TowneBank

2009 Annual Report

TowneBank

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BUSINESS PROFILE

TowneBank was organized in 1998 under the laws of the Commonwealth of Virginia to engage in a general retail and commercial banking business and began operations on April 8, 1999. We place special emphasis on serving the financial needs of small- and medium-size businesses, professionals, and individuals in the Greater Hampton Roads region in Southeastern Virginia. We offer a full range of banking and related financial services through our divisions and subsidiaries that include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, Inc. ("Towne Insurance"); TowneBank Commercial Mortgage, LLC; TFA Benefits, which encompasses Benefit Design Group and The Frieden Agency, Inc.; Out of Town, LLC, d/b/a Red Sky Travel Insurance ("Red Sky"); Towne Mortgage, LLC; NewTowne Mortgage, LLC; Corolla Classic Vacations, LLC ("CCV"); Towne 1031 Exchange, LLC ("Towne 1031 Exchange"); and Prudential Towne Realty ("PTR"), which includes Lawyers Escrow and Title, LLC ("LET"); Towne Investment Group, which provides investment and asset management services; and TowneBank Mortgage, which originates mortgage loans and sells them to investors on the national secondary market. Effective December 31, 2009, we acquired Taylor Johnson Insurance Group ("Taylor Johnson"), which will be affiliated with Towne Insurance to enable our insurance agency to expand the services available to our bank and insurance clients and position us as a full-service provider of risk management services.

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

CORPORATE MISSION STATEMENT

TowneBank will be a relationship and friendship-driven local bank focused on basic human values that will serve to create a warm sense of belonging and financial well-being among our family of members.

We will offer a competitive array of business and personal financial services, delivered only with the highest ethical standards. Our commitment to exquisite service for our members will lead to our ability to create a reasonable rate of return for our shareholders, a bright future for our dedicated bankers, and a leadership role for our bank in promoting the social, cultural, and economic well-being of our community.

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	2009	2008	2009/2008 Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 100,343	$ 87,127	$ 13,216	15.17%
Noninterest income (1)	51,590	40,907	10,683	26.12%
Noninterest expenses	111,791	91,257	20,534	22.50%
Provision for loan losses	12,891	7,022	5,869	83.58%
Net income	26,759	23,894	2,865	11.99%
Net income per common share - basic	0.67	0.93	(0.26)	(27.96%)
Net income per common share - diluted	0.66	0.89	(0.23)	(25.84%)
Period End Data:				
Total assets	$ 3,606,451	$ 3,133,578	$ 472,873	15.09%
Total assets - tangible	3,506,514	3,061,545	444,969	14.53%
Earning assets	3,240,497	2,860,820	379,677	13.27%
Loans (net of unearned income and deferred costs)	2,565,910	2,350,186	215,724	9.18%
Allowance for loan losses	33,793	27,503	6,290	22.87%
Goodwill and other intangibles	99,937	72,033	27,904	38.74%
Noninterest-bearing deposits	572,228	475,290	96,938	20.40%
Interest-bearing deposits	1,989,474	1,763,378	226,096	12.82%
Total deposits	2,561,702	2,238,668	323,034	14.43%
Shareholders' equity	464,321	419,671	44,650	10.64%
Shareholders' equity - tangible	364,384	347,637	16,747	4.82%
Book value per share	11.87	11.74	0.13	1.06%
Book value per share - tangible	8.23	8.81	(0.58)	(6.57%)
Cash dividends declared per share	0.32	0.32	-	-
Daily Average Balances:				
Total assets	$ 3,432,368	$ 2,778,722	$ 653,646	23.52%
Total assets - tangible	3,350,603	2,706,140	644,463	23.81%
Earning assets	3,145,322	2,491,049	654,273	26.26%
Loans (net of unearned income)	2,439,006	2,059,351	379,655	18.44%
Allowance for loan losses	28,841	23,745	5,096	21.46%
Goodwill and other intangibles	81,764	72,582	9,182	12.65%
Noninterest-bearing deposits	566,435	484,735	81,700	16.85%
Interest-bearing deposits	1,953,497	1,537,759	415,738	27.04%
Total deposits	2,519,931	2,022,494	497,437	24.60%
Total equity	437,556	296,749	140,807	47.45%
Total equity - tangible	355,792	224,167	131,625	58.72%
Key Ratios:				
Return on average assets	0.78%	0.86%	(0.08%)	(9.30%)
Return on average tangible assets	0.80%	0.88%	(0.08%)	(9.09%)
Return on average equity	6.12%	8.05%	(1.93%)	(23.98%)
Return on average tangible equity	7.52%	10.66%	(3.14%)	(29.46%)
Net interest margin (1)	3.29%	3.61%	(0.32%)	(8.86%)
Efficiency ratio (2)	73.58%	71.28%	2.30%	3.23%
Average earning assets/total average assets	91.64%	89.65%	1.99%	2.22%
Average loans/average deposits	96.79%	101.82%	(5.03%)	(4.94%)
Average noninterest deposits/total average deposits	22.48%	23.97%	(1.49%)	(6.22%)
Allowance for loan losses/period end loans	1.32%	1.17%	0.15%	12.82%
Period end equity/period end total assets	12.87%	13.39%	(0.52%)	(3.88%)

Notes:

(1) Includes bank-owned life insurance

(2) Excludes investment securities gains of $11.15 million in 2009 and $2.96 million in 2008.

TowneBank
Selected Financial Highlights

Period Ended December 31,	2007	2006	2005
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 85,499	$ 77,042	$ 62,443
Noninterest income (1)	36,752	35,561	34,076
Noninterest expenses	85,507	76,043	66,948
Provision for loan losses	2,743	2,572	2,364
Net income	23,259	21,786	17,680
Net income per common share - basic	0.98	0.93	0.79
Net income per common share - diluted	0.92	0.86	0.74
Period End Data:			
Total assets	$ 2,501,078	$ 2,194,585	$ 1,803,182
Total assets - tangible	2,433,009	2,137,537	1,747,320
Earning assets	2,267,763	2,009,270	1,625,125
Loans (net of unearned income and deferred costs)	1,829,456	1,641,826	1,264,492
Allowance for loan losses	21,323	19,670	17,071
Goodwill and other intangibles	68,069	57,048	55,862
Noninterest-bearing deposits	439,122	453,451	417,061
Interest-bearing deposits	1,395,224	1,251,248	1,050,664
Total deposits	1,834,346	1,704,699	1,467,725
Shareholders' equity	256,856	230,017	211,986
Shareholders' equity - tangible	188,787	172,969	156,124
Book value per share	10.66	9.75	9.21
Book value per share - tangible	7.83	7.33	6.78
Cash dividends declared per share, as restated for 3% stock dividend distributed September 2005	0.32	0.53	0.126
Daily Average Balances:			
Total assets	$ 2,387,258	$ 1,981,403	$ 1,629,425
Total assets - tangible	2,321,193	1,923,968	1,573,697
Earning assets	2,171,352	1,784,736	1,457,050
Loans (net of unearned income)	1,741,441	1,438,927	1,180,150
Allowance for loan losses	20,401	18,191	15,873
Goodwill and other intangibles	66,064	57,435	55,728
Noninterest-bearing deposits	453,799	434,490	389,658
Interest-bearing deposits	1,325,619	1,148,157	916,818
Total deposits	1,779,418	1,582,647	1,306,476
Shareholders' equity	242,186	220,932	202,811
Shareholders' equity - tangible	176,122	163,497	147,083
Key Ratios:			
Return on average assets	0.97%	1.10%	1.09%
Return on average tangible assets	1.00%	1.13%	1.12%
Return on average equity	9.60%	9.86%	8.72%
Return on average tangible equity	13.21%	13.33%	12.02%
Net interest margin	3.94%	4.32%	4.29%
Efficiency ratio (1)	69.94%	67.53%	69.36%
Average earning assets/total average assets	90.96%	90.07%	89.42%
Average loans/average deposits	97.87%	90.92%	90.33%
Average noninterest deposits/total average deposits	25.50%	27.45%	29.83%
Allowance for loan losses/period end loans	1.17%	1.20%	1.35%
Period end equity/period end total assets	10.27%	10.48%	11.76%

Notes:

The above data is retroactively restated to reflect the 3-for-2 stock split effective June 17, 2004, and the 3% stock dividend distributed on September 16, 2005.

(1) Excludes investment securities gains (losses) of $70,000, ($1.74 million), and $14,000 in 2007, 2006, and 2005, respectively

OVERVIEW

TowneBank ("Company," "we," "us") is headquartered in Portsmouth, Virginia, and operates primarily within the Greater Hampton Roads area. Within this geographic footprint, we operate under three business segments. These business segments are: Banking, Realty and Insurance.

During challenging financial times in 2009, we were able to grow our earnings by $2.87 million over 2008. Additionally, loans, deposits, and our overall customer base continued to grow in 2009, reflecting our commitment to customer service. Because of our conservative credit culture, our company has had minimal risk associated with the sub-prime issues currently affecting the financial services industry. Furthermore, we have no exposure to collateralized debt obligations backed by sub-prime residential mortgages.

The following is a summary of the Company's 2009 financial performance:

- Net income increased to $26.76 million compared with $23.89 million in 2008. Net income available to common shareholders for 2009 was $16.72 million after accretion and preferred dividend payments of $10.04 million on the Bank's preferred equity issued during the third and fourth quarters of 2008. The dividends and accretion related to the preferred equity issued in 2008 coupled with the net issuance of 2.90 million shares of common stock during 2009 resulted in a reduction of fully diluted earnings to $0.66 per common share as compared to $0.89 per common share in 2008.

- Net interest income increased $13.22 million, or 15.17%, primarily due to the growth in loans and other earning assets as net interest margin, on a tax-equivalent basis, decreased 31 basis points from 2008. The decrease in net interest margin was primarily a result of decreases in the Federal Funds rate and the Prime lending rate, both of which fell 400 basis points during 2008. The effect of the rate cuts was partially offset by a positive effect from the repricing of interest-bearing liabilities.

- The provision for loan losses increased $5.87 million, or 83.58%, over 2008. The increases were driven by loan growth of $215.72 million from 2008, an increase in nonaccrual loans, higher levels of net charge-offs, and current macro-economic conditions. The loan loss reserve increased to 1.32% of loans at December 31, 2009, from 1.17% at year-end 2008.

- Noninterest income improved $18.87 million, or 43.02%, compared to 2008. Excluding gains and losses on securities available for sale, noninterest income increased by $10.68 million, or 26.11%, over 2008. The increase was driven by an improvement in residential mortgage brokerage income related to significant growth in mortgage refinancing and purchase activity. Additionally, the Company realized an increase in real estate brokerage income due to the business combination that resulted in the formation of Prudential Towne Realty in January 2009.

- Noninterest expense increased $20.53 million, or 22.50%, compared to 2008. The increase was driven by $4.07 million in expenses related to the Prudential Towne Realty business combination, primarily consisting of transaction costs and higher occupancy and personnel expenses. Transaction costs of $453 thousand related to the acquisition of Taylor Johnson Insurance Group also contributed to the increase. Approximately $2.04 million of the expenses mentioned above were non-recurring charges related to the business combinations. Also contributing was an increase of $3.72 million in Federal Deposit Insurance Corporation (the "FDIC") and other insurance expenses, a 229.10% increase from last year. The Company's state franchise tax also increased by $1.07 million, 90.80% over 2008, due to the additional capital raised by the Bank in 2008 and 2009. Excluding the above mentioned costs, the increase in noninterest expense over 2008 was $11.22 million, or 12.30%

- The effective tax rate increased to 30.32% in 2009 compared to 26.81% in 2008. The increase was primarily due to an increase in nondeductible expenses, including compensation. The increase was offset by several factors, including additional tax-exempt interest income and a decrease in other disallowed expenses.

