

FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

FORM 10-Q

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

For the quarterly period ended September 30, 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 October 27, 2023, was 74,891,898 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
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
BHHS	Berkshire Hathaway HomeServices
BOLI	Bank-Owned Life Insurance
bp	Basis Points
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
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
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
OREO	Other Real Estate Owned
PCD	Purchased Credit Deteriorated
PD	Probability of Default

REPO	Retail Repurchase Agreement
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
TDR	Troubled Debt Restructure
U.S.	United States
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2023	December 31, 2022
	(unaudited)	(audited)
ASSETS		
Cash and due from banks	\$ 83,949	\$ 55,381
Interest-bearing deposits at FRB - Richmond	1,029,276	1,000,205
Federal funds sold and interest-bearing deposits in financial institutions	102,527	97,244
Total Cash and Cash Equivalents	1,215,752	1,152,830
Securities available for sale, at fair value (amortized cost of \$2,203,314 and \$2,033,040, and allowance for credit losses of \$1,343 and \$1,086 at September 30, 2023 and December 31, 2022, respectively)	1,963,453	1,840,902
Securities held to maturity, at amortized cost (fair value \$524,431 and \$518,993 at September 30, 2023 and December 31, 2022, respectively)	547,854	548,475
Less: Allowance for credit losses	(85)	(83)
Securities held to maturity, net of allowance for credit losses	547,769	548,392
Other equity securities	14,062	6,424
FHLB stock	16,634	9,617
Total Securities	2,541,918	2,405,335
Mortgage loans held for sale	188,048	102,339
Loans, net of unearned income and deferred costs	11,172,971	10,794,602
Less: Allowance for credit losses on loans	(125,159)	(110,816)
Net Loans	11,047,812	10,683,786
Premises and equipment, net	335,522	304,802
Goodwill	456,684	458,482
Other intangible assets, net	67,496	43,163
BOLI	275,240	258,069
Other assets	551,884	436,461
TOTAL ASSETS	\$ 16,680,356	\$ 15,845,267
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	\$ 4,444,861	\$ 5,265,186
Interest-bearing:		
Demand and money market accounts	6,764,415	6,185,075
Savings	350,031	374,987
Certificates of deposit	2,321,498	1,468,975
Total Deposits	13,880,805	13,294,223
Advances from the FHLB	104,139	29,674
Subordinated debt, net	255,580	247,420
Repurchase agreements and other borrowings	47,315	40,918
Total Borrowings	407,034	318,012
Other liabilities	408,305	344,275
TOTAL LIABILITIES	14,696,144	13,956,510
Preferred stock:		
Authorized and unissued shares - 2,000,000	—	—
Common stock, \$1.667 par value: 150,000,000 shares authorized		
74,887,083 and 72,841,379 shares issued at		
September 30, 2023 and December 31, 2022, respectively	124,837	121,426
Capital surplus	1,111,152	1,052,262
Retained earnings	911,042	840,777
Common stock issued to deferred compensation trust, at cost		
1,001,376 and 931,030 shares at		
September 30, 2023 and December 31, 2022, respectively	(20,740)	(18,974)
Deferred compensation trust	20,740	18,974
Accumulated other comprehensive income (loss)	(179,043)	(140,505)
TOTAL SHAREHOLDERS' EQUITY	1,967,988	1,873,960
Noncontrolling interest	16,224	14,797
TOTAL EQUITY	1,984,212	1,888,757
TOTAL LIABILITIES AND EQUITY	\$ 16,680,356	\$ 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 September 30,		Nine months ended September 30,	
	2023	2022	2023	2022
<i>(Dollars in thousands, except per share data)</i>				
INTEREST INCOME:				
Loans, including fees	\$ 143,605	\$ 111,590	\$ 415,351	\$ 307,595
Investment securities	20,292	13,979	57,519	35,913
Interest-bearing deposits in financial institutions and federal funds sold	15,031	9,509	40,168	15,472
Mortgage loans held for sale	3,928	2,446	8,079	7,038
Total interest income	182,856	137,524	521,117	366,018
INTEREST EXPENSE:				
Deposits	64,171	10,230	146,776	20,696
Advances from the FHLB	3,438	83	16,838	261
Subordinated debt, net	2,245	3,117	6,650	12,328
Repurchase agreements and other borrowings	(56)	56	806	151
Total interest expense	69,798	13,486	171,070	33,436
Net interest income	113,058	124,038	350,047	332,582
PROVISION FOR CREDIT LOSSES	1,007	3,925	16,232	2,532
Net interest income after provision for credit losses	112,051	120,113	333,815	330,050
NONINTEREST INCOME:				
Residential mortgage banking income, net	10,648	11,968	31,380	39,782
Insurance commissions and other income, net	23,777	19,435	69,098	58,255
Property management income, net	12,800	9,891	40,433	36,489
Real estate brokerage income, net	(63)	2,932	3,562	8,899
Service charges on deposit accounts	2,802	2,455	8,671	7,474
Credit card merchant fees, net	2,006	1,658	5,232	4,940
BOLI	1,814	1,585	5,196	5,155
Gain on sale of equity investments	554	—	9,386	—
Other income	5,468	5,274	15,570	18,052
Total noninterest income	59,806	55,198	188,528	179,046
NONINTEREST EXPENSE:				
Salaries and employee benefits	67,258	65,463	204,124	194,318
Occupancy	9,027	8,748	27,579	25,417
Furniture and equipment	4,100	3,764	12,733	11,097
Amortization - intangibles	3,610	2,644	10,744	8,145
Software expense	6,130	4,594	17,922	13,848
Data processing	4,140	3,628	11,504	10,778
Professional fees	2,770	2,627	8,948	6,416
Advertising and marketing	3,653	4,290	12,012	12,508
Other expenses	17,014	16,276	61,762	47,612
Total noninterest expense	117,702	112,034	367,328	330,139
Income before income tax expense and noncontrolling interest	54,155	63,277	155,015	178,957
Provision for income tax expense	9,410	12,606	28,424	34,983
Net income	\$ 44,745	\$ 50,671	\$ 126,591	\$ 143,974
Net income attributable to noncontrolling interest	117	(502)	(1,680)	(1,672)
Net income attributable to TowneBank	\$ 44,862	\$ 50,169	\$ 124,911	\$ 142,302
Per common share information				
Basic earnings	\$ 0.60	\$ 0.69	\$ 1.67	\$ 1.96
Diluted earnings	\$ 0.60	\$ 0.69	\$ 1.67	\$ 1.96

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
<i>(Dollars in thousands)</i>				
Net income	\$ 44,745	\$ 50,671	\$ 126,591	\$ 143,974
Other comprehensive income (loss)				
Unrealized gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	(42,539)	(79,424)	(47,466)	(217,376)
Tax effect	9,414	17,621	10,504	48,257
Net unrealized gains (losses)	(33,125)	(61,803)	(36,962)	(169,119)
Pension and postretirement benefit plans				
Prior service costs	(330)	—	(991)	—
Tax effect	73	—	219	—
Actuarial gain (loss)	28	21	84	62
Tax effect	(6)	(5)	(18)	(14)
Amortization of prior service costs	208	193	624	577
Tax effect	(46)	(43)	(138)	(128)
Amortization of net actuarial (gain) loss	(581)	19	(1,742)	57
Tax effect	128	(4)	386	(12)
Change in retirement plans, net of tax	(526)	181	(1,576)	542
Other comprehensive income (loss), net of tax	(33,651)	(61,622)	(38,538)	(168,577)
Comprehensive income (loss)	\$ 11,094	\$ (10,951)	\$ 88,053	\$ (24,603)
Comprehensive income attributable to noncontrolling interest	117	(502)	(1,680)	(1,672)
Comprehensive income (loss) attributable to TowneBank	\$ 11,211	\$ (11,453)	\$ 86,373	\$ (26,275)

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Nine Months Ended	
	September 30,	
	2023	2022
<i>(Dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$ 126,591	\$ 143,974
Adjustments to reconcile net income to net cash used for operating activities:		
Net amortization of securities	5,203	9,242
Depreciation, amortization, and other intangible amortization	25,715	21,541
Amortization of debt issuance costs	464	709
Provision for credit losses	16,232	2,532
BOLI	(5,196)	(4,252)
Deferred income tax expense	1,962	561
Share-based compensation expense	5,142	1,479
Originations of mortgage loans held for sale	(1,594,553)	(2,404,043)
Proceeds from sales of mortgage loans held for sale	1,553,493	2,661,482
Gain on sales of mortgage loans held for sale	(44,649)	(64,160)
Gain on sale of BHHS Towne Realty	(8,833)	—
Gain on sale and write-down of foreclosed assets	(206)	(596)
Changes in:		
Interest receivable	(6,555)	(7,933)
Other assets	2,773	(9,285)
Interest payable	10,061	(2,818)
Other liabilities	30,441	(11,021)
Net cash from operating activities	118,085	337,412
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(41,490)	(433,236)
Purchase of held-to-maturity securities	—	(396,059)
Purchase of other securities	(1,042)	—
Net change in FHLB stock	(7,017)	3,671
Proceeds from maturities, calls, and prepayments of available-for-sale securities	104,054	122,401
Proceeds from maturities, calls, and prepayments of held-to-maturity securities	397	898
Proceeds from maturities, calls, and prepayments of other securities	—	399
Net increase in loans	(105,080)	(1,054,547)
Net change in investment in LIHTC	(63,797)	(36,633)
Purchase of premises and equipment	(37,301)	(38,089)
Proceeds from sales of premises and equipment	1,106	587
Proceeds from sales of foreclosed assets	5,508	6,323
Proceeds from BOLI	—	903
Investment from noncontrolling interest in consolidated joint ventures	506	—
Acquisition of business, net of cash acquired	17,776	—
Net cash used for investing activities	(126,380)	(1,823,382)
FINANCING ACTIVITIES:		
Net change in deposit accounts	72,010	(161,564)
Net change in short-term borrowings	55,641	(33,577)
Repayment of long-term borrowings	(1,058)	(125,572)
Proceeds from issuance of subordinated debt, net of issuance cost	—	246,904
Redemption of subordinated debt	—	(250,000)
Distribution of noncontrolling interest	(759)	(1,608)
Purchase of noncontrolling interest	(1,947)	—
Cash dividends paid	(52,670)	(46,030)
Net cash from (used for) financing activities	71,217	(371,447)
Change in cash and cash equivalents	62,922	(1,857,417)
Cash and cash equivalents at beginning of year	1,152,830	3,296,636
Cash and cash equivalents at end of period	\$ 1,215,752	\$ 1,439,219
Supplemental cash flow information:		
Cash paid for interest	\$ 161,008	\$ 36,255
Cash paid for income taxes	\$ 9,870	\$ 14,178
Noncash financing and investing activities:		
Transfer from loans to foreclosed property	\$ 3,173	\$ 1,329
Net unrealized losses on available-for-sale securities, net of tax	\$ (36,962)	\$ (169,119)
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
Net income	—	—	—	41,716	—	—	—	1,652	43,368
Other comprehensive income (loss), net of taxes	—	—	—	—	—	—	(24,095)	—	(24,095)
Cash dividends declared on common stock (\$0.25 per share)	—	—	—	(18,720)	—	—	—	—	(18,720)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	193	193
Directors' deferred compensation	—	—	—	—	1,295	(1,295)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(404)	(404)
Issuance of common stock - stock compensation plans	73,812	123	2,073	—	—	—	—	—	2,196
Purchase of noncontrolling interest	—	—	(1,934)	—	—	—	—	—	(1,934)
Balance, June 30, 2023	74,878,243	\$ 124,805	\$ 1,109,526	\$ 884,901	\$ 20,134	\$ (20,134)	\$ (145,392)	\$ 16,659	\$ 1,990,499
Net income	—	—	—	44,862	—	—	—	(117)	44,745
Other comprehensive income (loss), net of taxes	—	—	—	—	—	—	(33,651)	—	(33,651)
Cash dividends declared on common stock (\$0.25 per share)	—	—	—	(18,721)	—	—	—	—	(18,721)
Investment of noncontrolling interest in consolidated joint ventures	—	—	—	—	—	—	—	37	37
Directors' deferred compensation	—	—	—	—	606	(606)	—	—	—
Distribution of interests in joint ventures	—	—	—	—	—	—	—	(355)	(355)
Issuance of common stock - stock compensation plans	8,840	32	1,626	—	—	—	—	—	1,658
Balance, September 30, 2023	74,887,083	\$ 124,837	\$ 1,111,152	\$ 911,042	\$ 20,740	\$ (20,740)	\$ (179,043)	\$ 16,224	\$ 1,984,212

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENT OF EQUITY

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

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- and nine-month periods ended September 30, 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 write-offs 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.

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Accounting standards not yet adopted		
Standard	Summary of guidance	Effects on financial statements
Topic 323 - Investments - Equity Method and Joint Ventures - Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method ASU 2023-02 Issued March 2023	Permits reporting entities to elect to account for their tax equity investments, regardless of the tax credit program from which the income tax credits are received, using the proportional amortization method if certain conditions are met.	Effective for periods beginning after December 15, 2023, including interim periods within those fiscal years. The Company does not expect this pronouncement to have a material impact on its Consolidated Financial Statements.
Topic 842 - Leases, Common Control Arrangements ASU 2023-01 Issued March 2023	Requires entities to classify and account for leases with related parties on the basis of legally enforceable terms and conditions of the arrangement.	Effective for periods beginning after December 15, 2023, including interim periods within those fiscal years. The Company is currently evaluating the provision of the standard and the impact on its future Consolidated 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 ASU 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

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common shares outstanding, assuming all securities that could be converted to common stock have been converted or exercised.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
<i>(Dollars in thousands, except per share data)</i>				
Basic				
Net income available to common shareholders, as reported	\$ 44,862	\$ 50,169	\$ 124,911	\$ 142,302
Weighted-average common shares outstanding	74,750,294	72,578,736	74,602,963	72,545,745
Basic earnings per common share	\$ 0.60	\$ 0.69	\$ 1.67	\$ 1.96
Diluted				
Net income available to common shareholders	\$ 44,862	\$ 50,169	\$ 124,911	\$ 142,302
Weighted-average common shares outstanding	74,750,294	72,578,736	74,602,963	72,545,745
Effect of dilutive securities:				
Stock compensation plans (1)	15,221	15,738	15,780	21,851
Weighted-average diluted shares outstanding	74,765,515	72,594,474	74,618,743	72,567,596
Diluted earnings per common share	\$ 0.60	\$ 0.69	\$ 1.67	\$ 1.96

(1) There were no shares excluded from the computation of diluted shares for the three and nine months ended September 30, 2023 or September 30, 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. 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 \$5.88 million.

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Goodwill resulted from a combination of expected synergies, acquisition of expanded insurance capabilities, 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.

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	244,892
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	31,757
Total assets	<u>\$ 618,858</u>
Fair value of liabilities assumed:	
Deposits	\$ 514,572
Total borrowings	33,806
Other liabilities	9,779
Total liabilities	<u>\$ 558,157</u>
Net identifiable assets acquired	\$ 60,701
Less: noncontrolling interest	6,975
Goodwill	5,883
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>

During the quarter ended September 30, 2023, there were no significant adjustments made to the purchase price allocation. During the quarter ended June 30, 2023, adjustments were made to the purchase price allocations that resulted in an increase to deferred taxes and other assets of \$8.70 million and an increase in other liabilities of \$0.13 million, which resulted in an overall \$8.57 million increase in net identifiable assets acquired and a corresponding decrease to goodwill. 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,

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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.

