	<u>\$ 13,619</u>	<u>\$ 5,952</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 348,864</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Term Loans By Origination								Revolving Loans Converted to Term	
	2021	2020	2019	2018	2017	Prior	Revolving Loans			Total
Consumer and Other										
Credit Score:										
> = 750	\$ 52,710	\$ 9,601	\$ 8,431	\$ 3,193	\$ 2,595	\$ 1,420	\$ 26,715	\$ 4	\$	104,669
650-749	3,027	2,413	1,307	1,258	221	316	5,693	3		14,238
450-649	138	321	208	39	185	9	606	2		1,508
300-649	—	—	—	—	—	228	—	—		228
	\$ 55,875	\$ 12,335	\$ 9,946	\$ 4,490	\$ 3,001	\$ 1,973	\$ 33,014	\$ 9	\$	120,643
Grand Total	\$ 2,723,341	\$ 2,159,806	\$ 1,192,070	\$ 717,836	\$ 496,342	\$ 1,113,686	\$ 886,703	\$ 7,781	\$	9,297,565

December 31, 2020 (1)

	Term Loans By Origination								Revolving Loans Converted to Term	Total	
	2020	2019	2018	2017	2016	Prior	Revolving Loans				
CRE - Construction and Development (1)											
Pass	\$ 766,276	\$ 283,692	\$ 87,004	\$ 7,925	\$ 6,447	\$ 12,204	\$ 33,361	\$ —	\$ 1,196,909		
Special Mention	808	514	—	124	—	—	668	—	2,114		
Substandard	90	259	1	—	399	—	—	—	749		
	\$ 767,174	\$ 284,465	\$ 87,005	\$ 8,049	\$ 6,846	\$ 12,204	\$ 34,029	\$ —	\$ 1,199,772		
CRE - Owner Occupied (1)											
Pass	\$ 374,092	\$ 294,097	\$ 170,681	\$ 122,545	\$ 123,230	\$ 243,358	\$ 23,386	\$ 69	\$ 1,351,458		
Special Mention	—	9,033	1,623	2,231	3,404	829	259	—	17,379		
Substandard	1,146	286	1,335	2,028	864	5,547	473	—	11,679		
	\$ 375,238	\$ 303,416	\$ 173,639	\$ 126,804	\$ 127,498	\$ 249,734	\$ 24,118	\$ 69	\$ 1,380,516		
CRE - Non-Owner Occupied (1)											
Pass	\$ 678,660	\$ 530,105	\$ 339,758	\$ 246,089	\$ 202,176	\$ 289,789	\$ 18,696	\$ 1,198	\$ 2,306,471		
Special Mention	—	2,814	14,859	—	—	5,500	949	—	24,122		
Substandard	3,250	—	300	394	—	698	—	—	4,642		
	\$ 681,910	\$ 532,919	\$ 354,917	\$ 246,483	\$ 202,176	\$ 295,987	\$ 19,645	\$ 1,198	\$ 2,335,235		
CRE - Multi-Family (1)											
Pass	\$ 99,395	\$ 86,876	\$ 23,254	\$ 17,612	\$ 10,116	\$ 46,492	\$ 3,682	\$ —	\$ 287,427		
Special Mention	—	—	4,775	—	—	—	—	—	4,775		
Substandard	2,953	—	—	—	—	333	—	—	3,286		
	\$ 102,348	\$ 86,876	\$ 28,029	\$ 17,612	\$ 10,116	\$ 46,825	\$ 3,682	\$ —	\$ 295,488		

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Term Loans By Origination									
	2020	2019	2018	2017	2016	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
Commercial and Industrial (1)									
Pass	\$ 1,109,682	\$ 169,359	\$ 99,304	\$ 37,937	\$ 19,962	\$ 18,779	\$ 511,625	\$ 337	\$ 1,966,985
Special Mention	3,074	2,992	3,894	2,024	284	14	4,927	—	17,209
Substandard	814	1,876	408	2,159	217	226	914	—	6,614
	<u>\$ 1,113,570</u>	<u>\$ 174,227</u>	<u>\$ 103,606</u>	<u>\$ 42,120</u>	<u>\$ 20,463</u>	<u>\$ 19,019</u>	<u>\$ 517,466</u>	<u>\$ 337</u>	<u>\$ 1,990,808</u>
Government (1)									
Pass	\$ 89,667	\$ 36,737	\$ 48,485	\$ 15,610	\$ 50,528	\$ 132,914	\$ 3,388	\$ —	\$ 377,329
Special Mention	1,914	—	—	—	—	—	—	—	1,914
Substandard	—	—	—	—	—	—	—	—	—
	<u>\$ 91,581</u>	<u>\$ 36,737</u>	<u>\$ 48,485</u>	<u>\$ 15,610</u>	<u>\$ 50,528</u>	<u>\$ 132,914</u>	<u>\$ 3,388</u>	<u>\$ —</u>	<u>\$ 379,243</u>
Residential 1 - 4 Family									
Credit Score:									
> = 750	\$ 294,478	\$ 186,829	\$ 111,587	\$ 108,038	\$ 103,351	\$ 138,147	\$ 2,198	\$ —	\$ 944,628
650-749	78,001	39,116	44,803	18,712	26,082	36,239	—	78	243,031
450-649	5,977	4,110	4,743	2,709	874	10,556	—	—	28,969
300-449	—	—	—	—	—	1	—	—	1
	<u>\$ 378,456</u>	<u>\$ 230,055</u>	<u>\$ 161,133</u>	<u>\$ 129,459</u>	<u>\$ 130,307</u>	<u>\$ 184,943</u>	<u>\$ 2,198</u>	<u>\$ 78</u>	<u>\$ 1,216,629</u>
HELOC									
Credit Score:									
> = 750	\$ 876	\$ 384	\$ 364	\$ 477	\$ 447	\$ 1,630	\$ 297,662	\$ 322	\$ 302,162
650-749	852	64	150	417	15	1,500	91,906	1	94,905
450-649	551	79	73	158	376	3,246	10,926	—	15,409
300-449	—	—	—	—	—	—	—	—	—
	<u>\$ 2,279</u>	<u>\$ 527</u>	<u>\$ 587</u>	<u>\$ 1,052</u>	<u>\$ 838</u>	<u>\$ 6,376</u>	<u>\$ 400,494</u>	<u>\$ 323</u>	<u>\$ 412,476</u>
Indirect									
Credit Score:									
> = 750	\$ 42,370	\$ 26,437	\$ 29,224	\$ 13,376	\$ 3,811	\$ 1,311	\$ —	\$ —	\$ 116,529
650-749	57,120	28,451	24,900	7,378	4,179	1,457	—	—	123,485
450-649	5,022	8,756	10,176	3,628	2,793	1,012	—	—	31,387
300-449	—	24	18	16	—	—	—	—	58
	<u>\$ 104,512</u>	<u>\$ 63,668</u>	<u>\$ 64,318</u>	<u>\$ 24,398</u>	<u>\$ 10,783</u>	<u>\$ 3,780</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 271,459</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Term Loans By Origination								Revolving Loans Converted to Term									
	2020	2019	2018	2017	2016	Prior	Revolving Loans			Total								
Consumer and Other																		
Credit Score:																		
> = 750	\$	76,556	\$	13,487	\$	5,150	\$	3,536	\$	685	\$	1,613	\$	31,048	\$	28	\$	132,103
650-749		3,650		2,106		2,091		435		37		318		3,882		28		12,547
450-649		761		310		50		142		372		44		648		8		2,335
300-449		—		—		—		—		457		—		—		—		457
	\$	80,967	\$	15,903	\$	7,291	\$	4,113	\$	1,551	\$	1,975	\$	35,578	\$	64	\$	147,442
Grand Total	\$	3,698,035	\$	1,728,793	\$	1,029,010	\$	615,700	\$	561,106	\$	953,757	\$	1,040,598	\$	2,069	\$	9,629,068

1. Loan balances in the Pass and Special Mention categories have been corrected for December 31, 2020 due to the identification of an error in which loans risk rated 60, which are Pass, were grouped with Special Mention. This error only impacts the tabular disclosure and is corrected for comparative purposes.

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.

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2021 and December 31, 2020 (in thousands):

September 30, 2021	Type of Collateral and Extent to Which Collateral Secures Loans				Loans Not Considered Collateral Dependent	Total
	Residential Property	Investment Property	Commercial Property	Business Assets		
Commercial Real Estate						
Construction and development	\$ —	\$ 962	\$ —	\$ —	\$ 1,004,630	\$ 1,005,592
Owner occupied	—	—	3,707	—	1,459,293	1,463,000
Non-owner occupied	—	27,546	—	—	2,620,079	2,647,625
Multi-family	—	3,125	—	—	360,608	363,733
Residential 1-4 family	2,447	—	—	—	1,230,678	1,233,125
HELOC	403	—	—	—	389,571	389,974
Commercial and industrial	—	—	—	—	1,253,972	1,253,972
Government	—	—	—	—	471,037	471,037
Indirect	—	—	—	—	348,864	348,864
Consumer and other	—	—	—	—	120,643	120,643
Total, amortized cost	\$ 2,850	\$ 31,633	\$ 3,707	\$ —	\$ 9,259,375	\$ 9,297,565
Collateral value	\$ 6,435	\$ 61,896	\$ 7,675	\$ —		

December 31, 2020	Type of Collateral and Extent to Which Collateral Secures Loans				Loans Not Considered Collateral Dependent	Total
	Residential Property	Investment Property	Commercial Property	Business Assets		
Commercial Real Estate						
Construction and development	\$ —	\$ 1,124	\$ —	\$ —	\$ 1,198,648	\$ 1,199,772
Owner occupied	—	—	2,407	—	1,378,109	1,380,516
Non-owner occupied	—	27,536	—	—	2,307,699	2,335,235
Multi-family	—	8,062	—	—	287,426	295,488
Residential 1-4 family	4,414	—	—	—	1,212,215	1,216,629
HELOC	637	—	—	—	411,839	412,476
Commercial and industrial	—	—	—	3,619	1,987,189	1,990,808
Government	—	—	—	—	379,243	379,243
Indirect	—	—	—	—	271,459	271,459
Consumer and other	—	—	—	—	147,442	147,442
Total, amortized cost	\$ 5,051	\$ 36,722	\$ 2,407	\$ 3,619	\$ 9,581,269	\$ 9,629,068
Collateral value	\$ 29,799	\$ 82,571	\$ 10,275	\$ 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 well-secured and in the process of collection.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table is an aging analysis at amortized cost of the Company's loans held for investment portfolio at September 30, 2021 and December 31, 2020 (in thousands):

September 30, 2021		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	\$ 1,005,550	\$ 41	\$ —	\$ 1	\$ 42	\$ 1,005,592	\$ —		
Owner occupied	1,462,296	381	—	323	704	1,463,000	—		
Non-owner occupied	2,647,625	—	—	—	—	2,647,625	—		
Multi-family	363,733	—	—	—	—	363,733	—		
Residential 1-4 family	1,231,588	1,204	147	186	1,537	1,233,125	—		
HELOC	389,339	404	132	99	635	389,974	—		
Commercial and industrial	1,253,751	85	70	66	221	1,253,972	—		
Government	471,037	—	—	—	—	471,037	—		
Indirect	346,886	1,070	169	739	1,978	348,864	127		
Consumer and other	120,575	54	3	11	68	120,643	16		
Total	\$ 9,292,380	\$ 3,239	\$ 521	\$ 1,425	\$ 5,185	\$ 9,297,565	\$ 143		

December 31, 2020		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	\$ 1,199,167	\$ 601	\$ 3	\$ 1	\$ 605	\$ 1,199,772	\$ —		
Owner occupied	1,378,279	1,704	424	109	2,237	1,380,516	—		
Non-owner occupied	2,333,112	469	974	680	2,123	2,335,235	—		
Multi-family	295,488	—	—	—	—	295,488	—		
Residential 1-4 family	1,211,928	2,001	411	2,289	4,701	1,216,629	484		
HELOC	411,083	874	156	363	1,393	412,476	—		
Commercial and industrial	1,986,460	641	789	2,918	4,348	1,990,808	—		
Government	379,243	—	—	—	—	379,243	—		
Indirect	269,496	779	333	851	1,963	271,459	44		
Consumer and other	147,411	30	1	—	31	147,442	—		
Total	\$ 9,611,667	\$ 7,099	\$ 3,091	\$ 7,211	\$ 17,401	\$ 9,629,068	\$ 528		

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 for the periods ended September 30, 2021 and December 31, 2020. Nonaccrual loans without specific reserves are included in collectively evaluated pools for which an ACL has been recorded.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

It also shows interest income recognized on nonaccrual loans (in thousands):

September 30, 2021	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 09/30/2021	Nonaccrual Loans With No Specific Reserve as of 09/30/2021	Interest Income Recognized as of 9/30/2021
	As of 06/30/2021	As of 09/30/2021			
Commercial Real Estate					
Construction and development	\$ —	\$ —	\$ —	\$ —	5
Owner occupied	1,023	331	—	331	154
Non-owner occupied	300	—	—	—	13
Multi-family	2,887	2,840	—	—	64
Residential 1-4 family	2,266	1,126	—	775	251
HELOC	789	562	—	562	111
Commercial and industrial	3,249	2,929	—	2,929	187
Government	—	—	—	—	—
Indirect	656	660	127	660	85
Consumer and other	8	3	16	3	25
Total	\$ 11,178	\$ 8,451	\$ 143	\$ 5,260	\$ 895