2009 ACQUISITIONS

Effective January 16, 2009, TowneBank contributed certain wholly-owned subsidiaries and $5.7 million in cash into a joint venture with Virginia Beach-based Prudential Decker Realty and Prudential McCardle Realty of Williamsburg. TowneBank owns 65% of the resulting new company, Prudential Towne Realty. The former owners of Prudential Decker and Prudential McCardle collectively own the balance of the shares of Prudential Towne Realty. The value of the transaction was $18.5 million.

Effective December 31, 2009, TowneBank acquired Taylor Johnson Insurance Group, an independent insurance agency that will be affiliated with Towne Insurance. The purchase price was $16.91 million in cash, stock, and other consideration.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make judgments, assumptions, and estimates in certain circumstances that affect amounts reported in the consolidated financial statements and the accompanying footnotes. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from management's current judgments. We consider our policies for the allowance for loan losses, deferred income taxes, estimates of fair value, and goodwill and intangibles to be critical accounting policies.

Allowance for Loan Losses: The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Increases and decreases in the allowance due to changes in the measurement of impaired loans, if applicable, are included in the provision for loan losses. We periodically evaluate the adequacy of the allowance for loan losses in order to maintain the allowance at a level that is sufficient to absorb probable credit losses. The amount of allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and external influences such as changes in economic conditions.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on their judgments of information available to them at the time of their examination. Although management believes that we use the best information available to evaluate the adequacy of the allowance, unknown market or borrower circumstances could result in adjustments and net earnings being significantly affected if conditions differ substantially from the assumptions used by management in determining the adequacy of the allowance.

Deferred Income Taxes: Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carry-forwards, and deferred

tax liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred income tax expense (benefit) represents the change during the period in the deferred tax assets and deferred tax liabilities.

We use the asset and liability method in accounting for income taxes. This method recognizes the amount of taxes payable or refundable for the current year and recognizes deferred tax liabilities and assets for the expected future tax consequences of events and transactions that have been recognized in our financial statements or tax returns.

Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Realization of the deferred income tax asset is dependent on generating sufficient taxable income in future years, and, as such, material changes could impact our financial condition and results of operations.

Estimates of Fair Value of Financial Instruments: The estimation of fair value is significant to certain assets, including loans held for sale, available-for-sale securities, and on-balance-sheet commitments to originate loans held for sale. These assets and liabilities are recorded either at fair value or at the lower of cost or fair value, as applicable. The 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. The fair values of available-for-sale securities 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 values of commitments to originate loans held for sale are based on fees currently charged to enter into similar agreements and, for fixed-rate commitments, also consider the difference between current levels of interest rates and committed rates.

Fair values can be volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, and market conditions. Since these factors can change significantly and rapidly, fair values are difficult to predict and subject to material changes that could impact our financial condition and results of operations.

Goodwill and Other Intangibles: We record all assets and liabilities acquired in purchase acquisitions, including goodwill, intangibles with indefinite lives, and other intangibles, at fair value as required by ASC 805, *Business Acquisitions*. The initial recording of goodwill and other intangibles requires subjective decisions concerning estimates of the fair value of the acquired assets and liabilities.

Goodwill is reviewed for potential impairment at the reporting unit level (one level below the business segments identified on pages 14-18) on an annual basis, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then if necessary, identifying the amount of impairment. The first step compares the fair value of the reporting unit to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess.

Other identifiable intangible assets are evaluated for impairment if events or changes in circumstances indicate a possible impairment. Such evaluation is based on undiscounted cash flow projections, which may extend far into the future and, by their nature, are difficult to determine over an extended timeframe. Fair value may be influenced by market prices, comparison to similar assets, market multiples, discounted cash flow analysis, and other determinants. Factors that may significantly affect the estimates include, among

others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology, changes in discount rates, and specific industry, or market sector conditions. Other key judgments in accounting for intangibles include useful life and classification between goodwill and intangibles with indefinite lives or other intangibles that require amortization.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Results of Operations: We reported net income for the years ended December 31, 2009, 2008, and 2007 of $26.76 million, $23.89 million, and $23.26 million, respectively. Diluted earnings per share were $0.66, $0.89, and $0.92 for the years ended December 31, 2009, 2008, and 2007, respectively.

Profitability, as measured by our return on average assets ("ROA") was 0.78%, 0.86%, and 0.97% for the years ended December 31, 2009, 2008, and 2007, respectively. Return on average tangible assets was 0.80%, 0.88%, and 1.00% for the same respective periods. ROA was negatively affected by the decline in margin resulting from the series of cuts to the Federal Funds rate and the Prime lending rate, as earning assets generally reprice more quickly than interest-bearing liabilities. Also negatively impacting net margin was our decision to increase liquidity during the year in response to the current financial environment. ROA was also affected by an increase in non-recurring expenses, as previously discussed on page 4 of this annual report, and the by the 23.52%, or $653.65 million, increase in average assets from the prior year.

Return on average equity ("ROE") was 6.12%, 8.05%, and 9.60% for years ended December 31, 2009, 2008, and 2007, respectively; while return on average tangible equity was 7.52%, 10.66%, and 13.21% for the same respective years. ROE was impacted by the 15.17% increase in net interest income from 2008 as compared to an increase in average equity of 47.45%, or $140.81 million, from the year ended December 31, 2008. The increase in average equity was related to the issuance of $135.53 million of preferred stock in the second half of 2008 and the issuance of $13.77 million of common stock in the offering of Series III Towne Investment Units during 2009.

Our operating income, calculated as net interest income and noninterest income less gains on available-for-sale ("AFS") securities, was $151.93 million for the year ended December 31, 2009, while it was $128.03 million and $122.25 million for 2008 and 2007, respectively.

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 impacted by the market interest rates and the mix and volume of earning assets and interest-bearing liabilities. The yields and rates in this discussion and in the following tables include income from bank-owned life insurance ("BOLI"), a non-GAAP measure, and have been computed based upon interest income and expense adjusted to a fully taxable equivalent basis using a 35% federal marginal tax rate for all periods shown.

Prior to the second quarter of 2009, our balance sheet has historically been asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, our net interest margin was likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. We are primarily funded by core deposits, with non interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Company's net interest income and net interest margin in a rising interest rate environment. We currently believe it is likely the federal funds rate and the prime interest rate will remain at the current, historically-low levels for the foreseeable future; however, there can be no assurance to that effect or as to the

magnitude of any change in market interest rates should a change occur, as such changes are dependent upon a variety of factors that are beyond our control. During 2009, we made the decision to take advantage of market volatility and recognize our gain position in certain securities, while at the same time redistributing our portfolio to better manage our interest rate risk. We used the proceeds from sales, maturities, and calls in our AFS portfolio to redeploy investment assets to primarily shorter-term securities with maturities ranging from 3 to 15 years and an average duration of 3.1 years.

Net interest income, on a tax-equivalent basis, was $105.07 million for the year ended December 31, 2009, which was $13.53 million, or 14.78% above the previous year's amount. In comparison to the prior year, net interest income improved primarily as a result of increases in the average volume of interest-earning assets partly offset by a decrease in the net interest margin. The average volume of earning assets for 2009 increased $655.69 million, or 25.87%, compared to the same period in 2008. Over the same time frame, the net interest margin decreased 32 basis points to 3.29% in 2009. Net interest margin was affected by our decision to increase liquidity during the year. While this decision resulted in a decrease in our net interest margin, we determined that it was prudent to ensure we had a sufficient margin of liquid assets on hand to cover unanticipated requirements during uncertain financial times. In the second half of 2009, we began deployment of these assets resulting in significant improvement to net interest margin, which increased to 3.53% in the fourth quarter.

Interest income, on a tax-equivalent basis, was $165.81 million, which was $10.54 million, or 6.79%, above the previous year's amount. In each comparison, growth in balances is partially offset by the declines in rates. The growth in average loans, which increased by $380.71 million, or 18.49%, had the most significant impact on interest income. Loans generally have significantly higher yields compared to securities, interest-bearing deposits and federal funds sold, and resell agreements and, as such, have a more positive effect on the net interest margin. The decline in rates was much smaller on a linked-quarter basis as the Federal Reserve concluded its reduction of short-term interest rates in December 2008.

Interest expense, for the quarter ended December 31, 2009, was $13.80 million, $2.67 million or 16.22% below the previous year's quarter, and $1.25 million or 8.29% below the quarter ended September 30, 2009. In the year-to-date period, interest expense was $60.74 million, which was $2.99 million or 4.69% less than the previous year's period. All interest expense comparisons benefitted from lower rates. Deposit repricing opportunities, following the Federal Reserve's reduction of short-term rates, served to partially offset the decrease in net interest margin results.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.29%, on a tax-equivalent basis, in the period ended December 31, 2009, which was 32 basis points lower than the previous year. Net interest margin will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

(continued on next page)

The purpose of volume and rate analysis is to describe the impact on interest income resulting from changes in average balances and average interest rates from those in effect during the previous year. The following tables include average balances, interest income and expense, average yields and costs, and volume and rate analysis (dollars in thousands).

	Year Ended December 31,								
	2009			2008			2007		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 2,440,060	$ 139,882	5.73%	$ 2,059,351	$ 130,742	6.35%	$ 1,741,441	$ 132,993	7.64%
Taxable investment securities	385,297	13,966	3.62%	257,666	13,649	5.30%	280,557	15,889	5.66%
Tax-exempt investment securities	107,943	5,741	5.32%	101,265	5,369	5.30%	80,995	4,176	5.16%
Interest-bearing deposits	153,328	403	0.26%	51,723	1,221	2.36%	48,854	2,429	4.97%
Mortgage loans held for sale	58,694	2,565	4.37%	21,044	1,196	5.68%	19,506	1,312	6.73%
Bank-Owned Life Insurance	44,810	3,251	7.25%	43,398	3,089	7.12%	14,228	1,091	7.67%
Total earning assets	3,190,132	165,808	5.20%	2,534,447	155,266	6.13%	2,185,581	157,890	7.22%
Less: allowance for loan losses	(28,841)			(23,745)			(20,401)		
Total nonearning assets	271,077			268,020			222,078		
Total assets	$ 3,432,368			$ 2,778,722			$ 2,387,258		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 509,654	$ 2,860	0.56%	$ 500,273	$ 6,161	1.23%	$ 483,207	$ 13,444	2.78%
Savings	64,057	610	0.95%	45,108	757	1.68%	24,246	400	1.65%
Certificates of deposit	1,379,786	39,107	2.83%	992,378	38,901	3.92%	818,166	40,497	4.95%
Total interest-bearing deposits	1,953,497	42,577	2.18%	1,537,759	45,819	2.98%	1,325,619	54,341	4.10%
FHLB advances and repurchase agreements	394,289	15,672	3.97%	384,845	15,737	4.09%	289,217	13,831	4.78%
Convertible subordinated capital debentures	42,920	2,489	5.80%	41,301	2,168	5.25%	42,119	2,253	5.35%
Total interest-bearing liabilities	2,390,706	60,738	2.54%	1,963,905	63,724	3.24%	1,656,955	70,425	4.25%
Noninterest-bearing liabilities									
Demand deposits	566,434			484,735			453,799		
Other noninterest-bearing liabilities	37,672			33,333			34,318		
Total liabilities	2,994,812			2,481,973			2,145,072		
Shareholders' equity	437,556			296,749			242,186		
Total liabilities and equity	$ 3,432,368			$ 2,778,722			$ 2,387,258		
Net interest income (tax-equivalent basis)		$ 105,070			$ 91,542			$ 87,465	
Reconcilement of Non-GAAP Financial Measures									
Bank-Owned Life Insurance		(3,251)			(3,089)			(1,091)	
Tax-equivalent basis adjustment		(1,476)			(1,326)			(875)	
Net interest income (GAAP)		$ 100,343			$ 87,127			$ 85,499	
Interest rate spread (2)			2.66%			2.89%			2.97%
Interest expense as a percent of average earning assets			1.90%			2.51%			3.22%
Net interest margin (tax-equivalent basis) (3)			3.29%			3.61%			4.00%
Total cost of deposits			1.69%			2.27%			3.05%

(1) Yields and interest income are presented on a taxable-equivalent basis using the federal statutory tax rate of 35%.
(2) Interest rate spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
(3) Net interest margin is net interest income expressed as a percentage of average earning assets.