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- and nine-month periods ended September 30, 2023. The results of activities from former Farmers Bank operations that are included in the Consolidated Statements of Income from the date of acquisition through September 30, 2023, are broken out in the following table (dollars in thousands):

	Actual for the Three Months Ended September 30, 2023	Actual from Acquisition Date Through September 30, 2023
Revenues (net interest income plus noninterest income)	\$ 3,802	\$ 11,571
Net Income	\$ 685	\$ 1,922

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):

September 30, 2023	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Credit Losses	Fair Value
U.S. agency securities	\$ 337,824	\$ 260	\$ (37,923)	\$ —	\$ 300,161
U.S. Treasury notes	28,388	—	(1,667)	—	26,721
Municipal securities	545,993	31	(61,437)	(489)	484,098
Trust preferred and other corporate securities	88,247	142	(14,365)	(854)	73,170
MBSs issued by GSEs and GNMA	1,202,862	42	(123,601)	—	1,079,303
Total available-for-sale securities	<u>\$ 2,203,314</u>	<u>\$ 475</u>	<u>\$ (238,993)</u>	<u>\$ (1,343)</u>	<u>\$ 1,963,453</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$11.41 million as of September 30, 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 of 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):

September 30, 2023	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Allowance for Credit Losses
U.S. agency securities	\$ 101,659	\$ —	\$ (8,373)	\$ 93,286	\$ —
U.S. Treasury notes	433,015	—	(14,598)	418,417	—
Municipal securities	5,249	—	(68)	5,181	(6)
Trust preferred and other corporate securities	2,185	82	—	2,267	(79)
MBSs issued by GSEs	5,746	—	(466)	5,280	—
Total held-to-maturity securities	<u>\$ 547,854</u>	<u>\$ 82</u>	<u>\$ (23,505)</u>	<u>\$ 524,431</u>	<u>\$ (85)</u>

(1) Amortized cost amounts exclude accrued interest receivable, which was \$2.20 million as of September 30, 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	5,181	235	—	5,416	(8)
Trust preferred and other corporate securities	2,223	85	—	2,308	(75)
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 of 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
September 30, 2023				
Due in one year or less	\$ 1,844	\$ 1,874	\$ 335,160	\$ 330,310
Due after one year through five years	585,928	523,069	199,134	181,334
Due after five years through 10 years	678,525	604,241	11,569	10,796
Due after 10 years	937,017	834,269	1,991	1,991
	<u>\$ 2,203,314</u>	<u>\$ 1,963,453</u>	<u>\$ 547,854</u>	<u>\$ 524,431</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
September 30, 2023							
Description of Securities	Number	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. agency securities	62	\$ 59,343	\$ (3,741)	\$ 187,498	\$ (34,182)	\$ 246,841	\$ (37,923)
U.S. Treasury notes	2	—	—	26,721	(1,667)	26,721	(1,667)
Municipal securities	90	40,454	(1,692)	149,904	(19,159)	190,358	(20,851)
MBSs issued by GSEs and GNMA	252	171,136	(10,080)	881,889	(113,521)	1,053,025	(123,601)
Total AFS securities	<u>406</u>	<u>\$ 270,933</u>	<u>\$ (15,513)</u>	<u>\$ 1,246,012</u>	<u>\$ (168,529)</u>	<u>\$ 1,516,945</u>	<u>\$ (184,042)</u>
		Less than 12 months		12 months or more		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 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 September 30, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 472	\$ 760	\$ 1,232
Provision for credit losses	17	94	111
Balance, end of period	\$ 489	\$ 854	\$ 1,343

Three Months Ended September 30, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 343	\$ 768	\$ 1,111
Provision for credit losses	25	(24)	1
Balance, end of period	\$ 368	\$ 744	\$ 1,112

Nine Months Ended September 30, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 351	\$ 735	\$ 1,086
Provision for credit losses	138	119	257
Balance, end of period	\$ 489	\$ 854	\$ 1,343

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

We monitor the credit quality of HTM debt securities through the use of credit ratings. These ratings are updated on a monthly basis, and were last updated September 30, 2023. The following table reflects the credit ratings aggregated by investment category for HTM debt securities as of the dates indicated (dollars in thousands):

September 30, 2023	Credit Ratings						Total
	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
Description of Securities							
U.S. agency securities	\$ 101,659	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 101,659
U.S. Treasury notes	433,015	—	—	—	—	—	433,015
Municipal securities	1,803	3,191	255	—	—	—	5,249
Trust preferred and other corporate securities	—	—	—	—	2,185	—	2,185
Mortgage-backed securities issued by GSEs	5,746	—	—	—	—	—	5,746
Total	\$ 542,223	\$ 3,191	\$ 255	\$ —	\$ 2,185	\$ —	\$ 547,854

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December 31, 2022

Description of Securities	Credit Ratings						Total
	AAA	AA+	AA-	A+ to A-	BBB+ to BBB-	BB+ and below	
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	<u>\$ 542,818</u>	<u>\$ 3,180</u>	<u>\$ 254</u>	<u>\$ —</u>	<u>\$ 2,223</u>	<u>\$ —</u>	<u>\$ 548,475</u>

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

September 30, 2023

Description of Securities	2023	2022	2021	2020	2019	Prior	Total
U.S. agency securities	\$ —	\$ 27,575	\$ 74,084	\$ —	\$ —	\$ —	\$ 101,659
U.S. Treasury notes	—	369,613	63,403	—	—	—	433,016
Municipal securities	—	—	—	—	—	5,248	5,248
Trust preferred and other corporate securities	—	—	—	—	1,685	500	2,185
Mortgage-backed securities issued by GSEs	—	—	—	—	—	5,746	5,746
Total	<u>\$ —</u>	<u>\$ 397,188</u>	<u>\$ 137,487</u>	<u>\$ —</u>	<u>\$ 1,685</u>	<u>\$ 11,494</u>	<u>\$ 547,854</u>

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	<u>\$ 396,525</u>	<u>\$ 138,433</u>	<u>\$ —</u>	<u>\$ 1,723</u>	<u>\$ —</u>	<u>\$ 11,794</u>	<u>\$ 548,475</u>

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

Three Months Ended September 30, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 6	\$ 81	\$ 87
Provision for credit losses	—	(2)	(2)
Balance, end of period	<u>\$ 6</u>	<u>\$ 79</u>	<u>\$ 85</u>

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Three Months Ended September 30, 2022	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 8	\$ 77	\$ 85
Provision for credit losses	—	(2)	(2)
Balance, end of period	\$ 8	\$ 75	\$ 83

Nine Months Ended September 30, 2023	Municipal Securities	Trust Preferred and Other Corporate Securities	Total
Balance, beginning of period	\$ 8	\$ 75	\$ 83
Provision for credit losses	(2)	4	2
Balance, end of period	\$ 6	\$ 79	\$ 85

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

Equity securities

We hold certain securities that do not have a readily determinable fair value and are recognized using cost or other measurement principles. These equity securities include FHLB stock, private equity, and tax credit investments. At September 30, 2023, FHLB stock totaled \$16.63 million and other equity securities totaled \$14.06 million. At December 31, 2022, FHLB stock totaled \$9.62 million and other equity securities totaled \$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

The market values of investment securities the Company had pledged as of the dates indicated are as follows (in thousands):

	September 30, 2023	December 31, 2022
To secure federal, state, and municipal deposits	\$ 603,791	\$ 440,605
To secure borrowings from the FHLB	\$ 6,351	\$ 8,264
Against repurchase agreements with commercial customers	\$ 71,187	\$ 66,615

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Note 5. Loans Held for Investment

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

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

	September 30, 2023	December 31, 2022
Commercial Real Estate		
Construction and land development	\$ 1,325,976	\$ 1,428,376
Owner occupied	1,686,888	1,580,099
Non-owner occupied	3,025,985	2,830,620
Multi-family	542,611	496,190
Total Commercial Real Estate	6,581,460	6,335,285
Residential 1-4 family	1,818,843	1,634,062
HELOC	371,861	395,526
Commercial and industrial business	1,237,524	1,256,697
Government	523,456	512,265
Indirect	548,621	568,190
Consumer loans and other	91,206	92,577
Loans, net of unearned income and deferred costs	\$ 11,172,971	\$ 10,794,602

The following table presents information related to our loan portfolio for the dates indicated (in thousands):

	September 30, 2023	December 31, 2022
Deferred loan costs in excess of unearned income	\$ 1,707	\$ 662
Unaccreted (discount) premium on PCD loans	(3,558)	(3,538)
Unaccreted (discount) premium on non-PCD loans	(6,151)	(2,434)
Nonaccrual loans ⁽¹⁾	7,110	6,273

⁽¹⁾ Interest that would have been earned if interest on nonaccrual loans had been accrued:

	September 30, 2023	September 30, 2022
Three months ended	\$ 123	\$ 76
Nine months ended	\$ 344	\$ 233

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.

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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 difficulty, disaggregated by class of financial receivable and type of concession granted (dollars in thousands):

Loan Classification	Loan Modifications Made to Borrowers Experiencing Financial Difficulty			
	For the Quarter Ended September 30, 2023		For the Nine Months Ended September 30, 2023	
	Term Extension		Term Extension	
	Amortized Cost Basis at September 30, 2023	% of Total Class of Financing Receivable	Amortized Cost Basis at September 30, 2023	% of Total Class of Financing Receivable
Commercial Real Estate				
Construction and land development	\$ —	— %	\$ 1,202	0.09 %
Owner occupied	4,111	0.24 %	4,862	0.29 %
Non-owner occupied	—	— %	907	0.03 %
Total Commercial Real Estate	4,111		6,971	
Residential 1-4 family	—	— %	317	0.02 %
HELOC	—	— %	392	0.11 %
Commercial and industrial business	1,135	0.09 %	1,534	0.12 %
Consumer loans and other	—	— %	193	0.21 %
Total	\$ 5,246	0.05 %	\$ 9,407	0.08 %

At September 30, 2023, \$38 thousand in accrued interest receivable has been excluded from loan modification calculations and is included in other assets.

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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.
Residential 1-4 family	Reamortized balances and extended maturities, which reduced monthly payment amounts for borrowers. These modifications did not impact the weighted-average life of Residential 1-4 family 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	Processed forbearance agreements, 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 (dollars in thousands).

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
Defaults as of March 31, 2023					
CRE non-owner occupied (1)	\$ —	\$ 72	\$ —	\$ —	\$ —
	\$ —	\$ 72	\$ —	\$ —	\$ —
(1) Default in first quarter 2023, subsequently brought current.					
Defaults as of June 30, 2023					
HELOC	\$ —	\$ 392	\$ —	\$ —	\$ —
	\$ —	\$ 464	\$ —	\$ —	\$ —

There were no defaults in the quarter ended September 30, 2023.

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

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Loan Classification	Payment Status (Amortized Cost Basis)		
	Current	30 - 89 Days Past Due	90+ Days Past Due
Commercial Real Estate	\$ —	\$ —	\$ —
Construction and land development	1,202	—	—
Owner occupied	4,862	—	—
Non-owner occupied	907	—	—
Residential 1-4 family	317	—	—
HELOC	—	392	—
Commercial and industrial business	1,534	—	—
Consumer loans and other	193	—	—
	<u>\$ 9,015</u>	<u>\$ 392</u>	<u>\$ —</u>

The nature and extent of 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 \$20.88 million with specific reserves of zero at September 30, 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 September 30, 2023, \$33.54 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- and nine-month periods ended September 30, 2023 and 2022 (in thousands):

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Three Months Ended September 30, 2023

	Balance, Beginning of Period	Provision (Benefit)	Write-offs	Recoveries	Balance, End of Period
Commercial Real Estate					
Construction and land development	\$ 21,402	\$ 23	\$ —	\$ 36	\$ 21,461
Owner occupied	12,866	61	—	5	12,932
Non-owner occupied	19,692	400	—	30	20,122
Multi-family	2,587	29	—	—	2,616
Residential 1-4 family	31,987	319	—	119	32,425
HELOC	16,558	31	—	244	16,833
Commercial and industrial	7,938	(1,232)	—	1,080	7,786
Government	3,301	(36)	—	—	3,265
Indirect	4,439	696	(355)	57	4,837
Consumer loans and other	2,743	280	(185)	44	2,882
Total	<u>\$ 123,513</u>	<u>\$ 571</u>	<u>\$ (540)</u>	<u>\$ 1,615</u>	<u>\$ 125,159</u>

Three Months Ended September 30, 2022

	Balance, Beginning of Period	Provision (Benefit)	Write-offs	Recoveries	Balance, End of Period
Commercial Real Estate					
Construction and land development	\$ 22,857	\$ (3,500)	\$ —	\$ 4	\$ 19,361
Owner occupied	11,785	(1,069)	—	—	10,716
Non-owner occupied	16,728	(1,081)	—	110	15,757
Multi-family	1,800	23	—	—	1,823
Residential 1-4 family	17,833	9,356	—	14	27,203
HELOC	16,210	74	—	26	16,310
Commercial and industrial	8,011	(1,237)	(13)	29	6,790
Government	3,001	(146)	—	—	2,855
Indirect	3,239	703	(110)	105	3,937
Consumer loans and other	2,555	168	(11)	33	2,745
Total	<u>\$ 104,019</u>	<u>\$ 3,291</u>	<u>\$ (134)</u>	<u>\$ 321</u>	<u>\$ 107,497</u>

Nine Months Ended September 30, 2023

	Balance, Beginning of Period	Provision (Benefit)	Initial Allowance for PCD Assets	Write-offs	Recoveries	Balance, End of Period
Commercial Real Estate						
Construction and land development	\$ 20,218	\$ 1,040	\$ 145	\$ —	\$ 58	\$ 21,461
Owner occupied	10,625	2,103	199	(2)	7	12,932
Non-owner occupied	16,478	3,504	63	—	77	20,122
Multi-family	1,909	705	2	—	—	2,616
Residential 1-4 family	27,688	4,499	94	(1)	145	32,425
HELOC	16,766	(481)	8	(2)	542	16,833
Commercial and industrial	6,912	3,094	357	(3,728)	1,151	7,786
Government	3,176	88	1	—	—	3,265
Indirect	4,172	1,303	1	(813)	174	4,837
Consumer loans and other	2,872	(84)	510	(539)	123	2,882
Total	<u>\$ 110,816</u>	<u>\$ 15,771</u>	<u>\$ 1,380</u>	<u>\$ (5,085)</u>	<u>\$ 2,277</u>	<u>\$ 125,159</u>

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Nine Months Ended September 30, 2022

	Balance, Beginning of Period	Provision (Benefit)	Write-offs	Recoveries	Balance, End of Period
Commercial Real Estate					
Construction and land development	\$ 18,337	\$ 1,014	\$ —	\$ 10	\$ 19,361
Owner occupied	12,760	(2,079)	—	35	10,716
Non-owner occupied	25,487	(9,935)	—	205	15,757
Multi-family	1,828	(5)	—	—	1,823
Residential 1-4 family	18,014	9,144	—	45	27,203
HELOC	14,550	1,714	(50)	96	16,310
Commercial and industrial	6,935	101	(481)	235	6,790
Government	3,458	(603)	—	—	2,855
Indirect	2,133	1,796	(237)	245	3,937
Consumer loans and other	2,557	150	(34)	72	2,745
Total	<u>\$ 106,059</u>	<u>\$ 1,297</u>	<u>\$ (802)</u>	<u>\$ 943</u>	<u>\$ 107,497</u>

The following table presents a roll forward of the allowance for off-balance-sheet exposure for the three and nine months ended September 30, 2023 and 2022, related to loans held for investment, which is carried in other liabilities on our Consolidated Balance Sheets (in thousands):

	Three Months Ended September 30, 2023			Three Months Ended September 30, 2022		
	Balance, Beginning of Period	Provision (Benefit)	Balance, End of Period	Balance, Beginning of Period	Provision (Benefit)	Balance, End of Period
Commercial Real Estate						
Construction and land development	\$ 697	\$ 96	\$ 793	\$ 390	\$ 508	\$ 898
Owner occupied	267	(8)	259	203	(36)	167
Non-owner occupied	268	124	392	194	20	214
Multi-family	84	—	84	30	19	49
Residential 1-4 family	—	—	—	—	—	—
HELOC	2,967	(9)	2,958	2,861	18	2,879
Commercial and industrial	1,218	(11)	1,207	1,373	57	1,430
Government	—	—	—	—	—	—
Indirect	—	—	—	—	—	—
Consumer loans and other	1,478	135	1,613	1,540	49	1,589
Total	<u>\$ 6,979</u>	<u>\$ 327</u>	<u>\$ 7,306</u>	<u>\$ 6,591</u>	<u>\$ 635</u>	<u>\$ 7,226</u>

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	Nine Months Ended September 30, 2023			Nine Months Ended September 30, 2022		
	Balance, Beginning of Period	Provision (Benefit)	Balance, End of Period	Balance, Beginning of Period	Provision (Benefit)	Balance, End of Period
Commercial Real Estate						
Construction and land development	\$ 648	\$ 145	\$ 793	\$ 640	\$ 258	\$ 898
Owner occupied	277	(18)	259	341	(174)	167
Non-owner occupied	284	108	392	331	(117)	214
Multi-family	31	53	84	40	9	49
Residential 1-4 family	—	—	—	—	—	—
HELOC	2,960	(2)	2,958	2,568	311	2,879
Commercial and industrial	1,285	(78)	1,207	1,434	(4)	1,430
Government	—	—	—	—	—	—
Indirect	—	—	—	—	—	—
Consumer loans and other	1,619	(6)	1,613	1,528	61	1,589
Total	<u>\$ 7,104</u>	<u>\$ 202</u>	<u>\$ 7,306</u>	<u>\$ 6,882</u>	<u>\$ 344</u>	<u>\$ 7,226</u>

Our provision for credit losses on funded and unfunded loan exposures was a net expense of \$0.90 million in third quarter 2023, compared to \$3.93 million in the prior year quarter.

