

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, 2022

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 ☒ ☐

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 28, 2022, was 72,839,291 shares.

TOWNE BANK

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GLOSSARY OF ACRONYMS AND DEFINED TERMS

As used in this report, the terms "Company," "we," "us," and "our" refer to TowneBank and our consolidated subsidiaries. The following 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
AMERIBOR	American Interbank Offered Rate
AOCI	Accumulated Other Comprehensive Income (Loss)
ASC	Accounting Standard Codification
ASU	Accounting Standards Update
Basel III	Basel Committee on Banking Supervision's Capital Guidelines for U.S. Banks
BOLI	Bank-Owned Life Insurance
bp	Basis Points
BSA	Bank Secrecy Act
C&I	Commercial and Industrial
CARES Act	Coronavirus Aid, Relief, and Economic Security Act
CDA	Collateral-Dependent Asset
CDARS	Certificate of Deposit Account Registry Service
CECL	Current Expected Credit Loss
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
GAAP	Accounting Principles Generally Accepted in the United States of America
GNMA	Government National Mortgage Association
GSE	Government Sponsored Enterprise
HELOC	Residential Home Equity Lines of Credit
HTM	Held-to-Maturity
LGD	Loss Given Default
LHFS	Loans Held for Sale

LIBOR	London InterBank Offered Rate
LIHTC	Low Income Housing Tax Credits
MBS	Mortgage-backed Security
N/M	Not Meaningful
OCI	Other Comprehensive Income
OIS	Overnight Index Swap
OREO	Other Real Estate Owned
PCD	Purchased Credit Deteriorated
PD	Probability of Default
PPP	Paycheck Protection Program
REPO	Retail Repurchase Agreement
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
SOFR	Secured Overnight Financing Rate
TBA	To Be Announced
TDR	Troubled Debt Restructuring
TE	Taxable Equivalent
TWM	Towne Wealth Management
U.S.	United States
Venture Resorts	Venture Resorts, Inc.
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2022	December 31, 2021
	(unaudited)	(audited)
ASSETS		
Cash and due from banks	\$ 97,290	\$ 17,373
Interest-bearing deposits at FRB - Richmond	1,245,067	3,244,484
Interest-bearing deposits in financial institutions	96,862	34,779
Total Cash and Cash Equivalents	1,439,219	3,296,636
Securities available for sale, at fair value (amortized cost of \$2,091,083 and \$1,788,853, and allowance for credit losses of \$1,112 and \$210 at September 30, 2022 and December 31, 2021, respectively)	1,890,136	1,806,183
Securities held to maturity, at amortized cost (fair value \$517,782 and \$155,676 at September 30, 2022 and December 31, 2021, respectively)	548,745	154,221
Less: Allowance for credit losses	(83)	(94)
Securities held to maturity, net of allowance for credit losses	548,662	154,127
Other equity securities	6,360	6,759
FHLB stock	9,475	13,146
Total Securities	2,454,633	1,980,215
Mortgage loans held for sale	165,023	358,303
Loans, net of unearned income and deferred costs:	10,559,611	9,506,252
Less: Allowance for credit losses on loans	(107,497)	(106,059)
Net Loans	10,452,114	9,400,193
Premises and equipment, net	295,345	270,772
Goodwill	458,482	457,187
Other intangible assets, net	44,854	50,379
BOLI	256,074	251,805
Other assets	386,053	295,897
TOTAL ASSETS	\$ 15,951,797	\$ 16,361,387
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 5,574,528	\$ 5,546,665
Interest-bearing:		
Demand and money market accounts	6,042,417	6,139,714
Savings	387,622	371,356
Certificates of deposit	1,407,495	1,515,891
Total Deposits	13,412,062	13,573,626
Advances from the FHLB	29,850	155,367
Subordinated debt, net	247,265	249,652
Repurchase agreements and other borrowings	43,165	76,797
Total Borrowings	320,280	481,816
Other liabilities	375,869	389,771
TOTAL LIABILITIES	14,108,211	14,445,213
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, \$1.667 par: 150,000,000 shares authorized 72,839,291 and 72,683,985 shares issued at September 30, 2022 and December 31, 2021, respectively	121,423	121,164
Capital surplus	1,052,374	1,050,948
Retained earnings	810,845	716,605
Common stock issued to deferred compensation trust, at cost 927,176 and 911,458 shares at September 30, 2022 and December 31, 2021, respectively	(18,862)	(18,257)
Deferred compensation trust	18,862	18,257
Accumulated other comprehensive income (loss)	(157,980)	10,597
TOTAL SHAREHOLDERS' EQUITY	1,826,662	1,899,314
Noncontrolling interests	16,924	16,860
TOTAL EQUITY	1,843,586	1,916,174
TOTAL LIABILITIES AND EQUITY	\$ 15,951,797	\$ 16,361,387

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,	
	2022	2021	2022	2021
<i>(Dollars in thousands, except per share data)</i>				
INTEREST INCOME:				
Loans, including fees	\$ 111,590	\$ 98,258	\$ 307,595	\$ 300,268
Investment securities	13,979	7,000	35,913	20,987
Interest-bearing deposits in financial institutions and federal funds sold	9,509	1,182	15,472	2,218
Mortgage loans held for sale	2,446	3,405	7,038	10,477
Total interest income	137,524	109,845	366,018	333,950
INTEREST EXPENSE:				
Deposits	10,230	6,028	20,696	21,721
Advances from the FHLB	83	247	261	1,017
Subordinated debt, net	3,117	2,962	12,328	8,854
Repurchase agreements and other borrowings	56	165	151	781
Total interest expense	13,486	9,402	33,436	32,373
Net interest income	124,038	100,443	332,582	301,577
PROVISION FOR CREDIT LOSSES	3,925	(1,582)	2,532	(15,665)
Net interest income after provision for credit losses	120,113	102,025	330,050	317,242
NONINTEREST INCOME:				
Residential mortgage banking income, net	11,968	25,422	39,782	88,359
Insurance commissions and other title fees and income, net	19,435	17,398	58,255	52,055
Property management income, net	9,891	10,502	36,489	33,076
Real estate commission income, net	2,932	3,781	8,899	10,125
Service charges on deposit accounts	2,455	2,524	7,474	7,104
Credit card merchant fees, net	1,658	1,660	4,940	4,630
BOLI	1,585	2,301	5,155	5,361
Other income	5,274	6,045	18,052	16,367
Net gain (loss) on investment securities	—	—	—	1,252
Total noninterest income	55,198	69,633	179,046	218,329
NONINTEREST EXPENSE:				
Salaries and employee benefits	65,463	61,230	194,318	181,030
Occupancy expense	8,748	7,656	25,417	23,286
Furniture and equipment	3,764	3,513	11,097	10,647
Amortization - intangibles	2,644	2,750	8,145	8,192
Software expense	4,594	4,209	13,848	12,896
Data processing	3,628	3,603	10,778	10,255
Professional fees	2,627	2,227	6,416	6,826
Advertising and marketing	4,290	3,865	12,508	10,090
Other expenses	16,276	15,033	47,612	43,583
Total noninterest expense	112,034	104,086	330,139	306,805
Income before income tax expense and noncontrolling interest	63,277	67,572	178,957	228,766
Provision for income tax expense	12,606	14,829	34,983	45,388
Net income	\$ 50,671	\$ 52,743	\$ 143,974	\$ 183,378
Net income attributable to noncontrolling interest	(502)	(2,343)	(1,672)	(8,177)
Net income attributable to TowneBank	\$ 50,169	\$ 50,400	\$ 142,302	\$ 175,201
Per common share information				
Basic earnings	\$ 0.69	\$ 0.70	\$ 1.96	\$ 2.42
Diluted earnings	\$ 0.69	\$ 0.69	\$ 1.96	\$ 2.41

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
<i>(Dollars in thousands)</i>				
Net income	\$ 50,671	\$ 52,743	\$ 143,974	\$ 183,378
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	(79,424)	(10,123)	(217,376)	(25,010)
Tax effect	17,621	2,227	48,257	5,556
Realized (gains) losses reclassified into earnings	—	—	—	(1,252)
Tax effect	—	—	—	263
Net unrealized gains (losses)	(61,803)	(7,896)	(169,119)	(20,443)
Pension and postretirement benefit plans				
Actuarial gain (loss)	21	64	62	431
Tax effect	(5)	(15)	(14)	(88)
Amortization of prior service costs	193	171	577	513
Tax effect	(43)	(38)	(128)	(114)
Amortization of net actuarial (gain) loss	19	49	57	147
Tax effect	(4)	(11)	(12)	(33)
Change in retirement plans, net of tax	181	220	542	856
Other comprehensive income (loss), net of tax	(61,622)	(7,676)	(168,577)	(19,587)
Comprehensive income (loss)	\$ (10,951)	\$ 45,067	\$ (24,603)	\$ 163,791
Comprehensive income attributable to noncontrolling interest	(502)	(2,343)	(1,672)	(8,177)
Comprehensive income (loss) attributable to TowneBank	\$ (11,453)	\$ 42,724	\$ (26,275)	\$ 155,614

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine Months Ended September 30,	
	2022	2021
<i>(Dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$ 143,974	\$ 183,378
Adjustments to reconcile net income to net cash used for operating activities:		
Net amortization of securities	9,242	6,777
Investment securities gains	—	(1,252)
Depreciation, amortization, and other intangible amortization	21,541	21,423
Amortization of debt issuance costs	709	448
Provision for credit losses	2,532	(15,665)
BOLI	(4,252)	(5,361)
Deferred income tax expense (benefit)	561	(5,382)
Share-based compensation expense	1,479	5,099
Originations of mortgage loans held for sale	(2,404,043)	(4,377,451)
Proceeds from sales of mortgage loans held for sale	2,661,482	4,643,871
Gain on sales of mortgage loans held for sale	(64,160)	(157,468)
Gain on sale and write-down of foreclosed assets	(596)	(235)
Changes in:		
Interest receivable	(7,933)	5,050
Other assets	(9,285)	3,889
Interest payable	(2,818)	(5,942)
Other liabilities	(11,021)	106,161
Net cash from operating activities	337,412	407,340
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(433,236)	(359,461)
Purchase of other securities	—	(305)
Purchase of held-to-maturity securities	(396,059)	—
Sale of available-for-sale securities	—	18,819
Redemption of FHLB stock	3,671	16,989
Proceeds from maturities, calls, and prepayments of available-for-sale securities	122,401	116,838
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	898	1,659
Proceeds from maturities, calls, and prepayments of other securities	399	177
Net (increase) decrease in loans	(1,054,547)	328,988
Net change in investment in LIHTC	(36,633)	(9,764)
Purchase of premises and equipment	(38,089)	(23,549)
Proceeds from sales of premises and equipment	587	265
Proceeds from sales of foreclosed assets	6,323	2,478
Proceeds from BOLI	903	1,665
Acquisition of business, net of cash acquired	—	(26,078)
Net cash (used for) from investing activities	(1,823,382)	68,721
FINANCING ACTIVITIES:		
Net change in deposit accounts	(161,564)	1,440,885
Net change in borrowings	(159,149)	(468,726)
Proceeds from issuance of subordinated debt, net of issuance cost	246,904	—
Redemption of subordinated debt	(250,000)	—
Distribution of interest in joint ventures	(1,608)	(7,811)
Cash dividends paid	(46,030)	(40,781)
Net cash (used for) from financing activities	(371,447)	923,567
Change in cash and cash equivalents	(1,857,417)	1,399,628
Cash and cash equivalents at beginning of year	3,296,636	1,864,287
Cash and cash equivalents at end of period	\$ 1,439,219	\$ 3,263,915
Supplemental cash flow information:		
Cash paid for interest	\$ 36,255	\$ 38,316
Cash paid (refunded) for income taxes	\$ 14,178	\$ 44,601
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 1,329	\$ 2,626
Sales of foreclosed assets financed by the Company	\$ —	\$ 475
Net unrealized losses on available-for-sale securities, net of tax	\$ (169,119)	\$ (20,443)

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, 2022	72,683,985	\$ 121,164	\$ 1,050,948	\$ 716,605	\$ 18,257	\$ (18,257)	\$ 10,597	\$ 16,860	\$ 1,916,174
Net income	—	—	—	45,586	—	—	—	664	46,250
Other comprehensive income (loss), net of taxes	—	—	—	—	—	—	(67,309)	—	(67,309)
Cash dividends declared on common stock (\$0.20 per share)	—	—	—	(14,577)	—	—	—	—	(14,577)
Directors' deferred compensation	—	—	—	—	66	(66)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(284)	(284)
Issuance of common stock - stock compensation plans	40,290	67	(561)	—	—	—	—	—	(494)
Balance, March 31, 2022	72,724,275	\$ 121,231	\$ 1,050,387	\$ 747,614	\$ 18,323	\$ (18,323)	\$ (56,712)	\$ 17,240	\$ 1,879,760
Net income	—	—	—	46,547	—	—	—	507	47,054
Other comprehensive income (loss), net of taxes	—	—	—	—	—	—	(39,646)	—	(39,646)
Cash dividends declared on common stock (\$0.23 per share)	—	—	—	(16,731)	—	—	—	—	(16,731)
Directors' deferred compensation	—	—	—	—	1,026	(1,026)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(935)	(935)
Issuance of common stock - stock compensation plans	20,099	34	997	—	—	—	—	—	1,031
Balance, June 30, 2022	72,744,374	\$ 121,265	\$ 1,051,384	\$ 777,430	\$ 19,349	\$ (19,349)	\$ (96,358)	\$ 16,812	\$ 1,870,533
Net income	—	—	—	50,169	—	—	—	502	50,671
Other comprehensive income, net of taxes	—	—	—	—	—	—	(61,622)	—	(61,622)
Cash dividends declared on common stock (\$0.23 per share)	—	—	—	(16,754)	—	—	—	—	(16,754)
Directors' deferred compensation	—	—	—	—	(487)	487	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(390)	(390)
Issuance of common stock - stock compensation plans	94,917	158	990	—	—	—	—	—	1,148
Balance, September 30, 2022	72,839,291	\$ 121,423	\$ 1,052,374	\$ 810,845	\$ 18,862	\$ (18,862)	\$ (157,980)	\$ 16,924	\$ 1,843,586

<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, 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 (loss), 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 (loss), 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 loss, 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

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 2021 audited Consolidated Financial Statements and the 2021 Annual Report on Form 10-K. Results of operations for the three- and nine-month periods ended September 30, 2022, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Effective January 1, 2022, TowneBank elected to carry mortgage loans held for sale within the best efforts program and forward loan sale commitments at fair value. For additional information, refer to Note 14.

Recent accounting pronouncements:

Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 326 - Financial Instruments - Credit Losses Subtopic 310-40 Troubled Debt Restructurings and Subtopic 326-20 Vintage Disclosures ASU 2022 - 02 Issued March 2022	Eliminates the accounting guidance for TDRs by creditors in Subtopic 310-40, while enhancing disclosure requirements for certain loan refinances and restructurings by creditors when a borrower is experiencing financial difficulty. Update requires disclosure of current-period gross writeoffs by year of origination for financing receivables and net investments in leases within the scope of Subtopic 326-20.	Effective for interim and annual periods beginning after December 15, 2022. Early adoption is permitted. An entity should apply the amendments prospectively, except for the transition method related to the recognition and measurement of TDRs, an entity has the option to apply a modified retrospective method. An entity may elect to adopt the amendments about TDRs and related disclosure enhancements separately from the amendments related to vintage disclosures. 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.

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Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 848 - Reference Rate Reform - Facilitation of the Effects of Reference Rate Reform on Financial Reporting ASU 2020 - 04 Issued March 2020 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 evaluating the impact the pronouncement will have on its Consolidated Financial Statements, but does not expect the adoption of this guidance to have a material impact.

Note 2. Earnings per Share and Shareholders' Equity

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
<i>(Dollars in thousands, except per share data)</i>				
Basic				
Net income available to common shareholders	\$ 50,169	\$ 50,400	\$ 142,302	\$ 175,201
Weighted-average common shares outstanding	72,578,736	72,506,877	72,545,745	72,463,644
Basic earnings per common share	\$ 0.69	\$ 0.70	\$ 1.96	\$ 2.42
Diluted				
Net income available to common shareholders, for diluted EPS	\$ 50,169	\$ 50,400	\$ 142,302	\$ 175,201
Weighted-average common shares outstanding	72,578,736	72,506,877	72,545,745	72,463,644
Effect of dilutive securities:				
Stock compensation plans (1)	15,738	84,404	21,851	83,834
Weighted-average diluted shares outstanding	72,594,474	72,591,281	72,567,596	72,547,478
Diluted earnings per common share	\$ 0.69	\$ 0.69	\$ 1.96	\$ 2.41

(1) There were no shares excluded from the computation of diluted shares for the three and nine months ended September 30, 2022 or September 30, 2021.

Note 3. Mergers and Acquisitions

Farmers Bankshares, Inc.: On August 18, 2022, the Company signed a definitive agreement and plan of reorganization (the "Farmers merger agreement"), pursuant to which the Company will acquire Farmers Bankshares, Inc. ("Farmers"), and its wholly owned bank subsidiary, Farmers Bank, a Windsor, Virginia, based bank with eight banking offices servicing Hampton Roads, Virginia. The proposed acquisition of Farmers and Farmers Bank has been approved by the Boards of Directors of TowneBank, Farmers and Farmers Bank and is expected to close in the first quarter of 2023, subject to customary closing conditions, including the receipt of required regulatory approvals and the approval of Farmers' shareholders. At June 30, 2022, Farmers had total assets of \$608.60 million, gross loans of \$277.34 million, and total deposits of \$520.78 million.