(in thousands)	2009 vs 2008 Increase (Decrease) Due to Changes In			2008 vs 2007 Increase (Decrease) Due to Changes In		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 22,632	$ (13,492)	$ 9,140	$ 22,184	$ (24,435)	$ (2,251)
Taxable investment securities	5,458	(5,141)	317	(1,255)	(985)	(2,240)
Tax-exempt investment securities	355	17	372	1,075	118	1,193
Interest-bearing deposits	931	(1,749)	(818)	135	(1,343)	(1,208)
Loans held for sale	1,701	(332)	1,369	99	(215)	(116)
Bank-owned life insurance	102	60	162	2,082	(84)	1,998
Total earning assets	31,179	(20,637)	10,542	24,320	(26,944)	(2,624)
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	113	(3,414)	(3,301)	458	(7,741)	(7,283)
Savings	250	(397)	(147)	350	7	357
Certificates of deposit	12,726	(12,520)	206	7,717	(9,313)	(1,596)
Total interest-bearing deposits	13,089	(16,331)	(3,242)	8,525	(17,047)	(8,522)
FHLB advances and repurchase agreements	381	(446)	(65)	4,107	(2,201)	1,906
Convertible subordinated capital debentures	87	234	321	(43)	(42)	(85)
Total interest-bearing liabilities	13,557	(16,543)	(2,986)	12,589	(19,290)	(6,701)
Net interest income (tax equivalent basis)	$ 17,622	$ (4,094)	$ 13,528	$ 11,731	$ (7,654)	$ 4,077

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

Provision for Loan Losses: A provision for loan losses is charged against earnings in order to establish and maintain the allowance for loan losses at a level that reflects management's evaluation of the risk inherent in the portfolio. Management considers continuing assessments of nonperforming and "watch list" loans, analytical reviews of loan loss experience in relation to outstanding loans, and management's judgment with respect to current and expected economic conditions and their impact on the existing loan portfolio. The provisions for loan losses recorded in 2009, 2008, and 2007 were $12.89 million, $7.02 million, and $2.74 million, respectively. Net charge-offs were $6.60 million, $842 thousand, and $1.09 million for 2009, 2008, and 2007. The increase in the provision for loan losses in 2009 was due to loan growth of $215.72 million, or 9.18%, over 2008 and additions to the reserve to reflect an increase in nonaccrual loans, higher levels of net charge-offs, and current macro-economic conditions. The allowance for loan losses as a percentage of period-end loans was 1.32% and 1.17% at December 31, 2009 and 2008.

Noninterest Income: Total noninterest income for the year ended December 31, 2009, was $62.74 million, or $18.87 million and 43.02% higher than 2008. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $10.68 million, or 26.11%, over 2008. Total noninterest income for the year ended December 31, 2008, was $43.87 million, representing a $7.05 million, or 19.13%, increase from 2007. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $4.16 million, or 11.31%, over 2007. Included in noninterest income were gains on securities available-for-sale of $11.15 million in 2009 and $2.96 million in 2008. There was a gain of $70 thousand on available-for-sale securities in 2007. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2009, was 33.96% of total operating income, compared with 31.95% for 2008 and 30.06% for 2007.

The following table provides an analysis of noninterest income (dollars in thousands).

For the Year Ended December 31,	2009	2008	2007	2009/2008 Increase/(Decrease) Amount	2009/2008 Increase/(Decrease) %	2008/2007 Increase/(Decrease) Amount	2008/2007 Increase/(Decrease) %
Residential mortgage brokerage income, net	$ 11,910	$ 5,319	$ 6,164	$ 6,591	123.91%	$ (845)	(13.69%)
Real estate brokerage and property management income, net	11,725	7,778	5,462	3,947	50.75%	2,316	42.40%
Insurance commissions and other title fees and income, net	13,264	13,154	13,101	110	0.84%	53	0.40%
Service charges on deposit accounts	6,342	5,845	5,554	497	8.50%	291	5.24%
Credit card merchant fees	1,823	1,824	1,710	(1)	(0.05%)	114	6.67%
Other income							
Other	1,762	1,901	1,287	(139)	(7.31%)	614	47.72%
Towne Investment income, net	1,132	1,217	1,056	(85)	(6.98%)	161	15.25%
Bank-owned life insurance income	2,113	2,008	709	105	5.23%	1,299	183.22%
Service fees on loans	683	780	687	(97)	(12.44%)	93	13.54%
Towne Mortgage LLC income, net	631	658	432	(27)	(4.10%)	226	52.31%
Commerical mortgage brokerage fees, net	170	295	379	(125)	(42.37%)	(84)	(22.16%)
Other real estate income	34	128	211	(94)	(73.44%)	(83)	(39.34%)
Total other income	6,525	6,987	4,761	(462)	(6.61%)	2,226	46.75%
Noninterest income before securities gain/(loss)	51,589	40,907	36,752	10,682	26.11%	4,155	11.31%
Gain/(loss) on securities available for sale	11,149	2,960	70	8,189	276.66%	2,890	N/M
Total noninterest income	$ 62,738	$ 43,867	$ 36,822	$ 18,871	43.02%	$ 7,045	19.13%

N/M = not meaningful

For the year ended December 31, 2009, residential mortgage brokerage income, net of commission expense, was $11.91 million, reflecting an increase of $6.59 million, or 123.91%, compared to 2008, which was $5.32 million, or 13.69%, lower than 2007. The majority of the increase in net mortgage brokerage income in 2009 is attributable to the higher volume in refinancing transactions, which increased 227.09%, and purchase transactions, which increased 32.12%. For further information, refer to our discussion of the Realty segment on page 15 of this annual report, which provides a comparative schedule of operations.

Real estate brokerage and property management income, net of commission expense, for the year ended December 31, 2009, was $11.73 million, an increase of $3.95 million , or 50.75%, from 2008, which was $2.32 million, or 42.40%, greater than 2007. The increase from the prior year is primarily attributable to revenue from the business combination that resulted in the formation of Prudential Towne Realty in January 2009.

For the year ended December 31, 2009, insurance commissions and other title income, net of commission expense, was $13.26 million, which was $110 thousand, or 0.84%, higher than comparative 2008. The year ended December 31, 2009 included contingency income from property and casualty insurance of $752 thousand compared to $936 thousand and $576 thousand for 2008 and 2007. When compared to 2007, insurance commissions for the year ended December 31, 2008, were $53 thousand, or 0.40%, higher.

Service charges on deposit accounts were $6.34 million for 2009, compared with $5.85 million and $5.55 million for 2008 and 2007, respectively. The increase reflects the 24.60% increase in average deposits over the year ended December 31, 2008.

For the year ended December 31, 2009, credit card merchant fees totaled $1.82 million, which was $1 thousand, or 0.05%, below comparative 2008, which was $114 thousand, or 6.67%, more than 2007.

Other noninterest income decreased by $461 thousand, or 6.60%, to $6.53 million as the prior year included proceeds from the sale of our credit card portfolio, which resulted in a gain of $598 thousand. Additionally, the amount includes income generated by TowneBank Commercial Mortgage and Towne Investment Group, net of commission expense. For the year ended December 31, 2009, net commission income totaled $170 thousand and $1.13 million for TowneBank Commercial Mortgage and Towne Investment Group, respectively. In comparison, net commission income for years ended December 31, 2008 and 2007, were $296 thousand and $379 thousand for TowneBank Commercial Mortgage and $1.22 million and $1.06 million for Towne Investment Group.

Noninterest Expense: Total noninterest expense for 2009 was $111.79 million, which was $20.54 million and 22.50% higher than 2008. The primary components of 2009 noninterest expense were salaries and employee benefits of $61.82 million, occupancy expenses of $11.34 million, furniture and equipment expenses of $5.19 million, FDIC and other insurance expenses of $5.34 million, and advertising and marketing expenses of $3.67 million. In comparison to 2008, a significant portion of the increase in total noninterest expense is due to the January 16, 2009, transaction, whereby TowneBank contributed certain wholly-owned subsidiaries and $5.7 million in cash into a venture with Virginia Beach-based Prudential Decker Realty and Prudential McCardle Realty of Williamsburg. TowneBank owns 65% of the resulting new company, Prudential Towne Realty. The acquisition resulted in additional expenses of $4.07 million compared to 2008, primarily in salaries and benefits, occupancy, advertising, and amortization of intangible assets. The additional expenses included non-recurring expenses of $1.53 million, which resulted from integration costs, legal expenses, involuntary termination costs, and lease exit liabilities related to the acquisition. Additionally, effective December 31, 2009, TowneBank acquired Taylor Johnson Insurance Group, an independent insurance agency that will be affiliated with Towne Insurance, resulting in transaction costs of $453 thousand. Total acquisition costs for 2009 were $2.04 million which, due to accounting standards adopted in the current year, were included in expenses rather than treated as a component of the purchase price in a business combination. FDIC insurance expense increased as the FDIC implemented a restoration plan designed to replenish the Deposit Insurance Fund over a period of seven years and to increase the deposit insurance reserve ratio, which decreased to 1.01% of insured deposits on June 30, 2008, to the statutory minimum of 1.15% of insured deposits by December 31, 2013. In order to implement the restoration plan, the FDIC adjusted its risk-based assessment system and its base assessment rates. In the second quarter of 2009, the FDIC adopted a rule imposing a 5 basis point special assessment on each insured depository institution's assets minus its Tier 1 capital as reported in its report of condition as of September 30, 2009. The special assessment resulted in a recorded expense of $1.6 million the second quarter of 2009, contributing to a total increase of $3.72 million in FDIC and other insurance expenses. The Company's state franchise tax also increased by $1.07 million over 2008, due to the additional capital raised by the Bank in 2008 and 2009. Total noninterest expense for the year ended December 31, 2008, was $91.26 million compared with $85.51 million for the year ended December 31, 2007, representing a 6.72% increase. Total noninterest expense to total operating revenue, excluding securities gains and losses, was 73.58% for the year ended December 31, 2009, compared with 71.28% for 2008 and 69.94% for 2007.

The following table provides an analysis of noninterest expense (dollars in thousands).