For the nine-month period ended September 30, 2023, our ACL increased in response to our Farmers acquisition, adjustments in the economic forecasts, and portfolio composition changes. Total loans increased \$378.37 million, compared to December 31, 2022. 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;
- inflation concerns that could potentially keep the Fed funds rate elevated for an extended period of time;
- the Russia/Ukraine war and its impact on supply-chain issues and manufacturing continues and worsens;
- the potential for China's actions through the Taiwan Strait to further worsen the chip shortage;
- the potential for a recession, driven by supply-chain shortages, political tensions, high inflation, and interest rates;
- changes in unemployment; and
- changes in Gross Domestic Product.

In general, the macroeconomic forecast scenarios utilized in the current quarter models showed modest improvements from the previous quarter. Additional factors considered were changes in interest rates, loan risk ratings, charge-off activities, and inherent risks within specific loan groups.

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

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for credit losses is an estimate of expected losses inherent within the Company's loans held for investment portfolio.

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

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

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

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

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

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

For consumer-related credits, the Company utilizes credit scores calculated and maintained by one of three credit bureaus. Credit scores range between 300 and 850, with a lower score indicating a potentially higher risk. Credit scores are updated semi-annually, with the most recent update in August 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 September 30, 2023 and December 31, 2022 (in thousands):

September 30, 2023

	Term Loans By Origination									
	2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Loans Converted to Term	Total	
CRE - Construction and Land Development										
Pass	\$ 496,825	\$ 575,027	\$ 183,570	\$ 19,577	\$ 5,691	\$ 12,191	\$ 28,729	\$ 1,996	\$ 1,323,606	
Special Mention	1,975	—	—	—	—	31	—	—	2,006	
Substandard	—	260	80	—	—	24	—	—	364	
	\$ 498,800	\$ 575,287	\$ 183,650	\$ 19,577	\$ 5,691	\$ 12,246	\$ 28,729	\$ 1,996	\$ 1,325,976	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Owner Occupied										
Pass	\$ 233,621	\$ 318,789	\$ 409,141	\$ 254,662	\$ 150,105	\$ 260,186	\$ 16,136	\$ —	\$ 1,642,640	
Special Mention	6,393	5,246	1,739	7,542	1,212	947	1,997	—	25,076	
Substandard	1,055	713	4,153	3,174	7,710	2,367	—	—	19,172	
	\$ 241,069	\$ 324,748	\$ 415,033	\$ 265,378	\$ 159,027	\$ 263,500	\$ 18,133	\$ —	\$ 1,686,888	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2	\$ —	\$ —	2	
CRE - Non-Owner Occupied										
Pass	\$ 437,895	\$ 789,653	\$ 743,686	\$ 415,586	\$ 250,678	\$ 313,902	\$ 12,641	\$ 1,591	\$ 2,965,632	
Special Mention	6,842	15,491	25,218	733	6,720	836	800	—	56,640	
Substandard	907	—	—	—	—	2,806	—	—	3,713	
	\$ 445,644	\$ 805,144	\$ 768,904	\$ 416,319	\$ 257,398	\$ 317,544	\$ 13,441	\$ 1,591	\$ 3,025,985	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
CRE - Multi-Family										
Pass	\$ 48,592	\$ 181,445	\$ 129,866	\$ 99,353	\$ 40,698	\$ 39,421	\$ 2,662	\$ 222	\$ 542,259	
Special Mention	—	—	—	—	—	—	—	—	—	
Substandard	—	—	220	—	—	132	—	—	352	
	\$ 48,592	\$ 181,445	\$ 130,086	\$ 99,353	\$ 40,698	\$ 39,553	\$ 2,662	\$ 222	\$ 542,611	
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	
Commercial and Industrial										
Pass	\$ 143,753	\$ 250,266	\$ 156,730	\$ 67,083	\$ 45,724	\$ 41,664	\$ 515,188	\$ 527	\$ 1,220,935	
Special Mention	124	1,776	1,557	301	372	534	6,830	20	11,514	
Substandard	1,016	252	565	1,306	963	159	—	814	5,075	
	\$ 144,893	\$ 252,294	\$ 158,852	\$ 68,690	\$ 47,059	\$ 42,357	\$ 522,018	\$ 1,361	\$ 1,237,524	
Gross Write- Offs	\$ 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	\$ 48,392	\$ 100,930	\$ 14,681	\$ 185,375	\$ 21,062	\$ 141,318	\$ 11,698	\$ —	\$ 523,456
Special Mention	—	—	—	—	—	—	—	—	—
Substandard	—	—	—	—	—	—	—	—	—
	<u>\$ 48,392</u>	<u>\$ 100,930</u>	<u>\$ 14,681</u>	<u>\$ 185,375</u>	<u>\$ 21,062</u>	<u>\$ 141,318</u>	<u>\$ 11,698</u>	<u>\$ —</u>	<u>\$ 523,456</u>
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Residential 1 - 4 Family									
Credit Score:									
> = 750	\$ 203,782	\$ 498,861	\$ 366,474	\$ 162,732	\$ 86,902	\$ 184,268	\$ 2,221	\$ —	\$ 1,505,240
650-749	34,264	101,794	69,722	35,910	11,245	46,347	110	—	299,392
450-649	843	6,091	604	652	347	5,674	—	—	14,211
300-449	—	—	—	—	—	—	—	—	—
	<u>\$ 238,889</u>	<u>\$ 606,746</u>	<u>\$ 436,800</u>	<u>\$ 199,294</u>	<u>\$ 98,494</u>	<u>\$ 236,289</u>	<u>\$ 2,331</u>	<u>\$ —</u>	<u>\$ 1,818,843</u>
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1	\$ —	\$ —	\$ 1
HELOC									
Credit Score:									
> = 750	\$ 2,206	\$ 2,549	\$ 863	\$ 346	\$ 90	\$ 794	\$ 278,572	\$ 627	\$ 286,047
650-749	865	434	430	—	962	1,758	74,465	—	78,914
450-649	252	132	310	49	26	853	5,124	19	6,765
300-449	—	—	—	—	—	—	135	—	135
	<u>\$ 3,323</u>	<u>\$ 3,115</u>	<u>\$ 1,603</u>	<u>\$ 395</u>	<u>\$ 1,078</u>	<u>\$ 3,405</u>	<u>\$ 358,296</u>	<u>\$ 646</u>	<u>\$ 371,861</u>
Gross Write- Offs	\$ —	\$ —	\$ —	\$ —	\$ 2	\$ —	\$ —	\$ —	\$ 2
Indirect									
Credit Score:									
> = 750	\$ 74,372	\$ 131,637	\$ 63,154	\$ 11,006	\$ 5,178	\$ 3,098	\$ —	\$ —	\$ 288,445
650-749	53,240	110,757	58,864	15,869	5,071	3,479	—	—	247,280
450-649	515	2,857	2,450	3,270	1,912	1,872	—	—	12,876
300-449	—	—	—	—	20	—	—	—	20
	<u>\$ 128,127</u>	<u>\$ 245,251</u>	<u>\$ 124,468</u>	<u>\$ 30,145</u>	<u>\$ 12,181</u>	<u>\$ 8,449</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 548,621</u>
Gross Write- Offs	\$ 8	\$ 407	\$ 281	\$ 57	\$ 32	\$ 28	\$ —	\$ —	\$ 813

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Term Loans By Origination									
	2023	2022	2021	2020	2019	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
Consumer Loans and Other									
Credit Score:									
>= 750	\$ 11,088	\$ 10,712	\$ 10,273	\$ 5,189	\$ 2,770	\$ 3,061	\$ 32,340	\$ 2	\$ 75,435
650-749	2,648	4,218	2,239	783	624	199	4,269	2	14,982
450-649	123	174	59	71	77	47	236	2	789
300-649	—	—	—	—	—	—	—	—	—
	\$ 13,859	\$ 15,104	\$ 12,571	\$ 6,043	\$ 3,471	\$ 3,307	\$ 36,845	\$ 6	\$ 91,206
Gross Write-Offs	\$ —	\$ 315	\$ 198	\$ 11	\$ 12	\$ 3	\$ —	\$ —	\$ 539
Grand Total	\$ 1,811,588	\$ 3,110,064	\$ 2,246,648	\$ 1,290,569	\$ 646,159	\$ 1,067,968	\$ 994,153	\$ 5,822	\$ 11,172,971
Total Gross Write-Offs	\$ 588	\$ 722	\$ 479	\$ 68	\$ 46	\$ 202	\$ —	\$ 2,980	\$ 5,085

December 31, 2022

Term Loans By Origination									
	2022	2021	2020	2019	2018	Prior	Revolving Loans	Revolving Loans Converted to Term	Total
CRE - Construction and Land 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 Loans 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 September 30, 2023 and December 31, 2022 (in thousands):

September 30, 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 land development	\$ —	\$ 1,146	\$ —	\$ 1,324,830	\$ 1,325,976
Owner occupied	—	—	10,225	1,676,663	1,686,888
Non-owner occupied	—	58,678	—	2,967,307	3,025,985
Multi-family	—	353	—	542,258	542,611
Residential 1-4 family	4,423	—	—	1,814,420	1,818,843
HELOC	1,336	—	—	370,525	371,861
Commercial and industrial	—	—	—	1,237,524	1,237,524
Government	—	—	—	523,456	523,456
Indirect	—	—	—	548,621	548,621
Consumer loans and other	—	—	—	91,206	91,206
Total, amortized cost	\$ 5,759	\$ 60,177	\$ 10,225	\$ 11,096,810	\$ 11,172,971
Collateral value	\$ 12,297	\$ 107,848	\$ 26,103		

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 land 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 loans 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 September 30, 2023 and December 31, 2022 (in thousands):

September 30, 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 land development	\$ 1,325,589	\$ —	\$ 127	\$ 260	\$ 387	\$ 1,325,976	\$ —
Owner occupied	1,686,340	70	70	408	548	1,686,888	—
Non-owner occupied	3,025,985	—	—	—	—	3,025,985	—
Multi-family	542,391	—	—	220	220	542,611	—
Residential 1-4 family	1,817,061	28	318	1,436	1,782	1,818,843	—
HELOC	369,241	1,349	168	1,103	2,620	371,861	827
Commercial and industrial	1,237,353	40	—	131	171	1,237,524	—
Government	523,456	—	—	—	—	523,456	—
Indirect	543,431	3,204	934	1,052	5,190	548,621	138
Consumer loans and other	91,023	80	39	64	183	91,206	5
Total	\$ 11,161,870	\$ 4,771	\$ 1,656	\$ 4,674	\$ 11,101	\$ 11,172,971	\$ 970

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 land 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 loans 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 September 30, 2023 and December 31, 2022. Nonaccrual loans, less than \$1 million, and not in the process of foreclosure, are not subject to individual assessment and are included in collectively evaluated pools for which an ACL has been recorded. It also shows interest income recognized on nonaccrual loans (in thousands):

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September 30, 2023	Nonaccrual Loans		Loans 90 Days or More Past Due, Not on Nonaccrual Status as of 09/30/23	Nonaccrual Loans With No Specific Reserve as of 09/30/23	Interest Income Recognized as of 09/30/23
	As of 06/30/23	As of 09/30/23			
Commercial Real Estate					
Construction and land development	\$ 405	\$ 263	\$ —	\$ 263	\$ 8
Owner occupied	541	526	—	526	1
Non-owner occupied	—	—	—	—	—
Multi-family	—	220	—	220	—
Residential 1-4 family	2,782	3,059	—	3,059	23
HELOC	386	551	827	551	31
Commercial and industrial	1,722	1,367	—	1,367	76
Government	—	—	—	—	—
Indirect	980	1,124	138	1,124	15
Consumer loans and other	11	—	5	—	—
Total	\$ 6,827	\$ 7,110	\$ 970	\$ 7,110	\$ 154

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 land 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 loans 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 September 30, 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	
	September 30, 2023	December 31, 2022
Assets		
Finance lease assets	\$ 28,142	\$ 28,620
Operating lease assets	49,379	49,505
Total lease assets	\$ 77,521	\$ 78,125
Liabilities		
Finance lease liabilities	\$ 30,306	\$ 28,886
Operating lease liabilities	53,618	53,289
Total lease liabilities	\$ 83,924	\$ 82,175

The following table presents a summary of activity related to leases for the three- and nine-month periods ended September 30, 2023 and 2022 (in thousands):

	Lease Cost			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Finance lease cost:				
Amortization of right-of-use assets	\$ 159	\$ —	\$ 478	\$ —
Interest on lease liabilities	486	—	1,420	—
Operating lease cost (1) included in occupancy expense	3,300	3,527	10,425	10,368
Variable lease cost included in occupancy expense	228	179	695	625
Sublease income included in occupancy expense	(56)	(63)	(165)	(215)
Net lease cost	\$ 4,117	\$ 3,643	\$ 12,853	\$ 10,778

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

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The following table presents lease liability maturities, by year, as of September 30, 2023 (in thousands):

Maturity of Lease Liabilities	
	Operating Leases (1)
October 1 - December 31, 2023	\$ 2,697
2024	9,398
2025	8,106
2026	6,826
2027	6,316
After 2027	44,640
Total lease payments	\$ 77,983
Less: interest	24,365
Present value of lease liabilities	\$ 53,618

(1) Operating lease payments include \$28.98 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 was expected to be executed prior to the end of 2023. Subsequent to September 30, 2023, the seller exercised the option to extend the closing date to June 30, 2024. The related financing lease liability was \$30.31 million at September 30, 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		
	September 30, 2023	September 30, 2022
Weighted - average remaining lease term - finance leases (in years)	0.25	—
Weighted - average remaining lease term - operating leases (in years)	13.77	13.76
Weighted - average discount rate - finance leases	6.43%	—%
Weighted - average discount rate - operating leases	5.09%	4.90%

The following table presents other information with regard to leases for the three- and nine-month periods ended September 30, 2023 and 2022 (in thousands):

Other Information		Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2023	2022	2023	2022
Cash paid for amounts included in the measurement of lease liabilities					
Operating cash flows from operating leases		\$ 2,848	\$ 3,198	\$ 8,912	\$ 9,274
Related Party Transactions (1)					
Rent expense included in occupancy expense		\$ 515	\$ 719	\$ 1,727	\$ 2,133

(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 resort property management services and originations of a variety of mortgage loans. Prior to the sale of BHHS Towne Realty in the second quarter of 2023, the segment also offered residential real estate services 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.

Effective April 27, 2023, the Company transferred its ownership interest in BHHS Towne Realty, which was formerly a subsidiary of TowneBank, to BHHS RW Towne Realty, LLC, in exchange for a minority interest in that company which is accounted for as an equity method investment. The transaction also included the combination of the contributing companies' respective mortgage, title and property management lines of businesses.