December 31, 2020	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 12/31/2020	Nonaccrual Loans With No Specific Reserve as of 12/31/2020	Interest Income Recognized as of 12/31/2020
	As of 01/01/2020	As of 12/31/2020			
Commercial Real Estate					
Construction and development	\$ 43	\$ —	\$ —	\$ —	8
Owner occupied	7,346	387	—	387	47
Non-owner occupied	221	1,163	—	694	98
Multi-family	—	—	—	—	—
Residential 1-4 family	5,525	3,432	484	3,042	371
HELOC	1,214	1,072	—	1,071	114
Commercial and industrial	3,284	4,414	—	4,414	404
Government	—	—	—	—	—
Indirect	976	717	45	890	135
Consumer and other	4	3	—	3	32
Total	\$ 18,613	\$ 11,188	\$ 529	\$ 10,501	\$ 1,209

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Other Real Estate Owned

The table below presents a summary of activity related to OREO for the nine-month periods ended September 30, 2021 and 2020 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Beginning balance	\$ 4,041	\$ 12,315	\$ 5,026	\$ 15,360
Additions and capital improvements	1,626	1,947	2,626	4,922
Sales	(258)	(827)	(2,478)	(6,735)
Net change in valuation allowance	—	—	—	(471)
Gain (loss) on sale and write-downs, net	—	(991)	235	(632)
Ending balance	<u>\$ 5,409</u>	<u>\$ 12,444</u>	<u>\$ 5,409</u>	<u>\$ 12,444</u>

As of September 30, 2021, the Company's recorded investment in OREO collateralized by residential real estate was \$0.66 million. As of September 30, 2021, the Company's recorded investment in mortgage loans collateralized by residential real estate that are in the process of foreclosure was \$0.26 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. Because 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, 2021, 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	September 30, 2021	December 31, 2020
Assets		
Operating lease assets included in other assets	\$ 54,963	\$ 60,340
Liabilities		
Accrued liability operating leases included in other liabilities	\$ 58,865	\$ 64,161

The following table presents a summary of activity related to leases for the three- and nine-month periods ended September 30, 2021 and 2020 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Operating lease cost (1) included in occupancy expense	\$ 3,608	\$ 3,960	\$ 10,702	\$ 10,520
Variable lease cost included in occupancy expense	183	151	621	493
Sublease income included in occupancy expense	(132)	(18)	(222)	(61)
Net lease cost	\$ 3,659	\$ 4,093	\$ 11,101	\$ 10,952

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

The following table presents lease liability maturities, by year, as of September 30, 2021 (in thousands):

	Operating Leases (1)
October 1 - December 31, 2021	\$ 3,249
2022	11,330
2023	8,723
2024	6,794
2025	5,868
After 2025	48,260
Total lease payments	\$ 84,224
Less: interest	25,359
Present value of lease liabilities	\$ 58,865

(1) Operating lease payments include \$29.86 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.

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

	September 30, 2021	September 30, 2020
Weighted - average remaining lease term - operating leases (in years)	13.12	13.55
Weighted - average discount rate - operating leases	4.86%	4.87%

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents other information with regard to leases for the three- and nine-month periods ended September 30, 2021 and 2020 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from operating leases	\$ 3,241	\$ 2,888	\$ 9,600	8,526
Related Party Transactions (1)				
Rent expense included in occupancy expense	\$ 707	\$ 655	\$ 2,026	1,965

(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. 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, and employee benefit services.

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

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables provide information about reportable segments and reconciliation of such information to the Consolidated Financial Statements for the periods indicated (dollars in thousands):

Three Months Ended September 30, 2021	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 97,668	\$ 2,775	\$ —	\$ 100,443
Provision for credit losses	(1,728)	146	—	(1,582)
Net interest income after provision for credit losses	99,396	2,629	—	102,025
Residential mortgage banking income, net	(1,215)	26,637	—	25,422
Insurance commissions and other title fees and income, net	55	706	16,637	17,398
Real estate brokerage and property management income, net	—	14,283	—	14,283
Other noninterest income	11,678	648	204	12,530
Noninterest expense	59,933	31,799	12,354	104,086
Income before income tax, corporate allocation and noncontrolling interest	49,981	13,104	4,487	67,572
Corporate allocation	1,241	(1,000)	(241)	—
Income before income tax provision and noncontrolling interest	51,222	12,104	4,246	67,572
Provision for income tax expense	10,225	3,546	1,058	14,829
Net income	40,997	8,558	3,188	52,743
Noncontrolling interest	2	(2,345)	—	(2,343)
Net income attributable to TowneBank	\$ 40,999	\$ 6,213	\$ 3,188	\$ 50,400
Net income as percentage of total	81.34 %	12.33 %	6.33 %	100.00 %
Total assets	\$ 14,619,735	\$ 764,394	\$ 427,243	\$ 15,811,372

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine Months Ended September 30, 2021				Consolidated
	Banking	Realty	Insurance	Totals
Net interest income	\$ 293,407	\$ 8,170	\$ —	\$ 301,577
Provision for credit losses	(14,661)	(1,004)	—	(15,665)
Net interest income after provision for credit losses	308,068	9,174	—	317,242
Residential mortgage banking income, net	(2,539)	90,898	—	88,359
Insurance commissions and other title fees and income, net	185	1,917	49,953	52,055
Real estate brokerage and property management income, net	—	43,201	—	43,201
Other noninterest income	32,046	2,017	651	34,714
Noninterest expense	177,927	90,562	38,316	306,805
Income before income tax, corporate allocation and noncontrolling interest	159,833	56,645	12,288	228,766
Corporate allocation	3,782	(3,000)	(782)	—
Income before income tax provision and noncontrolling interest	163,615	53,645	11,506	228,766
Provision for income tax expense	30,461	12,017	2,910	45,388
Net income	133,154	41,628	8,596	183,378
Noncontrolling interest	(1)	(8,176)	—	(8,177)
Net income attributable to TowneBank	\$ 133,153	\$ 33,452	\$ 8,596	\$ 175,201
Net income as percentage of total	76.00 %	19.09 %	4.91 %	100.00 %
Total assets	\$ 14,619,735	\$ 764,394	\$ 427,243	\$ 15,811,372

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 credit 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

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 10. Commitments and Contingencies**

Commitments to extend credit are agreements to lend to customers, provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2021, the amounts of off-balance-sheet commitments to extend credit were \$4.29 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, 2021, standby letters of credit and financial guarantees were \$148.07 million.

Additionally, the Company had \$2.68 billion in mortgage loans sold to investors with estimated recourse and warranty provisions totaling \$98.42 million as of September 30, 2021.

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 9 – Goodwill and Intangible Assets* of the 2020 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 other intangible assets as of the dates indicated (in thousands):

	September 30, 2021		December 31, 2020	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 31,339	\$ 22,024	\$ 31,339	\$ 19,288
Non-compete agreements	2,185	1,700	2,185	1,535
Customer lists	76,357	43,429	66,359	38,138
Total intangible assets subject to amortization	109,881	67,153	99,883	58,961
Trade name	4,880	—	1,380	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	8,111	—	4,611	—
Total other intangible assets	\$ 117,992	\$ 67,153	\$ 104,494	\$ 58,961

Amortization expense for intangible assets was \$2.75 million and \$2.85 million for the three-month periods, and \$8.19 million and \$8.70 million for the nine-month periods ended September 30, 2021 and 2020, respectively.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2020, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2020	\$ 344,713	\$ 27,667	\$ 79,948	\$ 452,328
Additions to goodwill	—	4,859	—	4,859
Other adjustments	—	—	—	—
Balance, September 30, 2021	\$ 344,713	\$ 32,526	\$ 79,948	\$ 457,187

Note 12. Postretirement Benefits

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

	SERP		Other Postretirement Benefits	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2021	2020	2021	2020
Service cost	\$ 1,059	\$ 1,100	\$ —	\$ —
Interest cost	370	375	10	11
Amortization of prior service costs	171	164	—	—
Amortization of actuarial (gain) loss	43	106	8	9
Net periodic postretirement benefit cost	\$ 1,643	\$ 1,745	\$ 18	\$ 20

	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Service cost	\$ 3,271	\$ 3,335	\$ —	\$ —
Interest cost	1,118	1,139	31	33
Amortization of prior service costs	513	504	—	—
Amortization of actuarial (gain) loss	125	316	25	29
Net periodic postretirement benefit cost	\$ 5,027	\$ 5,294	\$ 56	\$ 62

Postretirement benefit costs are included in our Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2021 and September 30, 2020. 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.

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 13. Accumulated Other Comprehensive Income (Loss)**

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2021 and 2020 (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, 2020	\$ 45,452	\$ (4,268)	\$ 41,184
Other comprehensive income before reclassifications	(19,454)	343	(19,111)
Amounts reclassified from AOCI	(989)	513	(476)
Other comprehensive income, net	(20,443)	856	(19,587)
Balance, September 30, 2021	<u>\$ 25,009</u>	<u>\$ (3,412)</u>	<u>\$ 21,597</u>
	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>

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

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

Note 14. Variable Interest Entities

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 \$288.17 million and \$281.28 million were not included in the Consolidated Balance Sheets at September 30, 2021 and December 31, 2020, respectively. These limited partner interests had carrying values of \$102.15 million and \$92.38 million at September 30, 2021 and December 31, 2020, 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 \$102.15 million and \$92.38 million at September 30, 2021 and December 31, 2020, respectively. The Company's maximum exposure to loss would result from the loss of its limited partner investments. As of September 30, 2021, the Company had \$80.71 million in funding commitments that are dependent on certain contractual milestones and \$12.00 million in unfunded short-term construction loans commitments. There were no loan balances outstanding at September 30, 2021. For the three- and nine-month periods ended September 30, 2021, tax benefits totaling \$0.60 million and \$1.90 million, net of amortization expenses of \$3.01 million and \$9.03 million, were recognized as a component of income tax expense. 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 15. Fair Value Disclosures

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

- Level 1** 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, which 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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. TowneBank elects 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. For additional information about loans held for sale, refer to Note 16.

Derivative financial instruments: Interest rate lock commitments, related to the origination of mortgage loans held for sale, are recorded at estimated fair value based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close. This factor, the fall-out rate, is derived from the Company's internal data and is adjusted using significant management judgment. The fall-out rate is largely dependent on the processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. As such, interest rate lock commitments are classified as recurring Level 3. For the three-month periods ended September 30, 2021 and September 30, 2020, the Company used weighted average fall-out rates of 12.77% and 13.27%, respectively. For the year ended December 31, 2020, the Company used a fall-out rate of 12.77%.

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2021 and December 31, 2020 (in thousands):

	September 30, 2021			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 207,949	\$ —	\$ 207,949
U.S. Treasury notes	1,007	—	—	1,007
Municipal securities	—	350,952	—	350,952
Mortgage-backed securities issued by GSEs	—	969,017	—	969,017
Trust preferred and other corporate securities	—	31,477	—	31,477
Loans held for sale - mandatory delivery	—	87,299	—	87,299
Derivative assets	—	776	6,087	6,863
Derivative liabilities	—	182	—	182

	December 31, 2020			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 184,657	\$ —	\$ 184,657
U.S. Treasury notes	1,000	—	—	1,000
Municipal securities	—	353,641	—	353,641
Mortgage-backed securities issued by GSEs	—	797,765	—	797,765
Trust preferred and other corporate securities	—	31,161	—	31,161
Loans held for sale - mandatory delivery	—	—	—	—
Derivative assets	—	—	11,781	11,781
Derivative liabilities	—	—	—	—

TowneBank elects the fair value option for loans held for sale within the mandatory delivery program. This election allows for a more effective offset of the changes in fair value of the loans and the derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting. TowneBank has not elected the fair value for other loans held for sale primarily because they are not actively hedged. Fair values of loans held for sale are recorded in mortgage loans held for sale in the Consolidated Balance Sheets.

The following table summarizes the difference between the aggregate fair value and the aggregate unpaid principal balance for mortgage loans held for sale measured at fair value at September 30, 2021 and September 30, 2020.

	September 30, 2021	September 30, 2020 (1)
Aggregate fair value	\$ 87,299	\$ —
Aggregate unpaid principal	87,560	—
Aggregate fair value less aggregate unpaid principal	\$ (261)	\$ —

(1) At September 30, 2020, the Company was temporarily not participating in the mandatory delivery system, so had no unpaid balance to report.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Net Gains (Losses) Resulting from Changes in Fair Value				
(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Mortgage loans held for sale, at fair value	\$ (865)	\$ (86)	\$ (261)	\$ (1,084)

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, 2021 and December 31, 2020 (in thousands):

September 30, 2021	Level 1	Level 2	Level 3	Fair Value
Collateral-dependent assets with specific reserves	\$ —	\$ —	\$ 4,825	\$ 4,825
Other real estate owned and other nonperforming assets	—	—	5,409	5,409
HTM trust preferred and other corporate securities	—	—	1,597	1,597

December 31, 2020	Level 1	Level 2	Level 3	Fair Value
Collateral-dependent assets with specific reserves	\$ —	\$ —	\$ 8,131	\$ 8,131
Other real estate owned and other nonperforming assets	—	—	5,025	5,025

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

Collateral-dependent assets with specific reserves: 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 5.10% to 100%, with a weighted average of 20.47%.

Loans held for sale - best efforts: Loans closed and held for sale within the mandatory program are carried at fair value. Loans held for sale within the best efforts program are carried at the lower of cost or fair value. Fair values of loans held for sale are based on commitments on hand from investors or, if commitments have not yet been obtained, prevailing market rates. For additional information about loans held for sale, refer to Note 16.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Other real estate owned and other nonperforming assets: The fair value of OREO and 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.

HTM trust preferred and other corporate securities: The fair value of certain corporate securities is based on a discounted cash flow model which utilizes Level 3, or unobservable inputs, the most significant of which were a discount rate and weighted-average life. At September 30, 2021, the discount rate utilized was 2.91% and the weighted-average life was 27.60 years.