Under the terms of the Farmers merger agreement, Farmers shareholders will receive 0.6050 shares of the Company's common stock for each share of Farmers common stock held immediately prior to the effective date of the merger. As a result of the merger, each restricted stock award granted under an equity or equity-based compensation plan that is unvested or contingent and outstanding, immediately prior to the effective date of the merger, will be fully vested and converted into the right to receive 0.6050 shares of the Company's common stock.

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. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income commencing July 1, 2021.

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 4. Investment Securities***Available-for-sale debt securities*

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 \$9.04 million as of September 30, 2022, was excluded from the estimate of expected credit loss and included in other assets.

As of September 30, 2022, we have not recorded an allowance for 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

As of September 30, 2022, no allowance for credit losses on Company-held MBSs issued by GSEs, U.S. government sponsored agency securities, and U.S. Treasury securities has 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 \$2.20 million was included in other assets as of September 30, 2022, and excluded from the estimate of expected credit losses. At September 30, 2022, all HTM debt securities are current for both principal and interest. There are no collateral-dependent HTM debt securities at September 30, 2022.

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, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 358,705	\$ 776	\$ (28,184)	\$ —	\$ 331,297
U.S. Treasury notes	27,726	—	(1,327)	—	26,399
Municipal securities	483,950	5	(57,235)	(368)	426,352
Trust preferred and other corporate securities	86,735	246	(7,480)	(744)	78,757
MBSs issued by GSEs and GNMA	1,133,967	265	(106,901)	—	1,027,331
Total available-for-sale securities	<u>\$ 2,091,083</u>	<u>\$ 1,292</u>	<u>\$ (201,127)</u>	<u>\$ (1,112)</u>	<u>\$ 1,890,136</u>

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December 31, 2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 311,665	\$ 1,293	\$ (2,371)	\$ —	\$ 310,587
U.S. Treasury notes	1,000	—	—	—	1,000
Municipal securities	375,327	13,075	(2,729)	(104)	385,569
Trust preferred and other corporate securities	53,484	805	(339)	(106)	53,844
MBSs issued by GSEs and GNMA	1,047,377	16,881	(9,075)	—	1,055,183
Total available-for-sale securities	<u>\$ 1,788,853</u>	<u>\$ 32,054</u>	<u>\$ (14,514)</u>	<u>\$ (210)</u>	<u>\$ 1,806,183</u>

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Gross gains	\$ —	\$ —	\$ —	\$ 1,252
Gross (losses)	—	—	—	—
Net gains	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,252</u>
Sales proceeds	\$ —	\$ —	\$ —	\$ 18,819

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, 2022	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
U.S. agency securities	\$ 100,905	\$ —	\$ (8,972)	\$ 91,933	\$ —
U.S. Treasury notes	434,148	—	(21,659)	412,489	—
Municipal securities	5,159	65	—	5,224	(8)
Trust preferred and other corporate securities	2,235	87	—	2,322	(75)
MBSs issued by GSEs and GNMA	6,298	1	(485)	5,814	—
Total held-to-maturity securities	<u>\$ 548,745</u>	<u>\$ 153</u>	<u>\$ (31,116)</u>	<u>\$ 517,782</u>	<u>\$ (83)</u>
December 31, 2021	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
U.S. agency securities	\$ 73,360	\$ 67	\$ (33)	\$ 73,394	\$ —
U.S. Treasury notes	66,326	—	(73)	66,253	—
Municipal securities	5,095	1,067	—	6,162	(10)
Trust preferred and other corporate securities	2,272	252	—	2,524	(84)
MBSs issued by GSEs and GNMA	7,168	175	—	7,343	—
Total held-to-maturity securities	<u>\$ 154,221</u>	<u>\$ 1,561</u>	<u>\$ (106)</u>	<u>\$ 155,676</u>	<u>\$ (94)</u>

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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, 2022				
Due in one year or less	\$ 37,047	\$ 36,922	\$ 80	\$ 73
Due after one year through five years	338,542	307,591	533,015	502,620
Due after five years through 10 years	913,457	823,374	13,563	13,001
Due after 10 years	802,037	722,249	2,087	2,088
	<u>\$ 2,091,083</u>	<u>\$ 1,890,136</u>	<u>\$ 548,745</u>	<u>\$ 517,782</u>
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2021				
Due in one year or less	\$ 25,963	\$ 26,415	\$ 43	\$ 43
Due after one year through five years	154,061	157,793	146,404	146,527
Due after five years through 10 years	1,004,265	1,013,847	5,595	6,913
Due after 10 years	604,564	608,128	2,179	2,193
	<u>\$ 1,788,853</u>	<u>\$ 1,806,183</u>	<u>\$ 154,221</u>	<u>\$ 155,676</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, 2022							
Description of Securities	Number						
U.S. agency securities	36	\$ 176,693	\$ (17,976)	\$ 59,988	\$ (10,208)	\$ 236,681	\$ (28,184)
U.S. Treasury notes	2	26,399	(1,327)	—	—	26,399	(1,327)
Municipal securities	63	124,464	(12,161)	29,836	(6,403)	154,300	(18,564)
MBSs issued by GSEs and GNMA	183	697,044	(62,062)	302,286	(44,839)	999,330	(106,901)
Total AFS securities	284	<u>\$ 1,024,600</u>	<u>\$ (93,526)</u>	<u>\$ 392,110</u>	<u>\$ (61,450)</u>	<u>\$ 1,416,710</u>	<u>\$ (154,976)</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, 2021							
Description of Securities	Number						
U.S. agency securities	23	\$ 148,150	\$ (830)	\$ 51,535	\$ (1,541)	\$ 199,685	\$ (2,371)
Municipal securities	20	58,314	(672)	15,950	(496)	74,264	(1,168)
MBSs issued by GSEs and GNMA	63	436,805	(6,846)	73,913	(2,229)	510,718	(9,075)
Total AFS securities	106	<u>\$ 643,269</u>	<u>\$ (8,348)</u>	<u>\$ 141,398</u>	<u>\$ (4,266)</u>	<u>\$ 784,667</u>	<u>\$ (12,614)</u>

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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, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 343	\$ 768	\$ 1,111
Provision for credit losses	25	(24)	1
Balance, end of period	\$ 368	\$ 744	\$ 1,112

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

Nine Months Ended September 30, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 104	\$ 106	\$ 210
Provision for credit losses	264	638	902
Balance, end of period	\$ 368	\$ 744	\$ 1,112

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

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, 2022. 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, 2022	Credit Ratings					Total
Description of Securities	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
U.S. agency securities	\$ 100,905	\$ —	\$ —	\$ —	\$ —	\$ 100,905
U.S. Treasury notes	434,148	—	—	—	—	434,148
Municipal securities	1,729	3,430	—	—	—	5,159
Trust preferred and other corporate securities	—	—	—	2,235	—	2,235
Mortgage-backed securities issued by GSEs and GNMA	6,298	—	—	—	—	6,298
Total	\$ 543,080	\$ 3,430	\$ —	\$ 2,235	\$ —	\$ 548,745

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Description of Securities	Credit Ratings						Total
	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
U.S. agency securities	\$ 73,360	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 73,360
U.S. Treasury notes	66,326	—	—	—	—	—	66,326
Municipal securities	1,676	3,419	—	—	—	—	5,095
Trust preferred and other corporate securities	—	—	—	—	2,272	—	2,272
Mortgage-backed securities issued by GSEs and GNMA	7,168	—	—	—	—	—	7,168
Total	<u>\$ 148,530</u>	<u>\$ 3,419</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,272</u>	<u>\$ —</u>	<u>\$ 154,221</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, 2022

Description of Securities	2022	2021	2020	2019	2018	Prior	Total
U.S. agency securities	\$ 27,236	\$ 73,669	\$ —	\$ —	\$ —	\$ —	\$ 100,905
U.S. Treasury notes	369,068	65,080	—	—	—	—	434,148
Municipal securities	—	—	—	—	—	5,159	5,159
Trust preferred and other corporate securities	—	—	—	1,735	—	500	2,235
Mortgage-backed securities issued by GSEs and GNMA	—	—	—	—	—	6,298	6,298
Total	<u>\$ 396,304</u>	<u>\$ 138,749</u>	<u>\$ —</u>	<u>\$ 1,735</u>	<u>\$ —</u>	<u>\$ 11,957</u>	<u>\$ 548,745</u>

December 31, 2021

Description of Securities	2021	2020	2019	2018	2017	Prior	Total
U.S. agency securities	\$ 73,360	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 73,360
U.S. Treasury notes	66,326	—	—	—	—	—	66,326
Municipal securities	—	—	—	—	—	5,095	5,095
Trust preferred and other corporate securities	—	—	1,772	—	—	500	2,272
Mortgage-backed securities issued by GSEs and GNMA	—	—	—	—	—	7,168	7,168
Total	<u>\$ 139,686</u>	<u>\$ —</u>	<u>\$ 1,772</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,763</u>	<u>\$ 154,221</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, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 8	\$ 77	\$ 85
Provision for credit losses	—	(2)	(2)
Balance, end of period	<u>\$ 8</u>	<u>\$ 75</u>	<u>\$ 83</u>

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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	\$ 10	\$ 84	\$ 94

Nine Months Ended September 30, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 10	\$ 84	\$ 94
Provision for credit losses	(2)	(9)	(11)
Balance, end of period	\$ 8	\$ 75	\$ 83

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

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, 2022, FHLB stock totaled \$9.48 million and other equity securities totaled \$6.36 million. At December 31, 2021, FHLB stock totaled \$13.15 million and other equity securities totaled \$6.76 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, 2022 and December 31, 2021, the Company had investment securities with market values of \$405.81 million and \$375.55 million, respectively, pledged to secure federal, state, and municipal deposits. The Company also had \$87.34 million in investment securities pledged against repurchase agreements with commercial customers at September 30, 2022, compared to \$110.12 million at December 31, 2021.

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Note 5. Loans Held for Investment

The Company grants commercial, real estate, and consumer loans to customers throughout our lending area. Although the Company has a diversified loan portfolio, a substantial portion of the Company's debtors' abilities to honor their contracts is dependent upon the economic environment of the lending area.

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

	September 30, 2022 (1)	December 31, 2021 (1)
Commercial Real Estate		
Construction and land development	\$ 1,324,831	\$ 1,125,863
Owner occupied	1,590,371	1,494,000
Non-owner occupied	2,799,363	2,620,334
Multi-family	458,803	332,659
Total Commercial Real Estate	6,173,368	5,572,856
Residential 1-4 family	1,567,024	1,305,915
HELOC	388,305	380,834
Commercial and industrial business	1,251,350	1,206,911
Government	520,198	525,358
Indirect	572,710	394,802
Consumer loans and other	86,656	119,576
Loans, net of unearned income and deferred costs	<u>\$ 10,559,611</u>	<u>\$ 9,506,252</u>

(1) Paycheck Protection Program loans totaling \$12.65 million and \$157.72 million, primarily in C&I, are included in the September 30, 2022 and December 31, 2021 balances, respectively.

Deferred loan costs in excess of unearned loan income was \$1.45 million at September 30, 2022, compared to unearned loan income in excess of deferred loan costs of \$5.71 million at December 31, 2021. Unearned loan income on PPP totaled \$0.17 million at September 30, 2022, and \$4.16 million at December 31, 2021. Unaccreted discounts on PCD loans were \$3.66 million at September 30, 2022, and \$5.96 million at December 31, 2021. Unaccreted discounts on non-PCD loans were \$2.56 million at September 30, 2022, and \$4.09 million at December 31, 2021. There were \$5.25 million and \$5.97 million in nonaccrual loans at September 30, 2022 and December 31, 2021, respectively. The Company would have earned \$76 thousand and \$233 thousand in the third quarter and first nine months of 2022, respectively, and \$120 thousand and \$515 thousand in the third quarter and first nine months of 2021, respectively, if interest on the nonaccrual loans had been accrued.

Nonaccrual loans

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.

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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.

At September 30, 2022, nonaccruing TDRs, which are included in nonperforming loans, totaled \$0.14 million, and accruing TDRs totaled \$10.53 million. At December 31, 2021, nonaccruing TDRs, which are included in nonperforming loans, totaled \$0.22 million, and accruing TDRs totaled \$9.79 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 months ended September 30, 2022, there were no loans modified as TDRs. For the nine months ended September 30, 2022, there was one commercial real estate owner occupied, loan modified as a TDR with a pre- and post-modification balance of \$1.28 million. For the three and nine months ended September 30, 2021, there were no loans modified as TDRs.

Restructured loans generally include terms to reduce the interest rate and extended payment terms. We have not forgiven any principal of the above loan. There were no loans restructured in the past 12 months that have subsequently defaulted.

Note 6. Allowance for Credit Losses

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, 2022, \$24.22 million in accrued interest receivable on loans is excluded from the estimate of ECL and is included in other assets, compared to \$21.65 million as of December 31, 2021.

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

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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 \$18.97 million with specific zero reserves at September 30, 2022, and \$16.89 million with specific reserves of \$0.34 million at December 31, 2021.

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, 2022 and 2021 (in thousands):

Three Months Ended September 30, 2022	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 22,857	\$ 11,785	\$ 16,728	\$ 1,800	\$ 17,833	\$ 16,210
Provision for credit losses	(3,500)	(1,069)	(1,081)	23	9,356	74
Write-offs	—	—	—	—	—	—
Recoveries	4	—	110	—	14	26
Net (write-offs) recoveries	4	—	110	—	14	26
Balance, end of period	19,361	10,716	15,757	1,823	27,203	16,310

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 8,011	\$ 3,001	\$ 3,239	\$ 2,555	\$ 104,019
Provision for credit losses	(1,237)	(146)	703	168	3,291
Write-offs	(13)	—	(110)	(11)	(134)
Recoveries	29	—	105	33	321
Net (write-offs) recoveries	16	—	(5)	22	187
Balance, end of period	6,790	2,855	3,937	2,745	107,497

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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

Nine Months Ended September 30, 2022	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 18,337	\$ 12,760	\$ 25,487	\$ 1,828	\$ 18,014	\$ 14,550
Provision for credit losses	1,014	(2,079)	(9,935)	(5)	9,144	1,714
Write-offs	—	—	—	—	—	(50)
Recoveries	10	35	205	—	45	96
Net (write-offs) recoveries	10	35	205	—	45	46
Balance, end of period	19,361	10,716	15,757	1,823	27,203	16,310

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 6,935	\$ 3,458	\$ 2,133	\$ 2,557	\$ 106,059
Provision for credit losses	101	(603)	1,796	150	1,297
Write-offs	(481)	—	(237)	(34)	(802)
Recoveries	235	—	245	72	943
Net (write-offs) recoveries	(246)	—	8	38	141
Balance, end of period	6,790	2,855	3,937	2,745	\$ 107,497

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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

The following table presents a roll forward of the allowance for off-balance-sheet exposure for the three and nine months ended September 30, 2022 and 2021, related to loans held for investment, which is carried in other liabilities on our Consolidated Balance Sheets (in thousands):

Three Months Ended September 30, 2022	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 390	\$ 203	\$ 194	\$ 30	\$ —	\$ 2,861
Provision for credit losses	508	(36)	20	19	—	18
Balance, end of period	\$ 898	\$ 167	\$ 214	\$ 49	\$ —	\$ 2,879

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 1,373	\$ —	\$ —	\$ 1,540	\$ 6,591
Provision for credit losses	57	—	—	49	635
Balance, end of period	\$ 1,430	\$ —	\$ —	\$ 1,589	\$ 7,226

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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

Nine Months Ended September 30, 2022	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 640	\$ 341	\$ 331	\$ 40	\$ —	\$ 2,568
Provision for credit losses	258	(174)	(117)	9	—	311
Ending balance	\$ 898	\$ 167	\$ 214	\$ 49	\$ —	\$ 2,879

	Commercial and Industrial	Government	Indirect	Consumer and Other	Total
Balance, beginning of period	\$ 1,434	\$ —	\$ —	\$ 1,528	\$ 6,882
Provision for credit losses	(4)	—	—	61	344
Ending balance	\$ 1,430	\$ —	\$ —	\$ 1,589	\$ 7,226

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

Our provision for credit losses on funded and unfunded loan exposures was a net expense of \$3.93 million in the third quarter of 2022 compared to net expense of \$0.03 million in the linked quarter, and a net benefit of \$1.59 million in the prior year quarter. The provision expense was driven by loan growth and weakening in our macroeconomic forecast scenarios used by management to assist in estimating credit losses. The provision expense for the nine months ended September 30, 2022 was partially offset by the release of the remaining qualitative reserves associated with industries heavily impacted by COVID-19, primarily hotels and restaurants in our non-owner-occupied portfolio segment. Expected loss estimates are subject to change

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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 are refreshed on an ongoing basis and affirmed at least semiannually. At affirmation, management analyzes the resulting scores, as well as external statistics and factors to track loan performance. On an as-needed basis, credit risk grades may be updated between review periods if new information arises related to the customer's ability to repay the loan. The Company differentiates its loan segments based on shared risk characteristics for which expected credit loss is measured on a pool basis.

The Company's internally assigned risk grades are as follows:

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

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

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

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

For consumer-related credits, the Company utilizes credit scores calculated and maintained by one of three credit bureaus. Credit scores range between 300 and 850, with a lower score indicating a potentially higher risk. Credit scores are updated semi-annually, with the most recent update in August 2022.