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

Three Months Ended September 30, 2023	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 112,189	\$ 869	\$ —	\$ 113,058
Provision for credit losses	1,206	(199)	—	1,007
Net interest income after provision for credit losses	110,983	1,068	—	112,051
Residential mortgage banking income, net	(307)	10,955	—	10,648
Insurance commissions and other income, net	—	—	23,777	23,777
Property management income, net	—	12,800	—	12,800
Real estate commission income, net	—	(63)	—	(63)
Gain on sale of equity investment	10	—	544	554
Other noninterest income	11,713	231	146	12,090
Noninterest expense	76,528	25,436	15,738	117,702
Income (loss) before income tax, corporate allocation, and noncontrolling interest	45,871	(445)	8,729	54,155
Corporate allocation	1,291	(600)	(691)	—
Income (loss) before income tax provision and noncontrolling interest	47,162	(1,045)	8,038	54,155
Provision for income tax expense	7,440	(99)	2,069	9,410
Net income (loss)	39,722	(946)	5,969	44,745
Noncontrolling interest	—	117	—	117
Net income (loss) attributable to TowneBank	\$ 39,722	\$ (829)	\$ 5,969	\$ 44,862
Net income (loss) as percentage of total	88.54 %	(1.85)%	13.31 %	100.00 %
Assets	\$ 15,564,147	\$ 522,660	\$ 593,549	\$ 16,680,356

Three Months Ended September 30, 2022	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 123,039	\$ 999	\$ —	\$ 124,038
Provision for credit losses	4,240	(315)	—	3,925
Net interest income after provision for credit losses	118,799	1,314	—	120,113
Residential mortgage banking income, net	(758)	12,726	—	11,968
Insurance commissions and other income, net	—	525	18,910	19,435
Property management income, net	—	9,891	—	9,891
Real estate commission income, net	—	2,932	—	2,932
Other noninterest income	10,203	586	183	10,972
Noninterest expense	70,062	28,042	13,930	112,034
Income (loss) before income tax, corporate allocation, and noncontrolling interest	58,182	(68)	5,163	63,277
Corporate allocation	902	(602)	(300)	—
Income (loss) before income tax provision and noncontrolling interest	59,084	(670)	4,863	63,277
Provision for income tax expense	11,507	(120)	1,219	12,606
Net income (loss)	47,577	(550)	3,644	50,671
Noncontrolling interest	—	(502)	—	(502)
Net income (loss) attributable to TowneBank	\$ 47,577	\$ (1,052)	\$ 3,644	\$ 50,169
Net income (loss) as percentage of total	94.84 %	(2.10)%	7.26 %	100.00 %
Assets	\$ 14,939,876	\$ 528,773	\$ 483,148	\$ 15,951,797

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Nine Months Ended September 30, 2023	Banking	Realty	Insurance	Consolidated Totals
Net interest income	\$ 349,165	\$ 882	\$ —	\$ 350,047
Provision for credit losses	16,442	(210)	—	16,232
Net interest income after provision for credit losses	332,723	1,092	—	333,815
Residential mortgage banking income, net	(1,584)	32,964	—	31,380
Insurance commissions and other income, net	—	443	68,655	69,098
Property management income, net	—	40,433	—	40,433
Real estate commission income, net	—	3,562	—	3,562
Gain on sale of equity investment	10	8,833	543	9,386
Other noninterest income	33,976	218	475	34,669
Noninterest expense	242,161	78,647	46,520	367,328
Income (loss) before income tax, corporate allocation, and noncontrolling interest	122,964	8,898	23,153	155,015
Corporate allocation	3,763	(1,800)	(1,963)	—
Income (loss) before income tax provision and noncontrolling interest	126,727	7,098	21,190	155,015
Provision for income tax expense	21,204	1,769	5,451	28,424
Net income (loss)	105,523	5,329	15,739	126,591
Noncontrolling interest	—	(1,680)	—	(1,680)
Net income (loss) attributable to TowneBank	\$ 105,523	\$ 3,649	\$ 15,739	\$ 124,911
Net income (loss) as percentage of total	84.47 %	2.92 %	12.61 %	100.00 %
Assets	\$ 15,564,147	\$ 522,660	\$ 593,549	\$ 16,680,356

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

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

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customer's creditworthiness. They tend to have fixed expiration dates and may expire without being utilized. Therefore, total commitment amounts may not necessarily represent future cash requirements. At September 30, 2023, the amounts of off-balance-sheet commitments to extend credit were \$4.48 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 September 30, 2023, standby letters of credit and financial guarantees were \$184.35 million.

Additionally, the Company had \$156.75 million in mortgage loans sold to investors with estimated recourse and warranty provisions totaling \$2.72 million as of September 30, 2023.

Note 10. Goodwill and Other Intangibles

The following table presents the gross carrying amount and accumulated amortization for the Company's other intangible assets as of the dates indicated (in thousands):

	September 30, 2023		December 31, 2022	
	Carrying Amount	Accumulated Amortization	Carrying Amount	Accumulated Amortization
Core deposit intangible	\$ 38,121	\$ 20,981	\$ 30,921	\$ 25,161
Non-compete agreements	1,115	1,001	1,143	906
Customer lists	81,332	40,661	72,113	43,058
Total intangible assets subject to amortization	120,568	62,643	104,177	69,125
Trade name	6,340	—	4,880	—
Contractual agreements	3,231	—	3,231	—
Total intangible assets not subject to amortization	9,571	—	8,111	—
Total other intangible assets	\$ 130,139	\$ 62,643	\$ 112,288	\$ 69,125

Amortization expense for intangible assets was \$3.61 million and \$2.64 million for the three-month periods, and \$10.74 million and \$8.15 million for the nine-month periods ended September 30, 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
Acquisitions	3,305	4,582	2,578	10,465
Sale of BHHS Towne Realty	—	(12,241)	—	(12,241)
Other	—	—	(22)	(22)
Balance, September 30, 2023	\$ 348,018	\$ 24,842	\$ 83,824	\$ 456,684

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The change in goodwill from December 31, 2022 to September 30, 2023, relates to the Company's completion of the acquisition of Farmers Bank and Manry-Rawls, LLC, the sale of majority ownership in BHHS Towne Realty, and the acquisition of a vacation property management company. During the quarter ended June 30, 2023, certain adjustments were made to purchase price allocations from the Farmers acquisition. See "Note 3. Mergers and Acquisitions" for additional information.

Note 11. Postretirement Benefits

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

	SERP		Other Postretirement Benefits	
	Three Months Ended September 30,		Three Months Ended September 30,	
	2023	2022	2023	2022
Service cost	\$ 771	\$ 1,098	\$ —	\$ —
Interest cost	695	396	8	9
Amortization of prior service costs	222	193	(14)	—
Amortization of actuarial (gain) loss	(531)	23	(50)	(4)
Net periodic postretirement benefit cost	<u>\$ 1,157</u>	<u>\$ 1,710</u>	<u>\$ (56)</u>	<u>\$ 5</u>

	SERP		Other Postretirement Benefits	
	Nine Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Service cost	\$ 2,312	\$ 3,293	\$ —	\$ —
Interest cost	2,080	1,189	24	28
Amortization of prior service costs	666	577	(42)	—
Amortization of actuarial (gain) loss	(1,594)	69	(148)	(12)
Net periodic postretirement benefit cost	<u>\$ 3,464</u>	<u>\$ 5,128</u>	<u>\$ (166)</u>	<u>\$ 16</u>

Postretirement benefit costs are included in our Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2023 and September 30, 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.

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Note 12. Accumulated Other Comprehensive Income (Loss)

The following table summarizes the components of accumulated other comprehensive income (loss) at September 30, 2023 and 2022 (in thousands), and changes in the nine months then ended. The amounts reclassified from AOCI for the securities available for sale are included in gain on investment securities, net in the Consolidated Statements of Income, while the amounts reclassified from AOCI for the pension and postretirement plans are a component of salaries and employee benefits expense and other expenses in the Consolidated Statements of Income.

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2022	\$ (148,772)	\$ 8,267	(140,505)
Other comprehensive income before reclassifications	(36,962)	(706)	(37,668)
Amounts reclassified from AOCI	—	(870)	(870)
Other comprehensive income, net	(36,962)	(1,576)	(38,538)
Balance, September 30, 2023	<u>\$ (185,734)</u>	<u>\$ 6,691</u>	<u>\$ (179,043)</u>

	Unrealized Gains (Losses) on Securities (a)	Pension and Postretirement Plans (b)	Accumulated Other Comprehensive Income (Loss), Net of Tax
Balance, December 31, 2021	\$ 13,618	\$ (3,021)	\$ 10,597
Other comprehensive income before reclassifications	(169,119)	48	(169,071)
Amounts reclassified from AOCI	—	494	494
Other comprehensive income, net	(169,119)	542	(168,577)
Balance, September 30, 2022	<u>\$ (155,501)</u>	<u>\$ (2,479)</u>	<u>\$ (157,980)</u>

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

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

Note 13. Variable Interest Entities

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

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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>	September 30, 2023	December 31, 2022
Partnership assets not included in the Consolidated Balance Sheets	\$ 621,331	\$ 453,431
Carrying value of limited partner interests (1)	227,175	163,378
Maximum exposure to loss from limited partner investments	230,754	163,420
Funding commitments dependent on contractual milestones	137,022	148,513
Unfunded short-term construction loan commitments	1,421	4,958

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

For the three- and nine-month periods ended September 30, 2023, tax benefits totaling \$0.88 million and \$2.98 million, respectively, net of amortization expenses of \$6.03 million and \$16.17 million, respectively, were recognized as a component of income tax expense. For the three- and nine-month periods ended September 30, 2022, tax benefits totaling \$1.04 million and \$2.70 million, respectively, net of amortization expenses of \$4.64 million and \$11.92 million, respectively, were recognized as a component of income tax expense.

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

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September 30, 2023, the discount rate utilized was between 11.00% and 16.78% and the weighted-average life was between 6.21 and 8.48 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 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 September 30, 2023, and the year ended December 31, 2022, the Company used a weighted average fall-out rate of 14.07%.

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 and the Company has elected the fair value option for the forward loan sale commitments. 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.

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.

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The following table presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of September 30, 2023 and December 31, 2022 (in thousands):

	September 30, 2023			
	Level 1	Level 2	Level 3	Total
U.S. agency securities	\$ —	\$ 300,161	\$ —	\$ 300,161
U.S. Treasury notes	26,721	—	—	26,721
Municipal securities	—	484,098	—	484,098
Mortgage-backed securities issued by GSEs	—	1,079,303	—	1,079,303
Trust preferred and other corporate securities	—	45,035	28,135	73,170
Loans held for sale	—	188,048	—	188,048
Forward loan commitment asset	—	237	—	237
Forward loan commitment liability	—	14	—	14
Derivative assets	—	2,631	1,348	3,979
Derivative liabilities	—	351	—	351

	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	—	48,395	29,306	77,701
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

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 delivery derivative instruments used to economically hedge them without the burden of complying with requirements for hedge accounting.

At September 30, 2023 and December 31, 2022, the aggregate fair value of mortgage loans held for sale accounted for under the fair value option was \$188.05 million and \$102.34 million, respectively, and the unpaid principal balance of those loans was \$186.95 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.

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(in thousands)	Net Gains (Losses) Resulting from Changes in Fair Value			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Mortgage loans held for sale, at fair value	\$ (190)	\$ (5,389)	\$ (1,384)	\$ (6,762)

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. For assets measured at fair value on a nonrecurring basis that were still held in the balance sheet at quarter-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at September 30, 2023 and December 31, 2022 (in thousands):

September 30, 2023	Level 1	Level 2	Level 3	Fair Value
Other real estate owned and other nonperforming assets	\$ —	\$ —	\$ 766	\$ 766

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 fair value less estimated selling costs. The fair value is generally determined using an external appraisal process and is discounted based on internal criteria when deemed necessary.

HTM trust preferred and other corporate securities: The fair value of certain corporate securities is based on a discounted cash flow model that utilizes Level 3, or unobservable inputs, the most significant of which were a discount rate and weighted-average life. At September 30, 2023, the discount rate utilized was 6.93% and the weighted-average life was 25.60 years.

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The levels within the fair value hierarchy and the estimated fair values of our financial instruments required to be disclosed under ASC 825, *Financial Instruments*, as of September 30, 2023 and December 31, 2022, are as follows (in thousands):

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
September 30, 2023					
Cash and due from banks	\$ 83,949	\$ 83,949	\$ 83,949	\$ —	\$ —
Interest-bearing deposits at FRB - Richmond	1,029,276	1,029,276	1,029,276	—	—
Interest-bearing deposits in financial institutions	102,527	102,527	102,527	—	—
Securities available for sale, net	1,963,453	1,963,453	26,721	1,908,597	28,135
Securities held to maturity, net	547,854	524,431	—	523,423	1,008
Other equity securities	14,062	14,062	—	14,062	—
Net loans	11,172,971	10,433,042	—	—	10,433,042
Interest receivable	49,376	49,376	—	49,376	—
Time deposits	2,321,498	2,303,831	—	2,303,831	—
Advances from the FHLB	104,139	103,669	—	103,669	—
Subordinated debt	255,580	189,993	—	189,993	—
	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	26,693	1,784,903	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.

Note 15. Derivative Instruments and Hedging Activities

The Company enters into rate lock commitments with its mortgage customers. The Company is also a party to forward mortgage loan sales contracts to sell loans servicing-released and sales of TBA MBSs. When the interest rate is locked with the borrower, the rate lock commitment, mandatory forward sale contract, and mortgage-backed security position are undesignated derivatives and marked to fair value through earnings. The fair value of the rate lock derivative is based on quoted prices for similar loans in the secondary market adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close.

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Both the rate lock commitment and the corresponding forward sales contracts are considered derivatives, but are not accounted for using hedge accounting. As such, changes in the estimated fair value of the derivatives during the commitment period are recorded in current earnings and included in net residential mortgage banking income in the Consolidated Statements of Income.

When the market is favorable, we sell mortgage loans under both "mandatory" and "best efforts" delivery programs. Under the mandatory delivery system, loans with interest rate locks with respective borrowers are paired with the sales of TBA MBSs bearing similar attributes. We commit to deliver loans to an investor at an agreed-upon price upon the closing of such loans.

The following table reflects the amount and market value of mortgage banking derivatives included in the Consolidated Balance Sheets as of the dates indicated (in thousands):

	September 30, 2023		December 31, 2022	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate contracts included in other assets	\$ 390,386	\$ 3,979	\$ 167,022	\$ 1,031
Interest rate contracts included in other liabilities	\$ 83,535	\$ 351	\$ 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 and nine months ended September 30, 2023, the Company recognized \$1.24 million and \$4.19 million in gains from mortgage banking derivatives. For the three and nine months ended September 30, 2022, the Company recognized \$0.91 million and \$2.25 million in losses from mortgage banking derivatives.

Note 16. Revenue from Contracts with Customers

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

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

Revenue from Contracts with Customers:	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Investment management income				
Investment commissions, net	\$ 2,363	\$ 2,310	\$ 6,581	\$ 6,880
Total	\$ 2,363	\$ 2,310	\$ 6,581	\$ 6,880
Insurance income				
Property and casualty insurance income, net	\$ 20,511	\$ 15,958	\$ 57,910	\$ 47,417
Benefit insurance income, net	3,266	2,952	10,745	9,248
Total	\$ 23,777	\$ 18,910	\$ 68,655	\$ 56,665
Real estate and property management income				
Real estate sales commissions, net	\$ (63)	\$ 2,932	\$ 3,562	\$ 8,899
Real estate property management income, net	12,800	9,891	40,433	36,489
Total	\$ 12,737	\$ 12,823	\$ 43,995	\$ 45,388
Provision (benefit) expense for credit losses on future reservation receivables	\$ (200)	\$ (295)	\$ 29	\$ (121)
Provision expense for credit losses on property and casualty insurance receivables	\$ 66	\$ 65	\$ 212	\$ 257

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

The Company had no material contract assets or contract liabilities recorded in the Consolidated Balance Sheets as of September 30, 2023 or December 31, 2022.

