

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 March 31, 2023

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 April 28, 2023, was 74,804,601 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
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
CDA	Collateral-Dependent Asset
CECL	Current Expected Credit Loss
CRE	Commercial Real Estate
EAD	Exposure at Default
ECL	Expected Credit Loss
EPS	Earnings Per Share
FASB	Financial Accounting Standards Board
Farmers	Farmers Bankshares Inc.
Farmers Bank	Farmers Bank, Windsor, Virginia
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
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
TE	Taxable Equivalent
TWM	Towne Wealth Management
U.S.	United States
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	March 31, 2023	December 31, 2022
	(unaudited)	(audited)
ASSETS		
Cash and due from banks	\$ 97,502	\$ 55,381
Interest-bearing deposits at FRB - Richmond	1,040,112	1,000,205
Federal funds sold and interest-bearing deposits in financial institutions	104,924	97,244
Total Cash and Cash Equivalents	1,242,538	1,152,830
Securities available for sale, at fair value (amortized cost of \$2,245,344 and \$2,033,040, and allowance for credit losses of \$1,150 and \$1,086 at March 31, 2023 and December 31, 2022, respectively)	2,078,483	1,840,902
Securities held to maturity, at amortized cost (fair value \$524,600 and \$518,993 at March 31, 2023 and December 31, 2022, respectively)	548,226	548,475
Less: Allowance for credit losses	(88)	(83)
Securities held to maturity, net of allowance for credit losses	548,138	548,392
Other equity securities	13,341	6,424
FHLB stock	29,837	9,617
Total Securities	2,669,799	2,405,335
Mortgage loans held for sale	157,161	102,339
Loans, net of unearned income and deferred costs:	11,173,785	10,794,602
Less: Allowance for credit losses on loans	(120,002)	(110,816)
Net Loans	11,053,783	10,683,786
Premises and equipment, net	321,944	304,802
Goodwill	477,234	458,482
Other intangible assets, net	73,238	43,163
BOLI	271,704	258,069
Other assets	463,076	436,461
TOTAL ASSETS	\$ 16,730,477	\$ 15,845,267
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 5,069,363	\$ 5,265,186
Interest-bearing:		
Demand and money market accounts	6,284,184	6,185,075
Savings	389,173	374,987
Certificates of deposit	1,855,411	1,468,975
Total Deposits	13,598,131	13,294,223
Advances from the FHLB	504,497	29,674
Subordinated debt, net	255,151	247,420
Repurchase agreements and other borrowings	46,602	40,918
Total Borrowings	806,250	318,012
Other liabilities	336,201	344,275
TOTAL LIABILITIES	14,740,582	13,956,510
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, \$1.667 par value: 150,000,000 shares authorized		
74,804,431 and 72,841,379 shares issued at		
March 31, 2023 and December 31, 2022, respectively	124,682	121,426
Capital surplus	1,109,387	1,052,262
Retained earnings	861,905	840,777
Common stock issued to deferred compensation trust, at cost		
926,727 and 931,030 shares at		
March 31, 2023 and December 31, 2022, respectively	(18,839)	(18,974)
Deferred compensation trust	18,839	18,974
Accumulated other comprehensive income (loss)	(121,297)	(140,505)
TOTAL SHAREHOLDERS' EQUITY	1,974,677	1,873,960
Noncontrolling interest	15,218	14,797
TOTAL EQUITY	1,989,895	1,888,757
TOTAL LIABILITIES AND EQUITY	\$ 16,730,477	\$ 15,845,267

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 March 31,	
	2023	2022
<i>(Dollars in thousands, except per share data)</i>		
INTEREST INCOME:		
Loans, including fees	\$ 132,768	\$ 94,962
Investment securities	18,375	9,671
Interest-bearing deposits in financial institutions and federal funds sold	10,649	1,347
Mortgage loans held for sale	1,604	2,375
Total interest income	163,396	108,355
INTEREST EXPENSE:		
Deposits	33,934	4,894
Advances from the FHLB	2,992	92
Subordinated debt, net	2,169	4,120
Repurchase agreements and other borrowings	923	45
Total interest expense	40,018	9,151
Net interest income	123,378	99,204
PROVISION FOR CREDIT LOSSES	11,670	(1,449)
Net interest income after provision for credit losses	111,708	100,653
NONINTEREST INCOME:		
Residential mortgage banking income, net	9,372	14,638
Insurance commissions and other title fees and income, net	22,823	19,074
Property management income, net	15,535	17,147
Real estate brokerage income, net	1,791	2,554
Service charges on deposit accounts	2,851	2,574
Credit card merchant fees, net	1,545	1,375
BOLI	1,672	1,717
Other income	5,177	7,129
Total noninterest income	60,766	66,208
NONINTEREST EXPENSE:		
Salaries and employee benefits	69,420	63,963
Occupancy	9,064	8,327
Furniture and equipment	4,244	3,690
Amortization - intangibles	3,524	2,817
Software expense	5,624	4,492
Data processing	3,353	3,594
Professional fees	3,011	2,027
Advertising and marketing	4,401	4,127
Other expenses	21,756	16,342
Total noninterest expense	124,397	109,379
Income before income tax expense and noncontrolling interest	48,077	57,482
Provision for income tax expense	9,599	11,232
Net income	\$ 38,478	\$ 46,250
Net income attributable to noncontrolling interest	(145)	(664)
Net income attributable to TowneBank	\$ 38,333	\$ 45,586
Per common share information		
Basic earnings	\$ 0.52	\$ 0.63
Diluted earnings	\$ 0.52	\$ 0.63

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 March 31,	
	2023	2022
<i>(Dollars in thousands)</i>		
Net income	\$ 38,478	\$ 46,250
Other comprehensive income (loss)		
Unrealized gains (losses) on securities		
Unrealized holding gains (losses) arising during the period	25,341	(86,772)
Tax effect	(5,608)	19,283
Net unrealized gains (losses)	19,733	(67,489)
Pension and postretirement benefit plans		
Prior service costs	(330)	—
Tax effect	73	—
Actuarial gain (loss)	28	20
Tax effect	(6)	(5)
Amortization of prior service costs	208	192
Tax effect	(46)	(42)
Amortization of net actuarial (gain) loss	(581)	19
Tax effect	129	(4)
Change in retirement plans, net of tax	(525)	180
Other comprehensive income (loss), net of tax	19,208	(67,309)
Comprehensive income (loss)	\$ 57,686	\$ (21,059)
Comprehensive income attributable to noncontrolling interest	(145)	(664)
Comprehensive income (loss) attributable to TowneBank	\$ 57,541	\$ (21,723)

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)

	Three Months Ended March 31,	
	2023	2022
<i>(Dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$ 38,478	\$ 46,250
Adjustments to reconcile net income to net cash used for operating activities:		
Net amortization of securities	1,757	3,087
Depreciation, amortization, and other intangible amortization	8,411	7,296
Amortization of debt issuance costs	155	201
Provision for credit losses	11,670	(1,449)
BOLI	(1,672)	(1,717)
Deferred income tax expense	351	750
Share-based compensation expense	5,216	1,063
Originations of mortgage loans held for sale	(417,696)	(838,706)
Proceeds from sales of mortgage loans held for sale	374,979	985,052
Gain on sales of mortgage loans held for sale	(12,105)	(22,663)
Loss (gain) on sale and write-down of foreclosed assets	76	(682)
Changes in:		
Interest receivable	(1,894)	(1,720)
Other assets	7,245	(13,945)
Interest payable	2,916	(2,004)
Other liabilities	(38,735)	(277)
Net cash (used for) from operating activities	(20,848)	160,536
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	—	(189,417)
Purchase of held-to-maturity securities	—	(279,979)
Purchase of other securities	(321)	(30)
Net change in FHLB stock	(20,220)	2,714
Proceeds from maturities, calls, and prepayments of available-for-sale securities	23,829	58,781
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	175	366
Net increase in loans	(104,734)	(403,471)
Net change in investment in LIHTC	(21,296)	(1,998)
Purchase of premises and equipment	(12,992)	(11,445)
Proceeds from sales of premises and equipment	277	143
Proceeds from sales of foreclosed assets	1,032	4,994
Proceeds from BOLI	—	140
Investment from noncontrolling interest in consolidated joint ventures	276	—
Acquisition of business, net of cash acquired	17,776	—
Net cash used for investing activities	(116,198)	(819,202)
FINANCING ACTIVITIES:		
Net change in deposit accounts	(210,664)	198,174
Net change in short-term borrowings	454,464	24,245
Repayment of long-term borrowings	(235)	(125,225)
Proceeds from issuance of subordinated debt, net of issuance cost	—	246,904
Distribution of interest in joint ventures	—	(284)
Purchase of noncontrolling interest	(13)	—
Cash dividends paid	(16,798)	(14,782)
Net cash from financing activities	226,754	329,032
Change in cash and cash equivalents	89,708	(329,634)
Cash and cash equivalents at beginning of year	1,152,830	3,296,636
Cash and cash equivalents at end of period	\$ 1,242,538	\$ 2,967,002
Supplemental cash flow information:		
Cash paid for interest	\$ 37,102	\$ 11,155
Cash paid for income taxes	\$ 461	\$ 262
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 947	\$ 289
Net unrealized gain (losses) on available-for-sale securities, net of tax	\$ 19,733	\$ (67,489)
Common stock issued in connection with business acquisitions	\$ 59,604	\$ —

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, 2023	72,841,379	\$ 121,426	\$ 1,052,262	\$ 840,777	\$ 18,974	\$ (18,974)	\$ (140,505)	\$ 14,797	\$ 1,888,757
Net income	—	—	—	38,333	—	—	—	145	38,478
Other comprehensive income (loss), net of taxes	—	—	—	—	—	—	19,208	—	19,208
Cash dividends declared on common stock (\$0.23 per share)	—	—	—	(17,205)	—	—	—	—	(17,205)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	276	276
Directors' deferred compensation	—	—	—	—	(135)	135	—	—	—
Issuance of common stock - acquisitions	1,897,019	3,162	56,442	—	—	—	—	—	59,604
Issuance of common stock - stock compensation plans	66,033	94	696	—	—	—	—	—	790
Purchase of noncontrolling interest	—	—	(13)	—	—	—	—	—	(13)
Balance, March 31, 2023	74,804,431	\$ 124,682	\$ 1,109,387	\$ 861,905	\$ 18,839	\$ (18,839)	\$ (121,297)	\$ 15,218	\$ 1,989,895

<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, 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, net	—	—	—	—	—	—	—	(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

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 2022 audited Consolidated Financial Statements and the 2022 Annual Report on Form 10-K. Results of operations for the three-month period ended March 31, 2023, are not necessarily indicative of the results of operations for the full year or any other interim periods.

Recent accounting pronouncements:

Accounting standards adopted in current year		
Standard	Summary of guidance	Effects on financial statements
Topic 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. The Company adopted the provisions related to Issue 2: Subtopic 326-20, effective December 31, 2022 and the provisions related to Issue 1: Subtopic 310-40 effective January 1, 2023. The adoption of this pronouncement did not have a material impact on the Company's Consolidated Financial Statements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 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 ASU 2022-06 Issued December 2022	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. Clarifies that certain optional expedients and exceptions in Topic 848 do apply to derivatives that are affected by the discounting transition. The amendments in ASU 2022-06, which were effective upon issuance, defer the sunset date provision from December 31, 2022 to December 31, 2024.	Effective for March 12, 2020, through December 31, 2024. An entity may elect to apply the amendments for contract modifications as of any date from the beginning of an interim period that includes, or is subsequent to, March 12, 2020, or prospectively from a date within the interim period that includes, or is subsequent to, March 12, 2020, up to the date that the financial statements are available to be issued. Once elected, the amendments in this Update must be applied prospectively for all eligible contract modifications. The Company does not expect this pronouncement to have a material impact on its Consolidated Financial Statements.

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.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended March 31,	
	2023	2022
<i>(Dollars in thousands, except per share data)</i>		
Basic		
Net income available to common shareholders	\$ 38,333	\$ 45,586
Weighted-average common shares outstanding	74,363,222	72,498,075
Basic earnings per common share	\$ 0.52	\$ 0.63
Diluted		
Net income available to common shareholders	\$ 38,333	\$ 45,586
Weighted-average common shares outstanding	74,363,222	72,498,075
Effect of dilutive securities:		
Stock compensation plans (1)	27,392	64,047
Weighted-average diluted shares outstanding	74,390,614	72,562,122
Diluted earnings per common share	\$ 0.52	\$ 0.63

(1) There were no shares excluded from the computation of diluted shares for the three months ended March 31, 2023 or March 31, 2022.

Note 3. Mergers and Acquisitions

Farmers Bankshares, Inc.: On January 13, 2023, TowneBank completed its acquisition of Farmers and its wholly-owned bank subsidiary, Farmers Bank, in an all-stock transaction. As part of the merger, Farmers and Farmers Bank merged with and into TowneBank. In connection with the Farmers acquisition, TowneBank acquired a majority interest in a full-service, independent insurance agency, Manry-Rawls, LLC. On January 31, 2023, TowneBank completed the acquisition by purchasing the noncontrolling interest in Manry-Rawls, LLC.

In the merger with Farmers, each outstanding share of Farmers common stock was converted into the right to receive 0.605 shares of TowneBank common stock. TowneBank issued an aggregate of 1.90 million shares of its common stock to former Farmers shareholders. Based on the closing price of TowneBank's common stock on January 13, 2023, of \$31.42 per share, the aggregate consideration paid to former Farmers common shareholders and holders of equity awards to acquire Farmers common stock was approximately \$59.60 million.

The Farmers merger has been accounted for under the acquisition method of accounting. Under this guidance, an entity is required to recognize the assets acquired, liabilities assumed, and the consideration given at their fair value on the acquisition date. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the January 13, 2023, merger date. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the merger date, or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the fair values of loans, deferred tax assets, certain intangible assets acquired, and the residual goodwill. The fair value of consideration exchanged exceeded the recognized amounts of the identifiable net assets and resulted in goodwill of \$14.45 million. Goodwill resulted from a combination of expected synergies, expansion into Isle of Wight and Southampton counties with the addition of five locations, and growth opportunities. None of the goodwill recognized is expected to be deductible for income tax purposes.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the estimated fair values of the assets acquired and liabilities assumed for Farmers as of January 13, 2023 (dollars in thousands):

Fair value of assets acquired:	
Cash and cash equivalents	\$ 26,109
Securities available for sale	244,412
Loans held for investment	277,890
Bank premises and equipment	8,921
OREO	89
Core deposit intangible	15,100
Other intangibles	14,100
Other assets	23,544
Total assets	<u>\$ 610,165</u>
Fair value of liabilities assumed:	
Deposits	\$ 514,572
Total borrowings	33,806
Other liabilities	9,649
Total liabilities	<u>\$ 558,027</u>
Net identifiable assets acquired	\$ 52,138
Less: noncontrolling interest	6,975
Goodwill	14,446
Purchase price	<u>\$ 59,609</u>
Purchase price:	
Company common shares issued	1,897,019
Purchase price per share of Company's common stock	\$ 31.42
Common stock issued	\$ 59,604
Cash exchanged for fractional shares	5
Fair value of total consideration transferred	<u>\$ 59,609</u>

The loans acquired in the Farmers merger were divided into loans with evidence of credit quality deterioration, or PCD, which are accounted for under ASC 326 -10, and loans that do not meet this criteria (purchased performing). As of January 13, 2023, the estimated fair value of the Farmers purchased performing loans acquired was \$228.27 million, the related gross contractual amount was \$233.72 million, and the estimated contractual cash flows not expected to be collected were \$1.93 million.