For the year ended December 31,	2009	2008	2007	2009/2008 Increase/(Decrease) Amount	2009/2008 Increase/(Decrease) %	2008/2007 Increase/(Decrease) Amount	2008/2007 Increase/(Decrease) %
Salaries and benefits	$ 61,818	$ 54,615	$ 50,083	$ 7,203	13.19%	$ 4,532	9.05%
Occupancy	11,335	8,506	7,694	2,829	33.26%	812	10.55%
Furniture and equipment	5,194	5,152	4,872	42	0.82%	280	5.75%
Other expenses							
Advertising and marketing	3,665	2,908	4,621	757	26.03%	(1,713)	(37.07%)
Charitable contributions	2,193	2,012	1,726	181	9.00%	286	16.57%
Telephone and postage	2,574	2,254	1,910	320	14.20%	344	18.01%
Outside processing	2,491	2,093	1,860	398	19.02%	233	12.53%
Professional fees	2,981	1,617	1,792	1,364	84.35%	(175)	(9.77%)
Other	3,393	1,345	1,741	2,048	152.27%	(396)	(22.75%)
Stationery and office supplies	1,674	1,458	1,707	216	14.81%	(249)	(14.59%)
Amortization expense of intangibles	2,803	2,488	1,591	315	12.66%	897	56.38%
FDIC and other insurance	5,338	1,622	1,536	3,716	229.10%	86	5.60%
Software expense	2,529	2,028	1,363	501	24.70%	665	48.79%
Travel/Meals/Entertainment	611	549	1,107	62	11.29%	(558)	(50.41%)
Directors' expense	952	1,436	1,056	(484)	(33.70%)	380	35.98%
Bank franchise tax/SCC fees	2,240	1,174	848	1,066	90.80%	326	38.44%
Total other expenses	33,444	22,984	22,858	10,460	45.51%	126	0.55%
Total noninterest expense	$ 111,791	$ 91,257	$ 85,507	$ 20,534	22.50%	$ 5,750	6.72%

Salaries and employee benefits, the largest portion of noninterest expense, were $61.82 million, representing 55.30% of total noninterest expense for the year ended December 31, 2009. This was a 13.19% increase over 2008 due to the addition of employees to create and service customer growth, the addition of staff resulting from the Prudential Towne Realty business combination in January 2009, and a $2.82 million increase due to the implementation of a retirement plan in December 2008. Also contributing to the increase was a reclassification of $817 thousand of certain Corolla expenses, which were included in commission expense in 2008 as an offset to property management income. Salaries and benefits expense for the year ended December 31, 2008, was $54.62 million, up 9.05%, or $4.53 million, over 2007.

In our Banking segment we had a total of 497 full-time equivalent employees ("FTE") at December 31, 2009, which was up from 480 and 467 at December 31, 2008 and 2007, respectively. In our non-Banking segments at December 31, 2009, we had a total of 378 FTEs, excluding real estate sales agents, which was up from 294 and 237 at December 31, 2008 and 2007, respectively. Real estate agents are independent contractors, and therefore, not included as the Company's employees. There were 460 real estate agents at December 31, 2009. Total operating revenue, excluding securities gains and losses per full-time equivalent employee, was approximately $174 thousand, $166 thousand, and $174 thousand for the years ended December 31, 2009, 2008, and 2007, respectively.

For the year ended December 31, 2009, occupancy expense totaled $11.34 million, representing an increase of $2.83, or 33.26%, over comparative 2008. Occupancy expense for 2008 was $8.51 million, or 10.55%, over the 2007 amount of $7.69 million. The primary driver of the increase in occupancy expense was the Prudential Towne Realty business combination previously discussed.

Furniture and equipment expense was $5.19 million for 2009, or $42 thousand and 0.82%, higher than 2008. Furniture and equipment expense was $5.15 million for 2008, or $280 thousand and 5.75%, higher than

comparative 2007. Increases due to the Prudential Towne Realty transaction were mostly offset by decreases in other areas, including maintenance contracts.

Other expenses for 2009 were $33.45 million, which was $10.46 million, or 45.52%, higher than the 2008 amount of $22.98 million. The primary drivers of the increase were the increase in FDIC assessments, including $1.6 million in the second quarter for the FDIC's special assessment, an increase in franchise tax, an increase in professional and legal fees, and an increase in other expenses that included a $1.0 million increase in expenses related to our loan portfolio. Other expenses for 2008 were $126 thousand, or 0.55%, higher than the 2007 amount of $22.86 million.

Income Taxes: Income taxes for the year ended December 31, 2009, were $11.65 million. This was $2.9 million higher than the 2008 amount of $8.75 million, which was $2.07 million lower than the 2007 amount of $10.82 million. The effective tax rate for 2009 was 30.32% versus 26.81% for 2008 and 31.76% for 2007. The increase was primarily due to an increase in nondeductible expenses, including compensation. The increase was offset by several factors, including additional tax-exempt interest income and a decrease in other disallowed expenses. Refer to Note 18 in the Notes to Consolidated Financial Statements for a discussion regarding the components of the statutory rate and the deferred tax composition.

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 22 in the Notes to Consolidated Financial Statements.

Banking Segment. For the year ended December 31, 2009, the Banking segment represented 88.80%, or $23.76 million, of our total consolidated net income, compared to 88.22% and 89.54% for 2008 and 2007.

Pre-tax earnings for the year ended December 31, 2009, for the Banking segment were $33.70 million, increasing $3.86 million, or 12.95%, from comparative 2008. The increase was primarily due to a $12.88 million, or 14.92%, increase in net interest income and an $8.19 million, or 276.67%, increase in the gain on sale of securities. Comparatively, pre-tax earnings for the year ended December 31, 2008, for the Banking segment were $29.84 million, decreasing $1.68 million, or 5.32%, over comparative 2007.

This increase was partially offset by an increase in the provision for loan losses of $5.76 million, or 81.97%, and an increase in noninterest expenses of $11.23 million, or 16.98%. The primary factors in the increase were increases in salaries and benefits of $3.35 million, which included a $2.82 million increase due to the December 2008 implementation of a retirement plan, and an increase in other noninterest expenses, which included increases in FDIC and other insurance fees of $3.41 million, or 223.97%, and an increase in bank franchise fees of $1.07 million, or 90.81%.

The following chart presents the revenue and expenses for the Banking segment (dollars in thousands).

	Year Ended December 31,			Increase/(Decrease)			
				2009 over 2008		2008 over 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 99,216	$ 86,337	$ 84,715	$ 12,879	14.92%	$ 1,622	1.91%
Service charges on deposit accounts	6,342	5,845	5,554	497	8.50%	291	5.24%
Credit card merchant fees	1,823	1,824	1,710	(1)	(0.05%)	114	6.67%
Other income	4,076	4,944	4,041	(868)	(17.56%)	903	22.35%
Subtotal	12,241	12,613	11,305	(372)	(2.95%)	1,308	11.57%
Gain (loss) on available for sale	11,149	2,960	70	8,189	276.66%	2,890	N/M
Total noninterest income	23,390	15,573	11,375	7,817	50.20%	4,198	36.91%
Total revenue	122,606	101,910	96,090	20,696	20.31%	5,820	6.06%
Provision for loan losses	12,778	7,022	2,743	5,756	81.97%	4,279	156.00%
Expenses							
Salaries and employee benefits	42,867	39,521	36,386	3,346	8.47%	3,135	8.62%
Occupancy expense	7,220	5,999	5,215	1,221	20.35%	784	15.03%
Furniture and equipment	3,808	4,112	3,986	(304)	(7.39%)	126	3.16%
Advertising and marketing	1,848	1,537	3,299	311	20.23%	(1,762)	(53.41%)
Charitable contributions	2,118	1,955	1,692	163	8.34%	263	15.54%
Outside processing	2,148	1,746	1,602	402	23.02%	144	8.99%
FDIC and other insurance	4,934	1,523	1,426	3,411	223.97%	97	6.80%
Professional fees	1,506	1,157	1,326	349	30.16%	(169)	(12.75%)
Telephone and postage	1,468	1,497	1,284	(29)	(1.94%)	213	16.59%
Other expenses	9,433	7,074	6,807	2,359	33.35%	267	3.92%
Total expenses	77,350	66,121	63,023	11,229	16.98%	3,098	4.92%
Income before income tax expense and corporate allocation	32,478	28,767	30,324	3,711	12.90%	(1,557)	(5.13%)
Corporate allocation	1,226	1,074	1,193	152	14.15%	(119)	(9.97%)
Income before income tax provision	33,704	29,841	31,517	3,863	12.95%	(1,676)	(5.32%)
Provision for income tax expense	(9,942)	(7,688)	(9,499)	(2,254)	29.32%	1,811	(19.07%)
Net income	$ 23,762	$ 22,153	$ 22,018	$ 1,609	7.26%	$ 135	0.61%

Realty Segment. For the year ended December 31, 2009, the Realty segment represented 6.42%, or $1.72 million, of total consolidated net income compared to (0.05%), or a net loss of $11 thousand, for 2008 and 0.86%, or $200 thousand, for 2007. Real estate brokerage and property management income for the years ended December 31, 2009, 2008, and 2007 was reported net of commission expense totaling $17.19 million, $8.22 million, and $10.83 million, respectively, while residential mortgage brokerage income was reported net of commission expense of $6.45 million, $2.87 million, and $3.29 million for the same respective periods.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2009, for the Realty segment were $2.52 million, increasing 100% from comparative 2008, which decreased $516 thousand from comparative 2007. Total revenue increased to $28.85 million in 2009 from $17.54 million and $15.38 million in 2008 and 2007, respectively. A majority of the growth in revenue is due to the increase in net mortgage brokerage income as a result of the increased volume in refinancing and purchase transactions. Also contributing to the growth is an increase attributed to the business combination that resulted in the formation of Prudential Towne Realty in January 2009.

Expenses for the Realty segment increased 51.11%, or $8.64 million, when compared to 2008, which increased 19.49%, or $2.76 million, when compared to 2007. The increase from 2008 is primarily due to the Prudential Towne Realty business combination. The acquisition resulted in additional expenses compared to 2008, primarily in salaries and benefits, occupancy, and amortization of intangible assets.

The following chart presents the revenue and expenses for the Realty segment (dollars in thousands).

	Year Ended December 31,			Increase/(Decrease)			
				2009 over 2008		2008 over 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage brokerage income, net	$ 12,221	$ 5,985	$ 5,855	$ 6,236	104.19%	$ 130	2.22%
Real estate brokerage income, net	6,381	3,357	4,530	3,024	90.08%	(1,173)	(25.89%)
Title insurance and settlement fees	2,401	2,117	2,695	284	13.42%	(578)	(21.45%)
Property management fees, net	5,344	4,421	932	923	20.88%	3,489	374.36%
Income from unconsolidated subsidiary	631	658	432	(27)	(4.10%)	226	52.31%
Net interest and other income	1,875	1,004	937	871	86.75%	67	7.15%
Total revenue	28,853	17,542	15,381	11,311	64.48%	2,161	14.05%
Expenses							
Salaries and employee benefits	12,879	9,198	7,638	3,681	40.02%	1,560	20.42%
Occupancy expense	3,646	2,010	2,030	1,636	81.39%	(20)	(0.99%)
Furniture and equipment	1,112	764	626	348	45.55%	138	22.04%
Amortization of intangible assets	1,460	1,175	377	285	24.26%	798	211.67%
Other expenses	6,436	3,750	3,470	2,686	71.63%	280	8.07%
Total expenses	25,533	16,897	14,141	8,636	51.11%	2,756	19.49%
Income before income tax, corporate allocation, and noncontrolling interest	3,320	645	1,240	2,675	414.73%	(595)	(47.98%)
Corporate allocation	(805)	(645)	(724)	(160)	24.81%	79	(10.91%)
Income before income tax provision and noncontrolling interest	2,515	-	516	2,515	N/M	(516)	(100.00%)
Provision for income tax	(807)	55	(328)	(862)	N/M	383	(116.77%)
Net income	1,708	55	188	1,653	N/M	(133)	(70.74%)
Noncontrolling interest	9	(66)	12	75	(113.64%)	(78)	(650.00%)
Net income (loss) attributable to TowneBank	$ 1,717	$ (11)	$ 200	1,728	N/M	(211)	(105.50%)

(continued on next page)

The following chart shows the key data for the Realty segment (dollars in thousands).