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The following table provides a breakdown of the Company's loans held for investment by credit score or risk grade and year of origination at September 30, 2022 and December 31, 2021 (in thousands):

September 30, 2022

	Term Loans By Origination									
	2022	2021	2020	2019	2018	Prior	Revolving Loans	Revolving Loans Converted to Term	Total	
CRE - Construction and Development										
Pass	\$ 628,540	\$ 487,268	\$ 120,236	\$ 18,206	\$ 4,663	\$ 13,972	\$ 51,101	\$ —	\$ 1,323,986	
Special Mention	—	—	—	—	—	490	—	—	490	
Substandard	125	84	—	19	1	126	—	—	355	
	\$ 628,665	\$ 487,352	\$ 120,236	\$ 18,225	\$ 4,664	\$ 14,588	\$ 51,101	\$ —	\$ 1,324,831	
CRE - Owner Occupied										
Pass	\$ 294,315	\$ 449,592	\$ 278,798	\$ 169,432	\$ 83,398	\$ 268,011	\$ 13,412	\$ —	\$ 1,556,958	
Special Mention	5,775	1,385	6,404	268	—	5,326	1,985	747	21,890	
Substandard	780	—	—	7,905	258	2,580	—	—	11,523	
	\$ 300,870	\$ 450,977	\$ 285,202	\$ 177,605	\$ 83,656	\$ 275,917	\$ 15,397	\$ 747	\$ 1,590,371	
CRE - Non-Owner Occupied										
Pass	\$ 650,854	\$ 788,423	\$ 468,078	\$ 331,854	\$ 149,813	\$ 360,274	\$ 9,136	\$ —	\$ 2,758,432	
Special Mention	2,644	26,552	2,328	—	7,729	—	800	—	40,053	
Substandard	—	—	697	—	—	181	—	—	878	
	\$ 653,498	\$ 814,975	\$ 471,103	\$ 331,854	\$ 157,542	\$ 360,455	\$ 9,936	\$ —	\$ 2,799,363	
CRE - Multi-Family										
Pass	\$ 126,744	\$ 125,591	\$ 108,895	\$ 43,562	\$ 16,036	\$ 34,759	\$ 823	\$ —	\$ 456,410	
Special Mention	—	—	—	—	2,178	—	—	—	2,178	
Substandard	—	—	—	—	—	215	—	—	215	
	\$ 126,744	\$ 125,591	\$ 108,895	\$ 43,562	\$ 18,214	\$ 34,974	\$ 823	\$ —	\$ 458,803	
Commercial and Industrial										
Pass	\$ 282,912	\$ 218,984	\$ 117,118	\$ 63,094	\$ 34,439	\$ 31,115	\$ 485,992	\$ 882	\$ 1,234,536	
Special Mention	1,021	2,110	378	1,167	396	10	7,676	—	12,758	
Substandard	327	1,522	1,901	118	172	16	—	—	4,056	
	\$ 284,260	\$ 222,616	\$ 119,397	\$ 64,379	\$ 35,007	\$ 31,141	\$ 493,668	\$ 882	\$ 1,251,350	
Government										
Pass	\$ 56,204	\$ 46,345	\$ 189,740	\$ 22,224	\$ 23,063	\$ 176,567	\$ 6,055	\$ —	\$ 520,198	
Special Mention	—	—	—	—	—	—	—	—	—	
Substandard	—	—	—	—	—	—	—	—	—	
	\$ 56,204	\$ 46,345	\$ 189,740	\$ 22,224	\$ 23,063	\$ 176,567	\$ 6,055	\$ —	\$ 520,198	

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	Term Loans By Origination										
	2022	2021	2020	2019	2018	Prior	Revolving Loans	Revolving Loans Converted to Term	Total		
Residential 1 - 4 Family											
Credit Score:											
> = 750	\$ 437,077	\$ 350,254	\$ 182,157	\$ 96,843	\$ 54,763	\$ 164,802	\$ 4,206	\$ 230	\$ 1,290,332		
650-749	81,658	69,430	44,534	11,357	19,517	35,657	—	—	262,153		
450-649	5,647	638	910	587	838	5,919	—	—	14,539		
300-449	—	—	—	—	—	—	—	—	—		
	\$ 524,382	\$ 420,322	\$ 227,601	\$ 108,787	\$ 75,118	\$ 206,378	\$ 4,206	\$ 230	\$ 1,567,024		
HELOC											
Credit Score:											
> = 750	\$ 1,051	\$ 1,087	\$ 723	\$ 126	\$ 130	\$ 1,324	\$ 300,374	\$ 994	\$ 305,809		
650-749	467	456	39	1,003	233	1,979	71,349	—	75,526		
450-649	181	351	—	120	99	1,073	4,879	267	6,970		
300-449	—	—	—	—	—	—	—	—	—		
	\$ 1,699	\$ 1,894	\$ 762	\$ 1,249	\$ 462	\$ 4,376	\$ 376,602	\$ 1,261	\$ 388,305		
Indirect											
Credit Score:											
> = 750	\$ 159,087	\$ 94,261	\$ 18,629	\$ 10,649	\$ 8,577	\$ 2,828	\$ —	\$ —	\$ 294,031		
650-749	126,698	86,046	25,491	9,651	7,634	2,040	—	—	257,560		
450-649	3,919	3,866	5,298	3,381	3,304	1,326	—	—	21,094		
300-449	—	—	—	25	—	—	—	—	25		
	\$ 289,704	\$ 184,173	\$ 49,418	\$ 23,706	\$ 19,515	\$ 6,194	\$ —	\$ —	\$ 572,710		
Consumer and Other											
Credit Score:											
> = 750	\$ 11,511	\$ 13,867	\$ 6,393	\$ 5,466	\$ 1,519	\$ 3,100	\$ 31,142	\$ 13	\$ 73,011		
650-749	1,976	2,023	1,136	871	694	166	4,678	745	12,289		
450-649	307	127	162	135	7	85	533	—	1,356		
300-649	—	—	—	—	—	—	—	—	—		
	\$ 13,794	\$ 16,017	\$ 7,691	\$ 6,472	\$ 2,220	\$ 3,351	\$ 36,353	\$ 758	\$ 86,656		
Grand Total	\$ 2,879,820	\$ 2,770,262	\$ 1,580,045	\$ 798,063	\$ 419,461	\$ 1,113,941	\$ 994,141	\$ 3,878	\$ 10,559,611		

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December 31, 2021

Term Loans By Origination									
	2021	2020	2019	2018	2017	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
CRE - Construction and Development									
Pass	\$ 735,699	\$ 294,630	\$ 39,074	\$ 7,049	\$ 5,136	\$ 11,343	\$ 31,833	\$ —	\$ 1,124,764
Special Mention	—	—	—	—	—	526	—	—	526
Substandard	87	—	33	—	73	380	—	—	573
	<u>\$ 735,786</u>	<u>\$ 294,630</u>	<u>\$ 39,107</u>	<u>\$ 7,049</u>	<u>\$ 5,209</u>	<u>\$ 12,249</u>	<u>\$ 31,833</u>	<u>\$ —</u>	<u>\$ 1,125,863</u>
CRE - Owner Occupied									
Pass	\$ 454,049	\$ 331,421	\$ 195,828	\$ 118,943	\$ 94,506	\$ 257,045	\$ 17,110	\$ 7	\$ 1,468,909
Special Mention	1,457	1,544	50	—	2,595	4,749	1,833	—	12,228
Substandard	—	—	8,045	281	291	3,996	250	—	12,863
	<u>\$ 455,506</u>	<u>\$ 332,965</u>	<u>\$ 203,923</u>	<u>\$ 119,224</u>	<u>\$ 97,392</u>	<u>\$ 265,790</u>	<u>\$ 19,193</u>	<u>\$ 7</u>	<u>\$ 1,494,000</u>
CRE - Non-Owner Occupied									
Pass	\$ 933,267	\$ 539,811	\$ 401,560	\$ 230,218	\$ 194,603	\$ 294,039	\$ 12,470	\$ —	\$ 2,605,968
Special Mention	—	—	—	7,967	2,278	—	800	—	11,045
Substandard	—	3,119	—	—	—	202	—	—	3,321
	<u>\$ 933,267</u>	<u>\$ 542,930</u>	<u>\$ 401,560</u>	<u>\$ 238,185</u>	<u>\$ 196,881</u>	<u>\$ 294,241</u>	<u>\$ 13,270</u>	<u>\$ —</u>	<u>\$ 2,620,334</u>
CRE - Multi-Family									
Pass	\$ 104,872	\$ 71,930	\$ 60,027	\$ 43,948	\$ 11,978	\$ 36,029	\$ 3,606	\$ —	\$ 332,390
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	269	—	—	269
	<u>\$ 104,872</u>	<u>\$ 71,930</u>	<u>\$ 60,027</u>	<u>\$ 43,948</u>	<u>\$ 11,978</u>	<u>\$ 36,298</u>	<u>\$ 3,606</u>	<u>\$ —</u>	<u>\$ 332,659</u>
Commercial and Industrial									
Pass	\$ 437,453	\$ 175,270	\$ 95,141	\$ 50,979	\$ 24,276	\$ 20,557	\$ 392,876	\$ 887	\$ 1,197,439
Special Mention	254	2,415	1,328	239	84	11	815	510	5,656
Substandard	2,733	258	182	213	11	19	400	—	3,816
	<u>\$ 440,440</u>	<u>\$ 177,943</u>	<u>\$ 96,651</u>	<u>\$ 51,431</u>	<u>\$ 24,371</u>	<u>\$ 20,587</u>	<u>\$ 394,091</u>	<u>\$ 1,397</u>	<u>\$ 1,206,911</u>
Government									
Pass	\$ 55,299	\$ 196,119	\$ 23,093	\$ 55,863	\$ 14,603	\$ 175,265	\$ 5,116	\$ —	\$ 525,358
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
	<u>\$ 55,299</u>	<u>\$ 196,119</u>	<u>\$ 23,093</u>	<u>\$ 55,863</u>	<u>\$ 14,603</u>	<u>\$ 175,265</u>	<u>\$ 5,116</u>	<u>\$ —</u>	<u>\$ 525,358</u>

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Term Loans By Origination										
	2021	2020	2019	2018	2017	Prior	Revolving Loans	Revolving Loans Converted to Term	Total	
Residential 1 - 4 Family										
Credit Score:										
> = 750	\$ 429,997	\$ 212,280	\$ 123,067	\$ 64,547	\$ 74,420	\$ 147,970	\$ 4,735	\$ 196	\$ 1,057,212	
650-749	82,697	58,086	16,368	28,811	10,028	41,215	—	—	237,205	
450-649	1,715	1,041	599	1,168	1,335	5,640	—	—	11,498	
300-449	—	—	—	—	—	—	—	—	—	
	<u>\$ 514,409</u>	<u>\$ 271,407</u>	<u>\$ 140,034</u>	<u>\$ 94,526</u>	<u>\$ 85,783</u>	<u>\$ 194,825</u>	<u>\$ 4,735</u>	<u>\$ 196</u>	<u>\$ 1,305,915</u>	
HELOC										
Credit Score:										
> = 750	\$ 2,492	\$ 1,191	\$ 190	\$ 189	\$ 545	\$ 1,302	\$ 287,783	\$ 23	\$ 293,715	
650-749	979	110	1,031	268	323	2,618	74,770	216	80,315	
450-649	479	238	121	98	243	1,124	4,422	79	6,804	
300-449	—	—	—	—	—	—	—	—	—	
	<u>\$ 3,950</u>	<u>\$ 1,539</u>	<u>\$ 1,342</u>	<u>\$ 555</u>	<u>\$ 1,111</u>	<u>\$ 5,044</u>	<u>\$ 366,975</u>	<u>\$ 318</u>	<u>\$ 380,834</u>	
Indirect										
Credit Score:										
> = 750	\$ 120,668	\$ 26,980	\$ 17,074	\$ 15,883	\$ 6,116	\$ 1,194	\$ —	\$ —	\$ 187,915	
650-749	111,602	36,472	14,976	12,926	3,200	1,722	—	—	180,898	
450-649	5,452	7,482	4,890	5,241	1,607	1,288	—	—	25,960	
300-449	—	—	29	—	—	—	—	—	29	
	<u>\$ 237,722</u>	<u>\$ 70,934</u>	<u>\$ 36,969</u>	<u>\$ 34,050</u>	<u>\$ 10,923</u>	<u>\$ 4,204</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 394,802</u>	
Consumer and Other										
Credit Score:										
> = 750	\$ 53,898	\$ 8,962	\$ 8,008	\$ 2,497	\$ 2,486	\$ 1,274	\$ 26,495	\$ —	\$ 103,620	
650-749	4,077	1,988	1,151	1,099	207	233	5,613	72	14,440	
450-649	188	226	190	26	179	6	550	1	1,366	
300-449	—	—	—	—	—	150	—	—	150	
	<u>\$ 58,163</u>	<u>\$ 11,176</u>	<u>\$ 9,349</u>	<u>\$ 3,622</u>	<u>\$ 2,872</u>	<u>\$ 1,663</u>	<u>\$ 32,658</u>	<u>\$ 73</u>	<u>\$ 119,576</u>	
Grand Total	<u>\$ 3,539,414</u>	<u>\$ 1,971,573</u>	<u>\$ 1,012,055</u>	<u>\$ 648,453</u>	<u>\$ 451,123</u>	<u>\$ 1,010,166</u>	<u>\$ 871,477</u>	<u>\$ 1,991</u>	<u>\$ 9,506,252</u>	

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

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

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is optional. For those CDA loans measured at the fair value of collateral, a credit loss expense is recorded for loan amounts in excess of fair value.

The following table provides a breakdown between loans identified as CDAs and non-CDAs, by type and securing collateral, as well as collateral coverage for those loans at September 30, 2022 and December 31, 2021 (in thousands):

September 30, 2022	Type of Collateral and Extent to Which Collateral Secures Loans			Loans Not Considered Collateral Dependent	Total
	Residential Property	Investment Property	Commercial Property		
Commercial Real Estate					
Construction and development	\$ —	\$ 973	\$ —	\$ 1,323,858	\$ 1,324,831
Owner occupied	—	—	2,624	1,587,747	1,590,371
Non-owner occupied	—	40,612	—	2,758,751	2,799,363
Multi-family	—	2,394	—	456,409	458,803
Residential 1-4 family	4,279	—	—	1,562,745	1,567,024
HELOC	50	—	—	388,255	388,305
Commercial and industrial	—	—	—	1,251,350	1,251,350
Government	—	—	—	520,198	520,198
Indirect	—	—	—	572,710	572,710
Consumer and other	—	—	—	86,656	86,656
Total, amortized cost	\$ 4,329	\$ 43,979	\$ 2,624	\$ 10,508,679	\$ 10,559,611
Collateral value	\$ 9,046	\$ 73,424	\$ 6,915		

December 31, 2021	Type of Collateral and Extent to Which Collateral Secures Loans			Loans Not Considered Collateral Dependent	Total
	Residential Property	Investment Property	Commercial Property		
Commercial Real Estate					
Construction and development	\$ —	\$ 945	\$ —	\$ 1,124,918	\$ 1,125,863
Owner occupied	—	—	3,953	1,490,047	1,494,000
Non-owner occupied	—	13,998	—	2,606,336	2,620,334
Multi-family	—	270	—	332,389	332,659
Residential 1-4 family	3,930	—	—	1,301,985	1,305,915
HELOC	506	—	—	380,328	380,834
Commercial and industrial	—	—	—	1,206,911	1,206,911
Government	—	—	—	525,358	525,358
Indirect	—	—	—	394,802	394,802
Consumer and other	—	—	—	119,576	119,576
Total, amortized cost	\$ 4,436	\$ 15,213	\$ 3,953	\$ 9,482,650	\$ 9,506,252
Collateral value	\$ 10,729	\$ 29,206	\$ 8,475		

Nonaccrual and past due loans

Loans are placed on nonaccrual status when management determines that the full repayment of principal and collection of interest according to contractual terms is no longer likely, generally when the loan becomes 90 days or more past due. However, some loans that are 90 days or more past due as to interest and principal are still accruing because they are (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual.