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The following table presents a reconciliation of the difference between the purchase price and the par value of PCD assets acquired at the acquisition date (dollars in thousands):

Purchase price of financial assets with credit deterioration	\$	49,578
Allowance for credit losses at acquisition date based on our assessment		1,380
Discount attributable to other factors		575
Par value of financial assets with credit deterioration	\$	<u>51,533</u>

Results of operations for Farmers prior to the acquisition date are not included in the Consolidated Statements of Income for the three-month period ended March 31, 2023. The results of activities from the former Farmers Bank operations that are included in the Consolidated Statements of Income from the date of acquisition through March 31, 2023 are broken out in the following table (dollars in thousands):

	Actual from Acquisition Date Through March 31, 2023	
Revenues (net interest income plus noninterest income)	\$	3,643
Net Income	\$	615

Note 4. Investment Securities

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):

March 31, 2023	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 359,212	\$ 461	\$ (25,462)	\$ —	\$ 334,211
U.S. Treasury notes	28,054	—	(782)	—	27,272
Municipal securities	549,115	937	(41,613)	(419)	508,020
Trust preferred and other corporate securities	86,736	264	(10,035)	(731)	76,234
MBSs issued by GSEs and GNMA	1,222,227	556	(90,037)	—	1,132,746
Total available-for-sale securities	<u>\$ 2,245,344</u>	<u>\$ 2,218</u>	<u>\$ (167,929)</u>	<u>\$ (1,150)</u>	<u>\$ 2,078,483</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$10.51 million as March 31, 2023 and is recorded in other assets on the Consolidated Balance Sheets.

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December 31, 2022	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 322,259	\$ 526	\$ (28,891)	\$ —	\$ 293,894
U.S. Treasury notes	27,891	—	(1,198)	—	26,693
Municipal securities	483,461	165	(52,327)	(351)	430,948
Trust preferred and other corporate securities	86,736	181	(8,481)	(735)	77,701
MBSs issued by GSEs and GNMA	1,112,693	239	(101,266)	—	1,011,666
Total available-for-sale securities	<u>\$ 2,033,040</u>	<u>\$ 1,111</u>	<u>\$ (192,163)</u>	<u>\$ (1,086)</u>	<u>\$ 1,840,902</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$9.65 million as December 31, 2022 and is recorded in other assets on the Consolidated Balance Sheets.

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):

March 31, 2023	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
U.S. agency securities	\$ 101,281	\$ —	\$ (7,330)	\$ 93,951	\$ —
U.S. Treasury notes	433,584	—	(16,290)	417,294	—
Municipal securities	5,203	302	—	5,505	(7)
Trust preferred and other corporate securities	2,210	90	—	2,300	(81)
MBSs issued by GSEs	5,948	—	(398)	5,550	—
Total held-to-maturity securities	<u>\$ 548,226</u>	<u>\$ 392</u>	<u>\$ (24,018)</u>	<u>\$ 524,600</u>	<u>\$ (88)</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$2.20 million as March 31, 2023 and is recorded in other assets on the Consolidated Balance Sheets.

December 31, 2022	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
U.S. agency securities	\$ 101,092	\$ —	\$ (8,897)	\$ 92,195	\$ —
U.S. Treasury notes	433,866	—	(20,462)	413,404	—
Municipal securities	2,223	85	—	2,308	(75)
Trust preferred and other corporate securities	5,181	235	—	5,416	(8)
MBSs issued by GSEs	6,113	—	(443)	5,670	—
Total held-to-maturity securities	<u>\$ 548,475</u>	<u>\$ 320</u>	<u>\$ (29,802)</u>	<u>\$ 518,993</u>	<u>\$ (83)</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$2.44 million as December 31, 2022 and is recorded in other assets on the Consolidated Balance Sheets.

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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
March 31, 2023				
Due in one year or less	\$ 14,404	\$ 14,244	\$ 210,662	\$ 205,181
Due after one year through five years	436,579	400,826	324,087	306,134
Due after five years through 10 years	823,588	754,152	11,434	11,243
Due after 10 years	970,773	909,261	2,043	2,042
	<u>\$ 2,245,344</u>	<u>\$ 2,078,483</u>	<u>\$ 548,226</u>	<u>\$ 524,600</u>
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
December 31, 2022				
Due in one year or less	\$ 12,513	\$ 12,323	\$ 29	\$ 29
Due after one year through five years	337,797	308,058	532,759	503,684
Due after five years through 10 years	897,849	808,611	13,623	13,216
Due after 10 years	784,881	711,910	2,064	2,064
	<u>\$ 2,033,040</u>	<u>\$ 1,840,902</u>	<u>\$ 548,475</u>	<u>\$ 518,993</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
March 31, 2023							
Description of Securities	Number	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	55	\$ 70,912	\$ (1,509)	\$ 176,487	\$ (23,953)	\$ 247,399	\$ (25,462)
U.S. Treasury notes	2	26,320	(730)	952	(52)	27,272	(782)
Municipal securities	54	40,776	(821)	149,706	(13,209)	190,482	(14,030)
MBSs issued by GSEs and GNMA	239	278,218	(8,311)	818,208	(81,726)	1,096,426	(90,037)
Total AFS securities	<u>350</u>	<u>\$ 416,226</u>	<u>\$ (11,371)</u>	<u>\$ 1,145,353</u>	<u>\$ (118,940)</u>	<u>\$ 1,561,579</u>	<u>\$ (130,311)</u>
December 31, 2022							
Description of Securities	Number	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	38	\$ 95,259	\$ (6,667)	\$ 132,595	\$ (22,224)	\$ 227,854	\$ (28,891)
U.S. Treasury notes	2	25,753	(1,134)	940	(64)	26,693	(1,198)
Municipal securities	57	114,781	(8,376)	38,381	(6,689)	153,162	(15,065)
MBSs issued by GSEs and GNMA	185	543,806	(41,783)	441,704	(59,483)	985,510	(101,266)
Total AFS securities	<u>282</u>	<u>\$ 779,599</u>	<u>\$ (57,960)</u>	<u>\$ 613,620</u>	<u>\$ (88,460)</u>	<u>\$ 1,393,219</u>	<u>\$ (146,420)</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 March 31, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 351	\$ 735	\$ 1,086
Provision for credit losses	68	(4)	64
Balance, end of period	\$ 419	\$ 731	\$ 1,150

Three Months Ended March 31, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 104	\$ 106	\$ 210
Provision for credit losses	205	666	871
Balance, end of period	\$ 309	\$ 772	\$ 1,081

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 March 31, 2023. The following table reflects the credit ratings aggregated by investment category for HTM debt securities as of the dates indicated (dollars in thousands):

March 31, 2023	Credit Ratings						
Description of Securities	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	Total
U.S. agency securities	\$ 101,281	\$ —		\$ —	\$ —	\$ —	\$ 101,281
U.S. Treasury notes	433,584			—	—	—	433,584
Municipal securities	1,765	3,184	254	—	—	—	5,203
Trust preferred and other corporate securities	—	—		—	2,210	—	2,210
Mortgage-backed securities issued by GSEs	5,948	—		—	—	—	5,948
Total	\$ 542,578	\$ 3,184	\$ 254	\$ —	\$ 2,210	\$ —	\$ 548,226

December 31, 2022	Credit Ratings						
Description of Securities	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	Total
U.S. agency securities	\$ 101,092	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 101,092
U.S. Treasury notes	433,866	—	—	—	—	—	433,866
Municipal securities	1,747	3,180	254	—	—	—	5,181
Trust preferred and other corporate securities	—	—	—	—	2,223	—	2,223
Mortgage-backed securities issued by GSEs	6,113	—	—	—	—	—	6,113
Total	\$ 542,818	\$ 3,180	\$ 254	\$ —	\$ 2,223	\$ —	\$ 548,475

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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):

March 31, 2023

Description of Securities	2023	2022	2021	2020	2019	Prior	Total
U.S. agency securities	—	\$ 27,405	\$ 73,876	\$ —	\$ —	\$ —	\$ 101,281
U.S. Treasury notes	—	369,339	64,244	—	—	—	433,583
Municipal securities	—	—	—	—	—	5,204	5,204
Trust preferred and other corporate securities	—	—	—	—	1,710	500	2,210
Mortgage-backed securities issued by GSEs	—	—	—	—	—	5,948	5,948
Total	\$ —	\$ 396,744	\$ 138,120	\$ —	\$ 1,710	\$ 11,652	\$ 548,226

December 31, 2022

Description of Securities	2022	2021	2020	2019	2018	Prior	Total
U.S. agency securities	\$ 27,320	\$ 73,772	\$ —	\$ —	\$ —	\$ —	\$ 101,092
U.S. Treasury notes	369,205	64,661	—	—	—	—	433,866
Municipal securities	—	—	—	—	—	5,181	5,181
Trust preferred and other corporate securities	—	—	—	1,723	—	500	2,223
Mortgage-backed securities issued by GSEs	—	—	—	—	—	6,113	6,113
Total	\$ 396,525	\$ 138,433	\$ —	\$ 1,723	\$ —	\$ 11,794	\$ 548,475

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 March 31, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 8	\$ 75	\$ 83
Provision for credit losses	(1)	6	5
Balance, end of period	\$ 7	\$ 81	\$ 88

Three Months Ended March 31, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 10	\$ 84	\$ 94
Provision for credit losses	(1)	(1)	(2)
Balance, end of period	\$ 9	\$ 83	\$ 92

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 March 31, 2023, FHLB stock totaled \$29.84 million and other equity securities totaled \$13.34 million. At December 31, 2022, FHLB stock totaled \$9.62 million and other equity securities totaled

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\$6.42 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 March 31, 2023 and December 31, 2022, the Company had investment securities with market values of \$558.00 million and \$440.60 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had \$7.75 million and \$8.26 million, respectively, in investment securities pledged to secure borrowings from the FHLB at March 31, 2023 and December 31, 2022. The Company also had \$103.93 million in investment securities pledged against repurchase agreements with commercial customers at March 31, 2023, compared to \$66.61 million at December 31, 2022.

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):

	March 31, 2023	December 31, 2022
Commercial Real Estate		
Construction and land development	\$ 1,473,034	\$ 1,428,376
Owner occupied	1,675,119	1,580,099
Non-owner occupied	2,908,791	2,830,620
Multi-family	505,237	496,190
Total Commercial Real Estate	6,562,181	6,335,285
Residential 1-4 family	1,734,698	1,634,062
HELOC	387,967	395,526
Commercial and industrial business	1,297,707	1,256,697
Government	510,494	512,265
Indirect	582,306	568,190
Consumer loans and other	98,432	92,577
Loans, net of unearned income and deferred costs	<u>\$ 11,173,785</u>	<u>\$ 10,794,602</u>

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<i>(in thousands)</i>	March 31, 2023	December 31, 2022
Deferred loan costs in excess of unearned loan income	\$ (1,997)	\$ (662)
Unaccreted discounts on PCD loans	4,026	3,538
Unaccreted discounts on non-PCD loans	7,170	2,434
Nonaccrual loans ⁽¹⁾	9,322	6,273

(1) The Company would have earned \$108 thousand and \$84 thousand in the first three months of 2023 and 2022, respectively, if interest on nonaccrual loans had been accrued.

Modifications to Debtors Experiencing Financial Difficulty

Effective January 1, 2023, the Company adopted the provisions of ASU 2022-02 that eliminate the accounting guidance for troubled debt restructuring, while enhancing the disclosure requirements for certain loan refinance and restructure activities by creditors when a borrower is experiencing financial difficulty. The adoption was made on a prospective basis.

In the ordinary course of business the Company may determine a borrower is experiencing financial difficulties and modify the originally agreed-upon terms of their loan.

For the purpose of these requirements, financial difficulties have been defined as one or more of the following:

- The borrower is currently in payment default or it is probable they will be in payment default in the foreseeable future without a loan modification.
- The borrower has declared or is in the process of declaring bankruptcy.
- There is substantial doubt as to whether the borrower will continue to be a going concern.
- Based on estimates and projections that only encompass the borrower's current capabilities, the Company forecasts the borrower's entity-specific cash flows will be insufficient to service their debt in accordance with the contractual terms of the existing agreement for the foreseeable future.
- Without the current modification, the borrower cannot obtain funds from other sources at an effective interest rate equal to the current market interest for a non-troubled borrower.

The following are specifically identified loan modifications that must be reported:

- principal forgiveness,
- interest reduction,
- an other-than-insignificant payment delay,
- or a term extension.

The Company has elected to exclude accrued interest from the calculation of loan modifications. The following table shows the amortized cost basis at the end of the reporting period of the loans modified to borrowers experiencing financial difficult, disaggregated by class of financial receivable and type of concession granted (in thousands):

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Loan Modifications Made to Borrowers Experiencing Financial Difficulty		
Loan Classification	Term Extension	
	Amortized Cost Basis at March 31, 2023	% of Total Class of Financing Receivable
Commercial Real Estate		
Construction and land development	\$ 1,204	0.08 %
Owner occupied	665	0.04 %
Non-owner occupied	917	0.03 %
HELOC	642	0.17 %
Commercial and industrial business	447	0.03 %
Consumer loans and other	277	0.28 %
Total	<u>\$ 4,152</u>	

At March 31, 2023, \$17 thousand in accrued interest receivable has been excluded from loan modification calculations and is included in other assets.

The following table describes the financial effect of the modifications made to borrowers experiencing financial difficulty:

Term Extension	
Loan Classification	Financial Effect
Commercial Real Estate	
Construction and land development	Extended interest only period. The modification did not impact the weighted-average life of C&D loans.
Owner occupied	Reamortized balances and extended maturities to allow time for project completion and alternate financing. These modifications did not impact the weighted-average life of CRE-OO loans.
Non-owner occupied	Extended maturities and converted to interest only, which reduced monthly payment amounts for borrowers. These modifications did not impact the weighted-average life of CRE-NOO loans.
HELOC	Extended line maturities to allow borrowers time to obtain financing or sell property. These modifications did not impact the weighted-average life of HELOC loans.
Commercial and industrial business	Reamortized balances and extended maturities, which reduced monthly payment amounts for borrowers. These modifications did not impact the weighted-average life of C&I loans.
Consumer loans and other	Renewed lines and extended maturities to allow borrowers additional time to pay off balances. These modifications did not impact the weighted-average life of consumer loans.