	Year Ended December 31,			Increase/(Decrease)			
				2009 over 2008		2008 over 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
Key data							
Number of homes sold	3,126	1,531	2,161	1,595	104.18%	(630)	(29.15%)
Volume of homes sold	$ 881,707	$ 246,253	$ 216,168	$ 635,454	258.05%	$ 30,085	13.92%
Number of real estate agents	460	291	336	169	58.08%	(45)	(13.39%)
Loans originated, mortgage	$ 544,612	$ 324,045	$ 383,731	$ 220,567	68.07%	$ (59,686)	(15.55%)
Loans originated, joint ventures	453,916	227,919	196,415	225,997	99.16%	31,504	16.04%
Total loans originated	$ 998,528	$ 551,964	$ 580,146	$ 446,564	80.90%	$ (28,182)	(4.86%)
Number of loans, mortgage	2,248	1,285	1,596	963	74.94%	(311)	(19.49%)
Number of loans, joint ventures	1,979	1,435	877	544	37.91%	558	63.63%
Total number of loans	4,227	2,720	2,473	1,507	55.40%	247	9.99%
Average loan amount, mortgage	$ 242	$ 252	$ 240	$ (10)	(3.97%)	$ 12	5.00%
Average loan amount, joint ventures	229	159	224	70	44.03%	(65)	(29.02%)
Average loan amount	$ 236	$ 203	$ 235	$ 33	16.26%	$ (32)	(13.62%)
Average number of originators, mortgage	32	31	26	1	3.23%	5	19.23%
Average number of originators, joint ventures	27	19	17	8	42.11%	2	11.76%
Average number of originators	59	50	43	9	18.00%	7	16.28%

Mortgage. The loan volume for the combined mortgage operations showed significant improvement during the year ended December 31, 2009, as compared to 2008. Total loans originated in 2009 were $998.53 million, an 80.90%, or $446.56 million increase from $551.96 million in 2008. This was a $28.18 million, or 4.86%, decrease compared to the 2007 volume of $580.15 million. Refinance activity comprised $451.74 million of loan volume for the year ended December 31, 2009, while purchases accounted for the remaining $546.79 million in loan volume for the year. For the years ended December 31, 2008 and 2007, refinance volume was $138.11 and $134.86 million, respectively, while purchase volume was $413.85 and $445.28, respectively.

Insurance Segment. The Insurance segment comprises property and casualty and group benefits divisions. Effective December 31, 2009, TowneBank acquired Taylor Johnson Insurance Group, an independent insurance agency that will be affiliated with Towne Insurance. Because the transaction occurred on December 31, 2009, TowneBank did not record any income related to Taylor Johnson Insurance Group for 2009.

The Insurance segment represented 4.78%, or $1.28 million, of total consolidated net income in 2009; 7.33%, or $1.75 million, in 2008; and 4.48%, or $1.04 million, in 2007. Insurance commissions for the years ended December 31, 2009, 2008, and 2007 are reported, net of commission expense, of $2.90 million, $2.68 million, and $1.91 million, respectively.

Earnings before taxes and noncontrolling interest for the Insurance segment were $2.18 million in 2009, decreasing $694 thousand, or 24.15%, from 2008. The decrease in earnings for the Insurance segment was primarily attributable to transaction costs related to the Taylor Johnson acquisition. Also contributing was a decrease in contingency and bonus revenue of $174 thousand, or 17.68%. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers. The carriers use several non-client-specific factors to determine the amount of the contingency payments. Such factors include the aggregate loss performance of insurance policies previously placed and the volume of business, among other

things. Such commissions are seasonal in nature and are mostly received during the first quarter of each year. Overall net commissions and fees increased only slightly from the previous year as current economic conditions led to reduced coverage as businesses downsized.

Net commissions for our property and casualty division decreased $20 thousand for the year ended December 31, 2009, compared to 2008. For our group benefits division, the increase of $733 thousand in 2008 was mainly due to acquisitions made in 2007.

The following chart presents the revenue and expenses for the Insurance segment (dollars in thousands).

	Year Ended December 31,			Increase/(Decrease)			
				2009 over 2008		2008 over 2007	
	2009	2008	2007	Amount	Percent	Amount	Percent
Revenue							
Net commission and fee income							
Property and casualty	$ 4,965	$ 4,985	$ 5,450	$ (20)	(0.40%)	$ (465)	(8.53%)
Group benefits	5,087	5,068	4,335	19	0.37%	733	16.91%
Specialized benefit services	289	227	131	62	27.31%	96	73.28%
Total net commissions and fees	10,341	10,280	9,916	61	0.59%	364	3.67%
Contingency and bonus revenue	810	984	621	(174)	(17.68%)	363	58.45%
Other income	358	279	313	79	28.32%	(34)	(10.86%)
Total revenue	11,509	11,543	10,850	(34)	(0.29%)	693	6.39%
Expenses							
Salaries and employee benefits	6,072	5,895	6,058	177	3.00%	(163)	(2.69%)
Occupancy expense	470	497	449	(27)	(5.43%)	48	10.69%
Furniture and equipment	275	276	260	(1)	(0.36%)	16	6.15%
Amortization of intangible assets	499	469	376	30	6.40%	93	24.73%
Other expenses	1,592	1,102	1,200	490	44.46%	(98)	(8.17%)
Total expenses	8,908	8,239	8,343	669	8.12%	(104)	(1.25%)
Income before income tax, corporate allocation, and noncontrolling interest	2,601	3,304	2,507	(703)	(21.28%)	797	31.79%
Corporate allocation	421	430	469	(9)	(2.09%)	(39)	(8.32%)
Income before income tax provision and noncontrolling interest	2,180	2,874	2,038	(694)	(24.15%)	836	41.02%
Provision for income tax expense	(898)	(1,118)	(997)	220	(19.68%)	(121)	12.14%
Net income	1,282	1,756	1,041	(474)	(26.99%)	715	68.68%
Noncontrolling interest	(2)	(4)	-	2	(50.00%)	(4)	N/M
Net income attributable to TowneBank	$ 1,280	$ 1,752	$ 1,041	$ (472)	(26.94%)	$ 711	68.30%

Salaries and employee benefits expense increased $177 thousand, or 3.00%, when comparing 2009, to 2008, which decreased $163 thousand, or 2.69%, compared to 2007.

Occupancy expense decreased $27 thousand, or 5.43%, when comparing 2009 to 2008, which increased $48 thousand, or 10.69%, over 2007.

Other expenses increased $490 thousand, or 44.46%, during the year ended December 31, 2009 compared to 2008, which was $98 thousand, or 8.17%, less than 2007. The current year increase was driven by $375 thousand of non-recurring transaction costs related to the Taylor Johnson transaction.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $472.87 million, or 15.09%, to $3.61 billion at December 31, 2009, from $3.13 billion at December 31, 2008. The increase was supported by growth in the loan portfolio, which increased $215.72 million, or 9.18%, to $2.57 billion at December 31, 2009, from $2.35 billion at December 31, 2008.

Our total average assets were $3.43 billion for 2009, reflecting an increase of $653.65 million, or 23.52%, compared to the 2008 average of $2.78 billion. Total average assets for 2008 increased $391.46 million, or 16.40%, compared to the 2007 average of $2.39 billion. Major balance sheet categories with increases in average balances include loans, up $379.65 million, or 18.44%, and securities available for sale, which increased $163.03 million, or 46.88%, over 2008. Additionally, average earning assets were $3.15 billion, excluding BOLI assets, in 2009, reflecting an increase of $654.27 million, or 26.26%, compared to 2008.

Our average total deposits were $2.52 billion in 2009, reflecting growth of $497.44 million, or 24.60%, compared to 2008. Interest-bearing deposits, which increased $415.74 million, or 27.04%, grew at a higher rate than noninterest-bearing deposits in 2009.

Securities: Our securities consist of available-for-sale securities and held-to-maturity securities. Our available-for-sale securities portfolio, which is held primarily for earnings, liquidity, and asset/liability management purposes, is reported at fair value based on market prices for similar instruments. Our held-to-maturity securities portfolio, which is held primarily for yield and pledging purposes, is valued at amortized cost. Our investment portfolio totaled $633.69 million as of December 31, 2009, with a balance of $510.77 million in available-for-sale and $122.92 million in held-to-maturity. Average yield on available-for-sale securities was 2.53% at December 31, 2009, compared with 3.77% at December 31, 2008, and 5.62% at December 31, 2007. Average yield on held-to-maturity securities was 4.82% at December 31, 2009, compared to 4.72% at December 31, 2008, and 4.45% at December 31, 2007.

Our available-for-sale securities portfolio consists of Treasuries, agencies, municipal bonds, mortgage-backed debt, trust preferred corporate debt, and industrial revenue bonds. Our held-to-maturity portfolio consists of municipal debt, trust preferred corporate debt, and industrial revenue bonds. Our investment activities are governed internally by a written and Board-approved investment policy, which is administered by our Asset-Liability Committee ("ALCO"). The ALCO meets regularly to review the economic environment, to assess current activities for appropriateness, and to establish investment strategies.

Investment strategies are established by the ALCO in consideration of the interest rate cycle, balance sheet mix, actual and anticipated loan demand, funding options, and our overall interest rate sensitivity. In general, the investment portfolio is managed in a manner appropriate with the attainment of the following goals: (i) to provide a sufficient margin of liquid assets to cover unanticipated deposit and loan fluctuations, seasonal funds flow variations, and overall funds management objectives; (ii) to provide eligible securities to secure public funds, trust deposits, and repurchase agreements as prescribed by law; and (iii) to earn the maximum return on funds invested that is commensurate with meeting the requirements of (i) and (ii).

The following table provides information regarding the composition of our securities portfolio, showing selected maturities and yields (dollars in thousands). For more information, refer to Note 3 of the Notes to Consolidated Financial Statements.

Year Ended December 31,	2009			2008			2007		
	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield	Amortized Cost	Estimated Fair Value	Weighted Average Yield
Securities Available for Sale:									
U.S. agency securities	$ 245,474	$ 243,435	1.96%	$ 70,002	$ 71,532	4.53%	$ 125,760	$ 126,974	5.49%
U.S. Treasury notes	-	-	-	77,000	77,000	(0.07%)	-	-	-
Municipal securities	21,481	21,410	4.21%	12,341	11,836	5.74%	2,740	2,859	5.23%
Trust preferred	6,990	6,755	7.80%	6,995	6,305	7.84%	-	-	-
Other investments	94	20	0.00%	131	57	-	161	86	-
FHLB stock[(1)]	26,063	26,063	0.00%	20,877	20,877	0.50%	17,305	17,305	6.00%
Mortgage-backed securities	213,191	213,083	3.16%	153,746	160,133	5.46%	131,274	133,204	5.71%
Total securities available for sale	513,293	510,766	2.53%	341,092	347,740	3.77%	277,240	280,428	5.62%
Securities Held to Maturity:									
U.S. Treasury securities	-	-	-	-	-	-	2,001	2,026	4.78%
Trust preferred	19,456	19,039	7.83%	9,357	8,688	8.20%	5,524	5,998	8.99%
Municipal bonds	17,977	18,259	4.53%	20,970	20,904	4.74%	16,863	16,867	3.53%
Industrial revenue bonds	85,491	85,491	4.19%	87,033	87,219	4.34%	75,328	73,376	4.32%
Total securities held to maturity	122,924	122,789	4.82%	117,360	116,811	4.72%	99,716	98,267	4.45%
Total Portfolio	$ 636,217	$ 633,555	2.97%	$ 458,452	$ 464,551	4.01%	$ 376,956	$ 378,695	5.31%

(1) This stock is stated at cost, as this is a restricted security without a readily determinable fair value.

(continued on next page)

The following table indicates the maturities of securities at December 31, 2009 (in thousands).