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The following table is an aging analysis at amortized cost of the Company's loans held for investment portfolio at September 30, 2022 and December 31, 2021 (in thousands):

September 30, 2022

September 30, 2022	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	\$	1,324,675	\$ 93	\$ 63	\$ —	\$ 156	\$ 1,324,831	\$ —
Owner occupied		1,590,058	—	—	313	313	1,590,371	—
Non-owner occupied		2,799,363	—	—	—	—	2,799,363	—
Multi-family		458,575	228	—	—	228	458,803	—
Residential 1-4 family		1,564,646	158	257	1,963	2,378	1,567,024	504
HELOC		387,963	285	—	57	342	388,305	57
Commercial and industrial		1,250,504	601	28	217	846	1,251,350	—
Government		520,198	—	—	—	—	520,198	—
Indirect		570,059	1,582	365	704	2,651	572,710	164
Consumer and other		86,631	23	2	—	25	86,656	—
Total	\$	10,552,672	\$ 2,970	\$ 715	\$ 3,254	\$ 6,939	\$ 10,559,611	\$ 725

December 31, 2021

December 31, 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	\$	1,125,863	\$	—	\$	—	\$	—	\$	1,125,863	\$	—		
Owner occupied		1,492,631		763		—		606		1,369		1,494,000	—	
Non-owner occupied		2,620,334		—		—		—		—		2,620,334	—	
Multi-family		332,659		—		—		—		—		332,659	—	
Residential 1-4 family		1,303,482		403		931		1,099		2,433		1,305,915	41	
HELOC		380,206		383		220		25		628		380,834	—	
Commercial and industrial		1,206,297		100		22		492		614		1,206,911	263	
Government		525,358		—		—		—		—		525,358	—	
Indirect		393,144		988		123		547		1,658		394,802	68	
Consumer and other		119,512		40		24		—		64		119,576	—	
Total	\$	9,499,486	\$	2,677	\$	1,320	\$	2,769	\$	6,766	\$	9,506,252	\$	372

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, 2022 and December 31, 2021. Nonaccrual loans without specific reserves are included in collectively evaluated pools for which an ACL has been recorded. It also shows interest income recognized on nonaccrual loans (in thousands):

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September 30, 2022	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 09/30/22	Nonaccrual Loans With No Specific Reserve as of 09/30/22	Interest Income Recognized as of 09/30/22
	As of 06/30/22	As of 09/30/22			
Commercial Real Estate					
Construction and development	\$ —	\$ 93	\$ —	\$ 93	\$ 6
Owner occupied	594	571	—	571	46
Non-owner occupied	—	—	—	—	16
Multi-family	—	—	—	—	—
Residential 1-4 family	2,118	2,088	504	2,088	156
HELOC	458	360	57	360	68
Commercial and industrial	1,822	1,547	—	1,547	177
Government	—	—	—	—	—
Indirect	501	591	164	591	93
Consumer and other	—	—	—	—	23
Total	\$ 5,493	\$ 5,250	\$ 725	\$ 5,250	\$ 585

December 31, 2021	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 12/31/2021	Nonaccrual Loans With No Specific Reserve as of 12/31/2021	Interest Income Recognized as of 12/31/2021
	As of 12/31/2020	As of 12/31/2021			
Commercial Real Estate					
Construction and development	\$ —	\$ —	\$ —	\$ —	7
Owner occupied	387	607	—	607	177
Non-owner occupied	1,163	—	—	—	17
Multi-family	—	—	—	—	91
Residential 1-4 family	3,432	1,839	41	1,498	316
HELOC	1,072	481	—	481	138
Commercial and industrial	4,414	2,433	263	2,433	243
Government	—	—	—	—	—
Indirect	717	613	68	613	128
Consumer and other	3	—	—	—	33
Total	\$ 11,188	\$ 5,973	\$ 372	\$ 5,632	\$ 1,150

Note 7. Leases

We lease certain office space, land, and equipment. These leases are 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

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extend the lease term, that option is included in estimating the value of the right-of-use asset and lease liability.

At September 30, 2022, 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.

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

	September 30, 2022	December 31, 2021
Assets		
Operating lease assets included in other assets	\$ 51,213	\$ 52,750
Liabilities		
Accrued liability operating leases included in other liabilities	\$ 55,053	\$ 56,554

The following table presents a summary of activity related to leases for the three- and nine-month periods ended September 30, 2022 and 2021 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Operating lease cost (1) included in occupancy expense	\$ 3,527	\$ 3,608	\$ 10,368	\$ 10,702
Variable lease cost included in occupancy expense	179	183	625	621
Sublease income included in occupancy expense	(63)	(132)	(215)	(222)
Net lease cost	\$ 3,643	\$ 3,659	\$ 10,778	\$ 11,101

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

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The following table presents lease liability maturities, by year, as of September 30, 2022 (in thousands):

	Operating Leases (1)
October 1 - December 31, 2022	\$ 3,110
2023	9,946
2024	7,490
2025	6,459
2026	5,434
After 2026	47,347
Total lease payments	\$ 79,786
Less: interest	24,733
Present value of lease liabilities	<u>\$ 55,053</u>

(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, 2022	September 30, 2021
Weighted - average remaining lease term - operating leases (in years)	13.76	13.12
Weighted - average discount rate - operating leases	4.90%	4.86%

The following table presents other information with regard to leases for the three- and nine-month periods ended September 30, 2022 and 2021 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows from operating leases	\$ 3,198	\$ 3,241	\$ 9,274	9,600
Related Party Transactions (1)				
Rent expense included in occupancy expense	\$ 719	\$ 707	\$ 2,133	2,026

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

Note 8. Segment Reporting

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers. 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

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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.

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, 2022	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 123,039	\$ 999	\$ —	\$ 124,038
Provision for credit losses	4,240	(315)	—	3,925
Net interest income after provision for credit losses	118,799	1,314	—	120,113
Residential mortgage banking income, net	(758)	12,726	—	11,968
Insurance commissions and other title fees and income, net	—	525	18,910	19,435
Property management income, net	—	9,891	—	9,891
Real estate commission income, net	—	2,932	—	2,932
Other noninterest income	10,203	586	183	10,972
Noninterest expense	70,062	28,042	13,930	112,034
Income (loss) before income tax, corporate allocation and noncontrolling interest	58,182	(68)	5,163	63,277
Corporate allocation	902	(602)	(300)	—
Income before income tax provision and noncontrolling interest	59,084	(670)	4,863	63,277
Provision for income tax expense	11,507	(120)	1,219	12,606
Net income (loss)	47,577	(550)	3,644	50,671
Noncontrolling interest	—	(502)	—	(502)
Net income (loss) attributable to TowneBank	\$ 47,577	\$ (1,052)	\$ 3,644	\$ 50,169
Net income (loss) as percentage of total	94.84 %	(2.10)%	7.26 %	100.00 %
Total assets	\$ 14,939,876	\$ 528,773	\$ 483,148	\$ 15,951,797

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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
Property management income, net	—	10,502	—	10,502
Real estate commission income, net	—	3,781	—	3,781
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

Nine Months Ended September 30, 2022	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 327,226	\$ 5,356	\$ —	\$ 332,582
Provision for credit losses	2,247	285	—	2,532
Net interest income after provision for credit losses	324,979	5,071	—	330,050
Residential mortgage banking income, net	(3,709)	43,491	—	39,782
Insurance commissions and other title fees and income, net	—	1,590	56,665	58,255
Property management income, net	—	36,489	—	36,489
Real estate commission income, net	—	8,899	—	8,899
Other noninterest income	33,206	1,854	561	35,621
Noninterest expense	200,230	89,613	40,296	330,139
Income before income tax, corporate allocation and noncontrolling interest	154,246	7,781	16,930	178,957
Corporate allocation	3,520	(2,602)	(918)	—
Income before income tax provision and noncontrolling interest	157,766	5,179	16,012	178,957
Provision for income tax expense	29,782	1,110	4,091	34,983
Net income	127,984	4,069	11,921	143,974
Noncontrolling interest	—	(1,672)	—	(1,672)
Net income attributable to TowneBank	\$ 127,984	\$ 2,397	\$ 11,921	\$ 142,302
Net income as percentage of total	89.94 %	1.68 %	8.38 %	100.00 %
Total assets	\$ 14,939,876	\$ 528,773	\$ 483,148	\$ 15,951,797

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Nine Months Ended September 30, 2021	Banking	Realty	Insurance	Consolidated 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
Property management income, net	—	33,076	—	33,076
Real estate commission income, net	—	10,125	—	10,125
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

Note 9. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers, provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case-by-case basis based on the customer's creditworthiness. They tend to have fixed expiration dates and may expire without being utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2022, the amounts of off-balance-sheet commitments to extend credit were \$4.63 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, 2022, standby letters of credit and financial guarantees were \$178.33 million.

Additionally, the Company had \$70.98 million in mortgage loans sold to investors with estimated recourse and warranty provisions totaling \$1.28 million as of September 30, 2022.

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Note 10. 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, 2022		December 31, 2021	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 30,921	\$ 24,551	\$ 30,921	\$ 22,419
Non-compete agreements	1,143	852	2,185	1,754
Customer lists	71,330	41,248	78,832	45,497
Total intangible assets subject to amortization	103,394	66,651	111,938	69,670
Trade name	4,880	—	4,880	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	8,111	—	8,111	—
Total other intangible assets	\$ 111,505	\$ 66,651	\$ 120,049	\$ 69,670

Amortization expense for intangible assets was \$2.64 million and \$2.75 million for the three-month periods, and \$8.15 million and \$8.19 million for the nine-month periods ended September 30, 2022 and 2021, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2021, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2021	\$ 344,713	\$ 32,526	\$ 79,948	\$ 457,187
Additions to goodwill	—	—	1,320	1,320
Other adjustments	—	(25)	—	(25)
Balance, September 30, 2022	\$ 344,713	\$ 32,501	\$ 81,268	\$ 458,482

The change in goodwill from December 31, 2021 to September 30, 2022, relates to an allowable adjustment made during the one-year period after the acquisition of Venture Resorts and the acquisition of a small insurance agency.

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Note 11. 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,	
	2022	2021	2022	2021
Service cost	\$ 1,098	\$ 1,059	\$ —	\$ —
Interest cost	396	370	9	10
Amortization of prior service costs	193	171	—	—
Amortization of actuarial (gain) loss	23	43	(4)	8
Net periodic postretirement benefit cost	<u>\$ 1,710</u>	<u>\$ 1,643</u>	<u>\$ 5</u>	<u>\$ 18</u>

	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Service cost	\$ 3,293	\$ 3,271	\$ —	\$ —
Interest cost	1,189	1,118	28	31
Amortization of prior service costs	577	513	—	—
Amortization of actuarial (gain) loss	69	125	(12)	25
Net periodic postretirement benefit cost	<u>\$ 5,128</u>	<u>\$ 5,027</u>	<u>\$ 16</u>	<u>\$ 56</u>

Postretirement benefit costs are included in our Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2022 and September 30, 2021. The service cost component of postretirement benefits is included in salaries and employee benefits. All other components of postretirement benefit costs are included in other expenses.

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Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2022 and 2021 (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 in 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 in 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, 2021	\$ 13,618	\$ (3,021)	10,597
Other comprehensive income before reclassifications	(169,119)	48	(169,071)
Amounts reclassified from AOCI	—	494	494
Other comprehensive income, net	(169,119)	542	(168,577)
Balance, September 30, 2022	<u>\$ (155,501)</u>	<u>\$ (2,479)</u>	<u>\$ (157,980)</u>

	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 at September 30, 2021	<u>\$ 25,009</u>	<u>\$ (3,412)</u>	<u>\$ 21,597</u>

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

(b) For additional information about retirement plans, refer to Note 11.

Note 13. Variable Interest Entities

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

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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. We receive tax credits for our partnership investments. We have determined that these partnerships are VIEs when we do not own 100% of the entity, because the holders of the equity investment at risk do not have the power through voting rights or similar rights to direct the activities of the entity that most significantly impact the entity's economic performance. Accordingly, our limited partner interests are variable interests that we evaluate for purposes of determining whether we are 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. We account for our limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of \$427.84 million and \$319.79 million were not included in the Consolidated Balance Sheets at September 30, 2022 and December 31, 2021, respectively. These limited partner interests had carrying values of \$139.05 million and \$102.42 million at September 30, 2022 and December 31, 2021, 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 \$139.05 million and \$102.42 million at September 30, 2022 and December 31, 2021, respectively. As of September 30, 2022, the Company had \$130.28 million in funding commitments that are dependent on certain contractual milestones and \$4.96 million in unfunded short-term construction loan commitments. For the three- and nine-month periods ended September 30, 2022, tax benefits totaling \$1.04 million and \$2.70 million, respectively, net of amortization expenses of \$4.64 million and \$11.92 million, respectively, were recognized as a component of income tax expense. For the three- and nine-month periods ended September 30, 2021, tax benefits totaling \$0.60 million and \$1.90 million, respectively, net of amortization expenses of \$3.01 million and \$9.03 million, respectively, were recognized as a component of income tax expense.

Note 14. 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.

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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. The fair value of certain corporate securities is based on a discounted cash flow model which utilized Level 3, or unobservable inputs, the most significant of which were a discount rate and weighted-average life. At September 30, 2022, the discount rate utilized was between 8.69% and 8.92% and the weighted-average life was between 7.21 and 9.46 years.

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 to sell on the mandatory market is established for mortgage loans held for sale 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 15.

Loans held for sale - best efforts: Effective January 1, 2022, TowneBank elected to carry mortgage loans held for sale within the best efforts program at fair value. Best efforts delivery transactions set the sale price with the investor on a loan-by-loan basis at the time each loan is locked with the respective borrower. 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.

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, 2022 and September 30, 2021, the Company used weighted average fall-out rates of 17.12% and 12.77%, respectively. For the year ended December 31, 2021, the Company used a fall-out rate of 11.97%.

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.

Forward Loan Sale Commitments: Loan sales agreements are evaluated to determine whether they meet the definition of a derivative because facts and circumstances may differ significantly. The Company has made the determination that the best efforts contracts do not meet the definition of derivative instruments. Effective January 1, 2022, the Company elected the fair value option on forward loan sales commitments. Accordingly, forward loan sale commitments that economically hedge the closed loan inventory are recognized at fair value in the Consolidated Balance Sheet in other assets or other liabilities, with changes in

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their fair values recorded as a component of mortgage banking activities in the Consolidated Statements of Income. The Company estimated the fair value of its forward loan sales commitments using a methodology similar to that used for derivative loan commitments.

The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2022 and December 31, 2021 (in thousands):

	September 30, 2022			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 331,297	\$ —	\$ 331,297
U.S. Treasury notes	26,399	—	—	26,399
Municipal securities	—	426,352	—	426,352
Mortgage-backed securities issued by GSEs	—	1,027,331	—	1,027,331
Trust preferred and other corporate securities	—	50,207	28,550	78,757
Loans held for sale	—	165,023	—	165,023
Forward loan commitment asset	—	6,448	—	6,448
Derivative assets	—	651	859	1,510
Derivative liabilities	—	212	—	212

	December 31, 2021			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 310,587	\$ —	\$ 310,587
U.S. Treasury notes	1,000	—	—	1,000
Municipal securities	—	385,569	—	385,569
Mortgage-backed securities issued by GSEs	—	1,055,183	—	1,055,183
Trust preferred and other corporate securities	—	45,844	8,000	53,844
Loans held for sale - mandatory delivery	—	109,823	—	109,823
Derivative assets	—	319	3,455	3,774
Derivative liabilities	—	121	—	121

TowneBank elects the fair value option for loans held for sale. This election allows for a more effective offset of the changes in fair value of the loans, the forward loan commitments, and mandatory derivative instruments used to economically hedge them without the burden of complying with the requirements for hedge accounting. Effective January 1, 2022, TowneBank elected to carry mortgage loans held for sale within the best efforts program at fair value; therefore, the balances as of December 31, 2021 do not include those loans, which were carried at the lower of cost or fair value.

At September 30, 2022 and December 31, 2021 the aggregate fair value of mortgage loans held for sale accounted for under the fair value option was \$165.02 million and \$109.82 million, respectively, and the unpaid principal balance of those loans was \$168.51 million and \$109.74 million, respectively.

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

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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,	
	2022	2021	2022	2021
Mortgage loans held for sale, at fair value	\$ (5,389)	\$ (865)	\$ (6,762)	\$ (261)

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, 2022 and December 31, 2021 (in thousands):

September 30, 2022	Level 1	Level 2	Level 3	Fair Value
Collateral-dependent assets with specific reserves	\$ —	\$ —	\$ —	\$ —
Other real estate owned and other nonperforming assets	—	—	186	186
December 31, 2021	Level 1	Level 2	Level 3	Fair Value
Collateral-dependent assets with specific reserves	\$ —	\$ —	\$ 341	\$ 341
Other real estate owned and other nonperforming assets	—	—	4,583	4,583

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

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

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

HTM trust preferred and other corporate securities: The fair value of certain corporate securities is based on a discounted cash flow model that utilizes Level 3, or unobservable inputs, the most significant of which were a discount rate and weighted-average life. At September 30, 2022, the discount rate utilized was 5.21% and the weighted-average life was 26.60 years.

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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, 2022 and December 31, 2021, are as follows (in thousands):

	Carrying	Estimated			
	Value	Fair Value	Level 1	Level 2	Level 3
September 30, 2022					
Cash and due from banks	\$ 97,290	\$ 97,290	\$ 97,290	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,245,067	1,245,067	1,245,067	—	—
Interest-bearing deposits in financial institutions	96,862	96,862	96,862	—	—
Securities available for sale, net	1,890,136	1,890,136	—	1,861,586	28,550
Securities held to maturity, net	548,745	517,782	—	516,571	1,211
Other equity securities	6,360	6,360	—	6,360	—
Net loans	10,559,611	10,121,920	—	—	10,121,920
Interest receivable	36,736	36,736	—	36,736	—
Time deposits	1,407,495	1,378,628	—	1,378,628	—
Advances from the FHLB	29,850	29,205	—	29,205	—
Subordinated debt	247,265	222,640	—	222,640	—
	Carrying	Estimated			
	Value	Fair Value	Level 1	Level 2	Level 3
December 31, 2021					
Cash and due from banks	\$ 17,373	\$ 17,373	\$ 17,373	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	3,244,484	3,244,484	3,244,484	—	—
Interest-bearing deposits in financial institutions	34,779	34,779	34,779	—	—
Securities available for sale, net	1,806,183	1,806,183	—	1,798,183	8,000
Securities held to maturity, net	154,221	155,676	—	154,022	1,654
Other equity securities	6,759	6,759	—	6,759	—
Net loans	9,506,252	9,448,448	—	—	9,448,448
Interest receivable	28,803	28,803	—	28,803	—
Time deposits	1,515,891	1,516,298	—	1,516,298	—
Advances from the FHLB	155,367	153,522	—	153,522	—
Subordinated debt	249,652	252,935	—	252,935	—

In accordance with disclosure guidance related to fair values of financial instruments, the Company did not include assets and liabilities that are not financial instruments, such as goodwill, other purchased intangibles, premises and equipment, deferred taxes, and other assets and liabilities. Additionally, receivables and payables due in one year or less and deposits with no defined or contractual maturities are excluded.