The following table provides the amortized cost basis of financing receivables that had a payment default during the period and were modified in the 12 months before default to borrowers experiencing financial difficulty.

Loan Classification	Amortized Cost Basis of Modified Financing Receivables that Subsequently Defaulted				
	Interest Rate Reduction	Term Extension	Principal Forgiveness	Combination-Term Extension and Principal Forgiveness	Combination-Term Extension and Interest Rate Reduction
CRE non-owner occupied	\$ —	\$ 72	\$ —	\$ —	\$ —
	<u>\$ —</u>	<u>\$ 72</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

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We closely monitor the performance of loans that are modified to borrowers experiencing financial difficulty to understand the effectiveness of its modification efforts. The following table depicts the performance of the loans that have been modified in the last 12 months (in thousands).

Loan Classification	Payment Status (Amortized Cost)		
	Current	30 - 89 Days Past	90+ Days Past Due
Commercial Real Estate	\$ —	\$ —	\$ —
Construction and land development	1,204	—	—
Owner occupied	593	72	—
Non-owner occupied	917	—	—
HELOC	642	—	—
Commercial and industrial business	447	—	—
Consumer loans and other	277	—	—
	<u>\$ 4,080</u>	<u>\$ 72</u>	<u>\$ —</u>

The nature and extent of the impairment of modified loans, including those which have experienced a subsequent payment default, are considered in the determination of an appropriate level of the ACL.

Note 6. Allowance for Credit Losses

Credit risk is inherent in the business of extending loans to borrowers and is continuously monitored by management and reflected within the allowance for credit losses for loans. The allowance for credit losses is an estimate of expected losses inherent within the Company's loans held for investment portfolio. In estimating the allowance for credit losses, loans with similar risk characteristics are aggregated into pools and collectively assessed. Risk characteristics for pooling include, but are not limited to: loan purpose, underlying collateral, and similarities in performance and structure. Some loans are not sufficiently similar in risk characteristics to other loans. These loans are excluded from collective evaluation and evaluated on an individual basis. Loans identified for individual assessment include: substandard loans equal to or greater than \$1.0 million, PCD loans with specific reserves, and/or loans identified as no longer sharing similar risk characteristics with other pooled loans. Individually assessed loans totaled \$19.22 million with specific reserves of zero at March 31, 2023, and \$22.31 million with specific reserves of zero at December 31, 2022.

The Company has a policy in place to exclude accrued interest from the calculation of its allowance for credit losses. As of March 31, 2023, \$30.33 million in accrued interest receivable on loans is excluded from the estimate of ECL and is included in other assets, compared to \$30.11 million as of December 31, 2022.

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 month periods ended March 31, 2023 and 2022 (in thousands):

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Three Months Ended March 31, 2023	Commercial Real Estate					
	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
Balance, beginning of period	\$ 20,218	\$ 10,625	\$ 16,478	\$ 1,909	\$ 27,688	\$ 16,766
Provision for credit losses	966	1,329	1,167	439	3,270	(128)
Initial allowance for PCD assets	145	199	63	2	94	8
Write-offs	—	—	—	—	(1)	—
Recoveries	19	2	26	—	15	178
Net (write-offs) recoveries	19	2	26	—	14	178
Balance, end of period	21,348	12,155	17,734	2,350	31,066	16,824
Three Months Ended March 31, 2022	Commercial and Industrial	Government	Indirect	Consumer and Other	Total	
Balance, beginning of period	\$ 6,912	\$ 3,176	\$ 4,172	\$ 2,872	\$ 110,816	
Provision for credit losses	4,198	209	622	(392)	11,680	
Initial allowance for PCD assets	357	1	1	510	1,380	
Write-offs	(3,728)	—	(297)	(219)	(4,245)	
Recoveries	35	—	59	37	371	
Net (write-offs) recoveries	(3,693)	—	(238)	(182)	(3,874)	
Balance, end of period	7,774	3,386	4,557	2,808	120,002	
Three Months Ended March 31, 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	3,187	(296)	(5,840)	(47)	(761)	820
Write-offs	—	—	—	—	—	—
Recoveries	3	3	34	—	19	49
Net (write-offs) recoveries	3	3	34	—	19	49
Balance, end of period	21,527	12,467	19,681	1,781	17,272	15,419
Three Months Ended March 31, 2022	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	1,028	(481)	371	(81)	(2,100)	
Write-offs	(392)	—	(57)	(12)	(461)	
Recoveries	135	—	75	17	335	
Net (write-offs) recoveries	(257)	—	18	5	(126)	
Balance, end of period	7,706	2,977	2,522	2,481	103,833	

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The following table presents a roll forward of the allowance for off-balance-sheet exposure for the three months ended March 31, 2023 and 2022, related to loans held for investment, which is carried in other liabilities on our Consolidated Balance Sheets (in thousands):

Commercial Real Estate						
Three Months Ended	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
March 31, 2023						
Balance, beginning of period	\$ 648	\$ 277	\$ 284	\$ 31	\$ —	\$ 2,960
Provision for credit losses	149	(105)	78	14	—	56
Balance, end of period	\$ 797	\$ 172	\$ 362	\$ 45	\$ —	\$ 3,016
	Commercial and Industrial	Government	Indirect	Consumer and Other	Total	
Balance, beginning of period	\$ 1,285	\$ —	\$ —	\$ 1,619	\$ 7,104	
Provision for credit losses	(145)	—	—	(126)	(79)	
Balance, end of period	\$ 1,140	\$ —	\$ —	\$ 1,493	\$ 7,025	

Commercial Real Estate						
Three Months Ended	Construction and Development	Owner Occupied	Non-Owner Occupied	Multi-Family	Residential 1-4 Family	HELOC
March 31, 2022						
Balance, beginning of period	\$ 640	\$ 341	\$ 331	\$ 40	\$ —	\$ 2,568
Provision for credit losses	(227)	(91)	(59)	(6)	—	153
Balance, end of period	\$ 413	\$ 250	\$ 272	\$ 34	\$ —	\$ 2,721
	Commercial and Industrial	Government	Indirect	Consumer and Other	Total	
Balance, beginning of period	\$ 1,434	\$ —	\$ —	\$ 1,528	\$ 6,882	
Provision for credit losses	58	—	—	(46)	(218)	
Balance, end of period	\$ 1,492	\$ —	\$ —	\$ 1,482	\$ 6,664	

Our provision for credit losses on funded and unfunded loan exposures was a net expense of \$11.60 million in the first quarter of 2023 compared to a net benefit of \$2.32 million in the prior year quarter.

For the period ended March 31, 2023, our ACL increased in response to our Farmers acquisition, adjustments in the economic forecasts, and portfolio changes. Total loans increased \$379.18 million, compared to December 31, 2022. Excluding the Farmers acquisition that increase was \$101.29 million. Economic forecasting includes the use of models to consider various scenarios in evaluating economic risks. The primary factors considered were:

- the economic outlook both nationally and for the metropolitan cities within our footprint;
- the potential regulatory impact of recent bank failures;
- the continued Russia/Ukraine war and its impact on the price of oil and inflation;
- predicted federal funds rate increases;
- changes in Gross Domestic Product;
- changes in unemployment; and
- the declining impact of COVID-19.

Additional factors considered were changes in interest rates, risk ratings, charge-off activities, and inherent risks within specific loan groups.

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Credit quality indicators

For commercial credits, the Company's internal credit risk grading analysis assesses the capability of the borrower to repay contractual obligations of the loan agreements as scheduled, or at all. The Company's internal credit risk grading system is based on numerous factors, including management's experiences with similarly graded loans. Credit risk is inherent in the business of extending loans and leases to borrowers and is monitored by management and reflected within the allowance for credit losses for loans. The allowance for credit losses is an estimate of expected losses inherent within the Company's loans held for investment portfolio.

Credit risk grades 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 February 2023.

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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 March 31, 2023 and December 31, 2022 (in thousands):

March 31, 2023

	Term Loans By Origination						Revolving Loans	Revolving Loans Converted to Term	Total	
	2023	2022	2021	2020	2019	Prior				
CRE - Construction and Development										
Pass	\$ 195,897	\$ 805,657	\$ 277,663	\$ 74,513	\$ 5,962	\$ 16,480	\$ 79,857	\$ 14,273	\$ 1,470,302	
Special Mention	1,204	175	775	—	—	60	—	—	2,214	
Substandard	—	335	82	—	8	93	—	—	518	
Gross Write- Offs	\$ 197,101	\$ 806,167	\$ 278,520	\$ 74,513	\$ 5,970	\$ 16,633	\$ 79,857	\$ 14,273	\$ 1,473,034	
	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Owner Occupied										
Pass	\$ 118,451	\$ 309,820	\$ 422,766	\$ 275,571	\$ 160,230	\$ 317,895	\$ 20,015	\$ 1,199	\$ 1,625,947	
Special Mention	393	9,953	7,894	10,414	264	5,372	2,256	593	37,139	
Substandard	—	747	—	693	7,807	2,786	—	—	12,033	
Gross Write- Offs	\$ 118,844	\$ 320,520	\$ 430,660	\$ 286,678	\$ 168,301	\$ 326,053	\$ 22,271	\$ 1,792	\$ 1,675,119	
	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Non-Owner Occupied										
Pass	\$ 160,701	\$ 820,604	\$ 755,143	\$ 426,973	\$ 307,052	\$ 385,211	\$ 13,926	\$ —	\$ 2,869,610	
Special Mention	—	2,529	26,201	780	—	7,655	880	—	38,045	
Substandard	226	—	—	692	—	168	50	—	1,136	
Gross Write- Offs	\$ 160,927	\$ 823,133	\$ 781,344	\$ 428,445	\$ 307,052	\$ 393,034	\$ 14,856	\$ —	\$ 2,908,791	
	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Multi-Family										
Pass	\$ 8,432	\$ 171,457	\$ 126,354	\$ 106,710	\$ 42,793	\$ 45,420	\$ 1,528	\$ —	\$ 502,694	
Special Mention	—	—	223	—	—	2,142	—	—	2,365	
Substandard	—	—	—	—	—	178	—	—	178	
Gross Write- Offs	\$ 8,432	\$ 171,457	\$ 126,577	\$ 106,710	\$ 42,793	\$ 47,740	\$ 1,528	\$ —	\$ 505,237	
	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
Commercial and Industrial										
Pass	\$ 79,666	\$ 296,836	\$ 178,667	\$ 85,532	\$ 54,300	\$ 53,531	\$ 534,717	\$ 2,052	\$ 1,285,301	
Special Mention	—	343	518	1,910	553	422	2,287	—	6,033	
Substandard	287	1,080	2,446	134	515	189	761	961	6,373	
Gross Write- Offs	\$ 79,953	\$ 298,259	\$ 181,631	\$ 87,576	\$ 55,368	\$ 54,142	\$ 537,765	\$ 3,013	\$ 1,297,707	
	\$ 580	\$ —	\$ —	\$ —	\$ —	\$ 168	\$ —	\$ 2,980	\$ 3,728	

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Term Loans By Origination									
	2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
Government									
Pass	\$ —	\$ 83,938	\$ 26,281	\$ 186,963	\$ 21,643	\$ 187,193	\$ 4,476	\$ —	\$ 510,494
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
	\$ —	\$ 83,938	\$ 26,281	\$ 186,963	\$ 21,643	\$ 187,193	\$ 4,476	\$ —	\$ 510,494
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential 1 - 4 Family									
Credit Score:									
> = 750	\$ 55,529	\$ 512,131	\$ 385,225	\$ 173,542	\$ 91,442	\$ 209,488	\$ 4,646	\$ 707	\$ 1,432,710
650-749	10,966	102,725	71,805	42,008	11,062	49,283	—	—	287,849
450-649	—	6,132	621	622	361	6,403	—	—	14,139
300-449	—	—	—	—	—	—	—	—	—
	\$ 66,495	\$ 620,988	\$ 457,651	\$ 216,172	\$ 102,865	\$ 265,174	\$ 4,646	\$ 707	\$ 1,734,698
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1	\$ —	\$ —	\$ 1
HELOC									
Credit Score:									
> = 750	\$ 1,681	\$ 1,838	\$ 879	\$ 497	\$ 98	\$ 842	\$ 296,412	\$ 177	\$ 302,424
650-749	307	344	443	—	981	1,894	74,759	68	78,796
450-649	334	143	329	49	119	964	4,809	—	6,747
300-449	—	—	—	—	—	—	—	—	—
	\$ 2,322	\$ 2,325	\$ 1,651	\$ 546	\$ 1,198	\$ 3,700	\$ 375,980	\$ 245	\$ 387,967
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Indirect									
Credit Score:									
> = 750	\$ 36,323	\$ 160,158	\$ 77,955	\$ 14,697	\$ 7,636	\$ 6,331	\$ —	\$ —	\$ 303,100
650-749	25,037	131,684	71,768	20,334	7,120	6,017	—	—	261,960
450-649	566	3,723	3,051	4,186	2,648	3,049	—	—	17,223
300-449	—	—	—	—	23	—	—	—	23
	\$ 61,926	\$ 295,565	\$ 152,774	\$ 39,217	\$ 17,427	\$ 15,397	\$ —	\$ —	\$ 582,306
Gross Write- Offs	\$ —	\$ 127	\$ 122	\$ 21	\$ 5	\$ 22	\$ —	\$ —	\$ 297

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	Term Loans By Origination								Revolving Loans Converted to Term									
	2023	2022	2021	2020	2019	Prior	Revolving Loans			Total								
Consumer and Other																		
Credit Score:																		
> = 750	\$	8,696	\$	9,558	\$	11,821	\$	6,003	\$	3,129	\$	3,758	\$	37,290	\$	1,016	\$	81,271
650-749		729		5,505		2,821		997		797		308		5,075		11		16,243
450-649		20		204		74		108		103		80		325		4		918
300-649		—		—		—		—		—		—		—		—		—
	\$	9,445	\$	15,267	\$	14,716	\$	7,108	\$	4,029	\$	4,146	\$	42,690	\$	1,031	\$	98,432
Gross Write-Offs	\$	—	\$	134	\$	83	\$	—	\$	2	\$	—	\$	—	\$	—	\$	219
Grand Total	\$	705,445	\$	3,437,619	\$	2,451,805	\$	1,433,928	\$	726,646	\$	1,313,212	\$	1,084,069	\$	21,061	\$	11,173,785
Total Gross Write-Offs	\$	580	\$	261	\$	205	\$	21	\$	5	\$	193	\$	—	\$	2,980	\$	4,245