This disclosure includes only revenue from contracts with third-party customers. See "Note 8. Segment Reporting" 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 September 30, 2023, the carrying value of the notes totaled \$247.88 million, compared to \$247.42 million at December 31, 2022.

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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 September 30, 2023, the total carrying value of these notes was \$7.70 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; an unforeseen outflow of cash or deposits or an inability to access the capital markets, which could jeopardize our overall liquidity or capitalization; changes in the creditworthiness of customers and the possible impairment of the collectability of loans; insufficiency of our allowance for credit losses due to market conditions, inflation, changing interest rates or other factors; adverse developments in the financial industry generally, such as the recent bank failures, responsive measures to mitigate and manage such developments, related supervisory and regulatory actions and costs, and related impacts on customer and client behavior; 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; geopolitical instability, including wars, conflicts, civil unrest, and terrorist attacks and the potential impact, directly or indirectly, on our business; the effects of weather-related or natural disasters, which may negatively affect our operations and/or our loan portfolio and increase our cost of conducting business; public health events (such as the COVID-19 pandemic) and governmental and societal responses to them; 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 Quarterly Report on Form 10-Q for the period ended June 30, 2023, and related disclosures in other filings that have been, or will be, filed by TowneBank with the Federal Deposit Insurance Corporation.*

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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 provides residential resort management services and originations of a variety of mortgage loans. Prior to the sale of BHHS Towne Realty, it offered residential real estate services and commercial and residential title insurance. Commercial and retail insurance and employee benefit services are provided through our Insurance segment.

TowneBank had total assets of \$16.68 billion at September 30, 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.

	September 30, 2023	December 31, 2022
Total cash and cash equivalents	7.29 %	7.28 %
Total securities	15.24 %	15.18 %
Mortgage loans held for sale	1.13 %	0.65 %
Loans, net of unearned income and deferred costs	66.98 %	68.13 %
Total deposits	83.22 %	83.90 %
Total borrowings	2.44 %	2.01 %

The following table lists key asset and liability categories at September 30, 2023 and June 30, 2023, for comparative purposes.

	September 30, 2023	June 30, 2023	Total Change Change	%
<i>(dollars in thousands)</i>				
Total assets	\$ 16,680,356	\$ 17,225,075	\$(544,719)	(3.16)%
Total cash and cash equivalents	1,215,752	1,636,269	(420,517)	(25.70)%
Total investment securities	2,541,918	2,608,033	(66,115)	(2.54)%
Mortgage loans held for sale	188,048	229,502	(41,454)	(18.06)%
Loans, net of unearned income and deferred costs	11,172,971	11,208,014	(35,043)	(0.31)%
Allowance for credit losses on loans	(125,159)	(123,513)	(1,646)	1.33 %
Noninterest-bearing deposits	4,444,861	4,774,830	(329,969)	(6.91)%
Total deposits	13,880,805	13,766,661	114,144	0.83 %
Total borrowings	407,034	1,059,582	(652,548)	(61.59)%
Allowance for credit losses on loans to period end loans	1.12 %	1.10 %		

Total assets decreased \$544.72 million in the quarter, driven primarily by declines in cash and cash equivalents as the Company paid down FHLB advances. Early in 2023, in response to bank closures and market turmoil, management prudently elected to increase short-term borrowings to bolster the Company's on balance sheet liquidity. As the year has progressed, continued strength of the Company's deposit business enabled the borrowings to mature.

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Investment securities, mortgage loans held for sale, and loans, net of unearned income and deferred cost declined in the quarter. Higher rates and low home sale inventory have adversely impacted mortgage loans held for sale. Investment securities declined, driven by the change in market value of AFS securities. Unrealized losses in our AFS debt securities increased to \$238.52 million at September 30, 2023, from \$195.98 million at June 30, 2023. In response to margin compression and slow deposit growth, management has focused on controlled loan growth and healthy loan to deposit ratios.

Total deposits increased \$114.14 million during the quarter. Partially offsetting this increase was the decline in noninterest-bearing deposits, primarily escrow deposits and commercial deposits, some of which have migrated to interest-bearing deposit accounts.

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.

<i>(dollars in thousands)</i>	September 30, 2023	December 31, 2022	Farmers Acquisition	Total Change Change	%
Total assets	\$ 16,680,356	\$15,845,267	\$ 618,858	\$ 835,089	5.27 %
Total cash and cash equivalents	1,215,752	1,152,830	26,109	62,922	5.46 %
Total investment securities	2,541,918	2,405,335	244,892	136,583	5.68 %
Mortgage loans held for sale	188,048	102,339	—	85,709	83.75 %
Loans, net of unearned income and deferred costs	11,172,971	10,794,602	277,890	378,369	3.51 %
Allowance for credit losses on loans	(125,159)	(110,816)	(1,380)	(14,343)	12.94 %
Noninterest-bearing deposits	4,444,861	5,265,186	176,789	(820,325)	(15.58)%
Total deposits	13,880,805	13,294,223	514,572	586,582	4.41 %
Total borrowings	407,034	318,012	33,806	89,022	27.99 %
Allowance for credit losses on loans to period end loans	1.12 %	1.03 %			

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The following table presents the key components affecting the Company's financial performance in the three and nine months ended September 30, 2023 compared to prior year.

	Three Months Ended			
	September 30,			
(dollars in thousands)	2023	2022	Change	%
Net income attributable to TowneBank	\$ 44,862	\$ 50,169	\$ (5,307)	(10.58)%
Net interest income	113,058	124,038	(10,980)	(8.85)%
Noninterest income	59,806	55,198	4,608	8.35 %
Total revenue	172,864	179,236	(6,372)	(3.56)%
Provision for credit losses	1,007	3,925	(2,918)	(74.34)%
Acquisition-related expenses	572	616	(44)	(7.14)%
Noninterest expense, excluding acquisition-related expenses	117,130	111,418	5,712	5.13 %

	Nine Months Ended			
	September 30,			
	2023	2022	Change	%
Net income attributable to TowneBank	\$ 124,911	\$ 142,302	\$ (17,391)	(12.22)%
Net interest income	350,047	332,582	17,465	5.25 %
Noninterest income	188,528	179,046	9,482	5.30 %
Total revenue	538,575	511,628	26,947	5.27 %
Provision for credit losses	16,232	2,532	13,700	541.07 %
Acquisition-related expenses	9,534	726	8,808	1213.22 %
Noninterest expense, excluding acquisition-related expenses	357,794	329,413	28,381	8.62 %

Net income attributable to TowneBank declined \$5.31 million, or 10.58%, in third quarter 2023 compared to third quarter 2022, driven by margin compression. Interest expense increased \$56.31 million, year over year, outpacing the \$45.33 million growth in interest income. This discussion should be read in conjunction with our Consolidated Financial Statements and notes to the financial statements appearing elsewhere in this report.

BHHS Towne Realty

Effective April 27, 2023, the Company transferred its ownership interest in BHHS Towne Realty, which was formerly a subsidiary of TowneBank, to BHHS RW Towne Realty, LLC, in exchange for a minority interest in that company, which is accounted for as an equity method investment. The new entity is the largest full-service real estate brokerage firm in the Hampton Roads market with over 750 agents. The transaction included the combination of the contributing companies' mortgage, title, and property management lines of business.

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.

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ANALYSIS OF RESULTS OF OPERATIONS

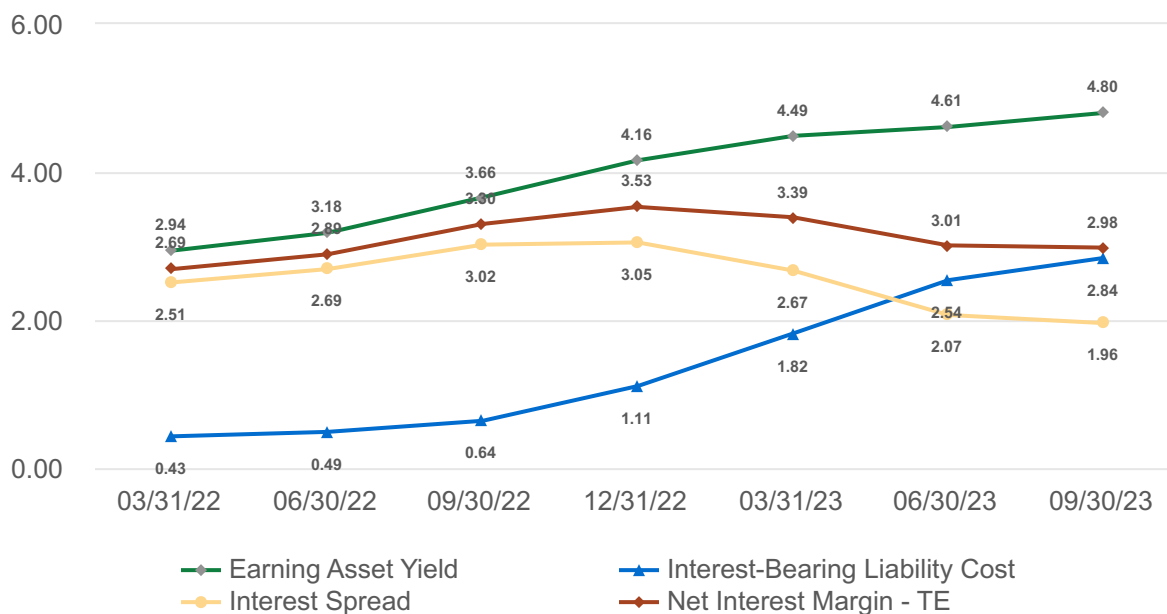
Consolidated Performance Summary

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

(dollars in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30, 2023	September 30, 2022	September 30, 2023	September 30, 2022
Total revenue	\$ 172,864	\$ 179,236	\$ 538,575	\$ 511,628
Operating revenue (non-GAAP)	\$ 172,310	\$ 179,236	\$ 529,189	\$ 511,628
Diluted earnings per share	\$ 0.60	\$ 0.69	\$ 1.67	\$ 1.96
Return on average assets	1.06 %	1.22 %	1.00 %	1.16 %
Return on average tangible assets (non-GAAP)	1.17 %	1.31 %	1.11 %	1.25 %
Return on average equity	8.96 %	10.60 %	8.48 %	10.09 %
Return on average tangible equity (non-GAAP)	12.97 %	15.08 %	12.35 %	14.40 %

Net Interest Income. Net interest income, the major source of our earnings, is the income generated by interest-earning assets reduced by the total interest cost of the funds incurred to carry them. It is affected by market interest rates and the volume and mix of earning assets and interest-bearing liabilities. The yields and rates in this discussion and in the following tables have been computed based upon interest income and expense adjusted to a TE basis (non-GAAP) using a 21% federal marginal tax rate.

Margin Comparison by Quarter



TowneBank reported net interest income, on a TE basis ("net interest income-TE"), of \$114.26 million for the quarter ended September 30, 2023, which was \$10.63 million, or 8.51%, less than the third quarter 2022 total of \$124.89 million. Interest income-TE was \$184.05 million in the quarter ended September 30, 2023,

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which was \$45.68 million, or 33.01%, higher than the \$138.38 million reported for the quarter ended September 30, 2022. Interest expense for the current quarter was \$69.80 million, which was \$56.31 million, or 417.56%, higher than interest expense of \$13.49 million for third quarter 2022. The comparative period increases were primarily driven by increases in rate. In the first nine months of 2023, net interest income-TE increased \$18.73 million, or 5.60%, but, as evidenced by quarterly results, the rate of increase has declined due to higher cost of funds. Interest income-TE was \$156.37 million, or 42.46%, higher than prior year. Interest expense increased \$137.63 million, or 411.63%, in the same comparison.

Average earning assets increased to \$15.21 billion in the quarter ended September 30, 2023, from \$14.99 billion in the comparative prior year quarter, an increase of \$220.92 million, or 1.47%. The yield on earning assets was 4.80% in the quarter ended September 30, 2023, up compared to 3.66% in the prior year. Average loan balances in third quarter 2023 were \$11.17 billion, \$0.70 billion, or 6.73%, higher than the same period one year ago, and loan yields increased by 88 bp.

Average interest-bearing liabilities were \$9.75 billion in third quarter 2023, up from \$8.35 billion in the comparative prior year quarter, an increase of 16.83%. The cost of interest-bearing liabilities was 2.84% in third quarter 2023, compared to 0.64% in third quarter 2022, a 220 bp increase.

TE net interest margin, which is net interest income-TE expressed as a percentage of average earning assets, was 2.98%, or 33 bp lower, for the quarter ended September 30, 2023, compared to the September 30, 2022, quarter margin of 3.31%. Movements in the Federal Reserve's Federal Funds target range impacts 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 - July 26, 2023	5.00 - 5.25
July 27, 2023 - present (1)	5.25 - 5.50

(1) 22-year high

A shift in deposit mix from noninterest-bearing to interest-bearing deposits has impacted margin. Loan growth has also been impacted by slower prepayments on our existing portfolio. The Company expects modest margin contraction owing to lagged deposit pricing impacts on interest-bearing deposit costs, with a cumulative cycle-to-date beta of approximately 47%.

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

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presented for the three-month periods are the changes in interest income and expense caused by variations in the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to the previous periods:

	Three Months Ended						Increase/(Decrease) Three Months Ended September 30, 2023 Compared to Three Months Ended September 30, 2022		
	September 30, 2023			September 30, 2022					
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Volume	Rate (4)	Total
(dollars in thousands)									
Assets:									
Loans (net of unearned income and deferred costs)	\$ 11,169,924	\$ 144,457	5.13 %	\$ 10,465,441	\$ 112,225	4.25 %	\$ 7,937	\$ 24,295	\$ 32,232
Taxable investment securities	2,373,731	18,645	3.14 %	2,385,218	12,943	2.17 %	(63)	5,765	5,702
Tax-exempt investment securities	206,639	1,993	3.86 %	147,184	1,252	3.41 %	558	183	741
Total securities	2,580,370	20,638	3.20 %	2,532,402	14,195	2.24 %	495	5,948	6,443
Interest-bearing deposits	1,230,582	15,031	4.85 %	1,800,798	9,509	2.09 %	(3,778)	9,300	5,522
Loans held for sale	227,426	3,928	6.91 %	188,737	2,446	5.18 %	565	917	1,482
Total earning assets	15,208,302	184,054	4.80 %	14,987,378	138,375	3.66 %	5,219	40,460	45,679
Less: allowance for credit losses	(125,553)			(104,178)					
Total nonearning assets	1,680,110			1,421,094					
Total assets	<u>\$ 16,762,859</u>			<u>\$ 16,304,294</u>					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 6,605,853	\$ 41,381	2.49 %	\$ 6,084,753	\$ 6,542	0.43 %	608	34,231	34,839
Savings	356,116	938	1.05 %	391,437	628	0.64 %	(61)	371	310
Certificates of deposit	2,236,102	21,852	3.88 %	1,456,746	3,060	0.83 %	2,401	16,391	18,792
Total interest-bearing deposits	9,198,071	64,171	2.77 %	7,932,936	10,230	0.51 %	2,948	50,993	53,941
Borrowings	299,105	3,382	4.42 %	94,411	139	0.58 %	800	2,443	3,243
Subordinated debt, net	255,446	2,245	3.52 %	320,518	3,117	3.89 %	(872)	—	(872)
Total interest-bearing liabilities	9,752,622	69,798	2.84 %	8,347,865	13,486	0.64 %	2,876	53,436	56,312
							<u>\$ 2,343</u>	<u>\$ (12,976)</u>	<u>\$ (10,633)</u>
Demand deposits	4,633,856			5,690,020					
Other noninterest-bearing liabilities	389,912			387,835					
Total liabilities	14,776,390			14,425,720					
Shareholders' equity	1,986,469			1,878,574					
Total liabilities and equity	<u>\$ 16,762,859</u>			<u>\$ 16,304,294</u>					
Net interest income-TE (3)		\$ 114,256			\$ 124,889				
Reconciliation of Non-GAAP Financial Measures									
TE basis adjustment		(1,198)			(851)				
Net interest income (GAAP)		<u>\$ 113,058</u>			<u>\$ 124,038</u>				
Interest rate spread (1)(3)			1.96 %			3.02 %			
Interest expense as a percent of average earning assets			1.82 %			0.36 %			
Net interest margin-TE (2)(3)			2.98 %			3.31 %			
Total cost of deposits			1.84 %			0.30 %			