Note 15. 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, mandatory 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.

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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.

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, 2022		December 31, 2021	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	\$ 233,777	\$ 1,510	\$ 404,393	\$ 3,774
Interest rate contracts included in other liabilities	\$ 21,021	\$ 212	\$ 62,864	\$ 121

Gains and losses from mortgage banking derivatives are included in residential mortgage banking income, net in the Consolidated Statements of Income. For the three and nine months ended September 30, 2022, the Company recognized \$0.91 million and \$2.25 million in losses from mortgage banking derivatives, respectively. 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.

Note 16. 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.

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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,	
	2022	2021	2022	2021
Investment management income				
Investment commissions, net	\$ 2,310	\$ 2,698	\$ 6,880	\$ 7,316
Total	\$ 2,310	\$ 2,698	\$ 6,880	\$ 7,316
Insurance income				
Property and casualty insurance income, net	\$ 15,958	\$ 13,808	\$ 47,417	\$ 41,379
Benefit insurance income, net	2,952	2,829	9,248	8,574
Total	\$ 18,910	\$ 16,637	\$ 56,665	\$ 49,953
Real estate and property management income				
Real estate sales commissions, net	\$ 2,932	\$ 3,781	\$ 8,899	\$ 10,125
Real estate property management income, net	9,891	10,502	36,489	33,076
Total	\$ 12,823	\$ 14,283	\$ 45,388	\$ 43,201
Provision expense (release) for credit losses on future reservation receivables	\$ (295)	\$ 6	\$ (121)	\$ 167
Provision expense (release) for credit losses on property and casualty insurance receivables	\$ 65	\$ 89	\$ 257	\$ 146

The provision for credit losses on receivables related to future reservations of resort properties is recorded in real estate property management income. The provision for credit losses related to property and casualty insurance receivables is recorded in property and casualty insurance income.

The Company had no material contract assets or contract liabilities recorded in the Consolidated Balance Sheets as of September 30, 2022.

This disclosure includes only revenue from contracts with third-party customers. See Note 8 for additional information regarding other revenue streams, primarily from revenue between the Company's consolidated subsidiaries and lines of business, in addition to those included in the table above.

Note 17. 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 August 1, 2022, the Company redeemed its \$250.0 million of fixed-to-floating-rate subordinated notes dated July 17, 2017, in full satisfaction of its outstanding principal and interest. At September 30, 2022, the carrying value of the notes totaled zero, compared with \$249.65 million at December 31, 2021.

On February 9, 2022, the Company issued \$250.0 million of fixed-to-floating-rate subordinated notes due February 15, 2032, in a public offering. The Company received \$246.90 million in net proceeds after

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deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 3.125% for the first five years until February 15, 2027. 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 SOFR plus 1.68%. The Company may redeem the subordinated notes, in whole or in part, on or after February 15, 2027. At September 30, 2022, the carrying value of the notes totaled \$247.27 million.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2021 audited Consolidated Financial Statements included in our 2021 Annual Report to Shareholders and our 2021 Annual Report on Form 10-K. The financial statements contained in this Form 10-Q have been subject to a review by FORVIS, LLP, independent certified public accountants, as described in their report included as Exhibit 99.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not historical facts, but instead represent only the beliefs, expectations, or opinions of TowneBank and its management regarding future events, many of which, by their nature, are inherently uncertain. Forward-looking statements may be identified by the use of such words as: "believe," "expect," "anticipate," "intend," "plan," "estimate," or words of similar meaning, or future or conditional terms, such as "will," "would," "should," "could," "may," "likely," "probably," or "possibly." These statements may address issues that involve significant risks, uncertainties, estimates, and assumptions made by management. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include competitive pressures in the banking industry that may increase significantly; changes in the interest rate environment that may reduce margins and/or the volumes and values of loans made or held, as well as the value of other financial assets held; changes in the creditworthiness of customers and the possible impairment of the collectability of loans; general economic conditions, either nationally or regionally, 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; unusual and infrequently occurring events, such as weather-related disasters, terrorist acts or public health events (such as the COVID-19 pandemic); 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, 2021, and related disclosures in other filings that have been, or will be, filed by TowneBank with the FDIC.*

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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, property management services, 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 and nine months ended September 30, 2022. 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, 2022, at \$50.17 million, or \$0.69 per common diluted share, was near level with \$50.40 million, or \$0.69 per common diluted share, for the same period in 2021. Net income for the nine months ended September 30, 2022, was \$142.30 million, or \$1.96 per common diluted share, compared to \$175.20 million, or \$2.41 per common diluted share, for the same period in 2021.
- Net interest income increased \$23.60 million, or 23.49%, to \$124.04 million in third quarter 2022 from the comparable period in 2021. Net interest income increased \$31.01 million, to \$332.58 million, or 10.28%, in the first nine months of 2022 from the comparable period in 2021. These increases were driven by a combination of growth in loans and investments and higher yields on earning assets.
- Third quarter 2022, we recorded a provision for credit losses of \$3.93 million compared to a provision benefit of \$1.58 million for the quarter ended September 30, 2021. The provision for credit losses was \$2.53 million in the first nine months of 2022 compared to a benefit of \$15.67 million in the first nine months of 2021. These increases in provision were driven by 2022 loan growth coupled with weakening macroeconomic forecast scenarios impacted by higher interest rates and inflation concerns. The allowance for credit losses on loans was 1.02% of period-end loans at September 30, 2022, 1.00% at June 30, 2022, and 1.15% at September 30, 2021.
- Noninterest income for the three-month period ended September 30, 2022, decreased \$14.44 million, or 20.73%, compared to the same period in 2021. The decrease was partially due to a decline in residential mortgage banking income and property management income. Noninterest income for the first nine months of 2022 decreased \$39.28 million, or 17.99%, compared to the first nine months of 2021, driven by the decline in residential mortgage banking income, partially offset by increased insurance commissions.
- Noninterest expense increased \$7.95 million, or 7.64%, in the quarterly comparison and \$23.33 million, or 7.61%, in the first nine months of 2022 compared to 2021. The increases in both comparative periods reflect growth in salaries, occupancy, and advertising and marketing.

PART I. FINANCIAL INFORMATION**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Estimates and Significant Accounting Policies**

Preparation of financial statements and related disclosures in conformity with GAAP requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the Consolidated Financial Statements and 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 policy for the allowance for credit losses to be a critical accounting policy. Refer to our 2021 Annual Report to Shareholders for further discussion of this policy and other significant accounting policies.

ANALYSIS OF RESULTS OF OPERATIONS**Consolidated Performance Summary**

Results of Operations: We reported the following for the periods indicated:

<i>(dollars in thousands, except per share data)</i>	Three Months Ended			Nine Months Ended	
	September 30, 2022	September 30, 2021	June 30, 2022	September 30, 2022	September 30, 2021
Net income attributable to TowneBank	\$ 50,169	\$ 50,400	\$ 46,547	\$ 142,302	\$ 175,201
Operating income (non-GAAP)	\$ 179,236	\$ 170,076	\$ 166,980	\$ 511,628	\$ 518,684
Diluted earnings per share	\$ 0.69	\$ 0.69	\$ 0.64	\$ 1.96	\$ 2.41
Return on average assets	1.22 %	1.27 %	1.13 %	1.16 %	1.55 %
Return on average tangible assets (non-GAAP)	1.31 %	1.37 %	1.22 %	1.25 %	1.66 %
Return on average equity	10.60 %	10.59 %	9.94 %	10.09 %	12.73 %
Return on average tangible equity (non-GAAP)	15.08 %	15.09 %	14.20 %	14.40 %	18.12 %

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 TE-basis (non-GAAP) using a 21% federal marginal tax rate.

TowneBank reported net interest income, on a TE-basis ("net interest income-TE"), of \$124.69 million for the quarter ended September 30, 2022, which was \$23.73 million, or 23.50%, higher than the third quarter 2021 total of \$100.97 million. On a linked-quarter basis, net interest income-TE, increased by \$14.93 million, or 13.60%, from \$109.76 million. Net interest income-TE was \$334.31 million for the nine months ended September 30, 2022, a \$30.71 million, or 10.11%, increase compared to \$303.61 million for the nine months ended September 30, 2021.

Interest income-TE was \$138.18 million for the quarter ended September 30, 2022, which was \$27.81 million, or 25.20%, higher than the \$110.37 million reported for the quarter ended September 30, 2021. On a linked-quarter basis, TE interest income increased \$17.61 million, or 14.61%, from \$120.56 million in second quarter 2022. Average earning assets grew to \$14.99 billion in the quarter ended September 30, 2022, from \$14.44 billion in the comparative prior year quarter, an increase of \$0.54 billion,

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or 3.77%. In the linked-quarter comparison, average earning assets decreased by \$0.26 billion, or 1.68%, from \$15.24 billion in second quarter 2022. The yield on earning assets was 3.66% in the quarter ended September 30, 2022, up compared to 3.03% in the prior year and 3.17% in the linked quarter. Average loan balances in third quarter 2022 were \$10.47 billion, \$1.22 billion or 13.15%, higher than the same period one year ago and loan yields increased by 1 bp. In the linked quarter, average loans increased by \$0.27 billion, or 2.61%, and loan yields increased 26 bp.

Interest expense for the quarter ended September 30, 2022, was \$13.49 million, which was \$4.08 million, or 43.44%, higher than interest expense of \$9.40 million for third quarter 2021. Average interest-bearing liabilities were \$8.35 billion in third quarter 2022, up from \$8.24 billion in the comparative prior year quarter, an increase of 1.33%. On a linked-quarter basis, interest expense increased 24.88% from \$10.80 million in second quarter 2022. Average interest-bearing liabilities decreased \$0.41 billion, or 4.65%, from \$8.75 billion in the linked quarter. The cost of interest-bearing liabilities was 0.64% in third quarter 2022, compared to 0.45% in third quarter 2021, and 0.49% in the linked quarter. This represented a 19 bp increase from prior year and a 15 bp increase from the linked quarter.

Net interest income-TE increased \$23.73 million in the quarter, compared to the prior year quarter, driven by increased loan and investment volume and higher yields on earning assets. This increase was partially offset by a 60% decline in loans held for sale volume and higher costs on interest bearing deposits. Average earning assets increased \$0.54 billion in the three-months' comparison to prior year while yields on earning assets increased 63 bp, for an increase in interest income of \$27.81 million. Average loans, including PPP loans, increased \$1.22 billion, driven by organic growth. Related interest and fee income on PPP loans was \$0.62 million compared to \$7.77 million in third quarter 2021. Excluding the impact of PPP loans, average loans increased \$1.56 billion, or 17.49%, while the yield on our loan portfolio increased 18 bp to 4.24% in third quarter 2022 compared to 4.06% in third quarter 2021. Average interest-bearing liabilities increased \$0.11 billion compared to third quarter 2021, while interest costs increased 19 bp, for an increase in interest expense of \$4.08 million. This increase was driven by \$0.24 billion growth in interest bearing deposits, primarily, interest-bearing demand and money market accounts.

Comparing third quarter 2022 to the linked quarter, net interest income-TE increased \$14.93 million due to higher yields on interest earning assets, primarily loans and interest-bearing deposits, combined with higher balances in average loans. This increase was partially offset by higher costs on interest-bearing deposits. Average loans held for investment increased \$0.31 billion excluding the decline in average PPP loans. The overall yield on earning assets increased 49 bp, driven by a 22 bp increase in investments' yield and 26 bp increase in yield on loans. The cost of interest-bearing deposits increased 24 bp and total interest-bearing liabilities increased 15 bp.

Interest income-TE was \$367.75 million for the nine months ended September 30, 2022, which was \$31.77 million, or 9.46%, higher than \$335.98 million reported for the nine months ended September 30, 2021. Average earning assets grew to \$15.09 billion in the nine months ended September 30, 2022, from \$13.93 billion in the comparative prior year, an increase of \$1.17 billion, or 8.37%. The yield on earning assets was 3.26% in the nine months ended September 30, 2022, up compared to 3.23% in the prior year. Average loan balances were \$0.61 billion, or 6.38%, higher in the first nine months of September 30, 2022, while loan yields decreased by 16 bp compared to prior year.

Interest expense for the nine months ended September 30, 2022, was \$33.44 million, which was \$1.06 million, or 3.28%, higher than interest expense of \$32.37 million for 2021. Average interest-bearing

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liabilities increased to \$8.55 billion in the first nine months of 2022 from \$8.11 billion in the prior year, an increase of 5.51%.

Net interest income-TE increased \$30.71 million in the first nine months of 2022 compared to 2021, driven by growth in loans and investment securities coupled with rate increases in securities and interest bearing deposits. Loan yield, year-to-date, declined while the yield in all other earning asset categories increased for a net 3 bp increase in yield on earning assets. Interest expense on interest-bearing deposits declined \$1.03 million in the first nine months of 2022 compared to 2021, driven by a \$0.43 billion decline in certificates of deposit. Interest cost associated with total interest-bearing liabilities increased \$1.06 million driven by the February 2022 subordinated debt issuance. Loans and investment securities increased an average \$1.51 billion, year over year, but were negatively impacted by the 16 bp decline in loan yield. Interest-bearing liabilities increased \$0.45 billion.

TE net interest margin, which is net interest income-TE expressed as a percentage of average earning assets, was 3.30%, or 53 bp higher, for the quarter ended September 30, 2022, compared to the September 30, 2021, quarter margin of 2.77%, and 41 bp higher than the quarter ended June 30, 2022, margin of 2.89%. TE net interest margin was 2.96%, or 5 bp higher, for the nine months ended September 30, 2022, compared to the nine months ended September 30, 2021. Movement in 2022 of the Federal Reserve's Federal Funds target range has impacted yields and margins. The following table lists the Federal Funds target range for the periods indicated.

Date	Target Range for Federal Funds (%)
March 15, 2020 - March 15, 2022	0 - 0.25
March 16, 2022 - May 3, 2022	0.25 - 0.50
May 4, 2022 - June 14, 2022	0.75 - 1.00
June 14, 2022 - July 27, 2022	1.50 - 1.75
July 28, 2022 - September 21, 2022	2.25 - 2.50
September 22, 2022 - November 2, 2022	3.00 - 3.25
November 3, 2022 - present	3.75 - 4.00

The Company expects to see continued margin growth in a rising rate environment due to the positioning of our balance sheet combined with the benefit of the third quarter 2022 retirement of the our subordinated debt issued in 2017. We expect margin expansion to be partially offset by increased deposit costs resulting from rising rates, with expected deposit betas ranging from 30% to 35% through the current cycle.

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:

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	Three Months Ended September 30, 2022			Three Months Ended June 30, 2022			Three Months Ended September 30, 2021		
	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) (1)(2)	\$ 10,465,441	\$ 112,225	4.25 %	\$ 10,199,019	\$ 101,463	3.99 %	\$ 9,248,867	\$ 98,733	4.24 %
Taxable investment securities	2,385,218	12,943	2.17 %	2,331,410	11,388	1.95 %	1,421,347	6,560	1.85 %
Tax-exempt investment securities	147,184	1,054	2.86 %	132,304	879	2.66 %	125,523	487	1.55 %
Total securities	2,532,402	13,997	2.21 %	2,463,714	12,267	1.99 %	1,546,870	7,047	1.82 %
Interest-bearing deposits	1,800,798	9,509	2.09 %	2,368,147	4,616	0.78 %	3,179,010	1,182	0.15 %
Loans held for sale	188,737	2,446	5.18 %	213,109	2,217	4.16 %	468,323	3,405	2.91 %
Total earning assets	14,987,378	138,177	3.66 %	15,243,989	120,563	3.17 %	14,443,070	110,367	3.03 %
Less: allowance for credit losses	(104,178)			(103,871)			(108,478)		
Total nonearning assets	1,421,094			1,389,692			1,372,406		
Total assets	<u>\$ 16,304,294</u>			<u>\$ 16,529,810</u>			<u>\$ 15,706,998</u>		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 6,084,753	\$ 6,542	0.43 %	\$ 6,349,725	\$ 3,094	0.20 %	\$ 5,486,788	\$ 2,095	0.15 %
Savings	391,437	628	0.64 %	387,498	526	0.54 %	358,739	533	0.59 %
Certificates of deposit	1,456,746	3,060	0.83 %	1,392,474	1,953	0.56 %	1,842,948	3,400	0.73 %
Total interest-bearing deposits	7,932,936	10,230	0.51 %	8,129,697	5,573	0.27 %	7,688,475	6,028	0.31 %
Borrowings	94,411	139	0.58 %	128,276	135	0.42 %	300,505	412	0.54 %
Subordinated debt, net	320,518	3,117	3.89 %	496,862	5,091	4.10 %	249,405	2,962	4.75 %
Total interest-bearing liabilities	8,347,865	13,486	0.64 %	8,754,835	10,799	0.49 %	8,238,385	9,402	0.45 %
Demand deposits	5,690,020			5,547,936			5,212,271		
Other noninterest-bearing liabilities	387,835			348,678			367,891		
Total liabilities	14,425,720			14,651,449			13,818,547		
Shareholders' equity	1,878,574			1,878,361			1,888,451		
Total liabilities and equity	<u>\$ 16,304,294</u>			<u>\$ 16,529,810</u>			<u>\$ 15,706,998</u>		
Net interest income-TE (5)		\$ 124,691			\$ 109,764			\$ 100,965	
Reconciliation of Non-GAAP Financial Measures									
TE basis adjustment		(653)			(424)			(522)	
Net interest income (GAAP)		<u>\$ 124,038</u>			<u>\$ 109,340</u>			<u>\$ 100,443</u>	
Interest rate spread (3)(5)			3.02 %			2.68 %			2.58 %
Interest expense as a percent of average earning assets			0.36 %			0.28 %			0.26 %
Net interest margin-TE (4)(5)			3.30 %			2.89 %			2.77 %
Total cost of deposits			0.30 %			0.16 %			0.19 %

- (1) Average loan balances for September 30, 2021, and related yields have been restated to include previously excluded, nonaccrual loans of \$9.95 million.
- (2) September 30, 2022, September 30, 2021, and June 30, 2022 balances include average PPP balances of \$18.68 million, \$357.17 million, and \$60.89 million, and related interest and fees of \$0.62 million, \$7.77 million, \$1.52 million, respectively.
- (3) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities. Taxable equivalent.
- (4) Net interest margin is net interest income expressed as a percentage of average earning assets. Taxable equivalent.
- (5) Non-GAAP.