December 31, 2022

	Term Loans By Origination							Revolving Loans Converted to Term	Total	
	2022	2021	2020	2019	2018	Prior	Revolving Loans			
CRE - Construction and Development										
Pass	\$ 908,741	\$ 339,800	\$ 96,320	\$ 6,082	\$ 4,388	\$ 12,803	\$ 59,217	\$ 229	\$ 1,427,580	
Special Mention	—	—	—	—	—	480	—	—	480	
Substandard	125	83	—	15	1	92	—	—	316	
	\$ 908,866	\$ 339,883	\$ 96,320	\$ 6,097	\$ 4,389	\$ 13,375	\$ 59,217	\$ 229	\$ 1,428,376	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Owner Occupied										
Pass	\$ 328,731	\$ 437,416	\$ 273,172	\$ 161,966	\$ 78,558	\$ 245,660	\$ 10,364	\$ —	\$ 1,535,867	
Special Mention	9,985	7,392	6,523	265	—	4,992	2,798	162	32,117	
Substandard	959	—	514	7,857	258	2,527	—	—	12,115	
	\$ 339,675	\$ 444,808	\$ 280,209	\$ 170,088	\$ 78,816	\$ 253,179	\$ 13,162	\$ 162	\$ 1,580,099	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2	\$ —	\$ —	2	
CRE - Non-Owner Occupied										
Pass	\$ 783,897	\$ 767,735	\$ 448,563	\$ 314,564	\$ 131,138	\$ 336,639	\$ 9,725	\$ —	\$ 2,792,261	
Special Mention	2,587	26,412	—	—	7,690	—	800	—	37,489	
Substandard	—	—	696	—	—	174	—	—	870	
	\$ 786,484	\$ 794,147	\$ 449,259	\$ 314,564	\$ 138,828	\$ 336,813	\$ 10,525	\$ —	\$ 2,830,620	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	—	

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	Term Loans By Origination										
	2022	2021	2020	2019	2018	Prior	Revolving Loans	Revolving Loans Converted to Term	Total		
CRE - Multi-Family											
Pass	\$ 146,146	\$ 147,562	\$ 107,153	\$ 42,966	\$ 14,918	\$ 33,597	\$ 1,268	\$ —	\$ 493,610		
Special Mention	—	224	—	—	2,158	—	—	—	2,382		
Substandard	—	—	—	—	—	198	—	—	198		
	\$ 146,146	\$ 147,786	\$ 107,153	\$ 42,966	\$ 17,076	\$ 33,795	\$ 1,268	\$ —	\$ 496,190		
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —		
Commercial and Industrial											
Pass	\$ 320,534	\$ 188,134	\$ 104,397	\$ 56,832	\$ 30,293	\$ 27,253	\$ 511,362	\$ 2,765	\$ 1,241,570		
Special Mention	906	1,958	503	640	461	—	5,416	—	9,884		
Substandard	482	1,488	1,762	544	182	25	760	—	5,243		
	\$ 321,922	\$ 191,580	\$ 106,662	\$ 58,016	\$ 30,936	\$ 27,278	\$ 517,538	\$ 2,765	\$ 1,256,697		
Gross Write- Offs	\$ 379	\$ 65	\$ 28	\$ —	\$ 26	\$ 11	\$ 2,871	\$ —	\$ 3,380		
Government											
Pass	\$ 81,994	\$ 26,577	\$ 189,199	\$ 21,930	\$ 22,926	\$ 167,496	\$ 2,143	\$ —	\$ 512,265		
Special Mention	—	—	—	—	—	—	—	—	—		
Substandard	—	—	—	—	—	—	—	—	—		
	\$ 81,994	\$ 26,577	\$ 189,199	\$ 21,930	\$ 22,926	\$ 167,496	\$ 2,143	\$ —	\$ 512,265		
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —		
Residential 1 - 4 Family											
Credit Score:											
> = 750	\$ 506,297	\$ 352,946	\$ 175,943	\$ 92,712	\$ 53,118	\$ 156,984	\$ 2,602	\$ 1,896	\$ 1,342,498		
650-749	100,710	71,128	43,192	10,784	19,237	31,737	—	—	276,788		
450-649	6,170	629	904	577	825	5,671	—	—	14,776		
300-449	—	—	—	—	—	—	—	—	—		
	\$ 613,177	\$ 424,703	\$ 220,039	\$ 104,073	\$ 73,180	\$ 194,392	\$ 2,602	\$ 1,896	\$ 1,634,062		
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 10	\$ —	\$ —	\$ 10		
HELOC											
Credit Score:											
> = 750	\$ 2,180	\$ 1,078	\$ 506	\$ 102	\$ 112	\$ 1,094	\$ 304,879	\$ 96	\$ 310,047		
650-749	524	451	—	992	228	1,924	74,387	1	78,507		
450-649	427	341	49	119	98	953	4,985	—	6,972		
300-449	—	—	—	—	—	—	—	—	—		
	\$ 3,131	\$ 1,870	\$ 555	\$ 1,213	\$ 438	\$ 3,971	\$ 384,251	\$ 97	\$ 395,526		
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 50	\$ —	\$ —	\$ 50		

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Term Loans By Origination									
	2022	2021	2020	2019	2018	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
Indirect									
Credit Score:									
> = 750	\$ 171,384	\$ 86,018	\$ 16,607	\$ 9,133	\$ 6,626	\$ 1,984	\$ —	\$ —	\$ 291,752
650-749	139,074	79,233	22,937	8,255	6,334	1,390	—	—	257,223
450-649	4,280	3,396	4,710	3,059	2,759	987	—	—	19,191
300-449	—	—	—	24	—	—	—	—	24
	<u>\$ 314,738</u>	<u>\$ 168,647</u>	<u>\$ 44,254</u>	<u>\$ 20,471</u>	<u>\$ 15,719</u>	<u>\$ 4,361</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 568,190</u>
Gross Write-Offs	\$ 82	\$ 239	\$ 13	\$ 20	\$ 36	\$ 8	\$ —	\$ —	\$ 398
Consumer and Other									
Credit Score:									
> = 750	\$ 17,244	\$ 12,467	\$ 6,107	\$ 5,087	\$ 1,242	\$ 3,002	\$ 34,443	\$ 48	\$ 79,640
650-749	2,616	1,826	1,019	806	581	114	5,001	—	11,963
450-649	231	82	113	122	6	81	333	6	974
300-449	—	—	—	—	—	—	—	—	—
	<u>\$ 20,091</u>	<u>\$ 14,375</u>	<u>\$ 7,239</u>	<u>\$ 6,015</u>	<u>\$ 1,829</u>	<u>\$ 3,197</u>	<u>\$ 39,777</u>	<u>\$ 54</u>	<u>\$ 92,577</u>
Gross Write-Offs	\$ —	\$ —	\$ 17	\$ —	\$ 16	\$ 1	\$ —	\$ —	\$ 34
Grand Total	<u>\$ 3,536,224</u>	<u>\$ 2,554,376</u>	<u>\$ 1,500,889</u>	<u>\$ 745,433</u>	<u>\$ 384,137</u>	<u>\$ 1,037,857</u>	<u>\$ 1,030,483</u>	<u>\$ 5,203</u>	<u>\$ 10,794,602</u>
Total Gross Write-Offs	\$ 461	\$ 304	\$ 58	\$ 20	\$ 78	\$ 82	\$ 2,871	\$ —	\$ 3,874

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 that we believe will necessitate the operation or sale of the underlying collateral to provide substantially all of the repayment.

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

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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 March 31, 2023 and December 31, 2022 (in thousands):

March 31, 2023	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	\$ —	\$ 486	\$ —	\$ 1,472,548	\$ 1,473,034
Owner occupied	—	—	6,041	1,669,078	1,675,119
Non-owner occupied	—	40,145	—	2,868,646	2,908,791
Multi-family	—	2,544	—	502,693	505,237
Residential 1-4 family	4,255	—	—	1,730,443	1,734,698
HELOC	2,069	—	—	385,898	387,967
Commercial and industrial	—	—	—	1,297,707	1,297,707
Government	—	—	—	510,494	510,494
Indirect	—	—	—	582,306	582,306
Consumer and other	—	—	—	98,432	98,432
Total, amortized cost	\$ 6,324	\$ 43,175	\$ 6,041	\$ 11,118,245	\$ 11,173,785
Collateral value	\$ 11,840	\$ 72,255	\$ 25,353		

December 31, 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	\$ —	\$ 953	\$ —	\$ 1,427,423	\$ 1,428,376
Owner occupied	—	—	2,732	1,577,367	1,580,099
Non-owner occupied	—	40,252	—	2,790,368	2,830,620
Multi-family	—	2,580	—	493,610	496,190
Residential 1-4 family	4,896	—	—	1,629,166	1,634,062
HELOC	2,205	—	—	393,321	395,526
Commercial and industrial	—	—	—	1,256,697	1,256,697
Government	—	—	—	512,265	512,265
Indirect	—	—	—	568,190	568,190
Consumer and other	—	—	—	92,577	92,577
Total, amortized cost	\$ 7,101	\$ 43,785	\$ 2,732	\$ 10,740,984	\$ 10,794,602
Collateral value	\$ 14,189	\$ 73,886	\$ 6,790		

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 March 31, 2023 and December 31, 2022 (in thousands):

March 31, 2023

	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	\$ 1,472,889	\$ 53	\$ —	\$ 92	145	\$ 1,473,034	\$ —
Owner occupied	1,674,533	163	—	423	586	1,675,119	—
Non-owner occupied	2,908,592	199	—	—	199	2,908,791	—
Multi-family	505,161	76	—	—	76	505,237	—
Residential 1-4 family	1,732,742	851	565	540	1,956	1,734,698	—
HELOC	387,495	333	65	74	472	387,967	—
Commercial and industrial	1,296,280	1,251	2	174	1,427	1,297,707	—
Government	510,494	—	—	—	—	510,494	—
Indirect	578,723	2,079	672	832	3,583	582,306	206
Consumer and other	98,249	114	42	27	183	98,432	—
Total	\$ 11,165,158	\$ 5,119	\$ 1,346	\$ 2,162	\$ 8,627	\$ 11,173,785	\$ 206

December 31, 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	\$ 1,427,238	\$ 1,046	\$ —	\$ 92	\$ 1,138	\$ 1,428,376	\$ —
Owner occupied	1,579,599	69	—	431	500	1,580,099	—
Non-owner occupied	2,829,724	896	—	—	896	2,830,620	—
Multi-family	496,190	—	—	—	—	496,190	—
Residential 1-4 family	1,630,510	1,855	21	1,676	3,552	1,634,062	—
HELOC	393,519	684	858	465	2,007	395,526	275
Commercial and industrial	1,256,338	28	121	210	359	1,256,697	—
Government	512,265	—	—	—	—	512,265	—
Indirect	564,563	2,367	621	639	3,627	568,190	49
Consumer and other	92,515	62	—	—	62	92,577	—
Total	\$ 10,782,461	\$ 7,007	\$ 1,621	\$ 3,513	\$ 12,141	\$ 10,794,602	\$ 324

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 March 31, 2023 and December 31, 2022. 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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March 31, 2023			Loans 90 Days or More Past Due,		
	Nonaccrual Loans		Not on Nonaccrual Status as of	Nonaccrual Loans With No Specific Reserve as of	Interest Income Recognized as of
	As of 12/31/22	As of 03/31/23	03/31/23	03/31/23	03/31/23
Commercial Real Estate					
Construction and development	\$ 93	\$ 430	\$ —	\$ 430	\$ 8
Owner occupied	565	736	—	736	15
Non-owner occupied	—	—	—	—	4
Multi-family	—	—	—	—	—
Residential 1-4 family	2,416	2,129	—	2,129	76
HELOC	457	306	—	306	33
Commercial and industrial	2,079	4,909	—	4,909	179
Government	—	—	—	—	—
Indirect	663	812	206	812	37
Consumer and other	—	—	—	—	8
Total	\$ 6,273	\$ 9,322	\$ 206	\$ 9,322	\$ 360

December 31, 2022	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 12/31/2022	Nonaccrual Loans With No Specific Reserve as of 12/31/2022	Interest Income Recognized as of 12/31/2022
	As of 12/31/2021	As of 12/31/2022			
Commercial Real Estate					
Construction and development	\$ —	\$ 93	\$ —	\$ 93	\$ 7
Owner occupied	607	565	—	565	57
Non-owner occupied	—	—	—	—	20
Multi-family	—	—	—	—	—
Residential 1-4 family	1,839	2,416	—	2,416	223
HELOC	481	457	275	457	90
Commercial and industrial	2,433	2,079	—	2,079	326
Government	—	—	—	—	—
Indirect	613	663	49	663	154
Consumer and other	—	—	—	—	31
Total	\$ 5,973	\$ 6,273	\$ 324	\$ 6,273	\$ 908

Note 7. Leases

TowneBank has operating and financing leases for certain office space, land, and equipment. Leases with an initial term of 12 months or less are not recorded on the Consolidated Balance Sheets; instead, the lease expenses for these leases are recognized over the lease term. At March 31, 2023, 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.

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

	Leases	
	March 31, 2023	December 31, 2022
Assets		
Finance lease assets	\$ 28,460	\$ 28,620
Operating lease assets	52,429	49,505
Total lease assets	\$ 80,889	\$ 78,125
Liabilities		
Finance lease liabilities	\$ 29,347	\$ 28,886
Operating lease liabilities	56,213	53,289
Total lease liabilities	\$ 85,560	\$ 82,175

The following table presents a summary of activity related to leases for the three month periods ended March 31, 2023 and 2022 (in thousands):

	Lease Cost	
	Three Months Ended March 31,	
	2023	2022
Finance lease cost:		
Amortization of right-of-use assets	\$ 159	\$ —
Interest on lease liabilities	460	—
Operating lease cost (1) included in occupancy expense	3,462	3,374
Variable lease cost included in occupancy expense	209	206
Sublease income included in occupancy expense	(56)	(82)
Net lease cost	\$ 4,234	\$ 3,498

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

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The following table presents lease liability maturities, by year, as of March 31, 2023 (in thousands):

Maturity of Lease Liabilities	
	Operating Leases (1)
April 1 - December 31, 2023	\$ 8,653
2024	9,016
2025	7,699
2026	6,445
2027	5,968
After 2027	42,701
Total lease payments	\$ 80,482
Less: interest	24,269
Present value of lease liabilities	\$ 56,213

(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.

TowneBank has one financing lease that commenced in 2022 with a purchase option that management expects to execute prior to the end of 2023. No lease payments are due until December 2023. The related financing lease liability was \$29.35 million at March 31, 2023. The purchase option is expected to be \$30.80 million.