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

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	Nine Months Ended						Increase/(Decrease) Nine Months Ended September 30, 2023 Compared to Nine Months Ended September 30, 2022		
	September 30, 2023			September 30, 2022					
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Volume	Rate (4)	Total
(dollars in thousands)									
Assets:									
Loans (net of unearned income and deferred costs)	\$ 11,159,329	\$ 417,808	5.01 %	\$ 10,113,980	\$ 309,283	4.09 %	\$ 34,229	\$ 74,296	\$ 108,525
Taxable investment securities	2,420,634	52,656	2.90 %	2,259,940	33,344	1.97 %	2,518	16,794	19,312
Tax-exempt investment securities	201,535	5,883	3.89 %	130,196	3,090	3.16 %	1,967	826	2,793
Total securities	2,622,169	58,539	2.98 %	2,390,136	36,434	2.03 %	4,485	17,620	22,105
Interest-bearing deposits	1,179,952	40,168	4.55 %	2,362,155	15,472	0.88 %	(11,206)	35,902	24,696
Loans held for sale	168,822	8,079	6.38 %	225,777	7,038	4.16 %	(2,080)	3,121	1,041
Total earning assets	15,130,272	524,594	4.64 %	15,092,048	368,227	3.26 %	25,428	130,939	156,367
Less: allowance for credit losses	(120,420)			(104,733)					
Total nonearning assets	1,637,952			1,394,691					
Total assets	\$ 16,647,804			\$ 16,382,006					
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	\$ 6,349,422	\$ 96,742	2.04 %	\$ 6,203,889	\$ 11,898	0.26 %	286	84,558	84,844
Savings	376,282	2,676	0.95 %	387,290	1,664	0.57 %	(49)	1,061	1,012
Certificates of deposit	1,964,718	47,358	3.22 %	1,440,661	7,134	0.66 %	3,458	36,766	40,224
Total interest-bearing deposits	8,690,422	146,776	2.26 %	8,031,840	20,696	0.34 %	3,695	122,385	126,080
Borrowings	505,856	17,644	4.60 %	119,336	412	0.46 %	4,522	12,710	17,232
Subordinated debt, net	253,612	6,650	3.50 %	401,195	12,328	4.10 %	(4,059)	(1,619)	(5,678)
Total interest-bearing liabilities	9,449,890	171,070	2.42 %	8,552,371	33,436	0.52 %	4,158	133,476	137,634
							\$ 21,270	\$ (2,537)	\$ 18,733
Demand deposits	4,873,945			5,569,186					
Other noninterest-bearing liabilities	353,459			374,794					
Total liabilities	14,677,294			14,496,351					
Shareholders' equity	1,970,510			1,885,655					
Total liabilities and equity	\$ 16,647,804			\$ 16,382,006					
Net interest income-TE (3)		\$ 353,524			\$ 334,791				
Reconciliation of Non-GAAP Financial Measures									
TE basis adjustment		(3,477)			(2,209)				
Net interest income (GAAP)		\$ 350,047			\$ 332,582				
Interest rate spread (1)(3)			2.22 %			2.74 %			
Interest expense as a percent of average earning assets			1.51 %			0.30 %			
Net interest margin-TE (2)(3)			3.12 %			2.97 %			
Total cost of deposits			1.45 %			0.20 %			

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

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Provision for Credit Losses. The third quarter 2023 provision for credit losses was an expense of \$1.01 million, compared to \$3.93 million for the same period one year ago. The provision for credit losses in the first nine months of 2023 was an expense of \$16.23 million compared to \$2.53 million in the prior year. Our 2023 provision includes 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.

In third quarter 2023, we had net recoveries of \$1.07 million compared to net recoveries of \$187 thousand in third quarter 2022. In the first nine months of 2023, net charge-offs were \$2.81 million, compared to net recoveries of \$141 thousand for the same period in 2022. Two notable recoveries in third quarter 2023 were related to commercial and industrial loan charge-offs that occurred in fourth quarter 2022 and first quarter 2023. Additional factors in the current quarter provision included changes in loan portfolio composition and modest improvements in our modeled macroeconomic forecast scenarios.

Noninterest Income. Total noninterest income for the third quarter and first nine months ended September 30, 2023, was \$59.81 million and \$188.53 million, respectively, compared to \$55.20 million and \$179.05 million for the same respective periods in 2022. Noninterest income as a percentage of total operating income was 34.71% for third quarter 2023, compared with 30.80% for third quarter 2022.

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

	Three Months Ended		Nine Months Ended		Increase/(Decrease)		Increase/(Decrease)	
	September 30,		September 30,		Three Months Ended		Nine Months Ended	
	2023	2022	2023	2022	Amount	Percent	Amount	Percent
<i>(dollars in thousands)</i>								
Residential mortgage banking, net	\$10,648	\$11,968	\$31,380	\$39,782	\$ (1,320)	(11.03)%	\$ (8,402)	(21.12)%
Insurance commissions and other income, net	23,777	19,435	69,098	58,255	4,342	22.34 %	10,843	18.61 %
Property management income, net	12,800	9,891	40,433	36,489	2,909	29.41 %	3,944	10.81 %
Real estate commission income, net	(63)	2,932	3,562	8,899	(2,995)	N/M	(5,337)	(59.97)%
Service charges on deposit accounts	2,802	2,455	8,671	7,474	347	14.13%	1,197	16.02 %
Credit card merchant fees, net	2,006	1,658	5,232	4,940	348	20.99 %	292	5.91 %
Bank-owned life insurance	1,814	1,585	5,196	5,155	229	14.45 %	41	0.80 %
Gain on sale of equity investments	554	—	9,386	—	554	N/M	9,386	N/M
Other income	5,468	5,274	15,570	18,052	194	3.68 %	(2,482)	(13.75)%
Total noninterest income	<u>\$59,806</u>	<u>\$55,198</u>	<u>\$188,528</u>	<u>\$179,046</u>	<u>\$ 4,608</u>	8.35 %	<u>\$ 9,482</u>	5.30 %
Noninterest income/operating income (non-GAAP)	34.71 %	30.80 %	35.63 %	35.00 %				

For third quarter 2023, residential mortgage banking income, net of commission expense, was \$10.65 million, a decrease of \$1.32 million, or 11.03%, compared to third quarter 2022. In the first nine months of 2023, residential mortgage banking income, net of commission expense, decreased \$8.40 million, or 21.12%, compared to 2022. The decrease in mortgage banking income in the third quarter and first nine months of 2023 was driven by a decline in volume from the same respective periods in 2022. Production volume was \$520.41 million in third quarter 2023, a decrease of \$172.29 million, or 24.87%, compared to third quarter 2022. Production volume in the first nine months of 2023 was \$1.55 billion, compared to \$2.35 billion in prior year. Refinance activities decreased to 4.04% of total loan volume in third quarter 2023, compared to 6.80% in the prior year quarter, driven by increases in mortgage rates. Margins on the sale of loans remained low, but increased 15 bp from 3.02% in third quarter 2022 to 3.17% in third quarter

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2023. Year-to-date production has been adversely impacted by a combination of low housing inventories and higher mortgage rates. 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.

In the third quarter and first nine months of 2023, insurance commissions and other income, net of commission expense, was \$23.78 million and \$69.10 million, respectively. This represents increases of \$4.34 million, or 22.34%, and \$10.84 million, or 18.61%, compared to the same respective periods in 2022. Insurance commissions increased due to organic growth in property and casualty commission income and from acquisitions completed after second quarter 2022. Contingency and bonus revenue, which consists primarily of amounts received from various property and casualty carriers, increased in the third quarter and first nine months of 2023 compared to 2022 due to higher than expected receipts and agency acquisitions.

Property management income, net of commission expense, was \$12.80 million for third quarter 2023, which was \$2.91 million, or 29.41%, above comparative 2022. In the first nine months of 2023, property management income was \$40.43 million, \$3.94 million, or 10.81%, higher than prior year. The primary source of these increases was income from a first quarter 2023 acquisition, combined with an increase in rental inventories. The primary source of income from this line of business is vacation property commissions and associated fees.

Other noninterest income for the three months ended September 30, 2023, was \$5.47 million, an increase of \$0.19 million, or 3.68%, compared to third quarter 2022. Included in the first nine 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 the third quarter and first nine months of 2023 or 2022, and there were no net gains or losses on the sale of AFS securities to record. The Company recorded a gain on the sale of a small insurance benefits subsidiary of \$0.54 million the third quarter 2023 and a gross gain on the sale of BHHS Towne Realty of \$8.83 million in second quarter 2023.

Noninterest Expense. For the quarter ended September 30, 2023, total noninterest expense was \$117.70 million, which was \$5.67 million, or 5.06%, higher than comparative 2022. As a percentage of operating income, noninterest expense was 68.31% for third quarter 2023 and 62.51% for comparative 2022.

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

(dollars in thousands)	Three Months Ended		Nine Months Ended		Increase/(Decrease)		Increase/(Decrease)	
	September 30,		September 30,		Three Months Ended		Nine Months Ended	
	2023	2022	2023	2022	Amount	Percent	Amount	Percent
Salaries and employee benefits	\$ 67,258	\$ 65,463	\$204,124	\$194,318	\$ 1,795	2.74 %	\$ 9,806	5.05 %
Occupancy expense	9,027	8,748	27,579	25,417	279	3.19 %	2,162	8.51 %
Furniture and equipment	4,100	3,764	12,733	11,097	336	8.93 %	1,636	14.74 %
Amortization - intangibles	3,610	2,644	10,744	8,145	966	36.54 %	2,599	31.91 %
Software expense	6,130	4,594	17,922	13,848	1,536	33.43 %	4,074	29.42 %
Data processing	4,140	3,628	11,504	10,778	512	14.11 %	726	6.74 %
Professional fees	2,770	2,627	8,948	6,416	143	5.44 %	2,532	39.46 %
Advertising and marketing	3,653	4,290	12,012	12,508	(637)	(14.85)%	(496)	(3.97)%
Other noninterest expenses:								
Acquisition-related expenses	572	616	9,534	726	(44)	N/M	8,808	N/M
Bank franchise tax/SCC fees	2,493	2,240	7,547	6,538	253	11.29 %	1,009	15.43 %
Charitable contributions	2,766	3,540	9,971	9,520	(774)	(21.86)%	451	4.74 %
Directors fees and expenses	727	640	2,644	1,741	87	13.59 %	903	51.87 %
FDIC and other insurance	2,736	1,367	8,051	3,933	1,369	100.15 %	4,118	104.70 %
Foreclosed property expenses	38	33	100	283	5	15.15 %	(183)	(64.66)%
Other	4,647	4,688	12,853	15,520	(41)	(0.87)%	(2,667)	(17.18)%
Stationery and supplies	710	680	2,397	2,033	30	4.41 %	364	17.90 %
Telephone and postage	1,426	1,718	5,021	5,033	(292)	(17.00)%	(12)	(0.24)%
Travel/meals/entertainment	899	754	3,644	2,285	145	19.23 %	1,359	59.47 %
Total other noninterest expenses	17,014	16,276	61,762	47,612	738	4.53 %	14,150	29.72 %
Total noninterest expense	<u>\$117,702</u>	<u>\$112,034</u>	<u>\$367,328</u>	<u>\$330,139</u>	<u>\$ 5,668</u>	<u>5.06 %</u>	<u>\$ 37,189</u>	<u>11.26 %</u>
Salaries and employee benefits/total noninterest expense	57.14 %	58.43 %	55.57 %	58.86 %				
Noninterest expense/operating income (non-GAAP)	68.31 %	62.51 %	69.41 %	64.53 %				

Salaries and employee benefits were \$67.26 million in third quarter and \$204.12 million in the first nine months of 2023, representing 57.14% and 55.57%, respectively, of total noninterest expense. Salaries and benefits expense increased in the third quarter and first nine months 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 2023.

In our Banking segment, we had a total of 1,446 full-time equivalent employees at September 30, 2023, as compared to 1,317 at September 30, 2022. We had a total of 1,384 full-time equivalent employees, compared to 1,470, in our non-Banking segments at September 30, 2023 and September 30, 2022, respectively.

Occupancy expense increased \$279 thousand, or 3.19%, and furniture and equipment increased \$336 thousand, or 8.93%, in third quarter 2023 compared to 2022. In the nine-month comparison, occupancy expense increased \$2.16 million, or 8.51%, and furniture and equipment increased \$1.64 million, or 14.74%. These increases were related to the Farmers acquisition and organic growth.

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Software expenses increased \$1.54 million and \$4.07 million in the third quarter and first nine months of 2023, respectively, due to costs related to Farmers prior to the system conversion in April, software licensing increases, and projects related to Towne Vacations, mortgage systems, and our loan portfolio. Professional fees increased \$0.14 million, or 5.44%, in third quarter and \$2.53 million, or 39.46%, in the first nine months of 2023, compared to 2022 due to increases in project-related accounting fees, professional information technology support services, and other consulting. Amortization of intangibles increased \$0.97 million and \$2.60 million in the third quarter and first nine months of 2023, respectively, due to the increase in intangibles related to the January 2023 acquisition of Farmers.

Other noninterest expenses in the third quarter and first nine months of 2023 were \$17.01 million and \$61.76 million, respectively, increasing \$0.74 million and \$14.15 million from the same respective periods in 2022. Acquisition-related expenses decreased to \$0.57 million in third quarter, but increased \$8.81 million in the first nine months of 2023 compared to 2022, primarily due to the acquisition of Farmers. Increases in our assessment rate drove FDIC and other insurance expense higher by \$1.37 million and \$4.12 million in the third quarter and first nine months of 2023, respectively.

Provision for Income Taxes. We reported a provision for income tax expense of \$9.41 million, representing an effective tax rate of 17.34% in third quarter 2023. The provision for income tax expense was \$12.61 million for third quarter 2022, with an effective rate of 20.08%. The third quarter 2023 decrease in effective tax rate compared to prior year was driven by lower state taxes.

Segment Performance Summary

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

Banking Segment. Income before income tax provision and noncontrolling interest from the Banking segment was \$47.16 million and \$126.73 million for the three and nine months ended September 30, 2023, respectively, compared to \$59.08 million and \$157.77 million for the same respective periods ended September 30, 2022.

Total revenue decreased \$8.88 million in the three months but increased \$24.84 million in the nine months ended September 30, 2023, compared to 2022, driven by changes in net interest income. Margin compression was the primary source of the decrease in revenue in the third quarter, because growth in interest expense outpaced growth in interest income. Revenue from the Farmers acquisition was \$3.80 million in the third quarter and \$11.57 million in the first nine months of 2023. The provision for credit losses decreased \$3.03 million in third quarter, but increased \$14.20 million in the first nine months of 2023, compared to prior year.

Noninterest expenses increased \$6.47 million in third quarter 2023 compared to 2022, due primarily to a \$3.38 million increase in salaries and employee benefits, \$1.36 million increase in FDIC insurance and other insurance, and \$0.57 million increase in amortization of intangibles. Increases in salaries and employee benefits were driven by additional personnel costs related to the Farmers acquisition.

In the first nine months of 2023 compared to 2022, noninterest expense increased \$41.93 million. This increase is primarily attributable to a \$13.08 million increase in salaries and employee benefits and

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\$8.44 million increase in acquisition-related expenses. Additional increases included a \$3.91 million increase in FDIC and other insurance, \$2.58 million increase in professional fees, \$2.39 million increase in software expense, and \$2.32 million increase in occupancy expense.