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	Increase/(Decrease) Three Months Ended September 30, 2022 Compared to Three Months Ended June 30, 2022			Increase/(Decrease) Three Months Ended September 30, 2022 Compared to Three Months Ended September 30, 2021		
(dollars in thousands)	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	\$ 3,046	\$ 7,716	\$ 10,762	\$ 13,043	\$ 449	\$ 13,492
Taxable investment securities	268	1,287	1,555	5,069	1,314	6,383
Tax-exempt investment securities	103	72	175	96	471	567
Total securities	371	1,359	1,730	5,165	1,785	6,950
Interest-bearing deposits	(1,346)	6,239	4,893	(743)	9,070	8,327
Loans held for sale	(273)	502	229	(2,721)	1,762	(959)
Total earning assets	1,798	15,816	17,614	14,744	13,066	27,810
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	(136)	3,584	3,448	252	4,195	4,447
Savings	6	96	102	51	44	95
Certificates of deposit	97	1,010	1,107	(772)	432	(340)
Total interest-bearing deposits	(33)	4,690	4,657	(469)	4,671	4,202
Borrowings	(41)	45	4	(305)	32	(273)
Subordinated capital debentures	(1,974)	—	(1,974)	155	—	155
Total interest-bearing liabilities	(2,048)	4,735	2,687	(619)	4,703	4,084
Net interest income	\$ 3,846	\$ 11,081	\$ 14,927	\$ 15,363	\$ 8,363	\$ 23,726

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

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	Nine Months Ended September 30, 2022			Nine Months Ended September 30, 2021			Nine Months Ended September 30, 2022 Compared with 2021		
	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) (1)(2)	\$10,113,980	\$309,283	4.09 %	\$ 9,507,082	\$ 302,182	4.25 %	\$ 7,101	\$(11,730)	\$ 18,831
Taxable investment securities	2,259,940	33,344	1.97 %	1,359,366	19,640	1.93 %	13,704	425	13,279
Tax-exempt investment securities	130,196	2,613	2.68 %	131,106	1,462	1.49 %	1,151	1,161	(10)
Total securities	2,390,136	35,957	2.01 %	1,490,472	21,102	1.89 %	14,855	1,586	13,269
Interest-bearing deposits	2,362,155	15,472	0.88 %	2,426,468	2,218	0.12 %	13,254	13,314	(60)
Loans held for sale	225,777	7,038	4.16 %	502,758	10,477	2.78 %	(3,439)	3,839	(7,278)
Total earning assets	15,092,048	367,750	3.26 %	13,926,780	335,979	3.23 %	31,771	7,009	24,762
Less: allowance for credit losses	(104,733)			(115,100)					
Total nonearning assets	1,394,691			1,340,170					
Total assets	<u>\$16,382,006</u>			<u>\$15,151,850</u>					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	6,203,889	11,898	0.26 %	5,192,658	6,175	0.16 %	5,723	4,343	1,380
Savings	387,290	1,664	0.57 %	345,739	1,583	0.61 %	81	(101)	182
Certificates of deposit	1,440,661	7,134	0.66 %	1,872,393	13,963	1.00 %	(6,829)	(4,050)	(2,779)
Total interest-bearing deposits	8,031,840	20,696	0.34 %	7,410,790	21,721	0.39 %	(1,025)	192	(1,217)
Borrowings	119,336	412	0.46 %	445,399	1,798	0.53 %	(1,386)	(229)	(1,157)
Subordinated debentures	401,195	12,328	4.10 %	249,261	8,854	4.74 %	3,474	(1,327)	4,801
Total interest-bearing liabilities	8,552,371	33,436	0.52 %	8,105,450	32,373	0.53 %	1,063	(1,364)	2,427
Demand deposits	5,569,186			4,880,493					
Other noninterest-bearing liabilities	374,794			325,639					
Total liabilities	14,496,351			13,311,582					
Shareholders' equity	1,885,655			1,840,268					
Total liabilities and equity	<u>\$16,382,006</u>			<u>\$15,151,850</u>					
Net interest income-TE (5)		\$334,314			\$ 303,606		\$ 30,708	\$ 8,373	\$ 22,335
Reconciliation of Non-GAAP Financial Measures									
TE basis adjustment		(1732)			(2,029)		297		
Net interest income (GAAP)		<u>\$332,582</u>			<u>\$ 301,577</u>		<u>\$ 31,005</u>		
Interest rate spread (3)(5)			2.74 %			2.70 %			
Interest expense as a percent of average earning assets			0.30 %			0.31 %			
Net interest margin-TE (4)(5)			2.96 %			2.91 %			
Total cost of deposits			0.20 %			0.24 %			

(1) Average loan balances for September 30, 2021, and related yields have been restated to include previously excluded, nonaccrual loans of \$11.63 million.

(2) September 30, 2022 and September 30, 2021, includes average PPP balances of \$64.67 million and \$641.82 million and related interest income of \$4.24 million and \$29.42 million, respectively.

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

(4) Net interest margin is net interest income expressed as a percentage of average earning assets. Taxable equivalent.

(5) Non-GAAP.

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Noninterest Income. Total noninterest income for the quarter ended September 30, 2022, was \$55.20 million, a decrease of \$14.44 million, or 20.73%, compared to the same period in 2021. As a percentage of total operating income (non-GAAP), noninterest income for third quarter 2022 was 30.80%, compared with 40.94% for comparative 2021. Total noninterest income in the nine months ended September 30, 2022, was \$179.05 million, a decrease of \$39.28 million, or 17.99%, compared to the first nine months of 2021.

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

	Increase/(Decrease)							
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,		September 30,		2022 over 2021		2022 over 2021	
	2022	2021	2022	2021	Amount	Percent	Amount	Percent
(dollars in thousands)								
Residential mortgage banking, net	\$ 11,968	\$ 25,422	\$ 39,782	\$ 88,359	\$ (13,454)	(52.92)%	\$ (48,577)	(54.98)%
Insurance commissions and other title fees and income, net	19,435	17,398	58,255	52,055	2,037	11.71 %	6,200	11.91 %
Property management income, net	9,891	10,502	36,489	33,076	(611)	(5.82)%	3,413	10.32 %
Real estate commission income, net	2,932	3,781	8,899	10,125	(849)	(22.45)%	(1,226)	(12.11)%
Service charges on deposit accounts	2,455	2,524	7,474	7,104	(69)	(2.73)%	370	5.21 %
Credit card merchant fees, net	1,658	1,660	4,940	4,630	(2)	(0.12)%	310	6.70 %
Bank-owned life insurance	1,585	2,301	5,155	5,361	(716)	(31.12)%	(206)	(3.84)%
Other income	5,274	6,045	18,052	16,367	(771)	(12.75)%	1,685	10.30 %
Subtotal before gain (loss) on investment securities	55,198	69,633	179,046	217,077	(14,435)	(20.73)%	(38,031)	(17.52)%
Net gain on investment securities	—	—	—	1,252	—	N/M	(1,252)	(100.00)%
Total noninterest income	\$ 55,198	\$ 69,633	\$ 179,046	\$ 218,329	\$ (14,435)	(20.73)%	\$ (39,283)	(17.99)%

For third quarter 2022, residential mortgage banking income, net of commission expense, was \$11.97 million, a decrease of \$13.45 million, or 52.92%, compared to third quarter 2021. The third quarter 2022 decrease in mortgage banking income was primarily driven by a decline in volume and a 59 bp decrease in margin from third quarter 2021. Production volume was \$0.69 billion in third quarter 2022, a decrease of \$0.62 billion, or 47.13%, from third quarter 2021. Refinance activities decreased to 6.80% of total loan volume in third quarter 2022, compared to 22.55% the prior year quarter, driven by increases in mortgage rates. Margins on the sale of loans decreased from 3.61% in third quarter 2021 to 3.02% in third quarter 2022. National mortgage applications have declined to their lowest levels since February 2000. Management expects inventory constraints and higher mortgage rates to continue to pressure purchase volumes resulting in continuation of competitive mortgage pricing pressure and compressed margins.

Residential mortgage banking income, net of commission expense, was \$39.78 million for the first nine months of 2022, a decrease of \$48.58 million, or 54.98%, compared to the same period in 2021. Production volumes in the first nine months of 2022 were \$2.35 billion compared to \$4.37 billion in 2021. Margins on the sale of loans declined from 3.77% in the first nine months of 2021, to 2.98% in the 2022 comparative period.

For the third quarter and first nine months of 2022, insurance commissions and other title income, net of commission expense, was \$19.44 million and \$58.26 million, respectively. Third quarter 2022 represents an

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increase of \$2.04 million, or 11.71%, while the nine-month increase was \$6.20 million, or 11.91%, compared to 2021. Higher property and casualty commissions due to organic growth and higher rates drove the increases. Contingency and bonus revenue, which consists primarily of amounts received from various property and casualty carriers, increased in the first nine months of 2022 compared to 2021 due to higher than expected receipts.

Property management income, net of commission expense, for third quarter 2022 was \$9.89 million, which was \$0.61 million, or 5.82%, below comparative 2021. Property management income, net of commission expense, was \$36.49 million in the first nine months of 2022, an increase of \$3.41 million, or 10.32%, compared to the same period in 2021. The primary source of income from this line of business is vacation property commissions and associated fees. The Company experienced near record levels of occupancy in all vacation property locations in 2021 due to COVID-related restrictions on international travel. In the quarterly comparison, reservation income has declined in 2022 with the loosening of those restrictions. Year to date, property management income increased due to the impact of the July 2021 acquisition of Venture Resorts, which contributed additional revenue of \$5.11 million in the first nine months of 2022.

Service charges on deposit accounts were \$2.46 million and \$7.47 million for the third quarter and first nine months of 2022, respectively, compared with \$2.52 million and \$7.10 million for the comparative 2021 periods. For the third quarter and first nine months of 2022, credit card merchant fees totaled \$1.66 million and \$4.94 million, respectively, compared to \$1.66 million and \$4.63 million, respectively in 2021. In April 2022, the Company eliminated fees for non-sufficient funds and other overdraft program fees for personal accounts. The change did not have a material effect on revenue in third quarter 2022 and is not expected to have a material effect on future revenue.

Income from BOLI was \$1.59 million and \$5.16 million in the third quarter and first nine months of 2022, respectively, compared to \$2.30 million and \$5.36 million in the third quarter and first nine months of 2021, respectively. Other noninterest income for the three months ended September 30, 2022, was \$5.27 million, a decrease of \$0.77 million, or 12.75%, compared to third quarter 2021. Other noninterest income for the nine months ended September 30, 2022, was \$18.05 million, an increase of \$1.69 million, or 10.30%, compared to 2021. A gain of \$1.19 million on the early extinguishment of debt related to the payoff of FHLB advances is included in noninterest income in the first nine months of 2022.

We did not sell any investment securities in the third quarter and first nine months of 2022. We did not sell any securities in the third quarter of 2021 but sold seven investment securities with a carrying value of \$17.57 million in the first nine months of 2021. There were no net gains or losses on the sale of AFS securities to record in third quarter of 2022 or 2021. There were no net gains or losses to record in the first nine months of 2022, compared to net gains of \$1.25 million in the first nine months of 2021.

Noninterest Expense. For the quarter ended September 30, 2022, total noninterest expense was \$112.03 million, which was \$7.95 million, or 7.64%, higher than comparative 2021. Noninterest expense was \$330.14 million for the first nine months of 2022, compared to \$306.81 million for the same period in 2021.

As a percentage of operating income (non-GAAP), noninterest expense was 62.51% for third quarter 2022 and 61.20% for comparative 2021. This increase was driven by a combination of the decline in noninterest income and the increase in noninterest expenses in 2022.

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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	
	2022	2021	2022	2021	2022 over 2021		2022 over 2021	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Salaries and employee benefits	\$ 65,463	\$ 61,230	\$ 194,318	\$ 181,030	\$ 4,233	6.91 %	\$ 13,288	7.34 %
Occupancy expense	8,748	7,656	25,417	23,286	1,092	14.26 %	2,131	9.15 %
Furniture and equipment	3,764	3,513	11,097	10,647	251	7.14 %	450	4.23 %
Amortization - intangibles	2,644	2,750	8,145	8,192	(106)	(3.85)%	(47)	(0.57)%
Software expense	4,594	4,209	13,848	12,896	385	9.15 %	952	7.38 %
Data processing	3,628	3,603	10,778	10,255	25	0.69 %	523	5.10 %
Professional fees	2,627	2,227	6,416	6,826	400	17.96 %	(410)	(6.01)%
Advertising and marketing	4,290	3,865	12,508	10,090	425	11.00 %	2,418	23.96 %
Other noninterest expenses:								
Acquisition-related expenses	616	719	726	972	(103)	(14.33)%	(246)	(25.31)%
Bank franchise tax/SCC fees	2,240	2,084	6,538	6,479	156	7.49 %	59	0.91 %
Charitable contributions	3,540	2,524	9,520	9,743	1,016	40.25 %	(223)	(2.29)%
Directors fees and expenses	640	553	1,741	1,529	87	15.73 %	212	13.87 %
FDIC and other insurance	1,367	1,485	3,933	3,909	(118)	(7.95)%	24	0.61 %
Foreclosed property expenses	33	19	283	296	14	73.68 %	(13)	(4.39)%
Other	4,688	4,475	15,520	12,044	213	4.76 %	3,476	28.86 %
Stationery and supplies	680	702	2,033	2,012	(22)	(3.13)%	21	1.04 %
Telephone and postage	1,718	1,845	5,033	5,309	(127)	(6.88)%	(276)	(5.20)%
Travel/meals/entertainment	754	627	2,285	1,290	127	20.26 %	995	77.13 %
Total other noninterest expenses	16,276	15,033	47,612	43,583	1,243	8.27 %	4,029	9.24 %
Total noninterest expense	\$ 112,034	\$ 104,086	\$ 330,139	\$ 306,805	\$ 7,948	7.64 %	\$ 23,334	7.61 %

Salary and benefits expense was \$65.46 million and \$194.32 million in third quarter and the first nine months of 2022, respectively, representing 58.43% and 58.86% of total noninterest expense. Salary and benefits expense increased in the third quarter and first nine months of 2022 compared to 2021, driven by an increase in the number of employees, year-over-year health insurance costs, and annual base salary adjustments that went into effect in third quarter 2022. The Company expects to see inflation and a tight labor market to continue in fourth quarter 2022 and into the first half of 2023, which will drive increases in compensation expense across most lines of business.

In our Banking segment, we had a total of 1,317 full-time equivalent employees at September 30, 2022, as compared to 1,173 at September 30, 2021. In our non-Banking segments at September 30, 2022, we had a total of 1,470 full-time equivalent employees, excluding real estate sales agents, compared to 1,349 at September 30, 2021. Real estate sales agents are independent contractors and, therefore, not included as our employees.

Occupancy expense increased \$1.09 million, or 14.26%, for third quarter 2022, and \$2.13 million, or 9.15%, in the first nine months of 2022, compared to 2021. The Company purchased McKinnon Tower in Norfolk,

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Virginia, in second quarter 2020. Included in that purchase was an existing lease that expired December 2021. The Company also sold a commercial rental property in Norfolk at the end of December 2021. The decline in rental income from these two locations, which is reported in occupancy, was the primary source of increased occupancy expense in the quarter and first nine months of 2022.

Data processing expenses increased \$0.03 million and \$0.52 million in the third quarter and first nine months of 2022, while software expenses increased \$0.39 million and \$0.95 million for the same respective periods, compared to 2021. Higher credit card fees resulting from vacation property reservation activity 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, 2022, advertising and marketing expense increased \$0.43 million and \$2.42 million, compared to 2021. Internet-based advertising programs in our vacation property management business and increases in media advertising were the drivers of the increases in the quarter and year to date.

For third quarter 2022, other noninterest expenses were \$16.28 million, an increase of 8.27%, or \$1.24 million, compared to the same period in 2021. In the first nine months of 2022, other noninterest expense increased \$4.03 million. An earnout adjustment of \$1.84 million for a prior year property management company acquisition was included in first quarter 2022. Charitable contributions increased \$1.02 million in the third quarter but decreased \$0.22 million in the first nine months of 2022, compared to 2021.

Provision for Income Taxes. We reported a provision for income tax expense of \$12.61 million, representing an effective tax rate of 20.08%, in third quarter 2022. The provision for income tax expense was \$14.83 million for third quarter 2021, with an effective rate of 22.73%.

Segment Performance Summary

Our reportable segments are a traditional full-service community bank, a full-service realty business, and a full-service insurance agency. In this section, we discuss the performance and financial results of our segments. For further financial details, see *Note 8 – Segment Reporting* of the Notes to Consolidated Financial Statements in this report.