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

Lease Term and Discount Rate		
	March 31, 2023	March 31, 2022
Weighted - average remaining lease term - finance leases (in years)	0.75	—
Weighted - average remaining lease term - operating leases (in years)	13.17	14.93
Weighted - average discount rate - finance leases	6.43%	—%
Weighted - average discount rate - operating leases	5.03%	4.87%

The following table presents other information with regard to leases for the three month periods ended March 31, 2023 and 2022 (in thousands):

Other Information		Three Months Ended March 31,	
		2023	2022
Cash paid for amounts included in the measurement of lease liabilities			
Operating cash flows from operating leases	\$	3,123	\$ 3,047
Operating cash flows from finance leases		—	—
Financing cash flows from finance leases		—	—
Related Party Transactions (1)			
Rent expense included in occupancy expense	\$	608	\$ 707

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

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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 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 March 31, 2023	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 123,650	\$ (272)	\$ —	\$ 123,378
Provision for credit losses	11,754	(84)	—	11,670
Net interest income after provision for credit losses	111,896	(188)	—	111,708
Residential mortgage banking income, net	(422)	9,794	—	9,372
Insurance commissions and other title fees and income, net	—	291	22,532	22,823
Property management income, net	—	15,535	—	15,535
Real estate commission income, net	—	1,791	—	1,791
Other noninterest income	10,558	522	165	11,245
Noninterest expense	82,484	26,673	15,240	124,397
Income (loss) before income tax, corporate allocation and noncontrolling interest	39,548	1,072	7,457	48,077
Corporate allocation	1,200	(600)	(600)	—
Income before income tax provision and noncontrolling interest	40,748	472	6,857	48,077
Provision for income tax expense	7,651	182	1,766	9,599
Net income (loss)	33,097	290	5,091	38,478
Noncontrolling interest	—	(145)	—	(145)
Net income (loss) attributable to TowneBank	\$ 33,097	\$ 145	\$ 5,091	\$ 38,333
Net income (loss) as percentage of total	86.34 %	0.38 %	13.28 %	100.00 %
Assets	\$ 15,663,593	\$ 524,045	\$ 542,839	\$ 16,730,477

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Three Months Ended March 31, 2022	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 96,770	\$ 2,434	\$ —	\$ 99,204
Provision for credit losses	(1,833)	384	—	(1,449)
Net interest income after provision for credit losses	98,603	2,050	—	100,653
Residential mortgage banking income, net	(1,268)	15,906	—	14,638
Insurance commissions and other title fees and income, net	—	504	18,570	19,074
Property management income, net	—	17,147	—	17,147
Real estate commission income, net	—	2,554	—	2,554
Other noninterest income	11,927	665	203	12,795
Noninterest expense	64,482	31,618	13,279	109,379
Income before income tax, corporate allocation and noncontrolling interest	44,780	7,208	5,494	57,482
Corporate allocation	1,292	(1,000)	(292)	—
Income before income tax provision and noncontrolling interest	46,072	6,208	5,202	57,482
Provision for income tax expense	8,519	1,374	1,339	11,232
Net income	37,553	4,834	3,863	46,250
Noncontrolling interest	—	(664)	—	(664)
Net income attributable to TowneBank	\$ 37,553	\$ 4,170	\$ 3,863	\$ 45,586
Net income as percentage of total	82.38 %	9.15 %	8.47 %	100.00 %
Assets	\$ 15,610,199	\$ 607,194	\$ 449,195	\$ 16,666,588

Note 9. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there is no violation of any condition set forth in the contract. 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 March 31, 2023, the amounts of off-balance-sheet commitments to extend credit were \$4.65 billion.

Standby letters of credit are written conditional commitments issued 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 March 31, 2023, standby letters of credit and financial guarantees were \$158.55 million and performance standby letters of credit were \$2.14 million.

Additionally, the Company had \$138.21 million in mortgage loans sold to investors with estimated recourse and warranty provisions totaling \$2.61 million as of March 31, 2023.

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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):

	March 31, 2023		December 31, 2022	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 38,121	\$ 18,476	\$ 30,921	\$ 25,161
Non-compete agreements	1,105	923	1,143	906
Customer lists	79,868	36,045	72,113	43,058
Total intangible assets subject to amortization	119,094	55,444	104,177	69,125
Trade name	6,357	—	4,880	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	9,588	—	8,111	—
Total other intangible assets	\$ 128,682	\$ 55,444	\$ 112,288	\$ 69,125

Amortization expense for intangible assets was \$3.52 million and \$2.82 million for the three-month periods ended March 31, 2023 and 2022, respectively.

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2022, are as follows (in thousands):

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2022	\$ 344,713	\$ 32,501	\$ 81,268	\$ 458,482
Additions to goodwill	8,105	4,306	6,341	18,752
Other adjustments	—	—	—	—
Balance, March 31, 2023	\$ 352,818	\$ 36,807	\$ 87,609	\$ 477,234

The change in goodwill from December 31, 2022 to March 31, 2023, relates to the Company's completion of the acquisition of Farmers Bank, Manry-Rawls, LLC, and a vacation property management company.

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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 March 31,		Three Months Ended March 31,	
	2023	2022	2023	2022
Service cost	\$ 767	\$ 1,098	\$ —	\$ —
Interest cost	689	396	8	9
Amortization of prior service costs	222	192	(14)	—
Amortization of actuarial (gain) loss	(531)	23	(50)	(4)
Net periodic postretirement benefit cost	<u>\$ 1,147</u>	<u>\$ 1,709</u>	<u>\$ (56)</u>	<u>\$ 5</u>

Postretirement benefit costs are included in our Consolidated Statements of Income for the three month periods ended March 31, 2023 and March 31, 2022. The service cost component of postretirement benefits is included in salaries and employee benefits. All other components of postretirement benefit costs are included in other expenses.

Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at March 31, 2023 and 2022 (in thousands), and changes in the three 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, 2022	\$ (148,772)	\$ 8,267	(140,505)
Other comprehensive income before reclassifications	19,733	(235)	19,498
Amounts reclassified from AOCI	—	(290)	(290)
Other comprehensive income, net	19,733	(525)	19,208
Balance, March 31, 2023	<u>\$ (129,039)</u>	<u>\$ 7,742</u>	<u>\$ (121,297)</u>

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	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	(67,489)	15	(67,474)
Amounts reclassified from AOCI	—	165	165
Other comprehensive income, net	(67,489)	180	(67,309)
Balance at March 31, 2022	<u>\$ (53,871)</u>	<u>\$ (2,841)</u>	<u>\$ (56,712)</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.

Low income housing tax credit partnerships

As part of its community reinvestment initiatives, the Company invests within its footprint in multi-family affordable housing developments as a limited partner. The Company 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.

<i>(dollars in thousands)</i>	March 31, 2023	December 31, 2022
Partnership assets not included in the Consolidated Balance Sheets	\$ 523,357	\$ 453,431
Carrying value of limited partner interests (1)	184,674	163,378
Maximum exposure to loss from limited partner investments	184,976	163,420
Funding commitments dependent on contractual milestones	146,635	148,513
Unfunded short-term construction loan commitments	4,698	4,958

(1) Included in other assets in the Consolidated Balance Sheets.

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For the three-month period ended March 31, 2023, tax benefits totaling \$0.94 million, net of amortization expenses of \$4.54 million, were recognized as a component of income tax expense. For three-month period ended March 31, 2022, tax benefits totaling \$0.63 million, net of amortization expenses of \$3.04 million, 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.

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 March 31, 2023, the discount rate utilized was between 10.34% and 11.80% and the weighted-average life was between 6.71 and 8.96 years.

Loans held for sale: TowneBank elects to carry loans held for sale at fair value. Fair values of loans held for sale are based on commitments on hand from investors or, if commitments have not yet been obtained, prevailing market rates. 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. 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.

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 period ended March 31, 2023 and the year ended December 31, 2022, the Company used a weighted average fall-out rate of 14.07%.

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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. Forward loan sale commitments that economically hedge the closed loan inventory are recognized at fair value in the Consolidated Balance Sheets in other assets or other liabilities, with changes in their fair values recorded as a component of mortgage banking activities in the Consolidated Statements of Income. The Company estimates 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 March 31, 2023 and December 31, 2022 (in thousands):

	March 31, 2023			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 334,211	\$ —	\$ 334,211
U.S. Treasury notes	27,272	—	—	27,272
Municipal securities	—	508,020	—	508,020
Mortgage-backed securities issued by GSEs	—	1,132,746	—	1,132,746
Trust preferred and other corporate securities	—	48,839	27,395	76,234
Other equity securities	—	—	—	—
Loans held for sale	—	157,161	—	157,161
Forward loan commitment asset	—	109	—	109
Forward loan commitment liability	—	349	—	349
Derivative assets	—	1,247	1,435	2,682
Derivative liabilities	—	797	—	797

	December 31, 2022			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 293,894	\$ —	\$ 293,894
U.S. Treasury notes	26,693	—	—	26,693
Municipal securities	—	430,948	—	430,948
Mortgage-backed securities issued by GSEs	—	1,011,666	—	1,011,666
Trust preferred and other corporate securities	—	48,295	29,306	77,601
Loans held for sale	—	102,339	—	102,339
Forward loan commitment asset	—	261	—	261
Forward loan commitment liability	—	127	—	127
Derivative assets	—	549	482	1,031
Derivative liabilities	—	1,004	—	1,004

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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.

At March 31, 2023 and December 31, 2022, the aggregate fair value of mortgage loans held for sale accounted for under the fair value option was \$157.16 million and \$102.34 million, respectively, and the unpaid principal balance of those loans was \$154.19 million and \$100.86 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 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 March 31,	
	2023	2022
Mortgage loans held for sale, at fair value	\$ 761	\$ (5,597)

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 March 31, 2023 and December 31, 2022 (in thousands):

March 31, 2023	Level 1	Level 2	Level 3	Fair Value
Other real estate owned and other nonperforming assets	—	—	564	564

December 31, 2022	Level 1	Level 2	Level 3	Fair Value
Other real estate owned and other nonperforming assets	—	—	560	560

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

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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 March 31, 2023, the discount rate utilized was 6.51% and the weighted-average life was 26.10 years.

The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of March 31, 2023 and December 31, 2022, are as follows (in thousands):

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
March 31, 2023					
Cash and due from banks	\$ 97,502	\$ 97,502	\$ 97,502	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,040,112	1,040,112	1,040,112	—	—
Interest-bearing deposits in financial institutions	104,924	104,924	104,924	—	—
Securities available for sale, net	2,078,483	2,078,483	—	2,051,088	27,395
Securities held to maturity, net	548,226	524,600	—	523,544	1,056
Other equity securities	13,341	13,341	—	13,341	—
Net loans	11,173,785	10,691,903	—	—	10,691,903
Interest receivable	44,715	44,715	—	44,715	—
Time deposits	1,855,411	1,832,856	—	1,832,856	—
Advances from the FHLB	504,497	504,239	—	504,239	—
Subordinated debt	255,151	220,693	—	220,693	—

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
December 31, 2022					
Cash and due from banks	\$ 55,381	\$ 55,381	\$ 55,381	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,000,205	1,000,205	1,000,205	—	—
Interest-bearing deposits in financial institutions	97,244	97,244	97,244	—	—
Securities available for sale, net	1,840,902	1,840,902	—	1,811,596	29,306
Securities held to maturity, net	548,475	518,993	—	518,002	991
Other equity securities	6,424	6,424	—	6,424	—
Net loans	10,794,602	10,369,326	—	—	10,369,326
Interest receivable	42,821	42,821	—	42,821	—
Time deposits	1,468,975	1,439,514	—	1,439,514	—
Advances from the FHLB	29,674	29,013	—	29,013	—
Subordinated debt	247,420	221,190	—	221,190	—

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.

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

	March 31, 2023		December 31, 2022	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	\$ 297,777	\$ 2,682	\$ 167,022	\$ 1,031
Interest rate contracts included in other liabilities	\$ 114,940	\$ 797	\$ 89,471	\$ 1,004

Gains and losses from mortgage banking derivatives are included in residential mortgage banking income, net in the Consolidated Statements of Income. For the three months ended March 31, 2023, the Company recognized \$1.03 million in gains from mortgage banking derivatives. For the three months ended March 31, 2022, the Company recognized \$0.68 million in gains from mortgage banking derivatives.

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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended March 31,	
	2023	2022
Revenue from Contracts with Customers:		
Investment management income		
Investment commissions, net	\$ 2,052	\$ 2,145
Total	\$ 2,052	\$ 2,145
Insurance income		
Property and casualty insurance income, net	\$ 18,873	\$ 15,547
Benefit insurance income, net	3,658	3,023
Total	\$ 22,531	\$ 18,570
Real estate and property management income		
Real estate sales commissions, net	\$ 1,791	\$ 2,554
Real estate property management income, net	15,535	17,147
Total	\$ 17,326	\$ 19,701
Provision expense for credit losses on future reservation receivables	\$ 233	\$ 275
Provision expense for credit losses on property and casualty insurance receivables	\$ 56	\$ 216

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 March 31, 2023.

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 February 9, 2022, the Company issued \$250.00 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. At March 31, 2023, the carrying value of the notes totaled \$247.57 million, compared to \$247.42 million at December 31, 2022.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

With the January 2023 acquisition of Farmers, the Company assumed two issues of capital notes with an aggregate carrying value of \$8.50 million. The first issue, with a carrying value of \$2.69 million at acquisition, bears a 3.00% fixed annual rate and matures August 14, 2025. The second issue, with a carrying value of \$5.82 million at acquisition, bears a 3.25% fixed annual rate, and matures August 14, 2027. At March 31, 2023 the total carrying value of these notes was \$7.58 million, and is included in subordinated debt, net in the Consolidated Balance Sheets.

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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 2022 audited Consolidated Financial Statements included in our 2022 Annual Report to Shareholders and our 2022 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, that may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit or other services; unusual and infrequently occurring events, such as weather-related or natural disasters, acts of war or terrorism, 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, that may adversely affect our business; costs or difficulties related to the integration of the businesses we have acquired may be greater than expected; expected cost savings associated with pending or recently completed acquisitions may not be fully realized or realized within the expected time frame; cybersecurity threats or attacks, the implementation of new technologies, and the ability to develop and maintain reliable electronic systems; our competitors may have greater financial resources and develop products that enable them to compete more successfully; changes in business conditions; changes in the securities market; and changes in our local economy with regard to our market area. Any forward-looking statements made by us or on our behalf speak only as of the date they are made or as of the date indicated, and we do not undertake any obligation to update forward-looking statements as a result of new information, future events, or otherwise. For additional information on factors that could materially influence forward-looking statements included in this report, see the "Risk Factors" in TowneBank's Annual Report on Form 10-K for the year ended December 31, 2022 and related disclosures in other filings that have been, or will be, filed by TowneBank with the Federal Deposit Insurance Corporation..*

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

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insurance. Commercial and retail insurance and employee benefit services are provided through our Insurance segment.

TowneBank had total assets of \$16.73 billion at March 31, 2023, compared to \$15.85 billion at December 31, 2022. The following table lists key asset and liability categories, as a percentage of total assets, as of the dates listed.