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

	Three Months Ended September 30,		Nine Months Ended September 30,		Increase/(Decrease) Three Months Ended September 30, 2023 September 30, 2022		Increase/(Decrease) Nine Months Ended September 30, 2023 September 30, 2022	
	2023	2022	2023	2022	Amount	Percent	Amount	Percent
<i>(dollars in thousands)</i>								
Net interest income	\$112,189	\$123,039	\$349,165	\$327,226	\$ (10,850)	(8.82)%	\$ 21,939	6.70 %
Service charges on deposit accounts	2,802	2,455	8,671	7,474	347	14.13 %	1,197	16.02 %
Credit card merchant fees	2,006	1,658	5,232	4,940	348	20.99 %	292	5.91 %
Other income	6,608	5,332	18,499	17,083	1,276	23.93 %	1,416	8.29 %
Total noninterest income	11,416	9,445	32,402	29,497	1,971	20.87 %	2,905	9.85 %
Total revenue	123,605	132,484	381,567	356,723	(8,879)	(6.70)%	24,844	6.96 %
Provision for credit losses	1,206	4,240	16,442	2,247	(3,034)	(71.56)%	14,195	N/M
Salaries and employee benefits	42,727	39,349	128,161	115,082	3,378	8.58 %	13,079	11.36 %
Occupancy	6,637	6,109	19,717	17,401	528	8.64 %	2,316	13.31 %
Furniture and equipment	3,273	2,803	10,150	8,259	470	16.77 %	1,891	22.90 %
Amortization of intangible assets	1,296	726	3,918	2,330	570	78.51 %	1,588	68.15 %
Other expenses	22,595	21,075	80,215	57,158	1,520	7.21 %	23,057	40.34 %
Total noninterest expenses	76,528	70,062	242,161	200,230	6,466	9.23 %	41,931	20.94 %
Income before income tax and corporate allocation	45,871	58,182	122,964	154,246	(12,311)	(21.16)%	(31,282)	(20.28)%
Corporate allocation	1,291	902	3,763	3,520	389	43.13 %	243	6.90 %
Income before income tax provision and noncontrolling interest	47,162	59,084	126,727	157,766	(11,922)	(20.18)%	(31,039)	(19.67)%
Provision for income tax expense	7,440	11,507	21,204	29,782	(4,067)	(35.34)%	(8,578)	(28.80)%
Net income	39,722	47,577	105,523	127,984	(7,855)	(16.51)%	(22,461)	(17.55)%
Noncontrolling interest	—	—	—	—	—	N/M	—	N/M
Net income attributable to TowneBank	\$ 39,722	\$ 47,577	\$105,523	\$127,984	\$ (7,855)	(16.51)%	\$ (22,461)	(17.55)%
% of total consolidated income	88.54%	94.84 %	84.47 %	89.94 %				
Efficiency ratio (non-GAAP)	60.86%	52.34 %	62.44 %	55.48 %				

Realty Segment. For the three months ended September 30, 2023, the Realty segment reported a loss before income tax provision and noncontrolling interest of \$1.05 million, as compared to a loss of \$670 thousand in 2022. In the first nine months of 2023, the Realty segment reported income before income tax provision and noncontrolling interest of \$7.10 million, compared to \$5.18 million in 2022, driven by the gain on sale of BHHS Towne Realty.

Total revenue was \$24.79 million and \$87.34 million in the third quarter and first nine months of 2023, respectively, compared to \$27.66 million and \$97.68 million in 2022. Included in the first nine months of 2023 revenue is an \$8.83 million gain on the sale of BHHS Towne Realty. Effective April 27, 2023, the Company transferred its ownership interest in BHHS Towne Realty, which was formerly a subsidiary of TowneBank, to BHHS RW Towne Realty, LLC, in exchange for a minority interest in that company. After noncontrolling interests, the Company recognized \$6.98 million of the pre-tax gain on the transaction.

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Low home sale inventory levels combined with increased mortgage rates continue to be a challenge in our footprint and industry wide. Residential mortgage banking income declined \$1.77 million in the third quarter and \$10.53 million in the first nine months of 2023, compared to 2022. Residential mortgage production decreased \$172.29 million, or 24.87%, to \$520.41 million, and refinance activities decreased to 4.04% of total loan volume in third quarter 2023, as compared to mortgage production of \$692.70 million and refinance activities of 6.80% in third quarter 2022. Residential mortgage production decreased \$0.80 billion, or 33.92%, in the first nine months of 2023 compared to 2022. Year-to-date 2023, the Company has recognized a net loss of \$6.35 million on its residential mortgage banking business, compared to a loss of \$2.87 million in the same period of 2022.

In response to the continued decline in revenue and the expectation of ongoing pressure on production volumes, the Company has focused on aligning its infrastructure costs with production levels and will continue to evaluate its cost structure in relation to the current economic environment. Additionally, the Company is placing greater emphasis on increasing production via retail channels as opposed to volumes from partner relationships and is focused on enhancing margin-related gains on sale.

Net property management fees increased \$2.91 million in the third quarter, and \$3.94 million in the first nine months of 2023, compared to 2022, driven by an increased number of rental properties and income from a recent acquisition.

The Realty segment's provision for credit losses was a benefit of \$199 thousand in third quarter 2023, compared to a provision benefit of \$315 thousand in third quarter 2022. Year-to-date 2023, the provision for credit losses was a benefit of \$210 thousand, compared to an expense of \$285 thousand in the first nine months of 2022.

Noninterest expenses declined \$2.61 million in third quarter 2023, compared to the prior year, driven by decreased salaries and employee benefits expense of \$2.97 million. Noninterest expense declined \$10.97 million in the first nine months of 2023 compared to 2022, \$4.25 million of which was related to the sale of BHHS Towne Realty. Salaries and employee benefits expense decreased \$7.98 million, with \$2.90 million attributable to the sale of BHHS Towne Realty.

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

	Three Months Ended September 30,		Nine Months Ended September 30,		Increase/(Decrease)		Increase/(Decrease)	
					Three Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30, 2023 September 30, 2022		September 30, 2023 September 30, 2022	
(dollars in thousands)	2023	2022	2023	2022	Amount	Percent	Amount	Percent
Residential mortgage banking income, net	\$ 10,955	\$ 12,726	\$ 32,964	\$ 43,491	\$ (1,771)	(13.92)%	\$ (10,527)	(24.21)%
Title insurance and settlement fees	—	525	443	1,590	(525)	(100.00)%	(1,147)	(72.14)%
Property management fees, net	12,800	9,891	40,433	36,489	2,909	29.41 %	3,944	10.81 %
Real estate brokerage income, net	(63)	2,932	3,562	8,899	(2,995)	(102.15)%	(5,337)	(59.97)%
Income (loss) from unconsolidated subsidiary	(63)	77	(884)	359	(140)	N/M	(1,243)	N/M
Gain on sale of BHHS Towne Realty	—	—	8,833	—	—	N/M	8,833	N/M
Net interest and other income	1,163	1,508	1,984	6,851	(345)	(22.88)%	(4,867)	(71.04)%
Total revenue	24,792	27,659	87,335	97,679	(2,867)	(10.37)%	(10,344)	(10.59)%
Provision for credit losses	(199)	(315)	(210)	285	116	(36.83)%	(495)	(173.68)%
Salaries and employee benefits	12,881	15,854	41,670	49,646	(2,973)	(18.75)%	(7,976)	(16.07)%
Occupancy	1,669	1,919	5,559	5,814	(250)	(13.03)%	(255)	(4.39)%
Furniture and equipment	600	765	1,933	2,232	(165)	(21.57)%	(299)	(13.40)%
Amortization of intangible assets	742	817	2,166	2,449	(75)	(9.18)%	(283)	(11.56)%
Other expenses	9,544	8,687	27,319	29,472	857	9.87 %	(2,153)	(7.31)%
Total expenses	25,436	28,042	78,647	89,613	(2,606)	(9.29)%	(10,966)	(12.24)%
Income before income tax, corporate allocation, and noncontrolling interest	(445)	(68)	8,898	7,781	(377)	(554.41)%	1,117	14.36 %
Corporate allocation	(600)	(602)	(1,800)	(2,602)	2	0.33 %	802	30.82 %
Income before income tax provision and noncontrolling interest	(1,045)	(670)	7,098	5,179	(375)	(55.97)%	1,919	37.05 %
Provision for income tax	(99)	(120)	1,769	1,110	21	17.50 %	659	59.37 %
Net income	(946)	(550)	5,329	4,069	(396)	(72.00)%	1,260	30.97 %
Noncontrolling interest	117	(502)	(1,680)	(1,672)	619	123.31 %	(8)	(0.48)%
Net income attributable to TowneBank	\$ (829)	\$ (1,052)	\$ 3,649	\$ 2,397	\$ 223	21.20 %	\$ 1,252	52.23 %
% of total consolidated income	(1.85)%	(2.10)%	2.92 %	1.68 %				

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	Three Months Ended September 30,		Nine Months Ended September 30,		Increase/(Decrease) Three Months Ended September 30, 2023 September 30, 2022		Increase/(Decrease) Nine Months Ended September 30, 2023 September 30, 2022	
	2023	2022	2023	2022	Amount	Percent	Amount	Percent
<i>(dollars in thousands)</i>								
Key data:								
Efficiency ratio (non-GAAP)	99.61%	98.43%	97.43%	89.24%				
Number of units sold	29	1,179	1,373	3,485	(1,150)	(97.54)%	(2,112)	(60.60)%
Volume of units sold	\$ 14,204	\$480,137	\$659,472	\$1,461,302	(465,933)	(97.04)%	(801,830)	(54.87)%
Number of real estate agents	—	405	—	405	(405)	(100.00)%	(405)	(100.00)%
Loans originated, mortgage	\$348,387	\$458,254	\$1,037,839	\$1,629,791	\$(109,867)	(23.98)%	\$(591,952)	(36.32)%
Loans originated, joint venture	172,021	234,443	515,289	720,703	(62,422)	(26.63)%	(205,414)	(28.50)%
Total loans originated	\$520,408	\$692,697	\$1,553,128	\$2,350,494	\$(172,289)	(24.87)%	\$(797,366)	(33.92)%
Number of loans, mortgage	938	1,236	2,776	4,253	(298)	(24.11)%	(1,477)	(34.73)%
Number of loans, joint venture	549	747	1,675	2,249	(198)	(26.51)%	(574)	(25.52)%
Total number of loans	1,487	1,983	4,451	6,502	(496)	(25.01)%	(2,051)	(31.54)%
Average loan amount, mortgage	\$ 371	\$ 371	\$ 374	\$ 383	\$ —	— %	\$ (9)	(2.35)%
Average loan amount, joint venture	313	314	308	320	(1)	(0.32)%	(12)	(3.75)%
Average loan amount	\$ 350	\$ 349	\$ 349	\$ 362	1	0.29 %	(13)	(3.59)%
Number of originators, mortgage	137	135	137	135	2	1.48 %	2	1.48 %
Number of originators, joint venture	55	59	55	59	(4)	(6.78)%	(4)	(6.78)%
Total number of originators	192	194	192	194	(2)	(1.03)%	(2)	(1.03)%

Insurance Segment. The Insurance segment reported earnings before income taxes and noncontrolling interest in the three months ended September 30, 2023, of \$8.04 million, an increase of \$3.18 million, or 65.29%, over comparative 2022. In the first nine months of 2023, earnings before income taxes and noncontrolling interest increased \$5.18 million, or 32.34%, compared to 2022.

Commissions on property and casualty insurance increased \$4.54 million and \$10.81 million, respectively, in the three- and nine-month periods ended September 30, 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 \$0.68 million in third quarter 2023, and \$1.29 million in the nine-month comparison to the same respective periods in 2022. The Company sold a small insurance benefits subsidiary in third quarter 2023 and reported a gain on sale of \$0.54 million. 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)		Increase/(Decrease)	
					Three Months Ended		Nine Months Ended	
					September 30, 2023		September 30, 2023	
					September 30, 2022		September 30, 2022	
(dollars in thousands)	2023	2022	2023	2022	Amount	Percent	Amount	Percent
Net commission and fee income								
Property and casualty	\$ 22,103	\$ 17,567	\$ 60,259	\$ 49,451	\$ 4,536	25.82 %	\$ 10,808	21.86 %
Employee benefits	4,245	4,020	13,393	12,105	225	5.60 %	1,288	10.64 %
Specialized benefit services	133	160	445	489	(27)	(16.88)%	(44)	(9.00)%
Total net commissions and fees	26,481	21,747	74,097	62,045	4,734	21.77 %	12,052	19.42 %
Contingency and bonus revenue	2,335	1,654	9,343	8,052	681	41.17 %	1,291	16.03 %
Other income	557	23	573	72	534	N/M	501	695.83 %
Total revenues	29,373	23,424	84,013	70,169	5,949	25.40 %	13,844	19.73 %
Employee commission expense	4,906	4,331	14,340	12,943	575	13.28 %	1,397	10.79 %
Revenue, net of commission expense	24,467	19,093	69,673	57,226	5,374	28.15 %	12,447	21.75 %
Salaries and employee benefits	11,650	10,260	34,293	29,590	1,390	13.55 %	4,703	15.89 %
Occupancy	721	720	2,303	2,202	1	0.14 %	101	4.59 %
Furniture and equipment	227	196	650	606	31	15.82 %	44	7.26 %
Amortization of intangible assets	1,572	1,101	4,660	3,366	471	42.78 %	1,294	38.44 %
Other expenses	1,568	1,653	4,614	4,532	(85)	(5.14)%	82	1.81 %
Total operating expenses	15,738	13,930	46,520	40,296	1,808	12.98 %	6,224	15.45 %
Income before income tax, corporate allocation, and noncontrolling interest	8,729	5,163	23,153	16,930	3,566	69.07 %	6,223	36.76 %
Corporate allocation	(691)	(300)	(1,963)	(918)	(391)	130.33 %	(1,045)	113.83 %
Income before income tax provision and noncontrolling interest	8,038	4,863	21,190	16,012	3,175	65.29 %	5,178	32.34 %
Provision for income tax	2,069	1,219	5,451	4,091	850	69.73 %	1,360	33.24 %
Net income	5,969	3,644	15,739	11,921	2,325	63.80 %	3,818	32.03 %
Noncontrolling interest	—	—	—	—	—	N/M	—	N/M
Net income attributable to TowneBank	\$ 5,969	\$ 3,644	\$ 15,739	\$ 11,921	\$ 2,325	63.80 %	\$ 3,818	32.03 %
% of total consolidated income	13.31 %	7.26 %	12.61 %	8.38 %				
Efficiency ratio (non-GAAP)	59.21 %	67.19 %	60.55 %	64.53 %				

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2023, total assets were \$16.68 billion, which is \$0.84 billion, or 5.27%, higher than total assets at December 31, 2022. Our loan portfolio, less unearned income and deferred costs, made up 66.98% of our period-end assets and totaled \$11.17 billion at September 30, 2023. Average assets for the quarter ended September 30, 2023, were \$16.76 billion, an increase of \$0.83 billion, or 5.23%, from the quarter ended December 31, 2022.

Average earning assets for third quarter 2023 increased \$0.63 billion from fourth quarter 2022 to \$15.21 billion. Our average total deposits were \$13.83 billion for third quarter 2023, an increase of \$477.46 million, or 3.58%, compared to fourth quarter 2022. Average noninterest-bearing deposits for the

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quarter ended September 30, 2023, decreased \$850.62 million, or 15.51%, from the quarter ended December 31, 2022.

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 September 30, 2023 and December 31, 2022, respectively, these balances were \$1.13 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 third quarter 2023 was \$1.23 billion, or 8.09%, 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 \$1.96 billion at September 30, 2023, compared with \$1.84 billion at December 31, 2022. The average balance during third quarter 2023 was \$2.00 billion, compared to \$1.86 billion during the quarter ended December 31, 2022. The average AFS debt securities portfolio represented 13.14% and 12.77% of average earning assets in third quarter 2023 and the quarter ended December 31, 2022, respectively. During the nine months ended September 30, 2023, we had maturities and calls totaling \$104.05 million in investment securities that were classified as AFS.

Net unrealized losses related to the fair value of AFS debt securities increased \$36.96 million in the first nine 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 September 30, 2023, the allowance for credit losses on AFS debt securities was \$1.34 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 \$547.85 million at September 30, 2023, and \$548.48 million at December 31, 2022. The average balance during third quarter 2023 was \$547.86 million, compared with \$548.54 million in fourth quarter 2022, representing 3.60% 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 \$85 thousand at September 30, 2023, and \$83 thousand at December 31, 2022. During the nine months ended September 30, 2023, we had maturities and calls totaling \$397 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 September 30, 2023, we held \$188.05 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 1.50% of average earning assets for the quarter ended September 30, 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.