Banking Segment. For the three months ended September 30, 2022, the Banking segment represented 94.84%, or \$47.58 million, of our total consolidated net income, compared to 81.34%, or \$41.0 million, for the three months ended September 30, 2021. For the first nine months of 2022, the Banking segment represented 89.94%, or \$127.98 million, of our total consolidated net income, compared to 76.00%, or \$133.15 million, in 2021.

Income before income tax provision and noncontrolling interest for the Banking segment was \$59.08 million and \$157.77 million for the third quarter and nine months ended September 30, 2022, respectively. This represents an increase of \$7.86 million in the quarterly comparison but a decrease of \$5.85 million in the first nine months from comparative 2021. Net interest income growth that outpaced the increase in noninterest expense was the source of the quarterly increase. The nine month decrease in earnings was driven by a combination of higher personnel costs and the change in the provision for credit losses between periods, outpacing the increase in net interest income.

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Total revenue increased \$24.30 million and \$33.62 million, while the increase in provision expense was \$5.97 million and \$16.91 million, respectively, in the three and nine months ended September 30, 2022, compared to 2021. Noninterest expenses increased \$10.13 million in third quarter 2022 compared to 2021, driven by a \$4.56 million increase in salaries and employee benefits between periods. Noninterest expense increased \$22.30 million in the first nine months of 2022 compared to 2021, driven primarily by a \$12.66 million increase in salaries and employee benefits. Additionally, increases in occupancy expense, software, data processing and marketing contributed to noninterest expense growth.

The following chart presents 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) Three Months Ended September 30, 2022 September 30, 2021		Increase/(Decrease) Nine Months Ended September 30, 2022 September 30, 2021	
	2022	2021	2022	2021	Amount	Percent	Amount	Percent
<i>(dollars in thousands)</i>								
Net interest income	\$123,039	\$97,668	\$327,226	\$293,407	\$ 25,371	25.98 %	\$ 33,819	11.53 %
Service charges on deposit accounts	2,455	2,524	7,474	7,104	(69)	(2.73)%	370	5.21 %
Credit card merchant fees	1,658	1,660	4,940	4,630	(2)	(0.12)%	310	6.70 %
Other income	5,332	6,334	17,083	16,706	(1,002)	(15.82)%	377	2.26 %
Net gain (loss) on investment securities	—	—	—	1,252	—	N/M	(1,252)	(100.00)%
Total noninterest income	9,445	10,518	29,497	29,692	(1,073)	(10.20)%	(195)	(0.66)%
Total revenue	132,484	108,186	356,723	323,099	24,298	22.46 %	33,624	10.41 %
Provision for credit losses	4,240	(1,728)	2,247	(14,661)	5,968	(345.37)%	16,908	(115.33)%
Salaries and employee benefits	39,349	34,791	115,082	102,427	4,558	13.10 %	12,655	12.36 %
Occupancy expense	6,109	5,098	17,401	15,657	1,011	19.83 %	1,744	11.14 %
Furniture and equipment	2,803	2,602	8,259	8,086	201	7.72 %	173	2.14 %
Amortization of intangible assets	726	862	2,330	2,737	(136)	(15.78)%	(407)	(14.87)%
Other expenses	21,075	16,580	57,158	49,020	4,495	27.11 %	8,138	16.60 %
Total noninterest expenses	70,062	59,933	200,230	177,927	10,129	16.90 %	22,303	12.53 %
Income before income tax and corporate allocation	58,182	49,981	154,246	159,833	8,201	16.41 %	(5,587)	(3.50)%
Corporate allocation	902	1,241	3,520	3,782	(339)	(27.32)%	(262)	(6.93)%
Income before income tax provision and noncontrolling interest	59,084	51,222	157,766	163,615	7,862	15.35 %	(5,849)	(3.57)%
Provision for income tax expense	11,507	10,225	29,782	30,461	1,282	12.54 %	(679)	(2.23)%
Net income	47,577	40,997	127,984	133,154	6,580	16.05 %	(5,170)	(3.88)%
Noncontrolling interest	—	2	—	(1)	(2)	(100.00)%	1	(100.00)%
Net income attributable to TowneBank	\$47,577	\$40,999	\$127,984	\$133,153	\$ 6,578	16.04 %	\$ (5,169)	(3.88)%
Efficiency ratio (non-GAAP)	52.34 %	54.60 %	55.48 %	54.43 %				

Realty Segment. For the three months ended September 30, 2022, the Realty segment had a loss before income tax provision and noncontrolling interest of \$0.67 million, as compared to income of \$12.10 million in 2021. In the nine months ended September 30, 2022, the Realty segment had income before income tax provision and noncontrolling interest of \$5.18 million, as compared to \$53.65 million in 2021. Total revenue was \$27.66 million and \$97.68 million in the third quarter and first nine months of 2022, respectively, compared to \$45.05 million and \$146.20 million for the same respective periods in 2021. For the first nine months of 2022, the Realty segment represented 1.68%, or \$2.40 million, of our total consolidated net income, compared to 19.09%, or \$33.45 million, in 2021.

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The decline in total revenue in third quarter and first nine months of 2022 compared to 2021 was driven by a decline in mortgage production volume and margin. Residential mortgage production decreased \$0.62 billion, or 47.13%, to \$0.69 billion, as compared to third quarter 2021, while margins declined 59 bp to 3.02%. Refinance activities decreased to 6.80% of total loan volume in third quarter 2022, compared to 22.55% in the prior year quarter, driven by increases in mortgage rates. Production volume in the first nine months of 2022 was \$2.35 billion compared to \$4.37 billion in the same period in 2021. Management expects the downward pressure on mortgage revenues to continue in the remainder of 2022, driven by rising interest rates, low inventories, and margin compression. In response to the decline in revenue and the expectation of continued pressure on production volumes, the Company has focused on aligning its infrastructure costs with production levels and will continue to evaluate its cost structure in relation to the current economic environment.

Net property management fees decreased \$0.61 million in the third quarter but increased \$3.41 million in the first nine months of 2022 compared to 2021. The nine month increase is due to the July 2021 acquisition of Venture Resorts, which contributed \$5.11 million in property management fee revenue over its year-to-date 2021 revenue. The decrease in the quarterly comparison was due to a decline in management fees from Venture Resorts of \$1.25 million compared to third quarter 2021.

Net real estate brokerage income decreased \$0.85 million in the quarter and \$1.23 million in the first nine months of 2022, compared to 2021. Year-to-date sales volume decreased \$144.09 million from prior year. Low inventory levels combined with increased mortgage rates continue to be a challenge in our footprint.

The Realty segment's provision for credit losses was a benefit of \$0.32 million in the quarter and an expense of \$0.29 million for the nine months ended September 30, 2022, compared to a provision expense of \$0.15 million and a provision benefit of \$1.00 million for the same respective periods in 2021.

Salaries and employee benefits decreased \$1.52 million and \$0.59 million in the third quarter and first nine months of 2022, respectively, compared to 2021.

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

	Three Months Ended		Nine Months Ended		Increase/(Decrease)		Increase/(Decrease)	
	September 30,		September 30,		Three Months Ended		Nine Months Ended	
	2022	2021	2022	2021	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
(dollars in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	\$ 12,726	\$ 26,637	\$ 43,491	\$ 90,898	\$ (13,911)	(52.22)%	\$ (47,407)	(52.15)%
Title insurance and settlement fees	525	706	1,590	1,917	(181)	(25.64)%	(327)	(17.06)%
Property management fees, net	9,891	10,502	36,489	33,076	(611)	(5.82)%	3,413	10.32 %
Real estate brokerage income, net	2,932	3,781	8,899	10,125	(849)	(22.45)%	(1,226)	(12.11)%
Income from unconsolidated subsidiary	77	269	359	964	(192)	(71.38)%	(605)	(62.76)%
Net interest and other income	1,508	3,154	6,851	9,223	(1,646)	(52.19)%	(2,372)	(25.72)%
Total revenue	27,659	45,049	97,679	146,203	(17,390)	(38.60)%	(48,524)	(33.19)%
Provision for credit losses	(315)	146	285	(1,004)	(461)	(315.75)%	1,289	(128.39)%
Salaries and employee benefits	15,854	17,375	49,646	50,240	(1,521)	(8.75)%	(594)	(1.18)%
Occupancy expense	1,919	1,926	5,814	5,732	(7)	(0.36)%	82	1.43 %
Furniture and equipment	765	693	2,232	1,934	72	10.39 %	298	15.41 %
Amortization of intangible assets	817	702	2,449	1,882	115	16.38 %	567	30.13 %
Other expenses	8,687	11,103	29,472	30,774	(2,416)	(21.76)%	(1,302)	(4.23)%
Total expenses	28,042	31,799	89,613	90,562	(3,757)	(11.81)%	(949)	(1.05)%
Income (loss) before income tax, corporate allocation, and noncontrolling interest	(68)	13,104	7,781	56,645	(13,172)	(100.52)%	(48,864)	(86.26)%
Corporate allocation	(602)	(1,000)	(2,602)	(3,000)	398	(39.80)%	398	13.27 %
Income (loss) before income tax provision and noncontrolling interest	(670)	12,104	5,179	53,645	(12,774)	(105.54)%	(48,466)	(90.35)%
Provision for income tax	(120)	3,546	1,110	12,017	(3,666)	(103.38)%	(10,907)	(90.76)%
Net income (loss)	(550)	8,558	4,069	41,628	(9,108)	(106.43)%	(37,559)	(90.23)%
Noncontrolling interest	(502)	(2,345)	(1,672)	(8,176)	1,843	(78.59)%	6,504	(79.55)%
Net income (loss) attributable to TowneBank	\$ (1,052)	\$ 6,213	\$ 2,397	\$ 33,452	\$ (7,265)	(116.93)%	\$ (31,055)	(92.83)%

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	Three Months Ended		Nine Months Ended		Increase/(Decrease)		Increase/(Decrease)	
	September 30,		September 30,		Three Months Ended		Nine Months Ended	
	2022	2021	2022	2021	September 30, 2022	September 30, 2021	September 30, 2022	September 30, 2021
<i>(dollars in thousands)</i>					Amount	Percent	Amount	Percent
Key data:								
Efficiency ratio (non-GAAP)	98.43%	69.03%	89.24%	60.66%				
Number of units sold	1,179	1,553	3,485	4,079	(374)	(24.08)%	(594)	(14.56)%
Volume of units sold	\$480,137	\$613,123	\$1,461,302	\$1,605,390	(132,986)	(21.69)%	(144,088)	(8.98)%
Number of real estate agents	405	407	405	407	(2)	(0.49)%	(2)	(0.49)%
Loans originated, mortgage	\$ 458,254	\$ 939,272	\$1,629,791	\$3,177,531	\$(481,018)	(51.21)%	\$(1,547,740)	(48.71)%
Loans originated, joint venture	234,443	370,865	720,703	1,191,906	(136,422)	(36.78)%	(471,203)	(39.53)%
Total loans originated	\$692,697	\$1,310,137	\$2,350,494	\$4,369,437	\$(617,440)	(47.13)%	\$(2,018,943)	(46.21)%
Number of loans, mortgage	1,236	2,643	4,253	9,362	(1,407)	(53.23)%	(5,109)	(54.57)%
Number of loans, joint venture	747	1,274	2,249	4,234	(527)	(41.37)%	(1,985)	(46.88)%
Total number of loans	1,983	3,917	6,502	13,596	(1,934)	(49.37)%	(7,094)	(52.18)%
Average loan amount, mortgage	\$ 371	\$ 355	\$ 383	\$ 339	\$ 16	4.51 %	\$ 44	12.98 %
Average loan amount, joint venture	314	291	320	282	23	7.90 %	38	13.48 %
Average loan amount	\$ 349	\$ 334	\$ 362	\$ 321	15	4.49 %	41	12.77 %
Number of originators, mortgage	135	160	135	160	(25)	(15.63)%	(25)	(15.63)%
Number of originators, joint venture	59	58	59	58	1	1.72 %	1	1.72 %
Total number of originators	194	218	194	218	(24)	(11.01)%	(24)	(11.01)%

Insurance Segment. The Insurance segment represented 7.26%, or \$3.64 million, of total consolidated net income for the three months ended September 30, 2022, compared to 6.33%, or \$3.19 million, for the three months ended September 30, 2021. In the nine-months comparison, the Insurance segment represented 8.38%, or \$11.92 million, of total consolidated net income for the period ended September 30, 2022, compared to 4.91%, or \$8.60 million, for the period ended September 30, 2021. Earnings before income taxes and noncontrolling interest for the three months ended September 30, 2022, were \$4.86 million, increasing \$0.62 million, or 14.53%, over comparative 2021. For the nine months ended September 30, 2022, earnings before income taxes and noncontrolling interest were \$16.01 million, an increase of \$4.51 million, or 39.16%, over comparative 2021.

Commissions on property and casualty insurance increased \$2.23 million and \$4.98 million in the respective three- and nine-month periods ended September 30, 2022, compared to the same periods in 2021, driven by organic growth due to increased rates and higher retention. Contingency and bonus revenue declined \$0.01 million in the third quarter but increased \$1.31 million in the first nine months of 2022. During 2022, the Company continued to build out its leadership team with strategic hiring of key personnel in order to facilitate future growth. 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 2022 increased \$1.58 million and \$1.98 million when compared to the same periods in 2021.

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

					Increase/(Decrease)		Increase/(Decrease)	
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30, 2022		September 30, 2022	
	September 30,		September 30,		September 30, 2021		September 30, 2021	
(dollars in thousands)	2022	2021	2022	2021	Amount	Percent	Amount	Percent
Net commission and fee income								
Property and casualty	\$ 17,567	\$ 15,338	\$ 49,451	\$ 44,467	\$ 2,229	14.53 %	\$ 4,984	11.21 %
Employee benefits	4,020	3,820	12,105	11,135	200	5.24 %	970	8.71 %
Specialized benefit services	160	164	489	494	(4)	(2.44)%	(5)	(1.01)%
Total net commissions and fees	21,747	19,322	62,045	56,096	2,425	12.55 %	5,949	10.61 %
Contingency and bonus revenue	1,654	1,664	8,052	6,746	(10)	(0.60)%	1,306	19.36 %
Other income	23	40	72	157	(17)	(42.50)%	(85)	(54.14)%
Total revenues	23,424	21,026	70,169	62,999	2,398	11.40 %	7,170	11.38 %
Employee commission expense	4,331	4,185	12,943	12,395	146	3.49 %	548	4.42 %
Revenue, net of commission expense	19,093	16,841	57,226	50,604	2,252	13.37 %	6,622	13.09 %
Salaries and employee benefits	10,260	9,064	29,590	28,363	1,196	13.20 %	1,227	4.33 %
Occupancy expense	720	632	2,202	1,897	88	13.92 %	305	16.08 %
Furniture and equipment	196	218	606	626	(22)	(10.09)%	(20)	(3.19)%
Amortization of intangible assets	1,101	1,186	3,366	3,573	(85)	(7.17)%	(207)	(5.79)%
Other expenses	1,653	1,254	4,532	3,857	399	31.82 %	675	17.50 %
Total operating expenses	13,930	12,354	40,296	38,316	1,576	12.76 %	1,980	5.17 %
Income before income tax, corporate allocation, and noncontrolling interest	5,163	4,487	16,930	12,288	676	15.07 %	4,642	37.78 %
Corporate allocation	(300)	(241)	(918)	(782)	(59)	24.48 %	(136)	17.39 %
Income before income tax provision and noncontrolling interest	4,863	4,246	16,012	11,506	617	14.53 %	4,506	39.16 %
Provision for income tax	1,219	1,058	4,091	2,910	161	15.22 %	1,181	40.58 %
Net income	3,644	3,188	11,921	8,596	456	14.30 %	3,325	38.68 %
Noncontrolling interest	—	—	—	—	—	N/M	—	N/M
Net income attributable to TowneBank	\$ 3,644	\$ 3,188	\$ 11,921	\$ 8,596	\$ 456	14.30 %	\$ 3,325	38.68 %
Efficiency ratio (non-GAAP)	67.19 %	66.31 %	64.53 %	68.66 %				

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2022, total assets were \$15.95 billion, which is \$0.41 billion, or 2.50%, lower than total assets at December 31, 2021. Our loan portfolio, less unearned income and deferred costs, made up 66.20% of our period-end assets and totaled \$10.56 billion at September 30, 2022. Average assets for the quarter ended September 30, 2022, were \$16.30 billion, an increase of \$0.23 billion, or 1.42%, from the quarter ended December 31, 2021.

Average earning assets for third quarter 2022 increased \$0.18 billion from fourth quarter 2021 to \$14.99 billion. Our average total deposits were \$13.62 billion for third quarter 2022, an increase of \$0.36 billion, or 2.74%, compared to fourth quarter 2021. Average noninterest-bearing deposits at September 30, 2022, increased \$0.20 billion, or 3.59%, from December 31, 2021.

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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, 2022 and December 31, 2021, respectively, these balances were \$1.34 billion and \$3.28 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 2022 was \$1.80 billion, or 12.02%, of average total earning assets, compared with \$3.27 billion, or 22.11%, of average total earning assets for fourth quarter 2021.

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 \$1.89 billion at September 30, 2022, compared with \$1.81 billion at December 31, 2021. The average balance during third quarter 2022 was \$1.97 billion, compared to \$1.71 billion during the quarter ended December 31, 2021. The average AFS debt securities portfolio represented 13.12% and 11.55% of average earning assets in third quarter 2022 and the quarter ended December 31, 2021, respectively. During the nine months ended September 30, 2022, we had maturities and calls totaling \$122.40 million in investment securities that were classified as AFS.