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, 2021 and December 31, 2020, are as follows (in thousands):

September 30, 2021	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	\$ 75,370	\$ 75,730	\$ 75,730	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	3,155,039	3,155,039	3,155,039	—	—
Interest-bearing deposits in financial institutions	33,506	33,506	33,506	—	—
Securities available for sale, net	1,560,402	1,560,402	—	1,560,402	—
Securities held to maturity, net	14,898	16,489	—	14,892	1,597
Other equity securities	6,621	6,621	—	6,621	—
Mortgage loans held for sale - mandatory delivery	87,299	87,299	—	87,299	—
Mortgage loans held for sale - best efforts	344,547	344,547	—	344,547	—
Net loans	9,297,565	9,227,986	—	—	9,227,986
Interest receivable	26,927	26,927	—	26,927	—
Non-maturity deposits	11,442,298	10,662,463	—	10,662,463	—
Time deposits	1,571,752	1,575,998	—	1,575,998	—
Advances from the FHLB	155,537	154,828	—	154,828	—
Subordinated debt	249,503	252,973	—	252,973	—
Repurchase agreements and other borrowings	82,413	73,219	—	73,219	—
Interest payable	3,852	3,852	—	3,852	—

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2020	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Cash and due from banks	\$ 41,514	\$ 41,514	\$ 41,514	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,795,241	1,795,241	1,795,241	—	—
Interest-bearing deposits in financial institutions	27,532	27,532	27,532	—	—
Securities available for sale	1,368,224	1,368,224	—	1,368,224	—
Securities held to maturity	16,512	18,469	—	16,648	1,821
Other equity securities	6,492	6,492	—	6,492	—
Mortgage loans held for sale	540,798	541,027	—	541,027	—
Net loans	9,629,068	9,542,454	—	—	9,542,454
Interest receivable	31,821	31,821	—	31,821	—
Non-maturity deposits	9,524,261	9,838,420	—	9,838,420	—
Time deposits	2,048,905	2,062,962	—	2,062,962	—
Advances from the FHLB	456,038	457,117	—	457,117	—
Subordinated debt	249,055	255,398	—	255,398	—
Repurchase agreements, FRB PPP lending facility and other borrowings	250,638	250,203	—	250,203	—
Interest payable	9,723	9,723	—	9,723	—

Note 16. Derivative Instruments and Hedging Activities

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2021		December 31, 2020	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	\$ 562,151	\$ 6,863	\$ 698,126	\$ 11,781
Interest rate contracts included in other liabilities	\$ 88,149	\$ 182	\$ —	\$ —

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, 2021, the Company recognized \$0.77 million and \$5.78 million in losses from mortgage banking derivatives, respectively. For the three and nine months ended September 30, 2020, the Company recognized \$3.33 million in gains and \$1.12 million in losses from mortgage banking derivatives, respectively.

Note 17. Revenue from Contracts with Customers

ASC 606 - *Revenue from Contracts with Customers*, requires the disaggregation of revenue from contracts with customers into categories that show how economic factors affect the nature, timing, and uncertainty of revenue and cash flows. Suggested categories of disaggregation included but were not limited to: (1) type of good or service, (2) geographical region, (3) market or type of customer, (4) type of contract, (5) contract duration, (6) timing of the transfer of goods or services, and (7) sales channels. The Company disaggregates revenue from contracts by major product line, a type of good or service.

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,	
	2021	2020	2021	2020
Investment management income				
Investment commissions, net	\$ 2,698	\$ 2,006	\$ 7,316	\$ 5,556
Total	\$ 2,698	\$ 2,006	\$ 7,316	\$ 5,556
Insurance income				
Property and casualty insurance income, net	\$ 13,808	\$ 12,581	\$ 41,379	\$ 37,789
Benefit insurance income, net	2,829	2,774	8,574	8,773
Travel insurance commissions, net	—	1,399	—	3,526
Total	\$ 16,637	\$ 16,754	\$ 49,953	\$ 50,088
Real estate and property management income				
Real estate sales commissions, net	\$ 3,781	\$ 3,688	\$ 10,125	\$ 8,212
Real estate property management income, net	10,502	7,613	33,076	20,808
Total	\$ 14,283	\$ 11,301	\$ 43,201	\$ 29,020

In the first nine months of 2021, the Company recorded a provision for credit losses on receivables related to future reservations of resort properties recorded in real estate property management income of \$0.17 million. The Company recorded a provision for credit losses related to property and casualty insurance receivables of \$0.15 million in the first nine months of 2021. In the first nine months of 2020, the Company recorded a provision for credit losses related to receivables for future reservations of resort properties recorded in real

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. A gain on the sale of Red Sky totaling \$17.63 million was recorded in other income. After distributions to noncontrolling interests, the Company retained a pre-tax gain of \$6.52 million. 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, 2021.

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 18. Borrowings

The Company has short-term borrowings for terms under one year consisting of REPOs and FHLB advances. FHLB advances are for various terms and are secured by a blanket lien on residential mortgages and other real estate-secured loans. All REPOs are overnight short-term investments and are not insured by the FDIC. Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and, therefore, are accounted for as a secured borrowing. Due to the overnight short-term nature of REPOs, potential risk due to a decline in the value of the pledged collateral is low. Collateral pledging requirements with REPOs are monitored daily.

On July 17, 2017, the Company issued \$250.0 million of fixed-to-floating-rate subordinated notes due July 30, 2027, in a public offering. The Company received \$247.07 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 4.50% for the first five years until July 30, 2022. From and including this date and for the remaining five years of the subordinated notes' term, interest will accrue at a floating rate of three-month LIBOR plus 2.55%. The Company may redeem the subordinated notes, in whole or in part, on or after July 30, 2022. At September 30, 2021, the carrying value of the notes totaled \$249.50 million, compared with \$249.05 million at December 31, 2020.

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 pledged PPP loans, on a non-recourse basis, and had no funding outstanding at September 30, 2021, and \$182.85 million in funding outstanding under the Federal Reserve's PPP lending facility at December 31, 2020.

PART I. FINANCIAL INFORMATION

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2020 audited Consolidated Financial Statements included in our 2020 Annual Report to Shareholders and our 2020 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, which 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, which may adversely affect our business; costs or difficulties related to the integration of the businesses we have acquired may be greater than expected; expected cost savings associated with pending or recently completed acquisitions may not be fully realized or realized within the expected time frame; cybersecurity threats or attacks, the implementation of new technologies, and the ability to develop and maintain reliable electronic systems; our competitors may have greater financial resources and develop products that enable them to compete more successfully; changes in business conditions; changes in the securities market; and changes in our local economy with regard to our market area. Any forward-looking statements made by us or on our behalf speak only as of the date they are made or as of the date indicated, and we do not undertake any obligation to update forward-looking statements as a result of new information, future events, or otherwise. For additional information on factors that could materially influence forward-looking statements included in this report, see the risk factors in "Item 1A. Risk Factors," in the Company's Form 10-K for the year ended December 31, 2020, and related disclosures in other filings that have been, or will be, filed by TowneBank with the FDIC.*

PART I. FINANCIAL INFORMATION

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

Financial Highlights

The following table sets forth certain financial highlights of TowneBank:

<i>(Dollars in thousands, except per share data)</i>	Third Quarter 2021	Second Quarter 2021	First Quarter 2021	Fourth Quarter 2020	Third Quarter 2020
Results of Operations:					
Interest income	\$ 109,845	\$ 111,815	\$ 112,290	\$ 115,983	\$ 115,528
Interest expense	9,402	10,671	12,300	15,369	18,769
Net interest income	100,443	101,144	99,990	100,614	96,759
Provision for credit losses	(1,582)	(10,055)	(4,027)	1,617	31,598
Net interest income after provision for credit losses	102,025	111,199	104,017	98,997	65,161
Total noninterest income	69,633	66,177	82,519	71,234	95,376
Total noninterest expense	104,086	105,394	97,326	105,932	101,981
Income before noncontrolling interest and income tax	67,572	71,982	89,210	64,299	58,556
Provision for income tax expense	14,829	13,980	16,580	10,408	7,841
Net income	\$ 52,743	\$ 58,002	\$ 72,630	\$ 53,891	\$ 50,715
Net income attributable to noncontrolling interest	(2,343)	(2,199)	(3,636)	(3,809)	(16,251)
Net income attributable to TowneBank	\$ 50,400	\$ 55,803	\$ 68,994	\$ 50,082	\$ 34,464
Per Share Data:					
Net income:					
Basic	\$ 0.70	\$ 0.77	\$ 0.95	\$ 0.69	\$ 0.48
Diluted	0.69	0.77	0.95	0.69	0.48
Book value at period end	25.91	25.51	24.78	24.31	23.83
Tangible book value at period end ^(non-GAAP)	18.92	18.70	17.94	17.46	17.06
Cash dividends declared	0.20	0.20	0.18	0.18	0.18
Selected Financial Ratios (annualized):					
Return on average assets	1.27 %	1.48 %	1.92 %	1.35 %	0.89 %
Return on average tangible assets ^(non-GAAP)	1.37 %	1.59 %	2.05 %	1.46 %	0.97 %
Return on average equity	10.59 %	12.21 %	15.56 %	11.26 %	7.85 %
Return on average tangible equity ^(non-GAAP)	15.09 %	17.38 %	22.19 %	16.28 %	11.66 %
Net interest margin (tax-equivalent basis) ^(non-GAAP)	2.78 %	2.94 %	3.05 %	2.98 %	2.72 %
Daily Averages:					
Total assets	\$15,706,998	\$15,143,888	\$14,592,416	\$14,722,385	\$15,487,152
Total tangible assets ^(non-GAAP)	15,200,767	14,647,829	14,094,970	14,230,932	14,992,914
Loans, net of unearned income, excluding nonaccrual loans	9,238,922	9,604,804	9,647,129	9,752,150	9,752,746
Total earning assets	14,433,125	13,917,421	13,383,380	13,515,147	14,276,258
Total deposits	12,900,747	12,280,121	11,679,560	11,690,387	11,302,887
FHLB advances and PPP lending facility	212,699	398,122	492,156	653,832	1,865,739
Total equity	1,888,451	1,833,592	1,797,767	1,768,906	1,747,033
Tangible equity ^(non-GAAP)	1,392,407	1,375,257	1,319,169	1,285,968	1,256,197
Basic weighted average shares outstanding	72,506,877	72,468,094	72,414,953	72,357,177	72,339,413
Diluted weighted average shares outstanding	72,591,281	72,560,234	72,517,008	72,455,096	72,375,736

PART I. FINANCIAL INFORMATION

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

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

The following discussion and analysis presents the significant factors affecting the Company's financial performance in the three months ended September 30, 2021. 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, 2021, was \$50.40 million, or \$0.69 per common diluted share, compared to \$34.46 million, or \$0.48 per common diluted share, for the same period in 2020. Net income for the nine months ended September 30, 2021, was \$175.20 million, or \$2.41 per common diluted share, compared to \$95.45 million, or \$1.32 per common diluted share, for the same period in 2020.
- Net interest income increased \$3.68 million, or 3.81%, to \$100.44 million in third quarter 2021 from the comparable period in 2020. Net interest income increased \$22.05 million, to \$301.58 million, or 7.89%, in the first nine months of 2021 from the comparable period in 2020. These increases were primarily attributable to a decline in interest expense due to lower rates on interest-bearing deposits and borrowings.
- Third quarter 2021, we recorded a negative provision for credit losses of \$1.58 million, a decline of \$33.18 million, when compared to the provision for credit losses of \$31.60 million for the quarter ended September 30, 2020. The provision for credit losses on loans decreased \$81.22 million in the first nine months of 2021 compared to 2020. The provision for credit losses includes a provision for losses on unfunded loan commitments. The Company built a significant reserve for loan losses in 2020 largely based on management's outlook of the effects of the COVID-19 pandemic on the local and national economy. A combination of year-to-date net recoveries and improvements in the economic forecast, offset by modest core loan growth in 2021, have led to the release of a portion of the reserves. The allowance for credit losses on loans was 1.15% of period-end loans at September 30, 2021 and June 30, 2021, compared to 1.22% at September 30, 2020.
- Noninterest income for the three-month period ended September 30, 2021, decreased \$25.74 million, or 26.99%, compared to the same period in 2020. The decrease was partially due to a decline in residential mortgage banking income. Additionally, in third quarter 2020, noninterest income included a gain on the sale of Red Sky, a travel insurance joint venture, of \$17.63 million. Noninterest income for the first nine months of 2021 increased \$5.37 million, or 2.52%, compared to the first nine months of 2020, driven by growth in property management commissions and residential mortgage banking income.

PART I. FINANCIAL INFORMATION

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

- Noninterest expense increased \$2.11 million, or 2.06%, in the quarterly comparison and \$16.91 million, or 5.83%, in the first nine months of 2021 compared to 2020. The year-to-date increase reflects increases in salaries, software, data processing, advertising and marketing, and charitable contributions.

COVID-19 Impact

The early 2020 outbreak of the global COVID-19 pandemic and related preventive measures taken across the U.S. and worldwide resulted in an extended economic downturn. During of third quarter 2021, COVID-19 cases rose despite the availability of the vaccine. Increased cases were noted in children and young adults, and evolving strains potentially resistant to the vaccine, also emerged. Consumer spending remains strong, but the state of the global supply chain continues to be a challenge that has been compounded by a shrunken workforce. Shortages of some goods, coupled with highly congested ports of entry for goods that are available, have added to the pressures of demand and driven prices upward. Economists are predicting sharp increases in the cost of food and fuel in the coming months. Many industries are experiencing workforce shortages. Costs associated with construction and other areas of industry have increased significantly due to supply shortages, and the demand for many consumer durable goods, such as appliances and autos, exceed the short-term supply.