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Loan Portfolio. Loans, net of unearned income and deferred costs, were \$11.17 billion at September 30, 2023, which was a \$378.37 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, would have increased \$100.48 million, or 0.93%, from December 31, 2022. As a percentage of total average earning assets, average loans were 73.45% for the quarter ended September 30, 2023, compared with 73.41% for the quarter ended December 31, 2022. We expect to continue managing loan growth to align with deposit growth trends.

Allowance for Credit Losses and Asset Quality. The allowance for credit losses on funded loans at September 30, 2023 and December 31, 2022, was \$125.16 million and \$110.82 million, respectively. The \$14.34 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, driven by loan growth and changes in our portfolio composition, were partially offset by moderate improvements in our modeled macroeconomic forecast scenarios. The allowance was equal to 1.12% of total loans outstanding at September 30, 2023, compared with 1.03% at December 31, 2022.

Classified loans, defined as loans in the substandard and doubtful categories, represented 0.33% and 0.25% of total loans at September 30, 2023 and December 31, 2022. Loans 30 to 89 days past due totaled \$6.43 million at September 30, 2023, as compared to \$8.63 million at December 31, 2022. Total past due and nonaccruing loans were \$14.19 million at September 30, 2023, compared to \$15.18 million at December 31, 2022. The allowance for credit losses on funded loans was equal to 17.60x of nonperforming loans at September 30, 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):

	September 30, 2023	December 31, 2022
Real estate - construction and development	\$ 21,461	\$ 20,218
Real estate - commercial owner occupied	12,932	10,625
Real estate - commercial non-owner occupied	20,122	16,478
Real estate - multi-family	2,616	1,909
Real estate - residential 1-4 family	32,425	27,688
HELOC	16,833	16,766
Commercial and industrial business loans	7,786	6,912
Government	3,265	3,176
Indirect	4,837	4,172
Consumer and other loans	2,882	2,872
Total	\$ 125,159	\$ 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		
	September 30,		December 31,
	2023	2022	2022
Nonperforming Assets			
Nonperforming loans	\$ 7,110	\$ 5,250	\$ 6,273
Foreclosed property	766	186	560
Total nonperforming assets	<u>\$ 7,876</u>	<u>\$ 5,436</u>	<u>\$ 6,833</u>
Loans past due 90 days and still accruing interest	<u>\$ 970</u>	<u>\$ 725</u>	<u>\$ 324</u>
Asset Quality Ratios			
Allowance for credit losses to nonperforming loans	17.60x	20.48x	17.67x
Allowance for credit losses to period-end loans	1.12%	1.02%	1.03%
Nonperforming loans to period-end loans	0.06%	0.05%	0.06%
Nonperforming assets to period-end assets	0.05%	0.03%	0.04%
Quarterly net charge-offs (recoveries) to average loans (annualized)	(0.04)%	(0.01)%	0.11%

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

	September 30, 2023	December 31, 2022
CRE - Construction and development	\$ 263	\$ 93
CRE - Owner occupied	526	565
CRE - Non-owner occupied	—	—
CRE - Multi-family	220	—
Residential 1-4 family	3,059	2,416
HELOC	551	457
Commercial and industrial business	1,367	2,079
Government	—	—
Indirect	1,124	663
Consumer and other loans	—	—
Total nonperforming loans	<u>\$ 7,110</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

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becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection.

At September 30, 2023, we had \$7.88 million in nonperforming assets, which amounted to 0.05% of total assets. Additionally, loans 60-89 days past due, excluding nonperforming loans, totaled \$1.30 million, and there were \$0.97 million in loans past due 90 days or more that were accruing interest. Nonperforming assets consisted of \$7.11 million in nonperforming loans and \$0.77 million in foreclosed property at September 30, 2023. Nonperforming loans increased by \$0.84 million from December 31, 2022. Foreclosed property increased \$206 thousand from December 31, 2022.

Deposits. Total deposits at September 30, 2023, were \$13.88 billion, representing an increase of \$468.74 million, or 3.49%, compared to September 30, 2022. Excluding \$514.57 million in acquired deposits, total deposits would have decreased \$45.83 million, or 0.34%, compared to prior year but increased \$72.01 million, or 0.54%, compared to December 31, 2022. Total average deposits were \$13.83 billion during third quarter 2023, compared to \$13.62 billion during third quarter 2022 and \$13.35 billion during fourth quarter 2022.

	Total Deposits Period Ended			September 30, 2023 vs. September 30, 2022		September 30, 2023 vs. December 31, 2022	
	September 30,		December 31,	Change		Change	
(dollars in thousands)	2023	2022	2022	\$	%	\$	%
Interest-bearing demand and money market accounts	\$ 6,764,415	\$ 6,042,417	\$ 6,185,075	\$ 721,998	11.95 %	\$ 579,340	9.37 %
Regular savings	350,031	387,622	374,987	\$ (37,591)	(9.70)%	\$ (24,956)	(6.66)%
Certificates of deposit	2,321,498	1,407,495	1,468,975	\$ 914,003	64.94 %	\$ 852,523	58.04 %
Total interest-bearing	9,435,944	7,837,534	8,029,037	\$ 1,598,410	20.39 %	\$ 1,406,907	17.52 %
Noninterest-bearing demand	4,444,861	5,574,528	5,265,186	\$ (1,129,667)	(20.26)%	\$ (820,325)	(15.58)%
Total	<u>\$ 13,880,805</u>	<u>\$ 13,412,062</u>	<u>\$ 13,294,223</u>	<u>\$ 468,743</u>	<u>3.49 %</u>	<u>\$ 586,582</u>	<u>4.41 %</u>

At September 30, 2023, we had \$6.44 billion in estimated uninsured deposits, \$0.70 billion of which is collateralized by securities, for an estimated uncollateralized and uninsured deposit total of \$5.75 billion, roughly 41% of total deposits. Total liquidity sources at September 30, 2023, totaled \$6.04 billion, or 105% of adjusted uninsured deposits.

Average noninterest-bearing demand deposits as a percentage of average total deposits were 33.50% during third quarter 2023 and 41.77% during the same period in 2022. The cost of interest-bearing deposits was 2.77% for third quarter 2023, compared with 0.51% for third quarter 2022.

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

	Average Balance/Cost Rate									
	Three Months Ended					Nine Months Ended				
	September 30,		December 31,			September 30,				
	2023	2022	2022			2023	2022			
Interest-bearing demand and money market accounts	\$ 6,605,853	2.49 %	\$ 6,084,753	0.43 %	\$ 6,022,582	0.92 %	\$ 6,349,422	2.04 %	\$ 6,203,889	0.26 %
Regular savings	356,116	1.05 %	391,437	0.64 %	378,816	0.80 %	376,282	0.95 %	387,290	0.57 %
Certificates of deposit	2,236,102	3.88 %	1,456,746	0.83 %	1,468,589	1.47 %	1,964,718	3.22 %	1,440,661	0.66 %
Total interest-bearing	9,198,071	2.77 %	7,932,936	0.51 %	7,869,987	1.01 %	8,690,422	2.26 %	8,031,840	0.34 %
Noninterest-bearing demand	4,633,856		5,690,020		5,484,477		4,873,945		5,569,186	
Total	<u>\$13,831,927</u>	1.84 %	<u>\$13,622,956</u>	0.30 %	<u>\$13,354,464</u>	0.60 %	<u>\$13,564,367</u>	1.45 %	<u>\$13,601,026</u>	0.20 %

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

	Average Balance and Composition			
	Three Months Ended			
	September 30,			
	2023		2022	
Interest-bearing demand and money market accounts	\$ 6,605,853	47.76 %	\$ 6,084,753	44.67 %
Regular savings	356,116	2.57 %	391,437	2.87 %
Certificates of deposit	2,236,102	16.17 %	1,456,746	10.69 %
Total interest-bearing	9,198,071	66.50 %	7,932,936	58.23 %
Noninterest-bearing	4,633,856	33.50 %	5,690,020	41.77 %
Total	<u>\$13,831,927</u>	100.00 %	<u>\$13,622,956</u>	100.00 %

Advances from the Federal Home Loan Bank of Atlanta. Advances from the FHLB at September 30, 2023, were \$104.14 million, compared to \$29.67 million at December 31, 2022. The average borrowing cost for third quarter 2023 was 5.39% and 2.78% in fourth quarter 2022.

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2023, are summarized as follows (dollars in thousands):

Maturity	Interest Rate	Call / Reset Date	Outstanding Amount
10/19/2023	5.48%	—	\$ 100,000
11/15/2028	3.43%	—	2,426
12/01/2028	2.83%	—	1,713
Total FHLB Loans			<u>\$ 104,139</u>

At September 30, 2023, certain residential, HELOCs, agency securities, and commercial mortgages secured by real estate with carrying values of \$2.86 billion collateralized the advances from the FHLB. At December 31, 2022, certain residential HELOCs, second mortgages, agency securities, and commercial

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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 \$299.11 million during third quarter 2023, compared with \$138.51 million for fourth quarter 2022, while the average cost of these funds was 4.42% 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.

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 September 30, 2023, the carrying value of the subordinated notes totaled \$255.58 million, compared with \$247.42 million at December 31, 2022. Average subordinated debt during third quarter 2023 was \$255.45 million, compared to \$247.32 million during fourth quarter 2022, while the average cost of the debentures was 3.52% and 3.41%, respectively.

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

On August 23, 2023, we declared a quarterly shareholder cash dividend of \$0.25 per common share. The dividend was paid October 13, 2023, to shareholders of record on September 29, 2023. On May 24, 2023, we declared a quarterly shareholder cash dividend of \$0.25 per common share. The dividend was paid July 14, 2023, to shareholders of record on June 30, 2023. 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.

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The following table provides summarized information on our availability of liquid funds and borrowings as of September 30, 2023 (in thousands):

	September 30, 2023
Available Liquid Funds:	
Cash and cash equivalents	\$ 1,215,752
Unencumbered investment securities	1,679,229
Availability of Borrowings:	
Amount available from FHLB	1,287,310
Amount available from unsecured lines of credit with correspondent banks	150,000
Amount available from Federal Reserve discount window	1,703,969
	<u>\$ 6,036,260</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 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 September 30, 2023.

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

	September 30,		December 31,
	2023	2022	2022
Risk-based capital ratios (1):			
Common equity Tier 1 (4.5% minimum requirement)	12.19 %	11.92 %	11.92 %
Tier 1 (6.0% minimum requirement)	12.31 %	12.05 %	12.04 %
Total (8.0% minimum requirement)	15.09 %	14.80 %	14.80 %
Tier 1 leverage ratio (4.0% minimum requirement)	10.06 %	9.52 %	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 tangible equity. This adjustment allows management to review the Company's core operating results and core capital position.

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Non-GAAP Reconciliations. Where non-GAAP financial measures are used, the comparable GAAP financial measure, as well as the reconciliation to the comparable GAAP financial measure, can be found in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
<i>(dollars in thousands)</i>				
Average assets (GAAP)	\$ 16,762,859	\$ 16,304,294	\$ 16,647,804	\$ 16,382,006
Less: average goodwill and intangible assets	526,445	504,000	526,375	504,715
Average tangible assets (non-GAAP)	\$ 16,236,414	\$ 15,800,294	\$ 16,121,429	\$ 15,877,291
Average equity (GAAP)	\$ 1,986,469	\$ 1,878,574	\$ 1,970,510	\$ 1,885,655
Less: average goodwill and intangible assets	526,445	504,000	526,375	504,715
Average tangible equity (non-GAAP)	\$ 1,460,024	\$ 1,374,574	\$ 1,444,135	\$ 1,380,940
Average common equity (GAAP)	\$ 1,969,898	\$ 1,861,845	\$ 1,954,850	\$ 1,869,112
Less: average goodwill and intangible assets	526,445	504,000	526,375	504,715
Average tangible common equity (non-GAAP)	\$ 1,443,453	\$ 1,357,845	\$ 1,428,475	\$ 1,364,397
Net Income (GAAP)	\$ 44,862	\$ 50,169	\$ 124,911	\$ 142,302
Amortization of intangibles, net of tax	2,852	2,089	8,488	6,435
Tangible net income (non-GAAP)	\$ 47,714	\$ 52,258	\$ 133,399	\$ 148,737
Total Revenue (GAAP)	\$ 172,864	\$ 179,236	\$ 538,575	\$ 511,628
Gain on sale of equity investments	(554)	—	(9,386)	—
Operating Income (non-GAAP)	\$ 172,310	\$ 179,236	\$ 529,189	\$ 511,628
Noninterest expense (GAAP)	\$ 117,702	\$ 112,034	\$ 367,328	\$ 330,139
Less: Amortization of intangibles	3,610	2,644	10,744	8,145
Noninterest expense net of amortization (non-GAAP)	\$ 114,092	\$ 109,390	\$ 356,584	\$ 321,994
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Return on average assets (GAAP basis)	1.06 %	1.22 %	1.00 %	1.16 %
Impact of excluding average goodwill and other intangibles and amortization	0.11 %	0.09 %	0.11 %	0.09 %
Return on average tangible assets	1.17 %	1.31 %	1.11 %	1.25 %
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Return on average equity (GAAP basis)	8.96 %	10.60 %	8.48 %	10.09 %
Impact of excluding average goodwill and other intangibles and amortization	4.01 %	4.48 %	3.87 %	4.31 %
Return on average tangible equity	12.97 %	15.08 %	12.35 %	14.40 %

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Efficiency ratio (GAAP)	68.09 %	62.51 %	68.20 %	64.53 %
Impact of excluding goodwill and other intangibles and amortization	(1.88)%	(1.48)%	(0.82)%	(1.59)%
Efficiency ratio (non-GAAP)	66.21 %	61.03 %	67.38 %	62.94 %

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

	September 30,	
	2023	2022
Book value per share (GAAP basis)	\$ 26.28	\$ 25.08
Impact of excluding goodwill and other intangibles and amortization	(7.00)	(6.91)
Tangible book value per share	\$ 19.28	\$ 18.17

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

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

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

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

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

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

At September 30, 2023, we had \$4.83 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	(9.30)%
+ 200 basis points	(6.22)%
+ 100 basis points	(3.07)%
- 100 basis points	(3.16)%
- 200 basis points	(3.93)%

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	\$ (313,542)
+ 200 basis points	\$ (215,837)
+ 100 basis points	\$ (111,679)
- 100 basis points	\$ (80,441)
- 200 basis points	\$ (27,270)

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 the risk of rates changing faster or slower or by a higher absolute amount as well as differing competitive

PART I. FINANCIAL INFORMATION

Item 3. Quantitative and Qualitative Disclosures About Market Risk

environments. Because 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 September 30, 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 September 30, 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 and Part II, Item 1A, of TowneBank's Quarterly Report on Form 10-Q for the period ended June 30, 2023. 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 and Quarterly Report on Form 10-Q for the period ended June 30, 2023.

Item 2. Unregistered Sales of Equity Securities, and Issuer Purchases of Equity Securities

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
(31.1)	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(31.2)	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
(32)	Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002.
(99)	Report of Independent Registered Public Accounting Firm dated November 3, 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

November 3, 2023

Date

By: /s/ William I. Foster III

William I. Foster III

President and Chief Executive Officer

November 3, 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 September 30, 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.

November 3, 2023

Date

/s/ William I. Foster III

William I. Foster III

President and Chief Executive Officer

CERTIFICATIONS

I, William B. Littreal, certify that:

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

November 3, 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 September 30, 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.

November 3, 2023

Date

/s/ William I. Foster III

William I. Foster III

Chief Executive Officer

November 3, 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 September 30, 2023, and the related condensed consolidated statements of income, comprehensive income (loss) and equity for the three and nine-month periods ended September 30, 2023 and 2022, and the statement of cash flows for the nine-month periods ended September 30, 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.

Charlotte, NC

November 3, 2023