	March 31, 2023	December 31, 2022
Total cash and cash equivalents	7.43%	7.28%
Total securities	15.96%	15.18%
Mortgage loans held for sale	0.94%	0.65%
Loans, net of unearned income and deferred costs	66.79%	68.13%
Total deposits	81.28%	83.90%
Total borrowings	4.82%	2.01%

The Company completed the acquisition of Farmers in January 2023. The table below includes selected balance sheet data for the consolidated Company and the acquired company for the periods indicated. For additional information about the acquisition, see *Note 3 – Mergers and Acquisitions* of the Notes to Consolidated Financial Statements in this report.

	March 31, 2023	December 31, 2022	Farmers Acquisition	Total Change Change	%	Change Excluding Acquisition Change	%
<i>(dollars in thousands)</i>							
Total assets	\$16,730,477	\$ 15,845,267	\$ 610,165	\$ 885,210	5.59 %	\$ 279,403	1.76 %
Total investment securities	2,669,799	2,405,335	244,412	264,464	10.99 %	20,052	0.83 %
Mortgage loans held for sale	157,161	102,339	—	54,822	53.57 %	54,822	53.57 %
Loans, net of unearned income and deferred costs	11,173,785	10,794,602	277,890	379,183	3.51 %	101,293	0.94 %
Allowance for credit losses on loans	(120,002)	(110,816)	1,380	(9,186)	8.29 %	(7,806)	7.04 %
Noninterest bearing deposits	5,069,363	5,265,186	176,789	(195,823)	(3.72)%	(372,612)	(7.08)%
Total deposits	13,598,131	13,294,223	514,572	303,908	2.29 %	(210,664)	(1.58)%
Total borrowings	806,250	318,012	33,806	488,238	153.53 %	454,432	142.90 %
Allowance for credit losses to period end loans	1.07 %	1.03 %					

Excluding the acquisition of Farmers, total assets increased \$279.40 million, or 1.76%, in the quarter driven by marginal growth in loans held for investment and mortgage loans held for sale and improvements in the market value of investment securities. Unrealized losses in our AFS debt securities were \$165.71 million at March 31, 2023, compared to \$191.05 million at December 31, 2022. Noninterest-bearing deposits declined in the quarter, primarily in commercial accounts, as we saw migration to interest-bearing deposit accounts.

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The following table presents the key components affecting the Company's financial performance in the three months ended March 31, 2023.

<i>(dollars in thousands)</i>	Three Months Ended		Change	%
	March 31, 2023	March 31, 2022		
Net income attributable to TowneBank	\$ 38,333	\$ 45,586	\$ (7,253)	(15.91)%
Net interest income	123,378	99,204	24,174	24.37 %
Provision for credit losses	11,670	(1,449)	13,119	(905.38)%
Noninterest income	60,766	66,208	(5,442)	(8.22)%
Acquisition-related expenses	5,964	59	5,905	10008.47 %
Noninterest expense, excluding acquisition-related expenses	118,433	109,320	9,113	8.34 %

Despite the increase in net interest income in the year-over-year comparison, net income attributable to TowneBank declined \$7.25 million, or 15.91%. This decrease was driven by acquisition-related expenses of \$5.96 million, combined with the initial provision on acquired loans and commitments of \$4.01 million, which contributed to an increase in the provision for credit losses of \$13.12 million. Also contributing were a decline in noninterest income of \$5.44 million and an increase in noninterest expense, excluding acquisition-related expense, of \$9.11 million. This discussion should be read in conjunction with our Consolidated Financial Statements and notes to the financial statements appearing elsewhere in this report.

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 2022 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	
	March 31, 2023	March 31, 2022
Total Revenue	\$ 184,144	\$ 165,412
Diluted earnings per share	\$ 0.52	\$ 0.63
Return on average assets	0.95 %	1.13 %
Return on average tangible assets (non-GAAP)	1.05 %	1.23 %
Return on average equity	7.99 %	9.73 %
Return on average tangible equity (non-GAAP)	11.71 %	13.91 %

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

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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 \$124.47 million for the quarter ended March 31, 2023, which was \$24.52 million, or 24.53%, higher than the first quarter 2022 total of \$99.96 million. Interest income-TE was \$164.49 million through March 31, 2023, which was \$55.38 million, or 50.76%, higher than the \$109.11 million reported for the quarter ended March 31, 2022. Interest expense for the current quarter was \$40.02 million, which was \$30.87 million, or 337.31%, higher than interest expense of \$9.15 million for first quarter 2022. The quarter-over-quarter increases, between comparative periods, were primarily driven by increases in rate.

Average earning assets declined to \$14.87 billion in the quarter ended March 31, 2023, from \$15.05 billion in the comparative prior year quarter, a decrease of \$171.71 million, or 1.14%. The yield on earning assets was 4.49% in the quarter ended March 31, 2023, up compared to 2.94% in the prior year. Average loan balances in first quarter 2023 were \$11.10 billion, \$1.43 billion, or 14.78%, higher than the same period one year ago and loan yields increased by 87 bp.

Average interest-bearing liabilities were \$8.91 billion in first quarter 2023, up from \$8.56 billion in the comparative prior year quarter, an increase of 4.11%. The cost of interest-bearing liabilities was 1.82% in first quarter 2023, compared to 0.43% in first quarter 2022, a 139 bp increase.

TE net interest margin, which is net interest income-TE expressed as a percentage of average earning assets, was 3.39%, or 70 bp higher, for the quarter ended March 31, 2023, compared to the March 31, 2022, quarter margin of 2.69%. Movements in the past 12 months of the Federal Reserve's Federal Funds target range impacted yields and margins. The following table lists the Federal Funds target range for the periods indicated.

Date	Target Range for Federal Funds (%)
March 16, 2020 - March 16, 2022	0 - 0.25
March 17, 2022 - May 4, 2022	0.25 - 0.50
May 5, 2022 - June 15, 2022	0.75 - 1.00
June 16, 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 - December 14, 2022	3.75 - 4.00
December 15, 2022 - February 1, 2023	4.25 - 4.50
February 2, 2023 - March 22, 2023	4.50 - 4.75
March 23, 2023 - May 3, 2023	4.75 - 5.00
May 4, 2023 - present	5.00 - 5.25

The Company expects modest margin contraction owing to lagged deposit pricing impacts on interest-bearing deposit costs, with an expected deposit beta ranging from 40% to 50% 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

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the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to the previous periods:

	Three Months Ended					
	March 31, 2023			March 31, 2022		
	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)	\$ 11,097,626	\$ 133,536	4.88 %	\$ 9,668,724	\$ 95,596	4.01 %
Taxable investment securities	2,438,489	16,816	2.76 %	2,059,614	9,013	1.75 %
Tax-exempt investment securities	188,033	1,887	4.01 %	110,698	777	2.81 %
Total securities	2,626,522	18,703	2.85 %	2,170,312	9,790	1.80 %
Interest-bearing deposits	1,044,538	10,649	4.13 %	2,929,929	1,347	0.19 %
Loans held for sale	105,018	1,604	6.11 %	276,448	2,375	3.44 %
Total earning assets	14,873,704	164,492	4.49 %	15,045,413	109,108	2.94 %
Less: allowance for credit losses	(114,447)			(106,172)		
Total nonearning assets	1,589,783			1,372,757		
Total assets	<u>\$ 16,349,040</u>			<u>\$ 16,311,998</u>		
Liabilities and Equity:						
Interest-bearing deposits						
Demand and money market	\$ 6,217,754	\$ 23,302	1.52 %	\$ 6,178,217	\$ 2,262	0.15 %
Savings	401,776	844	0.85 %	382,839	511	0.54 %
Certificates of deposit	1,683,354	9,788	2.36 %	1,472,942	2,121	0.58 %
Total interest-bearing deposits	8,302,884	33,934	1.66 %	8,033,998	4,894	0.25 %
Borrowings	355,833	3,915	4.40 %	135,775	137	0.40 %
Subordinated debt, net	250,066	2,169	3.47 %	386,934	4,120	4.26 %
Total interest-bearing liabilities	8,908,783	40,018	1.82 %	8,556,707	9,151	0.43 %
Demand deposits	5,164,415			5,467,153		
Other noninterest-bearing liabilities	329,840			387,871		
Total liabilities	14,403,038			14,411,731		
Shareholders' equity	1,946,002			1,900,267		
Total liabilities and equity	<u>\$ 16,349,040</u>			<u>\$ 16,311,998</u>		
Net interest income-TE (3)		\$ 124,474			\$ 99,957	
Reconciliation of Non-GAAP Financial Measures						
TE basis adjustment		(1,096)			(753)	
Net interest income (GAAP)		<u>\$ 123,378</u>			<u>\$ 99,204</u>	
Interest rate spread (1)(3)			2.67 %			2.51 %
Interest expense as a percent of average earning assets			1.09 %			0.25 %
Net interest margin-TE (2)(3)			3.39 %			2.69 %
Total cost of deposits			1.02 %			0.15 %

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

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

(3) Non-GAAP.

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	Increase/(Decrease)		
	Three Months Ended		
	March 31, 2023		
	Compared to Three Months Ended		
	March 31, 2022		
(dollars in thousands)	Volume	Rate (1)	Total
Assets:			
Loans	\$ 15,369	\$ 22,571	\$ 37,940
Taxable investment securities	1,889	5,914	7,803
Tax-exempt investment securities	687	423	1,110
Total securities	2,576	6,337	8,913
Interest-bearing deposits	(1,408)	10,710	9,302
Loans held for sale	(1,981)	1,210	(771)
Total earning assets	14,556	40,828	55,384
Liabilities and Equity:			
Interest-bearing deposits			
Demand and money market	14	21,026	21,040
Savings	26	307	333
Certificates of deposit	344	7,323	7,667
Total interest-bearing deposits	384	28,656	29,040
Borrowings	531	3,247	3,778
Subordinated capital debentures	(1,951)	—	(1,951)
Total interest-bearing liabilities	(1,036)	31,903	30,867
Net interest income	\$ 15,592	\$ 8,925	\$ 24,517

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

Provision for Credit Losses. The quarterly provision for credit losses was an expense of \$11.67 million compared to a provision benefit of \$1.45 million one year ago. The provision included an initial provision for credit losses of \$4.01 million related to non-PCD loans and commitments acquired in the Farmers transaction. In first quarter 2023, we had net charge-offs of \$3.87 million compared to \$125.63 thousand in first quarter 2022. Included in the current period was a charge-off of \$3.54 million related to a single credit relationship in our commercial and industrial portfolio. Additional factors in the increase included loan growth, combined with changes in loan portfolio composition and updates to our macroeconomic forecast scenarios.

Noninterest Income. Total noninterest income for the quarter ended March 31, 2023, was \$60.77 million, a decrease of \$5.44 million, or 8.22%, compared to the same period in 2022. As a percentage of total income, noninterest income for first quarter 2023 was 33.00%, compared with 40.03% for first quarter 2022.

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

(dollars in thousands)	Three Months Ended		Increase/(Decrease)	
	March 31,		Three Months Ended	
	2023	2022	Amount	Percent
Residential mortgage banking, net	\$ 9,372	\$ 14,638	\$ (5,266)	(35.97)%
Insurance commissions and other title fees and income, net	22,823	19,074	3,749	19.66 %
Property management income, net	15,535	17,147	(1,612)	(9.40)%
Real estate commission income, net	1,791	2,554	(763)	(29.87)%
Service charges on deposit accounts	2,851	2,574	277	10.76 %
Credit card merchant fees, net	1,545	1,375	170	12.36 %
Bank-owned life insurance	1,672	1,717	(45)	(2.62)%
Other income	5,177	7,129	(1,952)	(27.38)%
Subtotal before gain (loss) on investment securities	60,766	66,208	(5,442)	(8.22)%
Net gain on investment securities	—	—	—	N/M
Total noninterest income	<u>\$ 60,766</u>	<u>\$ 66,208</u>	<u>\$ (5,442)</u>	<u>(8.22)%</u>

For first quarter 2023, residential mortgage banking income, net of commission expense, was \$9.37 million, a decrease of \$5.27 million, or 35.97%, compared to first quarter 2022. The first quarter 2023 decrease in mortgage banking income was driven by a decline in volume from first quarter 2022. Production volume was \$416.22 million in first quarter 2023, a decrease of \$403.77 million, or 49.24%, compared to first quarter 2022. Refinance activities decreased to 5.01% of total loan volume in first quarter 2023, compared to 22.07% in the prior year quarter, driven by increases in mortgage rates. Margins on the sale of loans increased from 3.01% in first quarter 2022 to 3.11% in first quarter 2023. First quarter production was adversely impacted by a combination of low housing inventories, higher mortgage rates and seasonality. Management expects pressure from inventory constraints and higher mortgage rates to continue to impact purchase volumes and result in competitive mortgage pricing pressure and compressed margins.

For the first three months of 2023, insurance commissions and other title income, net of commission expense, was \$22.82 million, an increase of \$3.75 million, or 19.66%, compared to first quarter 2022. Insurance commissions increased due to income from two acquisitions, not included in the previous year, in addition to organic growth. Contingency and bonus revenue, which consists primarily of amounts received from various property and casualty carriers, increased in the first three months of 2023 compared to 2022 due to higher than expected receipts.

Property management income, net of commission expense was \$15.54 million for first quarter 2023 which was \$1.61 million, or 9.40%, below comparative 2022. The primary source of income from this line of business is vacation property commissions and associated fees. Reservation income is down compared to the prior year due to decreased bookings and could be adversely impacted by a slower economy.

Other noninterest income for the three months ended March 31, 2023, was \$5.18 million, a decrease of \$1.95 million, or 27.38%, compared to first quarter 2022. Included in the first three months of 2022 was a gain of \$1.19 million on the early extinguishment of debt related to the payoff of FHLB advances. We did not sell any investment securities in first quarter 2023 or 2022, and there were no net gains or losses on the sale of AFS securities to record.

Noninterest Expense. For the quarter ended March 31, 2023, total noninterest expense was \$124.40 million, which was \$15.02 million, or 13.73%, higher than comparative 2022. As a percentage of revenue,

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noninterest expense was 67.55% for first quarter 2023 and 66.13% for comparative 2022. This increase was driven by a combination of the decline in noninterest income and the increase in noninterest expenses in 2023.