Events surrounding the COVID-19 pandemic had an impact on both the timing and recognition of Company financial results in 2020 and will likely impact our comparisons throughout 2021. Although the sustained low rate environment continues to positively impact mortgage production and real estate brokerage income, refinance activities have declined and the demand for housing inventory exceeds the supply. The financial health of our members remains paramount, and management continues to closely evaluate our provision for credit losses after significantly increasing it in 2020. Through the end of third quarter 2021, rates remain low. Debate is ongoing about the current levels of inflation and whether it should be of long-term concern or if it is transitory.

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. On December 27, 2020, the Appropriations Act extended TDR relief and provided additional PPP funding.

Our relationship managers continue to maintain a high level of contact with our members to closely evaluate their financial needs and help them navigate their specific situations. As of September 30, 2021, the Company had 10 eligible loan modifications with outstanding balances of \$50.95 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 participated in both PPP lending programs provided by the CARES Act and Appropriations Act. As of September 30, 2021, outstanding balances from the 2020 PPP lending program were \$0.02 billion, and outstanding balances from the 2021 PPP lending program totaled \$0.23 billion. The CARES Act provides for forgiveness of up to the full principal amount of qualifying loans guaranteed under the PPP.

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

PART I. FINANCIAL INFORMATION

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

Consolidated Financial Statements and 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, 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 2020 Annual Report to Shareholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized ROA was 1.27% in third quarter 2021, compared to 0.89% in third quarter 2020, and 1.48% in second quarter 2021. The annualized return on average tangible assets (non-GAAP) was 1.37%, 0.97%, and 1.59% for the same respective periods. ROA for the nine-month period ended September 30, 2021, was 1.55%, compared to 0.91% for the same period in 2020.

Annualized ROE was 10.59% for third quarter 2021, 7.85% for third quarter 2020, and 12.21% for second quarter 2021, while the annualized return on average tangible equity (non-GAAP) was 15.09%, 11.66%, and 17.38% for the same respective periods. Return on average tangible equity (non-GAAP) for the nine-month period ended September 30, 2021, was 18.12%, compared to 11.32% for the nine-month period ended September 30, 2020.

Operating income (non-GAAP), calculated as net interest income and noninterest income less gains on investment securities and other nonrecurring income, was \$170.08 million for the quarter ended September 30, 2021, which was a decrease of \$2.73 million, or 1.58%, compared to the quarter ended September 30, 2020. Operating income for the first nine months of 2021 was \$518.68 million, an increase of \$53.46 million, or 11.49%, compared to the first nine months of 2020.

Diluted EPS was \$0.69 and \$2.41 for the three and nine months ended September 30, 2021, respectively, compared to \$0.48 and \$1.32 for the same periods in 2020.

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 \$100.97 million for the quarter ended September 30, 2021, which was \$3.61 million, or 3.71%, higher than the third quarter 2020 total of \$97.36 million. On a linked-quarter basis, net interest income, tax-equivalent, increased by \$1.09 million, or 1.07%, from \$102.06 million.

Net interest income, tax-equivalent, increased \$3.61 million in the quarter, compared to the prior year quarter, driven by a decline in rates on interest-bearing liabilities and a decline in borrowings and certificates of deposit balances. Average earning assets increased \$170.75 million in the three-months' comparison to prior year while yields on earning assets declined 21 bp, for a decrease in interest income of \$5.76 million. Average loans declined \$513.82 million, driven by a decrease in average PPP loans of \$741.13 million. Related interest and fee income on PPP loans was \$7.77 million. Excluding the impact of PPP loans, the

PART I. FINANCIAL INFORMATION

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

yield on our loan portfolio was 4.06% in third quarter 2021 and average loans increased \$220.80 million, or 2.55%. Average interest-bearing liabilities decreased \$0.98 billion compared to third quarter 2020 and, combined with a 36 bp decline in interest costs, resulted in a \$9.37 million decline in interest expense. Borrowings decreased an average of \$1.63 billion in the quarter, driven by the decline in average borrowings related to FHLB and the repayment in the prior year of borrowings under the Federal Reserve PPP lending facility.

Comparing third quarter 2021 to the linked quarter, net interest income, tax-equivalent, decreased \$1.09 million primarily due to the quarter-over-quarter decline in average loans held for investment that was partially offset by lower rates on certificates of deposit. Average loans held for investment declined \$365.88 million, driven by a \$409.30 million decline in average PPP loans. The overall yield on earning assets declined 22 bp. The average cost of certificates of deposit declined 29 bp between quarters. The cost of interest-bearing deposits and total interest-bearing liabilities declined 8 bp.

Net interest income, tax-equivalent, increased \$22.30 million in the first nine months of 2021 compared to 2020, driven by lower interest expense. Declines in interest rates on interest-bearing liabilities along with a decline in average borrowings and certificates of deposit led to a \$32.27 million decrease in interest costs that was only partially offset by the decline in rate on earning assets.

Interest income, on a tax-equivalent basis, was \$110.37 million for the quarter ended September 30, 2021, which was \$5.76 million, or 4.96%, lower than the \$116.13 million reported for the quarter ended September 30, 2020. On a linked-quarter basis, tax-equivalent interest income decreased \$2.36 million, or 2.10%, from \$112.73 million in second quarter 2021. Average earning assets grew to \$14.43 billion in the quarter ended September 30, 2021, from \$14.26 billion in the comparative prior year quarter, an increase of \$0.17 billion, or 1.20%. In the linked-quarter comparison, average earning assets increased by \$0.52 billion, or 3.72%, from \$13.92 billion in second quarter 2021. The yield on earning assets was 3.03% in the quarter ended September 30, 2021, down compared to 3.24% in the prior year and 3.25% in the linked quarter. Average loan balances in third quarter 2021, excluding nonaccrual loans, were \$9.24 billion, \$0.51 billion, or 5.27% lower than the same period one year ago, while loan yields increased by 2 bp. In the linked quarter, average loans decreased by \$0.37 billion, or 3.81%, and loan yields remained flat.

Interest income, on a tax-equivalent basis, was \$335.98 million for the nine months ended September 30, 2021, which was \$9.98 million, or 2.88%, lower than \$345.96 million reported for the nine months ended September 30, 2020. Average earning assets grew to \$13.92 billion in the nine months ended September 30, 2021, from \$11.80 billion in the comparative prior year, an increase of \$2.12 billion, or 17.96%. The yield on earning assets was 3.23% in the nine months ended September 30, 2021, down compared to 3.92% in the prior year. Average loan balances, excluding nonaccrual loans, of \$9.50 billion, were \$0.19 billion, or 2.00%, higher in the first nine months of September 30, 2021, while loan yields decreased by 15 bp compared to prior year.

Interest expense for the quarter ended September 30, 2021, was \$9.40 million, which was \$9.37 million, or 49.90%, lower than interest expense of \$18.77 million for third quarter 2020. Average interest-bearing liabilities were \$8.24 billion in third quarter 2021, down from \$9.21 billion in the comparative prior year quarter, a decrease of 10.59%. On a linked-quarter basis, interest expense decreased 11.89% from \$10.67 million in second quarter 2021. Average interest-bearing liabilities increased \$0.17 billion, or 2.12%, from \$8.07 billion in the linked quarter. The cost of interest-bearing liabilities was 0.45% in third quarter 2021, compared to 0.81% in third quarter 2020, and 0.53% in the linked quarter. This represented a 36 bp decrease from prior year and an 8 bp decrease from the linked quarter.

PART I. FINANCIAL INFORMATION

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

Interest expense for the nine months ended September 30, 2021, was \$32.37 million, which was \$32.27 million, or 49.92%, lower than interest expense of \$64.65 million for 2020. Average interest-bearing liabilities decreased to \$8.11 billion in the first nine months of 2021 from \$8.34 billion in the prior year, a decrease of 1.77%.

Over the past year, the Company has deployed its excess liquidity in low yielding interest-bearing deposits. This excess liquidity was approximately 14 bp dilutive in third quarter 2021, compared to the linked quarter. Based on pre-COVID-19 average balances in interest-bearing deposits, excess liquidity has had a negative impact on net interest margin of approximately 53 bp. Management expects this trend to continue and plans to accelerate deploying excess liquidity over the next several quarters.

Tax-equivalent net interest margin, which is net interest income, tax-equivalent, expressed as a percentage of average earning assets, was 2.78%, or 6 bp higher, for the quarter ended September 30, 2021, than the September 30, 2020, quarter margin of 2.72%, and 16 bp lower than the quarter ended June 30, 2021, margin of 2.94%. Tax-equivalent net interest margin was 2.92%, or 27 bp lower, for the nine months ended September 30, 2021, compared to September 30, 2020. Interest rates remained at historic lows during the first nine months of 2021 after the Federal Reserve decreased rates 150 bp 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 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:

PART I. FINANCIAL INFORMATION

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

	Three Months Ended September 30, 2021			Three Months Ended June 30, 2021			Three Months Ended September 30, 2020		
	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)	\$ 9,238,922	\$ 98,733	4.24 %	\$ 9,604,805	\$ 101,490	4.24 %	\$ 9,752,746	\$ 103,401	4.22 %
Taxable investment securities	1,421,347	6,560	1.85 %	1,351,922	6,476	1.92 %	1,206,679	6,726	2.23 %
Tax-exempt investment securities	125,523	487	1.55 %	128,094	434	1.36 %	144,999	779	2.15 %
Total securities	1,546,870	7,047	1.82 %	1,480,016	6,910	1.87 %	1,351,678	7,505	2.22 %
Interest-bearing deposits	3,179,010	1,182	0.15 %	2,327,310	619	0.11 %	2,523,644	632	0.10 %
Loans held for sale	468,323	3,405	2.91 %	503,706	3,711	2.95 %	634,309	4,587	2.89 %
Total earning assets	14,433,125	110,367	3.03 %	13,915,837	112,730	3.25 %	14,262,377	116,125	3.24 %
Less: allowance for credit losses	(108,478)			(116,025)			(95,594)		
Total nonearning assets	1,382,351			1,344,076			1,320,369		
Total assets	<u>\$15,706,998</u>			<u>\$15,143,888</u>			<u>\$15,487,152</u>		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 5,486,788	\$ 2,095	0.15 %	\$ 5,179,907	\$ 2,004	0.16 %	\$ 4,311,920	\$ 2,663	0.25 %
Savings	358,739	533	0.59 %	346,177	528	0.61 %	304,753	555	0.72 %
Certificates of deposit	1,842,948	3,400	0.73 %	1,816,283	4,612	1.02 %	2,417,772	9,747	1.60 %
Total interest-bearing deposits	7,688,475	6,028	0.31 %	7,342,367	7,144	0.39 %	7,034,445	12,965	0.73 %
Borrowings	300,505	412	0.54 %	476,122	565	0.47 %	1,931,120	2,841	0.58 %
Subordinated debt, net	249,405	2,962	4.75 %	249,260	2,962	4.75 %	248,807	2,962	4.76 %
Total interest-bearing liabilities	8,238,385	9,402	0.45 %	8,067,749	10,671	0.53 %	9,214,372	18,768	0.81 %
Demand deposits	5,212,271			4,937,754			4,268,443		
Other noninterest-bearing liabilities	367,891			304,793			257,304		
Total liabilities	13,818,547			13,310,296			13,740,119		
Shareholders' equity	1,888,451			1,833,592			1,747,033		
Total liabilities and equity	<u>\$15,706,998</u>			<u>\$15,143,888</u>			<u>\$15,487,152</u>		
Net interest income (tax-equivalent basis)		\$ 100,965			\$ 102,059			\$ 97,357	
Reconciliation of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(522)			(915)			(598)	
Net interest income (GAAP)		<u>\$ 100,443</u>			<u>\$ 101,144</u>			<u>\$ 96,759</u>	
Interest rate spread (2)(4)			2.58 %			2.72 %			2.43 %
Interest expense as a percent of average earning assets			0.26 %			0.31 %			0.52 %
Net interest margin (tax equivalent basis) (3)(4)			2.78 %			2.94 %			2.72 %
Total cost of deposits			0.19 %			0.23 %			0.46 %

- September 30, 2021, June 30, 2021, and September 30, 2020, balances include average PPP balances of \$0.36 billion, \$0.77 billion, and \$1.10 billion, and related interest and fees of \$7.77 million, \$10.02 million, and \$9.82 million, respectively.
- Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Fully tax equivalent.
- Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent.
- Non-GAAP.