Net unrealized losses related to the fair value of AFS debt securities have increased \$169.12 million in the first nine months of 2022, primarily driven by the increase in market interest rates rather than credit quality. 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, 2022, the allowance for credit losses on AFS debt securities was \$1.11 million compared to \$210 thousand at December 31, 2021. 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 \$548.75 million at September 30, 2022, and \$154.22 million at December 31, 2021. The average balance during third quarter 2022 was \$548.92 million, compared with \$52.96 million in fourth quarter 2021, representing 3.66% and 0.36% 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 \$83 thousand at September 30, 2022, and \$94 thousand at December 31, 2021. During the nine months ended September 30, 2022, we had maturities and calls totaling \$0.90 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, 2022, we held \$165.02 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$358.30 million at December 31, 2021. Average loans held for sale were 1.26% of average earning assets for the quarter ended September 30, 2022, and 2.56% of average earning assets for the quarter ended December 31, 2021. The majority of mortgage loans held for sale have been precommitted to investors, which minimizes our interest rate risk.

Loan Portfolio. Loans, net of unearned income and deferred costs, were \$10.56 billion at September 30, 2022, which was \$1.05 billion, or 11.08%, over \$9.51 billion at December 31, 2021. Included in loans, net of unearned income and deferred costs were PPP loans, which declined \$145.07 million, or 91.98%, from

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\$157.72 million at December 31, 2021, to \$12.65 million at September 30, 2022. As a percentage of total average earning assets, average loans were 69.83% for the quarter ended September 30, 2022, compared with 63.28% for the quarter ended December 31, 2021. Management expects loan growth to be moderate through year-end 2022.

Allowance for Credit Losses and Asset Quality. The allowance for credit losses on funded loans at September 30, 2022 and December 31, 2021, was \$107.50 million and \$106.06 million, respectively. This increase is primarily attributable to loan growth and weakening in the macroeconomic forecast scenarios used by management to assist in estimating credit losses. 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. The allowance was equal to 1.02% of total loans outstanding at September 30, 2022, compared with 1.12% at December 31, 2021. PPP loans, which totaled \$12.65 million and \$157.72 million at September 30, 2022 and December 31, 2021, 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.

Classified loans, defined as loans in the substandard and doubtful categories, represented 0.22% of total loans at September 30, 2022 and 0.29% at December 31, 2021. Loans 30 to 89 days past due totaled \$3.69 million at September 30, 2022, as compared to \$4.00 million at December 31, 2021. Total past due and nonaccruing loans were \$9.46 million at September 30, 2022, compared to \$10.04 million at December 31, 2021. The allowance for credit losses on funded loans was equal to 20.48x of nonperforming loans at September 30, 2022, compared with 17.75x at December 31, 2021. 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.

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

	September 30, 2022	December 31, 2021
Real estate - construction and development	\$ 19,361	\$ 18,337
Real estate - commercial owner occupied	10,716	12,760
Real estate - commercial non-owner occupied	15,757	25,487
Real estate - multi-family	1,823	1,828
Real estate - residential 1-4 family	27,203	18,014
HELOC	16,310	14,550
Commercial and industrial business loans	6,790	6,935
Government	2,855	3,458
Indirect	3,937	2,133
Consumer and other loans	2,745	2,557
Total	\$ 107,497	\$ 106,059

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

	Three Months Ended		
	September 30, 2022	December 31, 2021	December 31, 2021
<i>(dollars in thousands)</i>			
Nonperforming Assets			
Nonperforming loans	\$ 5,250	\$ 8,451	\$ 5,973
Foreclosed property	186	5,409	4,583
Total nonperforming assets	<u>\$ 5,436</u>	<u>\$ 13,860</u>	<u>\$ 10,556</u>
Loans past due 90 days and still accruing interest	<u>\$ 725</u>	<u>\$ 143</u>	<u>\$ 372</u>
Asset Quality Ratios			
Allowance for credit losses to nonperforming loans	20.48x	12.68x	17.75x
Allowance for credit losses to period-end loans	1.02%	1.15%	1.12%
Allowance for credit losses on loans to period end loans excluding PPP loans (non-GAAP)	1.02%	1.18%	1.13%
Nonperforming loans to period-end loans	0.05%	0.09%	0.06%
Nonperforming assets to period-end assets	0.03%	0.09%	0.06%
Quarterly net charge-offs (recoveries) to average loans (annualized)	(0.01)%	(0.03)%	—%
Annual net charge-offs (recoveries) to average loans	—%	—%	—%

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

	September 30, 2022	December 31, 2021
CRE - Construction and development	\$ 93	\$ —
CRE - Owner occupied	571	607
CRE - Non-owner occupied	—	—
CRE - Multi-family	—	—
Residential 1-4 family	2,088	1,839
HELOC	360	481
Commercial and industrial business	1,547	2,433
Government	—	—
Indirect	591	613
Consumer and other loans	—	—
Total nonperforming loans	<u>\$ 5,250</u>	<u>\$ 5,973</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, 2022, we had \$5.44 million in nonperforming assets, which amounted to 0.03% of total assets. Additionally, loans 60-89 days past due, excluding nonperforming loans, totaled \$0.67 million and there were \$0.73 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of \$5.25 million in nonperforming loans, as well as \$0.19 million in foreclosed property at September 30, 2022. Nonperforming loans decreased by \$0.72 million from December 31, 2021. Foreclosed property decreased by \$4.40 million from December 31, 2021.

At September 30, 2022, nonaccruing TDRs, which are included in nonperforming loans, totaled \$0.14 million and accruing TDRs totaled \$10.53 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.

Deposits. Total deposits at September 30, 2022, were \$13.41 billion, representing a decrease of \$0.16 billion, or 1.19%, compared to December 31, 2021. Total average deposits were \$13.62 billion during

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third quarter 2022, compared to \$12.90 billion during third quarter 2021 and \$13.26 billion during fourth quarter 2021.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 41.77% during third quarter 2022 and 40.40% during the same period in 2021. Average noninterest-bearing demand deposits were 41.42% of average total deposits for fourth quarter 2021. The cost of interest-bearing deposits was 0.51% for third quarter 2022, compared with 0.31% for third quarter 2021 and 0.28% for fourth quarter 2021.

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						Nine Months Ended			
	September 30,			December 31,			September 30,			
	2022		2021	2021			2022		2021	
Interest-bearing demand and money market accounts	\$ 6,084,753	0.43 %	\$ 5,486,788	0.15 %	\$ 5,853,873	0.15 %	\$ 6,203,889	0.26 %	\$ 5,192,658	0.16 %
Regular savings	391,437	0.64 %	358,739	0.59 %	371,901	0.57 %	387,290	0.57 %	345,739	0.61 %
Certificates of deposit	1,456,746	0.83 %	1,842,948	0.73 %	1,541,483	0.70 %	1,440,661	0.66 %	1,872,393	1.00 %
Total interest-bearing	7,932,936	0.51 %	7,688,475	0.31 %	7,767,257	0.28 %	8,031,840	0.34 %	7,410,790	0.39 %
Noninterest-bearing demand	5,690,020		5,212,271		5,492,894		5,569,186		4,880,493	
Total	<u>\$13,622,956</u>	0.30 %	<u>\$12,900,746</u>	0.18 %	<u>\$13,260,151</u>	0.16 %	<u>\$13,601,026</u>	0.20 %	<u>\$12,291,283</u>	0.24 %

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,	
	2022		2021		2021	
Interest-bearing demand and money market accounts	\$ 6,084,753	44.67 %	\$ 5,486,788	42.53 %	\$ 5,853,873	44.16 %
Regular savings	391,437	2.87 %	358,739	2.78 %	371,901	2.80 %
Certificates of deposit	1,456,746	10.69 %	1,842,948	14.29 %	1,541,483	11.62 %
Total interest-bearing	7,932,936	58.23 %	7,688,475	59.60 %	7,767,257	58.58 %
Noninterest-bearing	5,690,020	41.77 %	5,212,271	40.40 %	5,492,894	41.42 %
Total	<u>\$ 13,622,956</u>	100.00 %	<u>\$ 12,900,746</u>	100.00 %	<u>\$ 13,260,151</u>	100.00 %

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2022, were \$29.85 million, compared to \$155.37 million at December 31, 2021. The average borrowing cost for third quarter 2022 was 0.83% and 0.52% in fourth quarter 2021.

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The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2022, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
11/15/2028	3.43%	—	\$ 2,840
12/01/2028	2.83%	—	2,010
03/20/2023	0.37%	—	25,000
Total FHLB Loans			\$ 29,850

At September 30, 2022, certain residential, HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of \$3.16 billion collateralized the advances from the FHLB. At December 31, 2021, certain residential HELOCs, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of \$2.04 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. Average total borrowings, including FHLB advances, were \$0.09 billion during third quarter 2022 compared with \$0.25 million for fourth quarter 2021, while the average cost of these funds was 0.58% and 0.58%, respectively.

Subordinated Debt, net. On February 9, 2022, the Company issued \$250.0 million of fixed-to-floating-rate subordinated notes due February 15, 2032, in a public offering. The Company received \$246.90 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrue interest at a fixed rate of 3.125% for the first five years until February 15, 2027. 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 SOFR plus 1.68%. The Company may redeem the subordinated notes, in whole or in part, on or after February 15, 2027.

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 \$247.09 million in net proceeds after deducting discounts and issuance costs. The subordinated notes accrued 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 was to accrue at a floating rate of three-month LIBOR plus 2.55%. The Company redeemed these notes on August 1, 2022.

At September 30, 2022, the carrying value of the subordinated notes totaled \$247.27 million, compared with \$249.65 million at December 31, 2021. Average subordinated debt during third quarter 2022 was \$320.52 million, compared to \$249.56 million during fourth quarter 2021, while the average cost of the debentures was 3.89% and 4.75%, respectively.

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

On February 23, 2022, we declared a quarterly shareholder cash dividend of \$0.20 per common share. The dividend was paid April 8, 2022, to shareholders of record on March 30, 2022.

On May 24, 2022, we declared a quarterly shareholder cash dividend of \$0.23 per common share. The

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dividend was paid July 12, 2022, to shareholders of record on June 30, 2022.

On August 24, 2022, we declared a quarterly shareholder cash dividend of \$0.23 per common share. The dividend was paid October 14, 2022, to shareholders of record on September 30, 2022.

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. Liquidity represents our ability to respond to current and future funding requirements, in a timely manner, at a reasonable cost, without impairing profitability. In addition to meeting member demand for loans and deposit withdrawals, we must fund balance sheet growth and meet current obligations in relation to operating costs, investment repurchases, and short-term funding sources. We manage liquidity through adherence to established policies, which are monitored by management and ALCO. Our liquid assets consist of cash, interest-bearing deposits in financial institutions, federal funds sold, securities available for sale, investments, and loans maturing within one year. Loans held for sale are typically held on our books for less than 60 days and are funded, primarily, through their sale. We also have the ability to access short-term and long-term borrowings through FHLB, correspondent banks, federal funds purchased, and the Federal Reserve discount window.

The following table provides summarized information on our availability of liquid funds and borrowings as of September 30, 2022 (in thousands):

	September 30, 2022
Available Liquid Funds:	
Cash and cash equivalents	\$ 1,439,219
Unencumbered investment securities	1,778,750
Availability of Borrowings:	
Amount available from FHLB	2,010,495
Amount available from unsecured lines of credit with correspondent banks	150,000
Amount available from Federal Reserve discount window	355,268

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 1 to risk-based assets (CET1)
- Tier 1 capital to risk-based assets
- Total risk-based capital to risk-based assets
- Tier 1 capital to average quarterly assets (Tier 1 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.

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Risk-based capital ratios, which include CET1, Tier 1 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, 2022.

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

	September 30,		June 30,
	2022	2021	2022
Risk-based capital ratios (1):			
Common equity Tier 1 (4.5% minimum requirement)	11.92 %	12.53 %	11.83 %
Tier 1 (6.0% minimum requirement)	12.05 %	12.69 %	11.97 %
Total (8.0% minimum requirement)	14.80 %	15.85 %	16.76 %
Tier 1 leverage ratio (4.0% minimum requirement)	9.52 %	9.18 %	9.19 %

(1) Well-capitalized requirements under Prompt Corrective Action: Common equity Tier 1 of 6.5%, Tier 1 of 8.0%, Total of 10.0%, and Tier 1 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.

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

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
<i>(dollars in thousands)</i>				
Average assets (GAAP)	\$ 16,304,294	\$ 15,706,998	\$ 16,382,006	\$ 15,151,850
Less: average goodwill and intangible assets	504,000	506,231	504,715	499,944
Average tangible assets (non-GAAP)	\$ 15,800,294	\$ 15,200,767	\$ 15,877,291	\$ 14,651,906
Average equity (GAAP)	\$ 1,878,574	\$ 1,888,451	\$ 1,885,655	\$ 1,840,268
Less: average goodwill and intangible assets	504,000	506,231	504,715	499,944
Average tangible equity (non-GAAP)	\$ 1,374,574	\$ 1,382,220	\$ 1,380,940	\$ 1,340,324
Average common equity (GAAP)	\$ 1,861,845	\$ 1,871,820	\$ 1,869,112	\$ 1,824,753
Less: average goodwill and intangible assets	504,000	506,231	504,715	499,944
Average tangible common equity (non-GAAP)	\$ 1,357,845	\$ 1,365,589	\$ 1,364,397	\$ 1,324,809
Net Income (GAAP)	\$ 50,169	\$ 50,400	\$ 142,302	\$ 175,201
Amortization of intangibles, net of tax	2,089	2,172	6,435	6,472
Tangible net income (non-GAAP)	\$ 52,258	\$ 52,572	\$ 148,737	\$ 181,673
Total Revenue (GAAP)	\$ 179,236	\$ 170,076	\$ 511,628	\$ 519,906
Net (gain)/loss on investment securities	—	—	—	(1,252)
Other nonrecurring (income) loss	—	—	—	30
Operating Income (non-GAAP)	\$ 179,236	\$ 170,076	\$ 511,628	\$ 518,684
Noninterest expense (GAAP)	\$ 112,034	\$ 104,086	\$ 330,139	\$ 306,805
Less: Amortization of intangibles	2,644	2,750	8,145	8,192
Noninterest expense net of amortization (non-GAAP)	\$ 109,390	\$ 101,336	\$ 321,994	\$ 298,613
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Return on average assets (GAAP basis)	1.22 %	1.27 %	1.16 %	1.55 %
Impact of excluding average goodwill and other intangibles and amortization	0.09 %	0.10 %	0.09 %	0.11 %
Return on average tangible assets	1.31 %	1.37 %	1.25 %	1.66 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Return on average equity (GAAP basis)	10.60 %	10.59 %	10.09 %	12.73 %
Impact of excluding average goodwill and other intangibles and amortization	4.48 %	4.50 %	4.31 %	5.39 %
Return on average tangible equity	15.08 %	15.09 %	14.40 %	18.12 %

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Efficiency ratio (GAAP)	62.51 %	61.20 %	64.53 %	59.01 %
Impact of exclusions	(1.48)%	(1.62)%	(1.59)%	(1.44)%
Efficiency ratio (non-GAAP)	61.03 %	59.58 %	62.94 %	57.57 %

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,	
	2022	2021
Book value per share (GAAP basis)	\$ 25.08	\$ 25.91
Impact of excluding goodwill and other intangibles and amortization	(6.91)	(6.99)
Tangible book value per share	\$ 18.17	\$ 18.92

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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

At September 30, 2022, we had \$3.63 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	8.41%
+ 200 basis points	5.69%
+ 100 basis points	2.96%
- 100 basis points	(3.75)%

Market Value Simulation: Market value simulation is used to calculate the estimated fair value of assets and liabilities over different interest rate environments. Market values are calculated based on discounted cash flow analysis. The net market value is the market value of all assets minus the market value of all liabilities. The change in net market value over different rate environments is an indication of the longer-term repricing risk in the balance sheet. The same assumptions are used in the market value simulation as in the earnings simulation. The following table reflects the change in net market value over different rate environments:

<u>Change in Prime Rate</u>	<u>Change in Net Market Value (dollars in thousands)</u>
+ 300 basis points	\$(76,425)
+ 200 basis points	\$(41,502)
+ 100 basis points	\$(14,308)
- 100 basis points	\$(661)

PART I. FINANCIAL INFORMATION

Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2022, 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, 2022. 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 2021 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 2021 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 4, 2022.

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 4, 2022

Date

By: /s/ J. Morgan Davis

J. Morgan Davis

Chief Executive Officer

November 4, 2022

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, 2022, 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 4, 2022

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, 2022, 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 4, 2022

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, 2022 (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 4, 2022

Date

/s/ J. Morgan Davis

J. Morgan Davis

Chief Executive Officer

November 4, 2022

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, Audit Committee and
Shareholders of TowneBank
Suffolk, VA

Results of Review of Interim Financial Statements

We have reviewed the consolidated balance sheet of TowneBank (the “Company”) as of September 30, 2022 and the related consolidated statements of income, comprehensive income (loss) and equity for the three and nine-month periods ended September 30, 2022 and 2021, and the statements of cash flow for the nine-month periods ended September 30, 2022 and 2021, 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 to above 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 the Company as of December 31, 2021 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 25, 2022, 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, 2021, 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 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.

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 the 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.

FORVIS, LLP

(Formerly, Dixon Hughes Goodman LLP)
Charlotte, NC
November 4, 2022