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

(dollars in thousands)	Three Months Ended		Increase/(Decrease)	
	March 31,		Three Months Ended	
	2023	2022	2023 over 2022	
			Amount	Percent
Salaries and employee benefits	\$ 69,420	\$ 63,963	\$ 5,457	8.53 %
Occupancy expense	9,064	8,327	737	8.85 %
Furniture and equipment	4,244	3,690	554	15.01 %
Amortization - intangibles	3,524	2,817	707	25.10 %
Software expense	5,624	4,492	1,132	25.20 %
Data processing	3,353	3,594	(241)	(6.71)%
Professional fees	3,011	2,027	984	48.54 %
Advertising and marketing	4,401	4,127	274	6.64 %
Other noninterest expenses:				
Acquisition-related expenses	5,964	59	5,905	N/M
Bank franchise tax/SCC fees	2,527	2,200	327	14.86 %
Charitable contributions	3,756	2,730	1,026	37.58 %
Directors fees and expenses	394	470	(76)	(16.17)%
FDIC and other insurance	1,613	1,393	220	15.79 %
Foreclosed property expenses	22	131	(109)	(83.21)%
Other	3,072	6,400	(3,328)	(52.00)%
Stationery and supplies	822	639	183	28.64 %
Telephone and postage	1,990	1,643	347	21.12 %
Travel/meals/entertainment	1,596	677	919	135.75 %
Total other noninterest expenses	21,756	16,342	5,414	33.13 %
Total noninterest expense	<u>\$ 124,397</u>	<u>\$ 109,379</u>	<u>\$ 15,018</u>	<u>13.73 %</u>

Salaries and employee benefits expense were \$69.42 million in first quarter 2023, representing 55.81% of total noninterest expense. Salaries and benefits expense increased in the first quarter of 2023 compared to 2022, driven by an increase in the number of employees, primarily acquisition related, and annual base salary adjustments that went into effect in third quarter 2022.

In our Banking segment, we had a total of 1,430 full-time equivalent employees at March 31, 2023, as compared to 1,224 at March 31, 2022. In our non-Banking segments at March 31, 2023, we had a total of 1,432 full-time equivalent employees, excluding real estate sales agents, compared to 1,571 at March 31, 2022. Real estate sales agents are independent contractors and, therefore, not included as our employees.

Occupancy expense increased \$0.74 million, or 8.85%, and furniture and equipment increased \$0.55 million, or 15.01%, in first quarter 2023 compared to 2022. These increases were related to growth and higher cleaning and maintenance expenses.

Software expenses increased \$1.13 million due to several projects related to the Farmers acquisition, mortgage systems and our loan portfolio. Professional fees increased \$0.98 million, or 48.54%, in first

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quarter 2023 compared to 2022 due to increases in project-related accounting fees, professional IT support services, and other consulting.

For first quarter 2023, other noninterest expenses were \$21.76 million, an increase of 33.13%, or \$5.41 million, compared to the same period in 2022. Acquisition-related expenses increased to \$5.96 million in first quarter 2023 from \$59 thousand in first quarter 2022, due to the acquisition of Farmers. Charitable contributions increased \$1.03 million in first quarter 2023 compared to 2022 due to increases in both regional and foundation related contributions. An earnout adjustment of \$1.84 million for a prior year property management company acquisition was included in first quarter 2022.

Provision for Income Taxes. We reported a provision for income tax expense of \$9.60 million, representing an effective tax rate of 20.03%, in first quarter 2023. The provision for income tax expense was \$11.23 million for first quarter 2022, with an effective rate of 19.77%.

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 March 31, 2023, the Banking segment represented 86.34%, or \$33.10 million, of our total consolidated net income, compared to 82.38%, or \$37.55 million, for the three months ended March 31, 2022. Income before income tax provision and noncontrolling interest for the Banking segment was \$40.75 million for the three months ended March 31, 2023, a decrease of \$5.32 million in the quarterly comparison from first quarter 2022.

Total revenue increased \$26.36 million in the three months ended March 31, 2023, compared to 2022, driven by net interest income growth. Noninterest expenses increased \$18.00 million in first quarter 2023 compared to 2022, due primarily to a \$6.13 million increase in salaries and employee benefits between periods and acquisition-related expenses. Additionally, increases in professional fees, occupancy expense, and software, contributed to noninterest expense growth. The provision for credit losses increased \$13.59 million compared to prior year.

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

(dollars in thousands)	Three Months Ended		Increase/(Decrease)	
	March 31,		Three Months Ended	
	2023	2022	March 31, 2023	March 31, 2022
			Amount	Percent
Net interest income	\$123,650	\$96,770	\$ 26,880	27.78 %
Service charges on deposit accounts	2,851	2,574	277	10.76 %
Credit card merchant fees	1,545	1,375	170	12.36 %
Other income	5,740	6,710	(970)	(14.46)%
Total noninterest income	10,136	10,659	(523)	(4.91)%
Total revenue	133,786	107,429	26,357	24.53 %
Provision for credit losses	11,754	(1,833)	13,587	(741.24)%
Salaries and employee benefits	43,193	37,059	6,134	16.55 %
Occupancy	6,233	5,659	574	10.14 %
Furniture and equipment	3,333	2,709	624	23.03 %
Amortization of intangible assets	1,281	827	454	54.90 %
Other expenses	28,444	18,228	10,216	56.05 %
Total noninterest expenses	82,484	64,482	18,002	27.92 %
Income before income tax and corporate allocation	39,548	44,780	(5,232)	(11.68)%
Corporate allocation	1,200	1,292	(92)	(7.12)%
Income before income tax provision and noncontrolling interest	40,748	46,072	(5,324)	(11.56)%
Provision for income tax expense	7,651	8,519	(868)	(10.19)%
Net income	33,097	37,553	(4,456)	(11.87)%
Noncontrolling interest	—	—	—	N/M
Net income attributable to TowneBank	<u>\$33,097</u>	<u>\$37,553</u>	<u>\$ (4,456)</u>	<u>(11.87)%</u>
Efficiency ratio (non-GAAP)	60.70 %	59.25 %		

Realty Segment. For the three months ended March 31, 2023, the Realty segment reported income before income tax provision and noncontrolling interest of \$472 thousand, as compared to \$6.21 million in 2022. Total revenue was \$27.66 million in the first quarter of 2023, compared to \$39.21 million in 2022. For the first three months of 2023, the Realty segment represented \$145 thousand, or 0.38%, of our total consolidated net income, compared to \$4.17 million, or 9.15%, in 2022.

Revenue from all real-estate-related activities declined in first quarter 2023 compared to 2022. Low inventory levels combined with increased mortgage rates continue to be a challenge in our footprint. Residential mortgage banking income declined \$6.11 million, or 38.43%. Net real estate brokerage income decreased \$0.76 million in the first three months of 2023, compared to 2022. Net property management fees decreased \$1.61 million, or 9.40%. Title insurance and settlement fees declined \$213 thousand.

Residential mortgage production decreased \$403.77 million, or 49.24%, to \$416.22 million, and refinance activities decreased to 5.01% of total loan volume in first quarter 2023, as compared to mortgage production of \$819.99 million and refinance activities of 22.07% in first quarter 2022. Real estate brokerage volume decreased \$121.16 million from prior year. 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

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environment. Additionally, the Company is placing greater emphasis on increasing production via retail channels as opposed to volumes from partner relationships.

Net property management fees decreased \$1.61 million in first quarter 2023 compared to 2022 driven by lower reservation levels in 2023. The Realty segment's provision for credit losses was a benefit of \$84 thousand in the quarter, compared to a provision expense of \$384 thousand in first quarter 2022.

Noninterest expenses declined \$4.95 million in first quarter 2023, compared to the prior year, driven by decreased salaries and employee benefits expense of \$2.45 million.

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

			Increase/(Decrease)	
	Three Months Ended		Three Months Ended	
	March 31,		March 31, 2023	
	2023	2022	Amount	Percent
<i>(dollars in thousands)</i>				
Residential mortgage banking income, net	\$ 9,794	\$ 15,906	\$ (6,112)	(38.43)%
Title insurance and settlement fees	291	504	(213)	(42.26)%
Property management fees, net	15,535	17,147	(1,612)	(9.40)%
Real estate brokerage income, net	1,791	2,554	(763)	(29.87)%
Income from unconsolidated subsidiary	66	167	(101)	(60.48)%
Net interest and other income	184	2,932	(2,748)	(93.72)%
Total revenue	27,661	39,210	(11,549)	(29.45)%
Provision for credit losses	(84)	384	(468)	(121.88)%
Salaries and employee benefits	14,839	17,291	(2,452)	(14.18)%
Occupancy	2,021	1,898	123	6.48 %
Furniture and equipment	693	761	(68)	(8.94)%
Amortization of intangible assets	683	816	(133)	(16.30)%
Other expenses	8,437	10,852	(2,415)	(22.25)%
Total expenses	26,673	31,618	(4,945)	(15.64)%
Income before income tax, corporate allocation, and noncontrolling interest	1,072	7,208	(6,136)	(85.13)%
Corporate allocation	(600)	(1,000)	400	(40.00)%
Income before income tax provision and noncontrolling interest	472	6,208	(5,736)	(92.40)%
Provision for income tax	182	1,374	(1,192)	(86.75)%
Net income	290	4,834	(4,544)	(94.00)%
Noncontrolling interest	(145)	(664)	519	(78.16)%
Net income attributable to TowneBank	\$ 145	\$ 4,170	\$ (4,025)	(96.52)%

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<i>(dollars in thousands)</i>	Three Months Ended		Increase/(Decrease)	
	March 31,		Three Months Ended	
	2023	2022	March 31, 2023	March 31, 2022
			Amount	Percent
Key data:				
Efficiency ratio (non-GAAP)	93.96%	78.56%		
Number of units sold	660	1,003	(343)	(34.20)%
Volume of units sold	\$296,077	\$417,233	(121,156)	(29.04)%
Number of real estate agents	405	405	—	— %
Loans originated, mortgage	\$ 280,401	\$ 583,008	\$(302,607)	(51.90)%
Loans originated, joint venture	135,818	236,980	(101,162)	(42.69)%
Total loans originated	\$416,219	\$819,988	\$(403,769)	(49.24)%
Number of loans, mortgage	783	1,508	(725)	(48.08)%
Number of loans, joint venture	466	729	(263)	(36.08)%
Total number of loans	1,249	2,237	(988)	(44.17)%
Average loan amount, mortgage	\$ 358	\$ 387	\$ (29)	(7.49)%
Average loan amount, joint venture	291	325	(34)	(10.46)%
Average loan amount	\$ 333	\$ 367	(34)	(9.26)%
Number of originators, mortgage	136	148	(12)	(8.11)%
Number of originators, joint venture	57	58	(1)	(1.72)%
Total number of originators	193	206	(13)	(6.31)%

Insurance Segment. The Insurance segment represented 13.28%, or \$5.09 million, of total consolidated net income for the three months ended March 31, 2023, compared to 8.47%, or \$3.86 million, for the three months ended March 31, 2022. Earnings before income taxes and noncontrolling interest for the three months ended March 31, 2023, were \$6.86 million, increasing \$1.66 million, or 31.81%, over comparative 2022.

Commissions on property and casualty insurance increased \$2.79 million in the three-month period ended March 31, 2023, compared to the same periods in 2022, driven by organic growth and two agency acquisitions that occurred in third quarter 2022 and first quarter 2023. Contingency and bonus revenue increased \$0.97 million in first quarter 2023, compared to 2022. Total operating expenses for first quarter 2023 increased \$1.96 million when compared to the same period in 2022. The Company expects to continue actively pursuing attractive acquisition opportunities of insurance agencies.

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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)	
			Three Months Ended	
	Three Months Ended		March 31, 2023	
	March 31,		March 31, 2022	
(dollars in thousands)	2023	2022	Amount	Percent
Net commission and fee income				
Property and casualty	\$ 18,129	\$ 15,337	\$ 2,792	18.20 %
Employee benefits	4,587	4,161	426	10.24 %
Specialized benefit services	159	170	(11)	(6.47)%
Total net commissions and fees	22,875	19,668	3,207	16.31 %
Contingency and bonus revenue	4,369	3,404	965	28.35 %
Other income	6	33	(27)	(81.82)%
Total revenues	27,250	23,105	4,145	17.94 %
Employee commission expense	4,553	4,332	221	5.10 %
Revenue, net of commission expense	22,697	18,773	3,924	20.90 %
Salaries and employee benefits	11,388	9,613	1,775	18.46 %
Occupancy	810	770	40	5.19 %
Furniture and equipment	218	220	(2)	(0.91)%
Amortization of intangible assets	1,560	1,174	386	32.88 %
Other expenses	1,264	1,502	(238)	(15.85)%
Total operating expenses	15,240	13,279	1,961	14.77 %
Income before income tax, corporate allocation, and noncontrolling interest	7,457	5,494	1,963	35.73 %
Corporate allocation	(600)	(292)	(308)	105.48 %
Income before income tax provision and noncontrolling interest	6,857	5,202	1,655	31.81 %
Provision for income tax	1,766	1,339	427	31.89 %
Net income	5,091	3,863	1,228	31.79 %
Noncontrolling interest	—	—	—	N/M
Net income attributable to TowneBank	\$ 5,091	\$ 3,863	\$ 1,228	31.79 %
Efficiency ratio (non-GAAP)	60.27 %	64.48 %		

ANALYSIS OF FINANCIAL CONDITION

Overview. At March 31, 2023, total assets were \$16.73 billion, which is \$0.89 billion, or 5.59%, higher than total assets at December 31, 2022. Excluding the Farmers acquisition, total assets increased \$279.40 million, or 1.76%, compared to year-end 2022. Our loan portfolio, less unearned income and deferred costs, made up 66.79% of our period-end assets and totaled \$11.17 billion at March 31, 2023. Average assets for the quarter ended March 31, 2023, were \$16.35 billion, an increase of \$0.42 billion, or 2.63%, from the quarter ended December 31, 2022.

Average earning assets for first quarter 2023 increased \$296.73 million from fourth quarter 2022 to \$14.87 billion. Our average total deposits were \$13.47 billion for first quarter 2023, an increase of \$112.84 million, or 0.84%, compared to fourth quarter 2022. Average noninterest-bearing deposits at March 31, 2023, decreased \$320.06 million, or 5.84%, from December 31, 2022.

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Interest-Bearing Deposits in Financial Institutions. Interest-bearing deposits in other banks and 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 March 31, 2023 and December 31, 2022, respectively, these balances were \$1.15 billion and \$1.10 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 and at the FRB - Richmond and federal funds sold during first quarter 2023 was \$1.04 billion, or 7.02%, of average total earning assets, compared to \$1.32 billion, or 9.07%, of average total earning assets for fourth quarter 2022.

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 \$2.08 billion at March 31, 2023, compared with \$1.84 billion at December 31, 2022. The average balance during first quarter 2023 was \$2.05 billion, compared to \$1.86 billion during the quarter ended December 31, 2022. The average AFS debt securities portfolio represented 13.76% and 12.77% of average earning assets in first quarter 2023 and the quarter ended December 31, 2022, respectively. During the three months ended March 31, 2023, we had maturities and calls totaling \$23.83 million in investment securities that were classified as AFS.