PART I. FINANCIAL INFORMATION

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

	Increase/(Decrease) Three Months Ended September 30, 2021 Compared to Three Months Ended June 30, 2021			Increase/(Decrease) Three Months Ended September 30, 2021 Compared to Three Months Ended September 30, 2020		
<i>(dollars in thousands)</i>	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	\$ (2,804)	\$ 47	\$ (2,757)	\$ (5,230)	\$ 562	\$ (4,668)
Taxable investment securities	325	(241)	84	1,092	(1,258)	(166)
Tax-exempt investment securities	(9)	62	53	(95)	(197)	(292)
Total securities	316	(179)	137	997	(1,455)	(458)
Interest-bearing deposits	264	299	563	185	365	550
Loans held for sale	(259)	(47)	(306)	(1,208)	26	(1,182)
Total earning assets	(2,483)	120	(2,363)	(5,256)	(502)	(5,758)
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	134	(43)	91	615	(1,183)	(568)
Savings	22	(17)	5	90	(112)	(22)
Certificates of deposit	70	(1,281)	(1,211)	(1,931)	(4,416)	(6,347)
Total interest-bearing deposits	226	(1,341)	(1,115)	(1,226)	(5,711)	(6,937)
Borrowings	(228)	74	(154)	(2,248)	(181)	(2,429)
Subordinated capital debentures	—	—	—	—	—	—
Total interest-bearing liabilities	(2)	(1,267)	(1,269)	(3,474)	(5,892)	(9,366)
Net interest income	\$ (2,481)	\$ 1,387	\$ (1,094)	\$ (1,782)	\$ 5,390	\$ 3,608

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

PART I. FINANCIAL INFORMATION

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

	Nine Months Ended September 30, 2021			Nine Months Ended September 30, 2020			Nine Months Ended September 30, 2021 Compared with 2020		
	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)	\$ 9,495,456	\$302,182	4.25 %	\$ 9,309,256	\$ 306,622	4.40 %	\$ (4,440)	\$(10,384)	\$ 5,944
Taxable investment securities	1,359,366	19,640	1.93 %	1,253,783	23,304	2.48 %	(3,664)	(5,507)	1,843
Tax-exempt investment securities	131,106	1,462	1.49 %	140,248	2,476	2.35 %	(1,014)	(862)	(152)
Total securities	1,490,472	21,102	1.89 %	1,394,031	25,780	2.47 %	(4,678)	(6,369)	1,691
Interest-bearing deposits	2,426,468	2,218	0.12 %	615,466	2,168	0.47 %	50	(2,552)	2,602
Loans held for sale	502,758	10,477	2.78 %	477,964	11,386	3.18 %	(909)	(1,478)	569
Total earning assets	13,915,154	335,979	3.23 %	11,796,717	345,956	3.92 %	(9,977)	(20,783)	10,806
Less: allowance for credit losses	(115,100)			(73,538)					
Total nonearning assets	1,351,796			2,264,295					
Total assets	<u>\$15,151,850</u>			<u>\$13,987,474</u>					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	5,192,658	6,175	0.16 %	3,898,642	10,472	0.36 %	(4,297)	(7,044)	2,747
Savings	345,739	1,583	0.61 %	290,684	1,702	0.78 %	(119)	(408)	289
Certificates of deposit	1,872,393	13,963	1.00 %	2,451,715	34,925	1.90 %	(20,962)	(14,008)	(6,954)
Total interest-bearing deposits	7,410,790	21,721	0.39 %	6,641,041	47,099	0.95 %	(25,378)	(21,460)	(3,918)
Borrowings	445,399	1,798	0.53 %	1,452,652	8,661	0.78 %	(6,863)	(2,169)	(4,694)
Subordinated debentures	249,261	8,854	4.74 %	248,660	8,885	4.76 %	(31)	(52)	21
Total interest-bearing liabilities	8,105,450	32,373	0.53 %	8,342,353	64,645	1.04 %	(32,272)	(23,681)	(8,591)
Demand deposits	4,880,493			3,687,791					
Other noninterest-bearing liabilities	325,639			252,337					
Total liabilities	13,311,582			12,282,481					
Shareholders' equity	1,840,268			1,704,993					
Total liabilities and equity	<u>\$15,151,850</u>			<u>\$13,987,474</u>					
Net interest income (tax-equivalent basis)		\$303,606			\$ 281,311		\$ 22,295	\$ 2,898	\$ 19,397
Reconciliation of Non-GAAP Financial Measures									
Tax-equivalent basis adjustment		(2029)			(1,781)			(248)	
Net interest income (GAAP)		<u>\$301,577</u>			<u>\$ 279,530</u>			<u>\$ 22,047</u>	
Interest rate spread (2)(4)			2.69 %			2.88 %			
Interest expense as a percent of average earning assets			0.31 %			0.73 %			
Net interest margin (tax equivalent basis) (3)(4)			2.92 %			3.19 %			
Total cost of deposits			0.24 %			0.61 %			

(1) September 30, 2021 and September 30, 2020, includes average PPP balances of \$0.64 billion and \$0.64 billion and related interest income of \$29.42 million and \$15.65 million, respectively.

(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.

PART I. FINANCIAL INFORMATION

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

Noninterest Income. Total noninterest income for the quarter ended September 30, 2021, was \$69.63 million, a decrease of \$25.74 million, or 26.99%, compared to the same period in 2020. As a percentage of total operating income (non-GAAP), noninterest income for third quarter 2021 was 40.94%, compared with 55.19% for comparative 2020. There were zero net gains or losses on investment securities in third quarter 2021 included in noninterest income and net gains on investment securities of \$1.70 million in third quarter 2020. Total noninterest income in the nine months ended September 30, 2021, was \$218.33 million, an increase of \$5.37 million, or 2.52%, compared to the first nine months of 2020.

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:

	Three Months Ended		Nine Months Ended		Increase/(Decrease)			
					Three Months Ended		Nine Months Ended	
	September 30,		September 30,		2021 over 2020		2021 over 2020	
(dollars in thousands)	2021	2020	2021	2020	Amount	Percent	Amount	Percent
Residential mortgage banking, net	\$ 25,422	\$ 37,531	\$ 88,359	\$ 74,662	\$ (12,109)	(32.26)%	\$ 13,697	18.35 %
Insurance commissions and other title fees and income, net	17,398	17,468	52,055	51,973	(70)	(0.40)%	82	0.16 %
Real estate brokerage and property management, net	14,283	11,301	43,201	29,020	2,982	26.39 %	14,181	48.87 %
Service charges on deposit accounts	2,524	1,986	7,104	6,314	538	27.09 %	790	12.51 %
Credit card merchant fees, net	1,660	1,506	4,630	3,793	154	10.23 %	837	22.07 %
Bank-owned life insurance	2,301	1,605	5,361	6,295	696	43.36 %	(934)	(14.84)%
Other income	6,045	22,278	16,367	31,268	(16,233)	(72.87)%	(14,901)	(47.66)%
Subtotal before gain (loss) on investment securities	69,633	93,675	217,077	203,325	(24,042)	(25.67)%	13,752	6.76 %
Net gain on investment securities	—	1,701	1,252	9,632	(1,701)	(100.00)%	(8,380)	N/M
Total noninterest income	<u>\$ 69,633</u>	<u>\$ 95,376</u>	<u>\$ 218,329</u>	<u>\$ 212,957</u>	<u>\$ (25,743)</u>	<u>(26.99)%</u>	<u>\$ 5,372</u>	<u>2.52 %</u>

For third quarter 2021, residential mortgage banking income, net of commission expense, was \$25.42 million, a decrease of \$12.11 million, or 32.26%, compared to third quarter 2020. The third quarter 2021 decrease in mortgage banking income was primarily driven by a decline in volume and the income statement impact of the value of rate lock commitments. Production volumes in third quarter 2021 were \$1.31 billion, a decrease of \$0.48 billion, or 26.84%, from third quarter 2020. Refinance activities decreased to 22.55% of total loan volume in third quarter 2021, compared to 38.79% the prior year quarter, driven by rate. The value of rate lock commitments, which is a derivative, was a loss of \$1.67 million in the quarter, a \$4.95 million decline when compared to the prior year quarter. The derivative impact of forward contracts on noninterest income was a gain of \$0.90 million in third quarter 2021, an increase of \$0.85 million compared to third quarter 2020, while the unrealized loss on closed loans was \$0.87 million, compared to a loss of \$0.09 million for the same respective periods.

Residential mortgage banking income, net of commission expense, was \$88.36 million for the first nine months of 2021, an increase of \$13.70 million, or 18.35%, compared to the same period in 2020. Production volumes in the first nine months of 2021 were \$4.37 billion compared to \$4.19 billion in 2020. The income statement impact of the value of rate lock commitments and forward contracts recorded in the first nine months of 2021 was a loss of \$5.79 million, compared to a loss \$4.66 million in 2020, while the unrealized loss on closed loans was \$0.26 million, compared to a loss of \$1.08 million.

PART I. FINANCIAL INFORMATION

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

For the third quarter and first nine months of 2021, insurance commissions and other title income, net of commission expense, was \$17.40 million and \$52.05 million, respectively. Third quarter 2021 represents a decrease of \$0.07 million, or 0.40%, while the nine-month increase was \$0.08 million, or 0.16%, compared to 2020. The Company acquired a property and casualty insurance agency in December 2020, which brought in \$0.73 million and \$1.84 million in additional revenue in the third quarter and first nine months of 2021, respectively. This income partially offset the impact of the reduction in revenues due to the sale of Red Sky in third quarter 2020, which contributed revenue of \$1.40 million and \$3.53 million in the third quarter and first nine months of 2020, respectively.

Real estate brokerage and property management income, net of commission expense, for third quarter 2021 was \$14.28 million, which was \$2.98 million, or 26.39%, higher than comparative 2020. Real estate brokerage and property management income, net of commission expense, was \$43.20 million in the first nine months of 2021, an increase of \$14.18 million, or 48.87%, compared to the same period in 2020. The majority of the income from this line of business is related to vacation property commissions and associated fees. In 2021, with limitations on international travel still in place, reservation activity has been at record levels, with occupancy levels at near-capacity. In July 2021, the Company acquired Venture Resorts, Inc., one of the largest cabin rental companies in the Smoky Mountains of Tennessee, which brought in an additional \$3.0 million in property management fee revenue in the quarter.

Service charges on deposit accounts were \$2.52 million and \$7.10 million for the third quarter and first nine months of 2021, compared with \$1.99 million and \$6.31 million for the comparative 2020 periods when the Company waived fees for members experiencing financial hardships. For the third quarter and first nine months of 2021, credit card merchant fees totaled \$1.66 million and \$4.63 million, respectively, and were higher than comparative periods in 2020.

Income from BOLI was \$2.30 million and \$5.36 million in the third quarter and first nine months of 2021, compared to \$1.60 million and \$6.29 million in the third quarter and first nine months of 2020. Third quarter 2021 included proceeds from a life insurance claim, which resulted in higher income for the quarter. Income from BOLI declined in the current year-to-date period due to higher proceeds from life insurance claims in the prior year. Other noninterest income for the three months ended September 30, 2021, was \$6.04 million, a decrease of \$16.23 million, or 72.87%, compared to third quarter 2020. This decrease was driven by a gain on the sale of Red Sky totaling \$17.63 million that was recorded in other income third quarter 2020. Included in other noninterest income are net investment commissions from TIG, which increased \$0.69 million in the third quarter and \$1.76 million in the first nine months of 2021, compared to 2020.

We did not sell any investment securities in the third quarter of 2021. We sold seven investment securities with a carrying value of \$17.57 million in the first nine months of 2021. We sold 22 investment securities with a carrying value of \$81.80 million in third quarter and 47 investment securities with a carrying value of \$333.51 million in the first nine months of 2020. There were no net gains or losses on the sale of AFS securities to record in third quarter 2021, compared to net gains of \$1.70 million in third quarter 2020. Year-to-date 2021, we recorded net gains of \$1.25 million, compared to net gains of \$9.63 million in 2020.

Noninterest Expense. For the quarter ended September 30, 2021, total noninterest expense was \$104.09 million, which was \$2.11 million, or 2.06%, higher than comparative 2020. Noninterest expense was \$306.81 million for the first nine months of 2021, compared to \$289.89 million for the same period in 2020.

PART I. FINANCIAL INFORMATION

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

As a percentage of operating income (non-GAAP), noninterest expense was 61.20% for third quarter 2021 and 59.01% for comparative 2020. The July 1, 2021 acquisition of Venture Resorts, Inc. resulted in additional operating expenses of \$3.57 million in third quarter 2021, including \$0.72 million of acquisition-related expenses.

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

(dollars in thousands)	Three Months Ended		Nine Months Ended		Increase/(Decrease)			
	September 30,		September 30,		Three Months Ended		Nine Months Ended	
	2021	2020	2021	2020	2021 over 2020		2021 over 2020	
					Amount	Percent	Amount	Percent
Salaries and employee benefits	\$ 61,230	\$ 61,408	\$ 181,030	\$ 174,201	\$ (178)	(0.29)%	\$ 6,829	3.92 %
Occupancy expense	7,656	8,396	23,286	23,124	(740)	(8.81)%	162	0.70 %
Furniture and equipment	3,513	3,247	10,647	10,451	266	8.19 %	196	1.88 %
Amortization - intangibles	2,750	2,851	8,192	8,702	(101)	(3.54)%	(510)	(5.86)%
Software expense	4,209	3,572	12,896	10,556	637	17.83 %	2,340	22.17 %
Data processing	3,603	3,113	10,255	8,622	490	15.74 %	1,633	18.94 %
Professional fees	2,227	2,637	6,826	8,677	(410)	(15.55)%	(1,851)	(21.33)%
Advertising and marketing	3,865	1,870	10,090	7,440	1,995	106.68 %	2,650	35.62 %
Other noninterest expenses:								
Acquisition-related expenses	719	—	972	(134)	719	N/M	1,106	(825.37)%
Bank franchise tax/SCC fees	2,084	2,066	6,479	6,540	18	0.87 %	(61)	(0.93)%
Charitable contributions	2,524	2,214	9,743	6,185	310	14.00 %	3,558	57.53 %
Directors fees and expenses	553	498	1,529	1,373	55	11.04 %	156	11.36 %
FDIC and other insurance	1,485	1,522	3,909	4,576	(37)	(2.43)%	(667)	(14.58)%
Foreclosed property expenses	19	1,379	296	1,576	(1,360)	(98.62)%	(1,280)	(81.22)%
Other	4,475	4,719	12,044	9,342	(244)	(5.17)%	2,702	28.92 %
Stationery and supplies	702	603	2,012	1,919	99	16.42 %	93	4.85 %
Telephone and postage	1,845	1,677	5,309	5,209	168	10.02 %	100	1.92 %
Travel/meals/entertainment	627	209	1,290	1,535	418	200.00 %	(245)	(15.96)%
Total other noninterest expenses	15,033	14,887	43,583	38,121	146	0.98 %	5,462	14.33 %
Total noninterest expense	<u>\$ 104,086</u>	<u>\$ 101,981</u>	<u>\$ 306,805</u>	<u>\$ 289,894</u>	<u>\$ 2,105</u>	<u>2.06 %</u>	<u>\$ 16,911</u>	<u>5.83 %</u>

Salary and benefits expense were \$61.23 million and \$181.03 million in third quarter and the first nine months of 2021, respectively, representing 58.83% and 59.00% of total noninterest expense. Salary and benefits expense dipped slightly in third quarter 2021 compared to 2020. Year-to-date 2021, cost of living increases and higher variable production-related costs from our residential mortgage group drove the increase.