	Available for sale			Held to maturity		
	Amortized Cost	Fair Market Value	Weighted Average Yield	Amortized Cost	Fair Market Value	Weighted Average Yield
U.S. Treasury & U.S. agency securities						
Due in one year or less	$ -	$ -	-	$ -	$ -	-
After one year through five years	243,252	241,079	1.93%	-	-	-
After five years through ten years	-	-	-	-	-	-
After ten years	2,222	2,356	5.30%	-	-	-
Municipal securities						
Due in one year or less	-	-	-	4,199	4,233	3.78%
After one year through five years	9,305	9,377	3.90%	4,256	4,330	3.53%
After five years through ten years	3,713	3,778	3.82%	854	863	4.15%
After ten years	8,463	8,255	4.68%	8,668	8,833	5.39%
Mortgage-backed securities						
Due in one year or less	485	487	4.00%	-	-	-
After one year through five years	-	-	-	-	-	-
After five years through ten years	89,776	89,279	2.79%	-	-	-
After ten years	122,930	123,317	3.42%	-	-	-
Trust preferred						
After ten years	6,990	6,755	7.91%	19,456	19,039	7.83%
Industrial revenue bonds						
Due in one year or less	-	-	-	4,555	4,555	0.98%
After one year through five years	-	-	-	16,373	16,373	4.14%
After five years through ten years	-	-	-	21,380	21,380	4.37%
After ten years	-	-	-	43,183	43,183	4.45%
Other securities						
No stated maturity	26,157	26,083	0.00%	-	-	-
Total Portfolio	$ 513,293	$ 510,766	2.53%	$ 122,924	$ 122,789	4.82%

Loans Held for Sale: At December 31, 2009, we held $72.22 million in mortgage loans originated and intended for sale in the secondary market, compared with $25.88 million at December 31, 2008. Average loans held for sale were 1.87% and 0.84% of average earning assets for the years ended December 31, 2009 and 2008, respectively. The majority of loans held for sale have been pre-committed to investors, minimizing our interest rate risk.

Our mortgage banking activities include two types of commitments: rate lock commitments and forward loan commitments. Rate lock commitments are loans in our pipeline that have an interest rate lock with the customer. The commitments are generally for periods of 60 days and are at market rates. In order to mitigate the risk from interest rate fluctuations, we enter into forward loan sale commitments on a "best efforts" basis while the loan is in the pipeline.

Rate lock commitments related to the origination of mortgage loans held for sale and the corresponding forward loan sale commitments are considered derivative instruments. All of the gain on sale generated from mortgage banking activities is recorded in the financials at the time the loan is closed.

Loan Portfolio: Our loan portfolio, net of the allowance for loan losses, totaled $2.53 billion on December 31, 2009. As a percentage of total average earning assets, average loans were 77.58% in 2009 compared with 82.67% in 2008 and 80.20% in 2007. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were our local economy and the efforts of our experienced loan officers in developing new loan relationships, combined with the support of existing customers. The following tables provide the balance and composition of the loan portfolio by major classification for the periods indicated (dollars in thousands).

Year Ended December 31,	2009	2008	2007	2006	2005
Real estate loans					
Residential 1-4 family	$ 634,960	$ 589,075	$ 439,676	$ 362,034	$ 297,452
Commercial	866,165	737,244	561,341	364,657	275,027
Construction	652,221	617,390	522,780	529,933	377,246
Multifamily	41,652	30,079	27,515	17,919	8,247
Total real estate loans	2,194,998	1,973,788	1,551,312	1,274,543	957,972
Commercial loans	321,498	329,716	218,082	306,437	256,776
Consumer installment loans					
Personal	31,099	27,752	42,702	41,784	30,160
Credit lines	17,652	18,890	17,360	18,885	19,382
Total consumer installment loans	48,751	46,642	60,062	60,669	49,542
Agriculture loans	663	40	-	177	202
Loans, net of unearned income and deferred costs	$ 2,565,910	$ 2,350,186	$ 1,829,456	$ 1,641,826	$ 1,264,492

Year Ended December 31,	2009	2008	2007	2006	2005
Real estate loans					
Residential 1-4 family	24.74%	25.06%	24.03%	22.05%	23.52%
Commercial	33.76%	31.37%	30.68%	22.21%	21.75%
Construction	25.42%	26.27%	28.59%	32.28%	29.83%
Multifamily	1.62%	1.28%	1.50%	1.09%	0.65%
Total real estate loans	85.54%	83.98%	84.80%	77.63%	75.75%
Commercial loans	12.53%	14.03%	11.92%	18.66%	20.31%
Consumer installment loans					
Personal	1.21%	1.18%	2.33%	2.55%	2.39%
Credit lines	0.69%	0.80%	0.95%	1.15%	1.53%
Total consumer installment loans	1.90%	1.98%	3.28%	3.70%	3.92%
Agriculture loans	0.03%	0.01%	-	0.01%	0.02%
Loans, net of unearned income and deferred costs	100.00%	100.00%	100.00%	100.00%	100.00%

The table below provides the maturity and sensitivity of the loan portfolio at December 31, 2009 (in thousands).

	Due in one year or less	Due after one year through five years	Due after five years	Totals	Due after one year Fixed Rates	Due after one year Adjustable Rates
Real estate loans						
Residential 1-4 family	$ 81,966	$ 62,158	$ 490,836	$ 634,960	$ 234,210	$ 318,784
Commercial	128,652	90,635	646,878	866,165	619,525	117,988
Construction	510,370	119,761	22,090	652,221	58,058	83,793
Multifamily	8,892	7,011	25,749	41,652	29,369	3,391
Total real estate loans	729,880	279,565	1,185,553	2,194,998	941,162	523,956
Commercial loans	175,851	100,363	45,284	321,498	94,672	50,975
Consumer installment loans						
Personal	10,169	15,175	5,755	31,099	16,879	4,051
Credit lines	16,801	622	229	17,652	54	797
Total consumer installment loans	26,970	15,797	5,984	48,751	16,933	4,848
Agriculture loans	663	-	-	663	-	-
Loans, net of unearned income and deferred costs	$ 933,364	$ 395,725	$ 1,236,821	$ 2,565,910	$ 1,052,767	$ 579,779

Allowance for Loan Losses: The allowance for loan losses is established through a provision for loan losses charged against earnings. The level of the allowance for loan losses is based on management's evaluation of the risk inherent in the loan portfolio at the balance sheet date and changes in the nature and volume of loan activity. This evaluation includes a review of loans for which collection may not be reasonably assured. It considers internal risk grades, the estimated fair value of the underlying collateral, current and anticipated economic conditions, historical loan loss experience, and other current factors that warrant consideration in determining an adequate allowance.

The allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

It is our policy to assign internal risk grades to all loans as a component of the approval process. Based on the size of the loan, senior credit officers and the loan committee may review the classification to ensure accuracy and consistency of classification. Loan classifications are internally reviewed to determine if any changes in the circumstances of the loan require a different risk grade. To determine the most appropriate risk grade classification for each loan, the credit officers examine the borrower's liquidity level, asset quality, the amount of the borrower's other indebtedness, cash flow, earnings, sources of financing, and existing lending relationships. The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. Our pools of similar loans include groups of commercial loans, real estate construction loans, commercial real estate loans, consumer loans, residential 1-4 family real estate loans, multifamily real estate loans, and agriculture loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to TowneBank. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the bank's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis to determine an appropriate general valuation allowance.

The allowance for loan losses at December 31, 2009, 2008, and 2007 was $33.79 million, $27.50 million, and $21.32 million, respectively. The allowance was equal to 1.32% of total loans outstanding at December 31, 2009, compared with 1.17% for both 2008 and 2007.

(continued on next page)

The following table provides a summary of the activity in the allowance for loan losses for the periods indicated (dollars in thousands).

Year Ended December 31,	2009	2008	2007	2006	2005
Balance beginning of period	$ 27,503	$ 21,323	$ 19,670	$ 17,071	$ 14,999
Loans charged off:					
Residential 1-4 family	(1,749)	(385)	(474)	(7)	(5)
Construction	(4,050)	(22)	-	(6)	(3)
Commercial	(1,032)	(279)	(409)	(153)	(483)
Consumer	(310)	(284)	(285)	(48)	(65)
Total	(7,141)	(970)	(1,168)	(214)	(556)
Loans recovered:					
Residential 1-4 family	156	7	2	32	60
Construction	215	-	-	-	16
Commercial	148	89	50	176	117
Consumer	21	32	26	33	71
Total	540	128	78	241	264
Net loans (charged off)/recovered	(6,601)	(842)	(1,090)	27	(292)
Provision for loan losses	12,891	7,022	2,743	2,572	2,364
Balance end of period	$ 33,793	$ 27,503	$ 21,323	$ 19,670	$ 17,071
Nonperforming assets:					
Nonperforming loans	$ 42,150	$ 2,817	$ 726	$ 636	$ 213
Foreclosed property	2,043	980	1,570	400	400
Total nonperforming assets	$ 44,193	$ 3,797	$ 2,296	$ 1,036	$ 613
Loans past due 90 days accruing interest	$ 1,702	$ 847	$ 32	$ 459	$ 145
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	.80x	9.76x	29.37x	30.93x	80.15x
Allowance for loan losses to period end loans	1.32%	1.17%	1.17%	1.20%	1.35%
Nonperforming loans to period end loans	1.64%	0.12%	0.04%	0.04%	0.02%
Nonperforming assets to period end assets	1.23%	0.12%	0.07%	0.05%	0.03%
Net charge-offs to average loans	(0.27%)	(0.04%)	(0.06%)	-	(0.02%)

Nonperforming assets include nonaccrual loans, foreclosed real estate, and other repossessed collateral. It is our policy to place commercial loans on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. When loans are placed on nonaccrual status, interest receivable is reversed against interest income recognized in the current period, and any prior year unpaid interest is charged off against the allowance for 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, mortgage loans and other consumer loans are also placed on nonaccrual status when full collection of principal and interest becomes doubtful, or they become delinquent for a specified period of time.

Nonperforming assets consist of $42.15 million in nonperforming loans as well as $2.04 million in foreclosed property at December 31, 2009. Foreclosed property consists primarily of nine different residential properties. Additionally, loans past due 90 days or more that are accruing interest totaled $1.70 million. The increasing trend in nonperforming assets is reflective of the current weak economic conditions, as well as the overall growth of the loan portfolio. This trend is likely to continue until there is a recovery in local economic conditions. Construction loans of $11.30 million, residential land lot loans of $18.96 million, and commercial loans of $9.62 million comprised the majority of the nonperforming loans. As of December 31, 2009, all loans 60 to 89 days delinquent, including nonperforming loans, totaled $3.42 million. Additionally, there are other performing loans, totaling $20.90 million, that are current but have certain documentation deficiencies or other potential weaknesses that management considers warrant additional monitoring. All loans in these categories are subject to constant management attention, and their status is reviewed on a regular basis. With the exception of $6.23 million, which represents management's estimate of total potential loss of these loans, these loans are generally secured with appraised values that exceed the remaining principal balances on such loans.

Allocation of the Allowance for Loan Losses: In addition to internal and other factors, we also review peer data in determining the adequacy of the allowance. Management anticipates that the specific loan and loan type allocations will increase over time, and the reserves set aside for perceived and anticipated trends known to management will decrease as the loan portfolio ages and other information used in the allocation methodology changes with actual experience of the loan portfolio performance.

At December 31, 2009, all of the allowance for loan loss was allocated to specific loan categories. The following table provides a breakdown of the allowance for loan losses among the various loan types for the periods indicated (in thousands).

Year Ended December 31,	2009	2008	2007	2006	2005
Real estate loans:					
Residential 1-4 family	$ 7,094	$ 5,457	$ 3,846	$ 3,242	$ 3,055
Commercial	10,018	7,104	5,129	3,520	3,018
Construction	7,726	6,423	5,810	5,116	4,139
Multifamily	416	248	228	155	82
Total real estate loans	25,254	19,232	15,013	12,033	10,294
Commercial loans	7,330	7,187	4,895	6,207	5,539
Consumer installment loans:					
Personal	761	630	1,007	972	741
Credit lines	434	450	408	455	493
Total consumer installment loans	1,195	1,080	1,415	1,427	1,234
Agriculture loans	14	4	-	3	4
Total	$ 33,793	$ 27,503	$ 21,323	$ 19,670	$ 17,071

In the opinion of management, the allowance was adequate at December 31, 2009, based on known conditions. However, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, and changes in general economic conditions and other risk factors.