Net unrealized losses related to the fair value of AFS debt securities decreased \$19.73 million in the first three months of 2023. Unrealized losses in the AFS debt securities portfolio are 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 March 31, 2023, the allowance for credit losses on AFS debt securities was \$1.15 million compared to \$1.09 million at December 31, 2022. 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 \$548.23 million at March 31, 2023, and \$548.48 million at December 31, 2022. The average balance during first quarter 2023 was \$548.28 million, compared with \$548.54 million in fourth quarter 2022, representing 3.69% and 3.76% 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 \$88 thousand at March 31, 2023, and \$83 thousand at December 31, 2022. During the three months ended March 31, 2023, we had maturities and calls totaling \$175 thousand 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 March 31, 2023, we held \$157.16 million in mortgage loans originated and intended for sale in the secondary market, as compared with \$102.34 million at December 31, 2022. Average loans held for sale were 0.71% of average earning assets for the quarter ended March 31, 2023, and 0.86% of average earning assets for the quarter ended December 31, 2022. 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 \$11.17 billion at March 31, 2023, which was a \$379.18 million, or 3.51%, increase over \$10.79 billion at December 31, 2022. Excluding \$277.89 million in loans from the acquisition of Farmers, loans, net of unearned income and deferred costs, increased \$101.29 million or 0.94% in the quarter. As a percentage of total average earning assets, average

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loans were 74.61% for the quarter ended March 31, 2023, compared with 73.41% for the quarter ended December 31, 2022. We expect to continue moderating loan growth to align with deposit growth trends.

Allowance for Credit Losses and Asset Quality. The allowance for credit losses on funded loans at March 31, 2023 and December 31, 2022, was \$120.00 million and \$110.82 million, respectively. The \$9.19 million increase included \$5.05 million in initial allowance for credit losses from the January 2023 acquisition of Farmers. In relation to the loans acquired from Farmers, the Company recorded an initial ACL of \$1.38 million for PCD loans and \$3.67 million for non-PCD loans. Additional allowance increases were driven by loan growth, changes in our portfolio composition and updates in the macroeconomic forecast scenarios. The allowance was equal to 1.07% of total loans outstanding at March 31, 2023, compared with 1.03% at December 31, 2022.

Classified loans, defined as loans in the substandard and doubtful categories, represented 0.25% of total loans at March 31, 2023 and December 31, 2022. Loans 30 to 89 days past due totaled \$6.47 million at March 31, 2023, as compared to \$8.63 million at December 31, 2022. Total past due and nonaccruing loans were \$14.92 million at March 31, 2023, compared to \$15.18 million at December 31, 2022. The allowance for credit losses on funded loans was equal to 12.87x of nonperforming loans at March 31, 2023, compared with 17.67x at December 31, 2022. 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.

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):

	March 31, 2023	December 31, 2022
Real estate - construction and development	\$ 21,348	\$ 20,218
Real estate - commercial owner occupied	12,155	10,625
Real estate - commercial non-owner occupied	17,734	16,478
Real estate - multi-family	2,350	1,909
Real estate - residential 1-4 family	31,066	27,688
HELOC	16,824	16,766
Commercial and industrial business loans	7,774	6,912
Government	3,386	3,176
Indirect	4,557	4,172
Consumer and other loans	2,808	2,872
Total	\$ 120,002	\$ 110,816

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

(dollars in thousands)	Three Months Ended		
	March 31,		December 31,
	2023	2022	2022
Nonperforming Assets			
Nonperforming loans	\$ 9,322	\$ 4,825	\$ 6,273
Foreclosed property	564	560	560
Total nonperforming assets	<u>\$ 9,886</u>	<u>\$ 5,385</u>	<u>\$ 6,833</u>
Loans past due 90 days and still accruing interest	<u>\$ 206</u>	<u>\$ 40</u>	<u>\$ 324</u>
Asset Quality Ratios			
Allowance for credit losses to nonperforming loans	12.87x	21.52x	17.67x
Allowance for credit losses to period-end loans	1.07%	1.05%	1.03%
Nonperforming loans to period-end loans	0.08%	0.05%	0.06%
Nonperforming assets to period-end assets	0.06%	0.03%	0.04%
Quarterly net charge-offs (recoveries) to average loans (annualized)	0.14%	0.01%	0.03%

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

	March 31,	December 31,
	2023	2022
CRE - Construction and development	\$ 430	\$ 93
CRE - Owner occupied	736	565
CRE - Non-owner occupied	—	—
CRE - Multi-family	—	—
Residential 1-4 family	2,129	2,416
HELOC	306	457
Commercial and industrial business	4,909	2,079
Government	—	—
Indirect	812	663
Consumer and other loans	—	—
Total nonperforming loans	<u>\$ 9,322</u>	<u>\$ 6,273</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.

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At March 31, 2023, we had \$9.89 million in nonperforming assets, which amounted to 0.06% of total assets. Additionally, loans 60-89 days past due, excluding nonperforming loans, totaled \$1.35 million and there were \$0.21 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of \$9.32 million in nonperforming loans, as well as \$0.56 million in foreclosed property at March 31, 2023. Nonperforming loans increased by \$3.05 million from December 31, 2022. Foreclosed property increased \$4 thousand from December 31, 2022.

Deposits. Total deposits at March 31, 2023, were \$13.60 billion, representing a decrease of \$173.67 million, or 1.26%, compared to March 31, 2022. Excluding \$514.57 million in acquired deposits, total deposits decreased \$688.24 million, or 5.00%, compared to prior year and \$210.66 million, or 1.58%, compared to December 31, 2022. Total average deposits were \$13.47 billion during first quarter 2023, compared to \$13.50 billion during first quarter 2022 and \$13.35 billion during fourth quarter 2022.

	Total Deposits			
	Three Months Ended			
	March 31,		Change	
	2023	2022	\$	%
Interest-bearing demand and money market accounts	\$ 6,284,184	\$ 6,432,005	\$ (147,821)	(2.30)%
Regular savings	389,173	393,119	\$ (3,946)	(1.00)%
Certificates of deposit	1,855,411	1,414,339	\$ 441,072	31.19 %
Total interest-bearing	8,528,768	8,239,463	\$ 289,305	3.51 %
Noninterest-bearing demand	5,069,363	5,532,337	\$ (462,974)	(8.37)%
Total	<u>\$13,598,131</u>	<u>\$13,771,800</u>	<u>\$ (173,669)</u>	(1.26)%

At March 31, 2023, we had \$6.82 billion in uninsured deposits, \$0.65 billion of which is collateralized by securities, for an adjusted uninsured deposit total of \$6.17 billion, roughly 45% of total deposits. Total liquidity sources at March 31, 2023 totaled \$6.57 billion, or 107% of adjusted uninsured deposits.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 38.35% during first quarter 2023 and 40.49% during the same period in 2022. The cost of interest-bearing deposits was 1.66% for first quarter 2023, compared with 0.25% for first quarter 2022.

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			
	March 31,			
	2023		2022	
Interest-bearing demand and money market accounts	\$ 6,217,754	1.52 %	\$ 6,178,217	0.15 %
Regular savings	401,776	0.85 %	382,839	0.54 %
Certificates of deposit	1,683,354	2.36 %	1,472,942	0.58 %
Total interest-bearing	8,302,884	1.66 %	8,033,998	0.25 %
Noninterest-bearing demand	5,164,415		5,467,153	
Total	<u>\$13,467,299</u>	1.02 %	<u>\$13,501,151</u>	0.15 %

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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			
	March 31,			
	2023		2022	
Interest-bearing demand and money market accounts	\$ 6,217,754	46.17 %	\$ 6,178,217	45.76 %
Regular savings	401,776	2.98 %	382,839	2.84 %
Certificates of deposit	1,683,354	12.50 %	1,472,942	10.91 %
Total interest-bearing	8,302,884	61.65 %	8,033,998	59.51 %
Noninterest-bearing	5,164,415	38.35 %	5,467,153	40.49 %
Total	<u>\$13,467,299</u>	100.00 %	<u>\$13,501,151</u>	100.00 %

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at March 31, 2023, were \$504.50 million, compared to \$29.67 million at December 31, 2022. The average borrowing cost for first quarter 2023 was 4.53% and 2.78% in fourth quarter 2022.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at March 31, 2023, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
04/19/2023	4.83%	—	\$ 250,000
05/17/2023	5.00%	—	250,000
11/15/2028	3.43%	—	2,635
12/01/2028	2.83%	—	1,862
Total FHLB Loans			<u>\$ 504,497</u>

At March 31, 2023, certain residential, HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of \$3.91 billion collateralized the advances from the FHLB. At December 31, 2022, certain residential HELOCs, second mortgages, agency securities, and commercial mortgages secured by real estate with carrying values of \$3.09 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 \$355.83 million during first quarter 2023 compared with \$138.51 million for fourth quarter 2022, while the average cost of these funds was 4.40% and 2.57%, respectively.

Subordinated Debt, net. On February 9, 2022, the Company issued \$250.00 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.

PART I. FINANCIAL INFORMATION

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

With the January 2023 acquisition of Farmers, the Company assumed two issues of capital notes with an aggregate carrying value of \$8.50 million. The first issue, with a carrying value of \$2.69 million at acquisition, bears a 3.00% fixed annual rate and matures August 14, 2025. The second issue, with a carrying value of \$5.82 million at acquisition, bears a 3.25% fixed annual rate and matures August 14, 2027.

At March 31, 2023, the carrying value of the subordinated notes totaled \$255.15 million, compared with \$247.42 million at December 31, 2022. Average subordinated debt during first quarter 2023 was \$250.07 million, compared to \$247.32 million during fourth quarter 2022, while the average cost of the debentures was 3.47% and 3.41%, respectively.

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

On February 22, 2023, we declared a quarterly shareholder cash dividend of \$0.23 per common share. The dividend was paid April 12, 2023, to shareholders of record on March 30, 2023.

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 March 31, 2023 (in thousands):

	March 31, 2023
Available Liquid Funds:	
Cash and cash equivalents	\$ 1,242,538
Unencumbered investment securities	1,799,230
Availability of Borrowings:	
Amount available from FHLB	1,423,432
Amount available from unsecured lines of credit with correspondent banks	157,500
Amount available from Federal Reserve discount window	1,946,175
	<u>\$ 6,568,875</u>

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

PART I. FINANCIAL INFORMATION

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

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.

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 March 31, 2023.

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

	March 31,		December 31,
	2023	2022	2022
Risk-based capital ratios (1):			
Common equity Tier 1 (4.5% minimum requirement)	11.68 %	12.16 %	11.92 %
Tier 1 (6.0% minimum requirement)	11.80 %	12.31 %	12.04 %
Total (8.0% minimum requirement)	14.55 %	17.34 %	14.80 %
Tier 1 leverage ratio (4.0% minimum requirement)	9.86 %	9.16 %	9.87 %

(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

PART I. FINANCIAL INFORMATION

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

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:

<i>(dollars in thousands)</i>	Three Months Ended March 31,	
	2023	2022
Average assets (GAAP)	\$ 16,349,040	\$ 16,311,998
Less: average goodwill and intangible assets	521,972	506,496
Average tangible assets (non-GAAP)	\$ 15,827,068	\$ 15,805,502
Average equity (GAAP)	\$ 1,946,002	\$ 1,900,267
Less: average goodwill and intangible assets	521,972	506,496
Average tangible equity (non-GAAP)	\$ 1,424,030	\$ 1,393,771
Average common equity (GAAP)	\$ 1,931,063	\$ 1,884,101
Less: average goodwill and intangible assets	521,972	506,496
Average tangible common equity (non-GAAP)	\$ 1,409,091	\$ 1,377,605
Net Income (GAAP)	\$ 38,333	\$ 45,586
Amortization of intangibles, net of tax	2,784	2,225
Tangible net income (non-GAAP)	\$ 41,117	\$ 47,811
Noninterest expense (GAAP)	\$ 124,397	\$ 109,379
Less: Amortization of intangibles	3,524	2,817
Noninterest expense net of amortization (non-GAAP)	\$ 120,873	\$ 106,562
Three Months Ended March 31,		
	2023	2022
Return on average assets (GAAP basis)	0.95 %	1.13 %
Impact of excluding average goodwill and other intangibles and amortization	0.10 %	0.10 %
Return on average tangible assets	1.05 %	1.23 %
Three Months Ended March 31,		
	2023	2022
Return on average equity (GAAP basis)	7.99 %	9.73 %
Impact of excluding average goodwill and other intangibles and amortization	3.72 %	4.18 %
Return on average tangible equity	11.71 %	13.91 %

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

	Three Months Ended March 31,	
	2023	2022
Efficiency ratio (GAAP)	67.55 %	66.13 %
Impact of exclusions	(1.91)%	(1.71)%
Efficiency ratio (non-GAAP)	65.64 %	64.42 %

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.

	March 31,	
	2023	2022
Book value per share (GAAP basis)	\$ 26.40	\$ 25.61
Impact of excluding goodwill and other intangibles and amortization	(7.36)	(6.94)
Tangible book value per share	\$ 19.04	\$ 18.67

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

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

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

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

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

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

At March 31, 2023, we had \$4.28 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	(4.88)%
+ 200 basis points	(3.19)%
+ 100 basis points	(1.51)%
- 100 basis points	(3.03)%

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	\$(375,967)
+ 200 basis points	\$(257,239)
+ 100 basis points	\$(129,099)
- 100 basis points	\$(37,189)

Rates of loan prepayments are based on historical experience of similar loans in rising and falling rate environments. Assumptions used on non-maturity-deposit rate changes, or betas, are based on historical experience of similar account types. Time deposit pricing is assumed to change consistent with the changes in other market yield curves, such as U.S. Treasury rates. Those loan and deposit assumptions are subject to risk of rates changing faster or slower or by a higher absolute amount as well as differing competitive environments. As these correlations are based on competitive and market conditions, the Company notes that future results may be different from estimates, and such differences could be material.

PART I. FINANCIAL INFORMATION

Item 4. Controls and Procedures

Controls and Procedures. As of March 31, 2023, 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 March 31, 2023. 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 2022 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 2022 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 May 5, 2023.

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

May 5, 2023

Date

By: /s/ William I. Foster III

William I. Foster III

President and Chief Executive Officer

May 5, 2023

Date

By: /s/ William B. Littreal

William B. Littreal

Senior Executive Vice President/Chief
Financial Officer

CERTIFICATIONS

I, William I. Foster III, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2023, 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.

May 5, 2023

Date

/s/ William I. Foster III

William I. Foster III

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 March 31, 2023, 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.

May 5, 2023

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 March 31, 2023 (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.

May 5, 2023

Date

/s/ William I. Foster III

William I. Foster III

Chief Executive Officer

May 5, 2023

Date

/s/ William B. Littreal

William B. Littreal

Senior Executive Vice President/Chief Financial
Officer

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



Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of TowneBank

Results of Review of Interim Financial Statements

We have reviewed the condensed consolidated balance sheet of TowneBank ("the Company") as of March 31, 2023, and the related condensed consolidated statements of income, comprehensive income (loss), cash flows and equity for the three-month periods ended March 31, 2023, and 2022, 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 condensed 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, 2022 and the related consolidated statements of income, comprehensive income(loss), cash flows and equity for the year then ended (not presented herein), and in our report dated February, 24, 2023, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2022, 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 statements 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

Charlotte, NC
May 5, 2023