In our Banking segment, we had a total of 1,173 full-time equivalent employees at September 30, 2021, as compared to 1,131 at September 30, 2020. In our non-Banking segments at September 30, 2021, we had a total of 1,349 FTEs, excluding real estate sales agents, compared to 1,319 at September 30, 2020. Real estate sales agents are independent contractors and, therefore, not included as our employees. Total

PART I. FINANCIAL INFORMATION

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

operating income per FTE (non-GAAP) was \$67,000 for the quarter ended September 30, 2021, compared to \$70,000 for the quarter ended September 30, 2020.

Occupancy expense decreased \$0.74 million, or 8.81%, for third quarter 2021, and increased \$0.16 million, or 0.70%, in the first nine months of 2021, compared to 2020. The year-to-date increase is related to occupancy additions that occurred after first quarter 2020. The Company purchased McKinnon Tower in Norfolk, Virginia in second quarter 2020 and added a property lease for a branch in Charlotte, N.C., in third quarter 2020, which opened in first quarter 2021. General maintenance costs for these additions are also included in occupancy.

Data processing expenses increased \$0.49 million and \$1.63 million in the second quarter and first nine months of 2021, while software expenses increased \$0.64 million and \$2.34 million for the same respective periods, in 2020. Higher credit card fees resulting from increased vacation property reservation activity and increased costs related to residential mortgage activities drove the increase in data processing expense, while increases in costs associated with our core banking platform resulted in higher software expenses.

For the three- and nine-month periods ended September 30, 2021, professional fees decreased by \$0.41 million and \$1.85 million, respectively. The completion of two large projects in 2020, our core processor conversion and our CECL implementation, both of which relied on outside consultation, resulted in the year-over-year declines. Advertising and marketing expense increased \$2.00 million in the third quarter of 2021 and \$2.65 million in the first nine months of 2021, compared to 2020. Production-based advertising programs in our property management companies and consumer mortgage advertising in our residential mortgage operations were the drivers of the increase in the quarter. In addition, with the resumption of larger social and sports-related gatherings in 2021, Company advertising and sponsorships have resumed.

For third quarter 2021, other noninterest expenses were \$15.03 million, an increase of 0.98%, or \$0.15 million, compared to the same period in 2020. In the first nine months of 2021, other noninterest expense increased \$5.46 million. Acquisition-related expenses totaling \$0.72 million are included in third quarter 2021 due to our acquisition of Venture Resorts, Inc. Charitable contributions increased \$3.56 million in the first nine months of 2021, compared to 2020.

Provision for Income Taxes. We reported a provision for income tax expense of \$14.83 million, representing an effective tax rate of 22.73%, in third quarter 2021. The provision for income tax expense was \$7.84 million for third quarter 2020, with an effective rate of 17.74%. The increase in the provision and effective tax rate from the prior year was primarily due to an increase in income subject to the federal statutory rate of 21%.

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, 2021, the Banking segment represented 81.34%, or \$41.0 million, of our total consolidated net income, compared to 30.01%, or \$10.34 million, for the three months ended September 30, 2020. For the first nine months of 2021, the Banking segment

PART I. FINANCIAL INFORMATION

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

represented 76.00%, or \$133.15 million, of our total consolidated net income, compared to 59.76%, or \$57.04 million, in 2020.

Income before income tax provision and noncontrolling interest for the Banking segment was \$51.22 million for the quarter ended September 30, 2021, increasing \$40.40 million from comparative 2020. This increase in earnings was driven by a combination of a provision benefit for credit losses and higher net interest income.

Total revenue increased \$17.59 million in the first nine months of 2021 compared to 2020. The recording of a provision benefit resulted in a \$78.83 million, or 122.85%, year-over-year change in our provision for credit losses. This year-to-date reduction was driven by a combination of minimal charge-offs, reduction in loans deferred under the CARES Act, and improved economic conditions, partially offset by modest loan growth. Net interest income increased \$23.47 million primarily due to lower deposit costs. Noninterest income declined \$5.87 million compared to prior year due to lower net gains on the sale of AFS securities and lower BOLI income. Noninterest expense increased \$1.05 million. Salaries and employee benefits declined \$2.54 million, and amortization of intangibles declined \$0.60 million, while occupancy expense increased \$0.10 million, and charitable contributions increased \$3.56 million.

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

	Three Months Ended September 30,		Nine Months Ended September 30,		Increase/(Decrease)	
					Nine Months Ended September 30, 2021	
	September 30,		September 30,		September 30, 2020	
(dollars in thousands)	2021	2020	2021	2020	Amount	Percent
Net interest income	\$ 97,668	\$ 92,869	\$ 293,407	\$ 269,941	\$ 23,466	8.69 %
Service charges on deposit accounts	2,524	1,986	7,104	6,315	789	12.49 %
Credit card merchant fees	1,660	1,506	4,630	3,793	837	22.07 %
Other income	6,334	4,876	16,706	15,826	880	5.56 %
Net gain (loss) on investment securities	—	1,701	1,252	9,632	(8,380)	(87.00)%
Total noninterest income	10,518	10,069	29,692	35,566	(5,874)	(16.52)%
Total revenue	108,186	102,938	323,099	305,507	17,592	5.76 %
Provision for credit losses	(1,728)	31,070	(14,661)	64,170	(78,831)	(122.85)%
Salaries and employee benefits	34,791	36,535	102,427	104,970	(2,543)	(2.42)%
Occupancy expense	5,098	5,829	15,657	15,557	100	0.64 %
Furniture and equipment	2,602	2,424	8,086	7,800	286	3.67 %
Amortization of intangible assets	862	1,063	2,737	3,341	(604)	(18.08)%
Other expenses	16,580	15,793	49,020	45,214	3,806	8.42 %
Total noninterest expenses	59,933	61,644	177,927	176,882	1,045	0.59 %
Income before income tax and corporate allocation	49,981	10,224	159,833	64,455	95,378	147.98 %
Corporate allocation	1,241	595	3,782	1,891	1,891	100.00 %
Income before income tax provision and noncontrolling interest	51,222	10,819	163,615	66,346	97,269	146.61 %
Provision for income tax expense	10,225	474	30,461	9,304	21,157	227.40 %
Net income	40,997	10,345	133,154	57,042	76,112	133.43 %
Noncontrolling interest	2	(2)	(1)	2	(3)	(150.00)%
Net income attributable to TowneBank	\$ 40,999	\$ 10,343	\$ 133,153	\$ 57,044	\$ 76,109	133.42 %
Efficiency ratio (non-GAAP)	54.60 %	59.84 %	54.43 %	58.65 %		

PART I. FINANCIAL INFORMATION

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

Realty Segment. For the three months ended September 30, 2021, the Realty segment had income before income tax provision and noncontrolling interest of \$12.10 million, as compared to \$25.54 million in 2020. In the nine months ended September 30, 2021, the Realty segment had income before income tax provision and noncontrolling interest of \$53.65 million, as compared to \$39.95 million in 2020. Total revenue was \$45.05 million and \$146.20 million in the third quarter and first nine months of 2021, compared to \$54.58 million and \$118.50 million for the same respective periods in 2020. For the first nine months of 2021, the Realty segment represented 19.09%, or \$33.45 million, of our total consolidated net income, compared to 25.50%, or \$24.34 million, in 2020.

The decline in total revenue in third quarter 2021 compared to 2020 was driven by a decline in mortgage loan volume and the income statement impact of the value of rate lock commitments recorded in the quarter related to residential mortgage brokerage income, partially offset by an increase in property management fees. Despite the quarterly revenue decrease compared to 2020, year-to-date total revenue increased, driven by production-related increases in both residential mortgage banking income and property management fees, net.

Residential mortgage production volume in third quarter 2021 decreased \$0.48 billion, or 26.84%, to \$1.31 billion, as compared to third quarter 2020, while margins declined 4 bp to 3.61%. Refinance activities decreased to 22.55% of total loan volume in third quarter 2021, compared to 38.79% in the prior year quarter, driven by rate. In addition to the decline in production and profit margin in third quarter 2021, the impact of the value of rate lock commitments, which are derivatives, was a loss of \$1.67 million. The value of forward contracts, which are also derivatives, resulted in a gain of \$0.90 million, and the unrealized loss on closed loans was \$0.85 million in third quarter 2021. In third quarter 2020, the value of rate lock commitments was a gain of \$3.28 million, the value of forward contracts was a gain of \$0.05 million, while the unrealized loss on closed loans was \$0.09 million. Production volume in the first nine months of 2021 was \$4.37 billion compared to \$4.19 billion in the same period in 2020. The income statement impact of the value of rate lock commitments and forward contracts recorded in the first nine months of 2021 was a loss of \$5.79 million, compared to a loss \$4.66 million in the same period in 2020, while the unrealized loss on closed loans was \$0.26 million, compared to a loss of \$1.08 million for the same respective periods. The Company expects production volumes to slow and margins to continue to come under pressure in the fourth quarter of 2021.

Net property management fees increased in third quarter and the first nine months of 2021 compared to 2020. The majority of the income from this line of business is related to vacation property commissions and associated fees, a good portion of which are typically collected in the first three months of the year, well ahead of the renters' actual stay. In 2021, with limitations on international travel still in place, the demand for domestic vacation rentals has been at record levels, leading to strong reservation activities and near-capacity occupancy levels. In July 2021, we acquired Venture Resorts, Inc., one of the largest cabin rental company in the Smoky Mountains of Tennessee, which brought an additional \$3.0 million in management fee revenue in the quarter.

Real estate brokerage income, net increased \$0.09 million in the quarter and \$1.91 million in the first nine months of 2021, compared to 2020. Year-to-date sales volume increased 27.86% over prior year while the number of units increased 12.37%. Low inventory levels continue to be a challenge in our footprint and have driven up average home prices.

PART I. FINANCIAL INFORMATION

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

The Realty segment's provision for credit losses was an expense of \$0.15 million in the quarter and a benefit of \$1.00 million for the nine months ended September 30, 2021, compared to a provision expense of \$0.53 million and \$1.39 million for the same respective periods in 2020.

Salaries and employee benefits increased \$1.63 million and \$8.15 million in the third quarter and first nine months of 2021, respectively, compared to 2020. Overtime and retention bonuses related to mortgage production were the primary drivers of the increases.

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

	Three Months Ended		Nine Months Ended		Increase/(Decrease)	
	September 30,		September 30,		Nine Months Ended	
	2021	2020	2021	2020	September 30, 2021	September 30, 2020
(dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	\$ 26,637	\$ 38,074	\$ 90,898	\$ 76,549	\$ 14,349	37.69 %
Real estate brokerage income, net	3,781	3,688	10,125	8,212	1,913	51.87 %
Title insurance and settlement fees	706	654	1,917	1,728	189	28.90 %
Property management fees, net	10,502	7,613	33,076	20,808	12,268	161.15 %
Income from unconsolidated subsidiary	269	451	964	938	26	5.76 %
Net interest and other income	3,154	4,101	9,223	10,262	(1,039)	(25.34)%
Total revenue	45,049	54,581	146,203	118,497	27,706	50.76 %
Provision for credit losses	146	528	(1,004)	1,389	(2,393)	N/M
Salaries and employee benefits	17,375	15,744	50,240	42,095	8,145	51.73 %
Occupancy expense	1,926	1,906	5,732	5,595	137	7.19 %
Furniture and equipment	693	620	1,934	2,007	(73)	(11.77)%
Amortization of intangible assets	702	658	1,882	1,973	(91)	(13.83)%
Other expenses	11,103	9,226	30,774	24,366	6,408	69.46 %
Total expenses	31,799	28,154	90,562	76,036	14,526	51.59 %
Income (loss) before income tax, corporate allocation, and noncontrolling interest	13,104	25,899	56,645	41,072	15,573	60.13 %
Corporate allocation	(1,000)	(356)	(3,000)	(1,119)	(1,881)	(528.37)%
Income (loss) before income tax provision and noncontrolling interest	12,104	25,543	53,645	39,953	13,692	53.60 %
Provision for income tax	3,546	4,780	12,017	7,614	4,403	92.11 %
Net income (loss)	8,558	20,763	41,628	32,339	9,289	44.74 %
Noncontrolling interest	(2,345)	(4,790)	(8,176)	(7,996)	(180)	(3.76)%
Net income (loss) attributable to TowneBank	\$ 6,213	\$ 15,973	\$ 33,452	\$ 24,343	\$ 9,109	57.03 %