Allowance for Loan Losses Policy and Methodology: Our allowance for loan loss methodology is based on guidance provided in SEC Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues," and includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables," and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools, and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for possible loan losses is designed to account for credit deterioration as it occurs. Our objective is to maintain a loan portfolio that is diverse in terms of loan type, industry concentration, and borrower concentration in order to reduce overall credit risk by minimizing the adverse impact of any single event or combination of related events.

Commercial lending involves a higher degree of risk as compared to other types of lending because repayment usually depends on the cash flows generated by a borrower's business, and the debt service capacity of a business can deteriorate because of downturns in national and local economic conditions. To control risk, initial and continuing financial analysis of a borrower's financial information is required. While management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance methodology may be necessary if economic conditions differ substantially from the assumptions used in making the valuations, or if required by regulators based upon information at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

Deposits: Customer deposits are attractive sources of liquidity because of their stability, cost, and the ability to generate fee income through the cross-sale of other services to the depositors. Deposits are attracted principally from customers within our market area through the offering of a broad selection of deposit instruments, including demand deposits, negotiable order of withdrawal accounts, savings accounts, money rate savings, certificates of deposit, and individual retirement accounts. Deposit account terms vary with respect to the minimum balance required, the time period the funds must remain on deposit, and service charge schedules.

Interest rates paid on specific deposit types are set by considering the (i) interest rates offered by competitors, (ii) anticipated amount and timing of funding needs, (iii) availability of and cost of alternative sources of funding, and (iv) anticipated future economic conditions and interest rates.

Deposit accounts held as of December 31, 2009, totaled $2.56 billion. This represented an increase of $323.03 million, or 14.43%, over 2008, which was $404.32 million, or 22.04%, over 2007. Overall growth in deposits is primarily attributed to an increase in the Banking segment customer base and in the number of accounts. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in the Greater Hampton Roads area. The deposits consist of demand deposits, interest-bearing checking accounts, money market deposit accounts, and time deposits. Some of our interest-bearing deposits were obtained through brokered transactions and our participation in the Certificate of Deposit Account Registry Service (CDARS). We had brokered time deposits of $79.99 million and CDARS deposits of $132.80 million at December 31, 2009.

The following tables provide the average balance and cost rate of interest-bearing deposits in addition to maturities of certificates of deposit of $100 thousand and greater for the periods indicated (dollars in thousands). See Note 8 in the Notes to Consolidated Financial Statements for additional information on deposits.

	Average Balance			Average Cost Rate		
For the Year Ended December 31,	**2009**	**2008**	**2007**	**2009**	**2008**	**2007**
Noninterest-bearing demand deposits	$ 566,434	$ 484,735	$ 453,799	-	-	-
Demand and money markets	509,654	500,273	483,207	0.56%	1.23%	2.78%
Savings	64,057	45,108	24,246	0.95%	1.68%	1.65%
Certificates of deposit:						
Less than $100,000	624,331	434,354	336,729	3.10%	3.81%	4.74%
$100,000 or more	755,455	558,024	481,437	2.62%	4.01%	4.91%
Total interest-bearing deposits	1,953,497	1,537,759	1,325,619	2.18%	2.98%	4.10%
Total deposits	$2,519,931	$2,022,494	$ 1,779,418	1.69%	2.27%	3.05%

Maturities of CDs $100,000 and Greater at December 31, 2009

	Amount	Percent
Three months or less	$ 262,541	27.73%
Over three months through twelve months	456,257	48.19%
Over twelve months through three years	199,842	21.11%
Over three years	28,091	2.97%
Total	$ 946,731	100.00%

Average noninterest-bearing demand deposits as a percentage of average total deposits were 22.48% during the year ended December 31, 2009, and 23.97% and 25.50% during the same period in 2008 and 2007, respectively. This change is attributed to more competition for funds within the community and has led to an increased cost of funds due to a change in funding mix towards a higher proportion of certificates of deposit. The average cost of interest-bearing deposits was 2.18% for the year ended December 31, 2009, compared with 2.98% for 2008 and 4.10% for 2007.

Advances from the FHLB: Our ability to borrow funds through nondeposit sources provides additional flexibility in meeting the liquidity needs of customers while enhancing our cost of funds structure. Average funds borrowed were $366.16 million and $337.55 million for the years ended December 31, 2009 and 2008, respectively. Refer to Note 9 in the Notes to Consolidated Financial Statements for additional disclosures related to borrowing arrangements.

Convertible Subordinated Capital Notes: Convertible subordinated capital debentures are unsecured debt that has a lesser priority than that of other debt claims and are not insured by the FDIC or any other governmental agency. Our notes are convertible to common stock at the option of the note holder. Total convertible subordinated capital debentures at December 31, 2009, were $50.76 million. At December 31, 2008, the debentures totaled $40.88 million and included a convertible debenture premium of $198 thousand. Average total convertible subordinated capital debentures for the year ended December 31, 2009, were $42.92 million, compared with $41.30 million for 2008. The average cost of these debentures was 5.80% and 5.25%, respectively. Refer to Note 9 of the Notes to Consolidated Financial Statements for information on convertible subordinated capital debentures.

Liquidity: Liquidity represents our ability to provide funds to meet customer demand for loan and deposit withdrawals without impairing profitability. Our liquid assets consist of cash, interest-bearing deposits in financial institutions, federal funds sold, and investments and loans maturing within one year. Asset liquidity is also provided by managing both loan and security maturities.

We maintained an average of $153.33 million outstanding in overnight interest-bearing deposits during 2009, compared with $51.72 million for 2008. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2009, we funded our growth in total assets with deposit growth, increased borrowings, and preferred stock offerings.

Capital Resources: Federal banking laws set forth certain regulatory capital requirements that apply to us. Within the framework established by the law, we qualify for the classification "well-capitalized," which is the highest regulatory classification. Due to our growth, Series I and II Towne Investment Units were offered to existing shareholders and customers in subscription offerings in early March 2002 and August 2004, respectively.

In August 2008, the Company issued 598,542 shares of 8% Non-Cumulative Convertible Preferred Stock, Series A (the "Series A Preferred Stock"), at a purchase price of $100 per share. The Series A Preferred Stock pays a non-cumulative dividend of 8% per year. Each share of the Series A Preferred Stock may be converted at any time, at the option of the holder, into shares of common stock equal to the purchase price divided by $18.56.

In December 2008, under the U.S. Treasury's TARP Capital Purchase Program, we issued to the U.S. Treasury 76,458 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), and a ten-year warrant to purchase 538,184 common shares at an exercise price of $21.31 per share, for aggregate proceeds of $76.46 million. Non-cumulative dividends on the Series B Preferred Stock are payable at a rate of 5% annually through February 14, 2013, and at a rate of 9% annually thereafter.

In October 2009, the Company offered Series III Investment units to existing shareholders, customers, and the general public in subscription offerings. As a result of that offering, $27.77 million in capital was raised, resulting in the issuance of 1,041,300 shares of common stock, and $13.88 million in convertible subordinated capital debentures were issued at 8%.

Additional information concerning our capital resources is contained in Note 15 of the Notes to Consolidated Financial Statements.

Contractual Obligations, Contingent Liabilities, and Commitments: The following table summarizes our significant contractual obligations, contingent liabilities, and certain other commitments outstanding as of December 31, 2009 (in thousands).

	Payments due by period				
Contractual Obligations	**Total**	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Operating lease obligations	$ 40,131	$ 5,598	$ 10,142	$ 8,920	$ 15,471
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	453,840	123,000	50,840	-	280,000
Convertible subordinated capital debentures	50,755	-	-	-	50,755
Other commitments					
Standby letters of credit	36,570	36,570	-	-	-
Commitments to extend credit	1,335,707	1,335,707	-	-	-
Total contractual obligations	$ 1,917,003	$ 1,500,875	$ 60,982	$ 8,920	$ 346,226

Impact of Inflation and Changing Prices: The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles. These principles dictate that financial position and operating results be measured in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. A financial institution's assets and liabilities are primarily monetary in nature. As a result, general levels of inflation typically have a less significant effect on financial performance than do changes in interest rates; however, noninterest expenses tend to rise in periods of general inflation.

Return on Equity and Assets: The annualized ratio of operating income to average total assets and average shareholders' equity and average equity to average assets for the periods indicated are as follows:

Year Ended December 31,	2009	2008	2007
Return on average assets	0.78%	0.86%	0.97%
Return on average equity	6.12%	8.05%	9.60%
Average equity to average assets	12.75%	10.68%	10.14%

Interest Sensitivity: 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.

We 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 protect ourselves from unanticipated rate movements, by understanding the dynamic nature of our balance sheet components.

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. At December 31, 2009, we had $116.45 million more liabilities than assets subject to repricing within one year, and therefore, were in a liability-sensitive position.

Market Risk Management: 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 the management of interest rate risk 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. 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 and liability management process is designed to achieve relatively stable net interest margins and assure liquidity by coordinating the volumes, maturities, and/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. In addition, funding and balance sheet management strategies are adopted with the intent to ensure that the potential impact on earnings and liquidity due to fluctuations in interest rates are within acceptable standards.

We currently do not use off-balance-sheet financial instruments to manage interest rate sensitivity and net interest income.

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 is reflected in the different rate scenarios. The following table represents the interest rate sensitivity on our net interest income using different rate scenarios.

Change in Prime Rate	% Change in Net Interest Income
+ 200 basis points	2.85%
- 200 basis points	(17.47%)

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.

Change in Prime Rate	Change in Net Market Value (dollars in thousands)
+ 200 basis points	$ (77,883)
- 200 basis points	$ 43,886

Credit Risk Elements: We place a loan in nonaccrual status when management believes, after considering economic and business conditions and collections efforts, that the borrower's financial condition is such that full collection of principal and interest is doubtful or when the loan is past due for 120 days or more, unless the debt is both well-secured and in the process of collection.

FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to our plans, objectives, future performance, and business, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "expects," "anticipates," "believes," "estimates," and other similar expressions or future or conditional verbs such as "will," "should," "would," and "could" are intended to identify such forward-looking statements. These forward-looking statements are no guarantees of future performance and involve certain risks and uncertainties and are based on the beliefs and assumptions of our management.

Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following:

- competitive pressures in the banking industry may increase significantly;
- changes in the interest rate environment may reduce margins and/or the volumes and values of loans made or held, as well as the value of other financial assets held;
- general economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit or other services;
- changes in the legislative or regulatory environment, including changes in accounting standards, may adversely affect our businesses;
- costs or difficulties related to the integration of the business and 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;
- 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 and its heavy concentration of U.S. military bases and related personnel.

We do not undertake and specifically disclaim any obligation to publicly update or revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

(continued on next page)

NON-GAAP RECONCILIATIONS

The Company presents return on average assets, return on average tangible assets, return on average equity, and return on average tangible equity. Management excludes the balance of average goodwill and other intangible assets from our calculation of return on average tangible assets and return on average tangible equity. This adjustment allows management to review the Company's core operating result and core capital position.