PART I. FINANCIAL INFORMATION

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

	Three Months Ended		Nine Months Ended		Increase/(Decrease)	
	September 30,		September 30,		Nine Months Ended	
	September 30,		September 30,		September 30, 2021	
	September 30,		September 30,		September 30, 2020	
(dollars in thousands)	2021	2020	2021	2020	Amount	Percent
Key data:						
Efficiency ratio (non-GAAP)	69.03%	50.38%	60.66%	62.50%		
Number of units sold	1,553	1,518	4,079	3,630	449	12.37 %
Volume of units sold	\$ 613,123	\$ 573,923	\$1,605,390	\$1,255,629	349,761	27.86 %
Number of real estate agents	407	407	407	407	—	— %
Loans originated, mortgage	\$ 939,272	\$1,292,801	\$3,177,531	\$3,128,263	\$ 49,268	1.57 %
Loans originated, joint venture	370,865	498,100	1,191,906	1,060,437	131,469	12.40 %
Total loans originated	\$1,310,137	\$1,790,901	\$4,369,437	\$4,188,700	\$ 180,737	4.31 %
Number of loans, mortgage	2,643	3,964	9,362	9,584	(222)	(2.32)%
Number of loans, joint venture	1,274	1,853	4,234	4,076	158	3.88 %
Total number of loans	3,917	5,817	13,596	13,660	(64)	(0.47)%
Average loan amount, mortgage	\$ 355	\$ 326	\$ 339	\$ 326	13	3.99 %
Average loan amount, joint venture	291	\$ 269	282	\$ 260	22	8.46 %
Average loan amount	\$ 334	\$ 308	\$ 321	\$ 307	14	4.56 %
Number of originators, mortgage	160	161	160	161	(1)	(0.62)%
Number of originators, joint venture	58	63	58	63	(5)	(7.94)%
Total number of originators	218	224	218	224	(6)	(2.68)%

Insurance Segment. The Insurance segment includes property and casualty and group benefit divisions. The Insurance segment represented 6.33%, or \$3.19 million, of total consolidated net income for the three months ended September 30, 2021, compared to 23.64%, or \$8.15 million, for the three months ended September 30, 2020. In the nine-months comparison, the Insurance segment represented 4.91%, or \$8.60 million, of total consolidated net income for the period ended September 30, 2021, compared to 14.74%, or \$14.07 million, for the period ended September 30, 2020. Earnings before income taxes and noncontrolling interest for the three months ended September 30, 2021, were \$4.25 million, decreasing \$17.95 million, or 80.87%, from comparative 2020. For the nine months ended September 30, 2021, earnings before income taxes and noncontrolling interest were \$11.51 million, a decline of \$19.23 million, or 62.56%, from comparative 2020.

Commissions on property and casualty insurance increased \$1.27 million and \$3.68 million in the respective three- and nine-month period ended September 30, 2021, compared to the same periods in 2020, due to a combination of organic growth and the December 2020 acquisition of an insurance agency. The Company acquired a property and casualty insurance agency, which brought in \$0.73 million and \$1.84 million in additional revenue in the third quarter and first nine months of 2021, respectively, and partially offset the impact of the reduction in revenues due to the sale of Red Sky in third quarter 2020. Red Sky contributed revenue of \$1.40 million and \$3.53 million in the third quarter and first nine months of 2020. In third quarter 2020, the Company recorded a gain on the sale of Red Sky of \$17.63 million in other income. After distributions to noncontrolling interests, the Company retained \$6.52 million of the pre-tax gain. The Company expects to continue actively pursuing attractive acquisition opportunities of insurance agencies.

Total operating expenses for the third quarter and first nine months of 2021 increased \$0.17 million and \$1.34 million when compared to the same periods in 2020. The nine-month increase was driven by increases

PART I. FINANCIAL INFORMATION

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

in salaries and employee benefits. Income related to noncontrolling interests in the prior year periods was associated with Red Sky, which was sold in 2020.

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

	Three Months Ended		Nine Months Ended		Increase/(Decrease)	
	September 30,		September 30,		Nine Months Ended	
	2021	2020	2021	2020	September 30, 2021	September 30, 2020
<i>(dollars in thousands)</i>					Amount	Percent
Net commission and fee income						
Property and casualty	\$ 15,338	\$ 14,072	\$ 44,467	\$ 40,784	\$ 3,683	9.03 %
Employee benefits	3,820	3,825	11,135	11,534	(399)	(3.46)%
Travel insurance	—	1,399	—	3,526	(3,526)	(100.00)%
Specialized benefit services	164	165	494	489	5	1.02 %
Total net commissions and fees	19,322	19,461	56,096	56,333	(237)	(0.42)%
Contingency and bonus revenue	1,664	1,112	6,746	5,144	1,602	31.14 %
Other income	40	17,697	157	17,906	(17,749)	(99.12)%
Total revenues	21,026	38,270	62,999	79,383	(16,384)	(20.64)%
Employee commission expense	4,185	3,654	12,395	10,900	1,495	13.72 %
Revenue, net of commission expense	16,841	34,616	50,604	68,483	(17,879)	(26.11)%
Salaries and employee benefits	9,064	9,129	28,363	27,136	1,227	4.52 %
Occupancy expense	632	661	1,897	1,972	(75)	(3.80)%
Furniture and equipment	218	203	626	644	(18)	(2.80)%
Amortization of intangible assets	1,186	1,130	3,573	3,388	185	5.46 %
Other expenses	1,254	1,060	3,857	3,836	21	0.55 %
Total operating expenses	12,354	12,183	38,316	36,976	1,340	3.62 %
Income before income tax, corporate allocation, and noncontrolling interest	4,487	22,433	12,288	31,507	(19,219)	(61.00)%
Corporate allocation	(241)	(239)	(782)	(772)	(10)	1.30 %
Income before income tax provision and noncontrolling interest	4,246	22,194	11,506	30,735	(19,229)	(62.56)%
Provision for income tax	1,058	2,587	2,910	4,574	(1,664)	(36.38)%
Net income	3,188	19,607	8,596	26,161	(17,565)	(67.14)%
Noncontrolling interest	—	(11,459)	—	(12,095)	12,095	(100.00)%
Net income attributable to TowneBank	\$ 3,188	\$ 8,148	\$ 8,596	\$ 14,066	\$ (5,470)	(38.89)%
Efficiency ratio (non-GAAP)	66.31 %	31.93 %	68.66 %	49.05 %		

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2021, total assets were \$15.81 billion, which is \$1.18 billion, or 8.10%, higher than total assets at December 31, 2020. Our loan portfolio, less unearned income and deferred costs, made up 58.80% of our period-end assets and totaled \$9.30 billion at September 30, 2021. Average assets for the quarter ended September 30, 2021, were \$15.71 billion, an increase of \$0.98 billion, or 6.69%, from the quarter ended December 31, 2020.

PART I. FINANCIAL INFORMATION

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

Average earning assets for third quarter 2021 increased \$0.95 billion from fourth quarter 2020 to \$14.43 billion. Our average total deposits were \$12.90 billion for third quarter 2021, an increase of \$1.21 billion, or 10.35%, compared to fourth quarter 2020. Average noninterest-bearing deposits at September 30, 2021, increased \$0.58 billion, or 12.56%, from December 31, 2020.

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, 2021 and December 31, 2020, respectively, these balances were \$3.19 billion and \$1.82 billion and consisted mainly of deposits in other banks and overnight deposits with the FRB - Richmond.

The average balance of interest-bearing deposits in other banks, at the FRB - Richmond, and federal funds sold during third quarter 2021 was \$3.18 billion, or 22.03%, of average total earning assets, compared with \$1.75 billion, or 13.01%, of average total earning assets for fourth quarter 2020.

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 \$1.56 billion at September 30, 2021, compared with \$1.37 billion at December 31, 2020. The average balance during third quarter 2021 was \$1.51 billion, compared to \$1.33 billion during the quarter ended December 31, 2020. The average AFS debt securities portfolio represented 10.46% and 9.88% of average earning assets in third quarter 2021 and the quarter ended December 31, 2020, respectively. During the nine months ended September 30, 2021, we had sales, maturities, and calls totaling \$135.66 million in investment securities that were classified as AFS.

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, 2021, the allowance for credit losses on AFS debt securities was \$142 thousand compared to \$348 thousand at December 31, 2020. For further financial details, see *Note 4 - Investment Securities* of the Notes to Consolidated Financial Statements in this report.

Securities Held to Maturity. HTM debt securities are valued at amortized cost and totaled \$14.90 million at September 30, 2021, and \$16.51 million at December 31, 2020. The average balance during third quarter 2021 was \$15.09 million, compared with \$16.78 million in fourth quarter 2020, representing 0.10% and 0.12% of total average earning assets, respectively. These securities are held primarily for yield and pledging purposes. HTM debt securities are reviewed quarterly for potential credit losses. The allowance for credit losses on HTM debt securities was \$94 thousand at September 30, 2021, and \$97 thousand at December 31, 2020. During the nine months ended September 30, 2021, we had maturities and calls totaling \$1.66 million in HTM debt securities. For further financial details, see *Note 4 - Investment Securities* of the Notes to Consolidated Financial Statements in this report.

Loans Held for Sale. At September 30, 2021, we held \$431.85 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$540.80 million at December 31, 2020. Average loans held for sale were 3.24% of average earning assets for the quarter ended September 30, 2021, and 4.36% of average earning assets for the quarter ended December 31, 2020. The majority of mortgage loans held for sale have been precommitted to investors, which minimizes our interest rate risk.

PART I. FINANCIAL INFORMATION

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

Loan Portfolio. Loans, net of unearned income and deferred costs, were \$9.30 billion at September 30, 2021, which was \$0.33 billion, or 3.44%, below \$9.63 billion at December 31, 2020. Included in loans, net of unearned income and deferred costs were PPP loans, which declined \$0.60 billion, or 70.62%, from \$0.86 billion at December 31, 2020, to \$0.25 billion at September 30, 2021. As a percentage of total average earning assets, average loans were 64.01% for the quarter ended September 30, 2021, compared with 72.32% for the quarter ended December 31, 2020.

Allowance for Credit Losses and Asset Quality. The allowance for credit losses on funded loans at September 30, 2021 and December 31, 2020, was \$107.18 million and \$120.16 million, respectively. This decrease is primarily attributable to minimal charge-offs, a reduction in loans deferred under the CARES Act, and improved economic conditions, partially offset by modest loan growth. Expected loss estimates consider various factors, including the impacts of changes in economic activity and 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 1.15% of total loans outstanding at September 30, 2021, compared with 1.25% at December 31, 2020. PPP loans, which totaled \$0.25 billion and \$0.86 billion at September 30, 2021 and December 31, 2020, respectively, 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 1.18% of total loans outstanding at September 30, 2021 and 1.37% at December 31, 2020.

Classified loans, defined as loans in the substandard and doubtful categories, represented 0.34% of total loans at September 30, 2021 and 0.43% at December 31, 2020. Loans 30 to 89 days past due totaled \$3.76 million at September 30, 2021, as compared to \$10.19 million at December 31, 2020. Total past due and nonaccruing loans were \$12.29 million at September 30, 2021, compared to \$20.38 million at December 31, 2020. The allowance for credit losses on funded loans was equal to 12.68x of nonperforming loans at September 30, 2021, compared with 10.74x at December 31, 2020. 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.

PART I. FINANCIAL INFORMATION

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

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, 2021	December 31, 2020
Real estate - construction and development	\$ 17,354	\$ 23,681
Real estate - commercial owner occupied	13,709	16,158
Real estate - commercial non-owner occupied	26,007	27,567
Real estate - multi-family	2,789	2,054
Real estate - residential 1-4 family	16,361	13,779
HELOC	16,991	15,240
Commercial and industrial business loans	6,869	11,056
Government	2,886	2,334
Indirect	1,754	2,901
Consumer and other loans	2,457	5,387
Total	\$ 107,177	\$ 120,157

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

	Three Months Ended		
	September 30, 2021	September 30, 2020	December 31, 2020
<i>(dollars in thousands)</i>			
Nonperforming Assets			
Nonperforming loans	\$ 8,451	\$ 11,178	\$ 11,188
Former bank premises	—	—	750
Foreclosed property	5,409	4,041	4,276
Total nonperforming assets	<u>\$ 13,860</u>	<u>\$ 15,219</u>	<u>\$ 16,214</u>
Loans past due 90 days and still accruing interest	<u>\$ 143</u>	<u>\$ 1,584</u>	<u>\$ 528</u>
Asset Quality Ratios			
Allowance for credit losses to nonperforming loans	12.68x	7.31x	10.74x
Allowance for credit losses to period-end loans	1.15%	1.22%	1.25%
Allowance for credit losses on loans to period end loans excluding PPP loans (non-GAAP)	1.18%	1.37%	1.37%
Nonperforming loans to period-end loans	0.09%	0.17%	0.12%
Nonperforming assets to period-end assets	0.09%	0.19%	0.11%
Quarterly Net charge-offs (recoveries) to average loans (annualized)	(0.03)%	(0.01)%	—%
Annual Net charge-offs (recoveries) to average loans	—%	—%	—%

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

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

	September 30, 2021	December 31, 2020
CRE - Construction and development	\$ —	\$ —
CRE - Owner occupied	331	387
CRE - Non-owner occupied	—	1,163
CRE - Multi-family	2,840	—
Residential 1-4 family	1,126	3,432
HELOC	562	1,072
Commercial and industrial business	2,929	4,414
Government	—	—
Indirect	660	717
Consumer and other loans	3	3
Total nonperforming loans	<u>\$ 8,451</u>	<u>\$ 11,188</u>

Nonperforming assets consist of nonaccrual loans, foreclosed real estate, and other repossessed collateral. Unless the debt is both well-secured and in the process of collection, 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. 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, 2021, we had \$13.86 million in nonperforming assets, which amounted to 0.09% of total assets. Additionally, loans 60-89 days past due, excluding nonperforming loans, totaled \$0.49 million and there were \$0.14 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of \$8.45 million in nonperforming loans, as well as \$5.41 million in foreclosed property at September 30, 2021. Nonperforming loans decreased by \$2.74 million from December 31, 2020. Foreclosed property increased by \$1.13 million from December 31, 2020. Foreclosed property consists of two construction and development, three commercial, and two residential properties.

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, or TDR, 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.

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

At September 30, 2021, nonaccruing TDRs, which are included in nonperforming loans, totaled \$3.06 million and accruing TDRs totaled \$9.90 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. On December 27, 2020, the Appropriations Act amended Section 4013 of the CARES Act and extended TDR relief to the earlier of January 1, 2022, or 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 offered short-term modifications in response to the COVID-19 outbreak to borrowers who were current and otherwise not past due. These generally included 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 were insignificant. As of September 30, 2021, we had 10 loans with modifications under Section 4013 with total outstanding balances of \$50.95 million, compared to 210 loans with modifications under Section 4013 with outstanding balances of \$340.81 million at December 31, 2020.

Deposits. Total deposits at September 30, 2021, were \$13.01 billion, representing an increase of \$1.44 billion, or 12.45%, compared to December 31, 2020. Total average deposits were \$12.90 billion during third quarter 2021, compared to \$11.30 billion during third quarter 2020 and \$11.69 billion during fourth quarter 2020. The increase was primarily due to a combination of seasonality and businesses holding higher levels of cash on hand.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 40.40% during third quarter 2021 and 37.76% during the same period in 2020. Average noninterest-bearing demand deposits were 39.61% of average total deposits for fourth quarter 2020. The cost of interest-bearing deposits was 0.31% for third quarter 2021, compared with 0.73% for third quarter 2020 and 0.61% for fourth quarter 2020.

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,		
	2021		2020		2020	
Interest-bearing demand and money market accounts	\$ 5,486,788	0.15 %	\$ 4,311,920	0.25 %	\$ 4,582,588	0.23 %
Regular savings	358,739	0.59 %	304,753	0.72 %	317,561	0.69 %
Certificates of deposit	1,842,948	0.73 %	2,417,772	1.60 %	2,159,573	1.40 %
Total interest-bearing	7,688,475	0.31 %	7,034,445	0.73 %	7,059,722	0.61 %
Noninterest-bearing demand	5,212,271		4,268,443		4,630,665	
Total	\$ 12,900,746	0.18 %	\$ 11,302,888	0.45 %	\$ 11,690,387	0.37 %

PART I. FINANCIAL INFORMATION

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

	Average Balance/Cost Rate			
	Nine Months Ended			
	September 30,			
	2021		2020	
Interest-bearing demand and money market accounts	\$ 5,192,658	0.16 %	\$ 3,898,642	0.36 %
Regular savings	345,739	0.61 %	290,684	0.78 %
Certificates of deposit	1,872,393	1.00 %	2,451,715	1.90 %
Total interest-bearing	7,410,790	0.39 %	6,641,041	0.95 %
Noninterest-bearing demand	4,880,493		3,687,791	
Total	\$ 12,291,283	0.24 %	\$ 10,328,832	0.61 %

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,		
	2021		2020		2020	
Interest-bearing demand and money market accounts	\$ 5,486,788	42.53 %	\$ 4,311,920	38.15 %	\$ 4,582,588	39.20 %
Regular savings	358,739	2.78 %	304,753	2.70 %	317,561	2.72 %
Certificates of deposit	1,842,948	14.29 %	2,417,772	21.39 %	2,159,573	18.47 %
Total interest-bearing	7,688,475	59.60 %	7,034,445	62.24 %	7,059,722	60.39 %
Noninterest-bearing	5,212,271	40.40 %	4,268,443	37.76 %	4,630,665	39.61 %
Total	\$ 12,900,746	100.00 %	\$ 11,302,888	100.00 %	\$ 11,690,387	100.00 %

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2021, were \$155.54 million, compared to \$456.04 million at December 31, 2020. The average borrowing cost for third quarter 2021 was 0.52% and 0.99% in fourth quarter 2020.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2021, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
11/15/2028	3.43%	—	\$ 3,239
12/01/2028	2.83%	—	2,298
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			\$ 155,537

At September 30, 2021, certain residential HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of \$2.16 billion collateralized the advances from the FHLB. At

PART I. FINANCIAL INFORMATION

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

December 31, 2020, certain residential HELOCs, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of \$3.14 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. To facilitate the funding of PPP loans, the Federal Reserve offered a PPP lending facility. The Company had no outstanding balance under this facility at September 30, 2021, compared to \$182.85 million in borrowings under this facility at December 31, 2020, at an average cost of 0.35%. Average total borrowings, including FHLB advances and the PPP lending facility, were \$0.30 billion during third quarter 2021 compared with \$0.72 million for fourth quarter 2020, while the average cost of these funds was 0.54% and 0.89%, 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, 2021, the carrying value of the subordinated notes totaled \$249.50 million, compared with \$249.05 million at December 31, 2020. Average subordinated debt during third quarter 2021 was \$249.41 million, compared to \$248.97 million during fourth quarter 2020, while the average cost of the debentures was 4.75% and 4.76%, respectively.

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

On February 24, 2021, we declared a quarterly shareholder cash dividend of \$0.18 per common share. The dividend was paid April 9, 2021, to shareholders of record on March 30, 2021.

On May 28, 2021, we declared a quarterly shareholder cash dividend of \$0.20 per common share. The dividend was paid July 10, 2021, to shareholders of record on June 30, 2021.

On August 25, 2021, we declared a quarterly shareholder cash dividend of \$0.20 per common share. The dividend was paid October 12, 2021, to shareholders of record on September 30, 2021.

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.

PART I. FINANCIAL INFORMATION

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

We will continue to closely monitor liquidity and available resources as economic conditions change. The following table provides summarized information on our availability of liquid funds and borrowings as of September 30, 2021 (in thousands):

	September 30, 2021
Available Liquid Funds:	
Cash and cash equivalents	\$ 3,263,915
Unencumbered investment securities	1,078,811
Availability of Borrowings:	
Amount available from FHLB	1,227,104
Amount available from unsecured lines of credit with correspondent banks	155,000
Amount available from Federal Reserve discount window	378,180
Amount available from Federal Reserve PPP liquidity facility	—

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)

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.

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, 2021.

PART I. FINANCIAL INFORMATION

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

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

	September 30,		June 30,
	2021	2020	2020
Tier I Capital:			
Shareholders' equity	\$ 1,900,434	\$ 1,748,703	\$ 1,869,856
Add: modified CECL transitional amount	15,359	18,904	15,595
Less: goodwill and disallowed intangible assets, net of deferred tax	500,716	485,227	487,288
AOCI-related adjustments	21,597	44,569	29,273
Preferred equity	—	—	—
Noncontrolling interests	17,347	16,961	16,012
Total common equity Tier I capital	1,376,133	1,220,850	1,352,878
Included noncontrolling interests	17,347	16,961	16,012
Total Tier I capital	1,393,480	1,237,811	1,368,890
Tier II Capital:			
Qualifying allowance for loan losses (1)	113,400	127,423	114,250
Qualifying subordinated debt	249,503	248,906	249,353
Less: modified adjusted allowance for credit losses (ACL)	15,783	19,328	16,019
Total Tier II capital	347,120	357,001	347,584
Total Risk-Based Capital	\$ 1,740,600	\$ 1,594,812	\$ 1,716,474
Total assets	\$ 15,811,372	\$ 14,795,417	\$ 15,803,835
Total risk-weighted assets (2)	10,979,433	10,389,372	10,889,209
Average assets for leverage capital purposes	15,174,898	13,922,857	14,494,973
Risk-weighted assets to total assets	69.44 %	70.22 %	68.90 %
Risk-based capital ratios (3):			
Common equity Tier I (4.5% minimum requirement)	12.53 %	11.75 %	12.42 %
Tier I (6.0% minimum requirement)	12.69 %	11.91 %	12.57 %
Total (8.0% minimum requirement)	15.85 %	15.35 %	15.76 %
Tier I leverage ratio (4.0% minimum requirement)	9.18 %	8.89 %	9.44 %

(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.

(3) Well-capitalized requirements under Prompt Corrective Action: Common equity Tier I of 6.5%, Tier I of 8.0%, Total of 10.0%, and Tier I leverage ratio of 5%.

Non-GAAP Financial Measures

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

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

PART I. FINANCIAL INFORMATION

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

taxable and tax-exempt sources. The fully taxable equivalent basis assumes a federal statutory tax rate of 21%.

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.

Non-GAAP Reconciliations. 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 the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
<i>(dollars in thousands)</i>				
Average assets (GAAP)	\$ 15,706,998	\$ 15,487,152	\$ 15,151,850	\$ 13,987,474
Less: average goodwill and intangible assets	506,231	494,238	499,944	497,135
Average tangible assets (non-GAAP)	\$ 15,200,767	\$ 14,992,914	\$ 14,651,906	\$ 13,490,339
Average equity (GAAP)	\$ 1,888,451	\$ 1,747,033	\$ 1,840,268	\$ 1,704,993
Less: average goodwill and intangible assets	506,231	494,238	499,944	497,135
Average tangible equity (non-GAAP)	\$ 1,382,220	\$ 1,252,795	\$ 1,340,324	\$ 1,207,858
Average common equity (GAAP)	\$ 1,871,820	\$ 1,732,881	\$ 1,824,753	\$ 1,692,202
Less: average goodwill and intangible assets	506,231	494,238	499,944	497,135
Average tangible common equity (non-GAAP)	\$ 1,365,589	\$ 1,238,643	\$ 1,324,809	\$ 1,195,067
Net Income (GAAP)	\$ 50,400	\$ 34,464	\$ 175,201	\$ 95,453
Amortization of intangibles, net of tax	2,172	2,252	6,472	6,875
Tangible net income (non-GAAP)	\$ 52,572	\$ 36,716	\$ 181,673	\$ 102,328
Net Income (GAAP)	\$ 50,400	\$ 34,464	\$ 175,201	\$ 95,453
Provision for credit losses	(1,582)	31,598	(15,665)	65,559
Provision for income tax	14,829	7,841	45,388	21,492
Other nonrecurring (income) loss net of noncontrolling interest	—	(6,521)	30	(6,521)
Pre-provision, pre-tax net revenues (non-GAAP)	\$ 63,647	\$ 67,382	\$ 204,954	\$ 175,983
Total Revenue (GAAP)	\$ 170,076	\$ 192,136	\$ 519,906	\$ 492,487
Net (gain)/loss on investment securities	—	(1,701)	(1,252)	(9,632)
Other nonrecurring (income) loss	—	(17,626)	30	(17,626)
Operating Income (non-GAAP)	\$ 170,076	\$ 172,809	\$ 518,684	\$ 465,229
Noninterest expense (GAAP)	\$ 104,086	\$ 101,981	\$ 306,805	\$ 289,894
Less: Amortization of intangibles	2,750	2,851	8,192	8,702
Noninterest expense net of amortization (non-GAAP)	\$ 101,336	\$ 99,130	\$ 298,613	\$ 281,192

PART I. FINANCIAL INFORMATION

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Return on average assets (GAAP basis)	1.27 %	0.89 %	1.55 %	0.91 %
Impact of excluding average goodwill and other intangibles and amortization	0.10 %	0.08 %	0.11 %	0.10 %
Return on average tangible assets	1.37 %	0.97 %	1.66 %	1.01 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Return on average equity (GAAP basis)	10.59 %	7.85 %	12.73 %	7.48 %
Impact of excluding average goodwill and other intangibles and amortization	4.50 %	3.81 %	5.39 %	3.84 %
Return on average tangible equity	15.09 %	11.66 %	18.12 %	11.32 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Efficiency ratio (GAAP)	61.20 %	53.08 %	59.01 %	58.86 %
Impact of exclusions	(1.62)%	4.28 %	(1.44)%	1.58 %
Efficiency ratio (non-GAAP)	59.58 %	57.36 %	57.57 %	60.44 %

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.

	September 30,	
	2021	2020
Book value per share (GAAP basis)	\$ 25.91	\$ 23.83
Impact of excluding goodwill and other intangibles and amortization	(6.99)	(6.77)
Tangible book value per share	\$ 18.92	\$ 17.06

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

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

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

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

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

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

At September 30, 2021, we had \$0.94 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	26.24%
+ 200 basis points	16.9%
+ 100 basis points	7.93%
- 100 basis points	(4.14)%

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	\$291,021
+ 200 basis points	\$191,993
+ 100 basis points	\$72,548
- 100 basis points	\$(187,315)

PART I. FINANCIAL INFORMATION

Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2021, 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, 2021. There were no changes that occurred during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

For information regarding factors that could affect the Company's results of operations, financial condition, or liquidity, see the risk factors discussed in Part I, Item 1A, of TowneBank's 2020 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Part I, Item 2, of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2020 Annual Report on Form 10-K.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

<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 5, 2021.

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 5, 2021

Date

By: /s/ J. Morgan Davis

J. Morgan Davis

Chief Executive Officer

November 5, 2021

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, 2021, 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 5, 2021

Date

/s/ J. Morgan Davis

J. Morgan Davis

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, 2021, 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 5, 2021

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, 2021 (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 5, 2021

Date

/s/ J. Morgan Davis

J. Morgan Davis

Chief Executive Officer

November 5, 2021

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 sheet of TowneBank (the “Company”) as of September 30, 2021, the related consolidated statements of income, comprehensive income, and equity for the three and nine-month periods ended September 2021 and 2020, and the statements of cash flows for the nine-month periods ended September 2021 and 2020 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, 2020, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the year then ended (not presented herein); and in our report dated February 26, 2021 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2020, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

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

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

Dixon Hughes Goodman LLP

Charlotte, NC
November 5, 2021