Year Ended December 31,	2009	2008
Return on average assets (GAAP basis)	0.78%	0.86%
Impact of excluding average goodwill and other intangibles	0.02%	0.02%
Return on average tangible assets	0.80%	0.88%
Return on average equity (GAAP basis)	6.12%	8.05%
Impact of excluding average goodwill and other intangibles	1.40%	2.61%
Return on average tangible equity	7.52%	10.66%

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

	Per share	
Year Ended December 31,	2009	2008
Book value (GAAP basis)	$ 11.87	$ 11.74
Impact of excluding average goodwill and other intangibles	(3.65)	(2.94)
Tangible book value	$ 8.23	$ 8.81

When computing the efficiency ratio (noninterest expense divided by the sum of net interest income and noninterest income, excluding securities gains or losses), management excludes the gains and losses on securities because of the uncertainty of the amount of gain or loss recognized.

Year Ended December 31,	2009	2008
Efficiency ratio (GAAP basis)	69.90%	69.90%
Impact of excluding securities gains/(losses)	3.68%	1.38%
Efficiency ratio, as reported	73.58%	71.28%

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
TowneBank

We have audited the accompanying consolidated balance sheets of ***TowneBank*** and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2009. We also have audited ***TowneBank's*** internal control over financial reporting as of December 31, 2009, including controls over the preparation of regulatory financial statements in accordance with the instructions for Consolidated Reports of Condition and Income (Call Report) of the Federal Financial Institutions Examination Council, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ***TowneBank's*** management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on these financial statements and an opinion on the company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and call report instructions, and that

receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ***TowneBank*** and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, ***TowneBank*** maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Goodman and Company, LLP

Norfolk, Virginia
March 11, 2010

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of TowneBank is responsible for the preparation and fair presentation of the financial statements and other financial information contained in this report. The accompanying consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include, as necessary, best estimates and judgments by management. Management also prepared other information in the Annual Report and is responsible for its accuracy and consistency with the consolidated financial statements. Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for our compliance with laws and regulations relating to safety and soundness designated by the Federal Deposit Insurance Corporation ("FDIC"). Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We maintain systems of controls that we believe are reasonably designed to provide our management with timely and accurate information about our operations. The system of internal controls includes, but is not limited to, maintaining internal audit and compliance functions; establishing formal written policies, procedures, and codes of conduct; training personnel; and segregating key duties and functions, where appropriate.

The Audit Committee of the Board of Directors participates in the adequacy of the system of internal controls and financial reporting. The Audit Committee consists of independent directors who meet regularly with management, the internal auditor, and the independent auditors to review the scope of their work and findings.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework. Based on our assessment we believe that, as of December 31, 2009, our internal control over financial reporting is effective based on those criteria, and that we complied with the FDIC's safety and soundness laws and regulations over the course of the year ended December 31, 2009.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2009, and for the year then ended. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, and as such, include amounts, some of which are based on management's judgments and estimates.

Compliance with Laws and Regulations

Our management is also responsible for compliance with federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations. Management assessed our compliance with the designated laws and regulations. Based on this assessment, our management believes that we complied, in all significant respects, with the designated laws and regulations relating to safety and soundness for the year ended December 31, 2009.

Goodman & Company, LLP, the registered public accounting firm that performed our financial statement audit, has issued an attestation report on our assessment of our internal controls over financial reporting. A copy of this report, which is combined with the report expressing an opinion on the consolidated financial statements, precedes.

March 11, 2010

/s/ G. Robert Aston, Jr

G. Robert Aston, Jr.
Chairman and Chief Executive Officer

/s/ Clyde E. McFarland, Jr.

Clyde E. McFarland, Jr.
Senior Executive Vice President and Chief Financial Officer

CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share data)
December 31, 2009 and 2008

ASSETS	2009	2008
Cash and due from banks	$ 55,748	$ 67,280
Interest-bearing deposits in financial institutions	8,976	2,467
Federal funds sold	-	20,000
Total Cash and Cash Equivalents	64,724	89,747
Securities available for sale, at fair value	510,766	347,740
Securities held to maturity, at amortized cost	122,924	117,360
Total Securities	633,690	465,100
Mortgage loans held for sale	72,221	25,884
Loans, net of unearned income and deferred costs:	2,565,910	2,350,186
Less: allowance for loan losses	(33,793)	(27,503)
Net Loans	2,532,117	2,322,683
Premises and equipment, net	89,758	78,991
Goodwill	80,646	60,198
Other intangible assests, net	19,291	11,835
Bank-owned life insurance policies	46,642	44,529
Other assets	67,362	34,611
TOTAL ASSETS	$ 3,606,451	$ 3,133,578
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 572,228	$ 475,290
Interest-bearing:		
Demand and money market accounts	532,348	489,485
Savings	62,630	60,071
Certificates of deposit:		
Less than $100,000	447,765	545,563
$100,000 and more	946,731	668,259
Total Deposits	2,561,702	2,238,668
Advances from the Federal Home Loan Bank	453,840	363,877
Convertible subordinated capital debentures	50,755	40,878
Repurchase agreements and other borrowings	21,524	36,248
Total Borrowings	526,119	441,003
Other liabilities	54,309	34,144
TOTAL LIABILITIES	3,142,130	2,713,815
Preferred stock, $5.00 par value		
Authorized shares - 2,000,000		
Issued and outstanding shares 665,750 in 2009 and 669,650 in 2008	3,329	3,348
Common stock, $1.667 par value		
Authorized shares - 45,000,000		
Issued and outstanding shares 27,451,172 in 2009 and 24,549,150 in 2008	45,762	40,923
Capital surplus	340,825	310,237
Retained earnings	69,341	60,832
Accumulated other comprehensive income	(1,633)	4,331
TOTAL SHAREHOLDERS' EQUITY	457,624	419,671
Noncontrolling interest	6,697	92
TOTAL EQUITY	464,321	419,763
TOTAL LIABILITIES AND EQUITY	$ 3,606,451	$ 3,133,578

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share data)

For the Years Ended December 31, 2009, 2008, and 2007

	2009	2008	2007
INTEREST INCOME:			
Loans, including fees	$ 139,758	$ 130,633	$ 132,993
Investment securities	18,356	17,801	19,190
Interest-bearing deposits in financial institutions and federal funds sold	403	1,221	2,429
Mortgage loans held for sale	2,564	1,195	1,312
Total interest income	161,081	150,850	155,924
INTEREST EXPENSE:			
Deposits	42,577	45,818	54,341
Advances from the Federal Home Loan Bank	15,504	14,840	12,391
Convertible subordinated capital debentures	2,489	2,168	2,253
Repurchase agreements and other borrowings	168	897	1,440
Total interest expense	60,738	63,723	70,425
Net interest income	100,343	87,127	85,499
PROVISION FOR LOAN LOSSES	12,891	7,022	2,743
Net interest income after provision for loan losses	87,452	80,105	82,756
NONINTEREST INCOME:			
Residential mortgage brokerage income, net	11,910	5,319	6,164
Real estate brokerage and property management income, net	11,725	7,778	5,462
Insurance commissions and other title fees and income, net	13,264	13,154	13,101
Service charges on deposit accounts	6,342	5,845	5,554
Credit card merchant fees, net	1,823	1,824	1,710
Other income	6,525	6,987	4,761
Gain on securities available for sale	11,149	2,960	70
Total noninterest income	62,738	43,867	36,822
NONINTEREST EXPENSE:			
Salaries and employee benefits	61,818	54,615	50,083
Occupancy	11,335	8,506	7,694
Furniture and equipment	5,194	5,152	4,872
Other expenses	33,444	22,984	22,858
Total noninterest expense	111,791	91,257	85,507
Income before income tax expense & noncontrolling interest	38,399	32,715	34,071
Provision for income tax expense	11,647	8,751	10,824
Net income	$ 26,752	$ 23,964	$ 23,247
Net (income) loss attributable to noncontrolling interest	7	(70)	12
Net income attributable to TowneBank	26,759	23,894	23,259
Preferred stock dividends and accretion	10,044	1,396	-
Net income applicable to common shareholders	$ 16,715	$ 22,498	$ 23,259
Per common share information			
Basic earnings	$ 0.67	$ 0.93	$ 0.98
Diluted earnings	$ 0.66	$ 0.89	$ 0.92
Cash dividends declared	$ 0.32	$ 0.32	$ 0.32

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF EQUITY

(dollars in thousands, except share data)
For the Years Ended December 31, 2009, 2008, and 2007

	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Comprehensive Income	Noncontrolling Interest	Total
Balance, December 31, 2006	**23,601,356**	**-**	**39,343**	**159,023**	**30,734**	**917**	**25,083**	**-**	**230,017**
Net Income	-	-	-	-	23,259	-	23,247	(12)	23,247
Unrealized gain on securities, net of tax expense of $627	-	-	-	-	-	1,166	1,166	-	1,166
Cash dividends declared	-	-	-	-	(7,766)	-	-	-	(7,766)
Directors' deferred compensation	(42,178)	-	(70)	(739)	-	-	-	-	(809)
Issuance of common stock - stock compensation plans	143,867	-	241	3,351	-	-	-	-	3,592
Issuance of common stock - business acquisition	65,480	-	115	1,144	-	-	-	-	1,259
Investment in joint ventures	-	-	-	-	-	-	-	37	37
Issuance of common stock	335,893	-	553	5,585	-	-	-	-	6,138
Balance, December 31, 2007	**24,104,418**	**-**	**40,182**	**168,364**	**46,227**	**2,083**	**24,413**	**25**	**256,881**
Net Income	-	-	-	-	23,894	-	23,964	70	23,964
Unrealized gain on securities, net of tax expense of $1,211	-	-	-	-	-	2,248	2,248	-	2,248
Cash dividends declared on common stock	-	-	-	-	(7,893)	-	-	-	(7,893)
Cash dividends declared on preferred stock	-	-	-	-	(1,396)	-	-	-	(1,396)
Directors' deferred compensation	(50,079)	-	(85)	3,595	-	-	-	-	3,510
Conversion of preferred stock into common stock	28,824	(27)	47	487	-	-	-	-	507
Issuance of preferred stock	-	3,375	-	132,159	-	-	-	-	135,534
Issuance of common stock - stock compensation plans	150,735	-	254	778	-	-	-	-	1,032
Investment in joint ventures	-	-	-	-	-	-	-	(3)	(3)
Issuance of common stock	315,252	-	525	4,854	-	-	-	-	5,379
Balance, December 31, 2008	**24,549,150**	**$ 3,348**	**$ 40,923**	**$ 310,237**	**$ 60,832**	**$ 4,331**	**$ 26,212**	**$ 92**	**$ 419,763**
Net Income		-	-	-	26,759	-	26,752	(7)	26,752
Unrealized loss on securities, net of tax benefit of $3,211	-	-	-	-	-	(5,964)	(5,964)	-	(5,964)
Cash dividends declared on common stock	-	-	-	-	(8,211)	-	-	-	(8,211)
Cash dividends declared on preferred stock	-	-	-	-	(9,218)	-	-	-	(9,218)
Directors' deferred compensation	(35,736)	-	(58)	60	-	-	-	-	2
Issuance of common stock - acquisitions	753,136	-	1,255	7,541	-	-	-	-	8,796
Conversion of preferred stock into common stock	21,011	(19)	35	8	-	-	-	-	24
Accretion of preferred stock discount	-	-	-	827	(827)	-	-	-	-
Issuance of common stock - stock compensation plans	296,813	-	495	4,560	-	-	-	-	5,055
Investment in joint ventures	-	-	-	-	-	-	-	6,612	6,612
Issuance of common stock	1,866,798	-	3,112	17,300	-	-	-	-	20,412
Other	-	-	-	292	6	-	-	-	298
Balance, December 31, 2009	**27,451,172**	**$ 3,329**	**$ 45,762**	**$ 340,825**	**$ 69,341**	**$ (1,633)**	**$ 20,788**	**$ 6,697**	**$ 464,321**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2009, 2008, and 2007

OPERATING ACTIVITIES:	2009	2008	2007
Net income	$ 26,752	$ 23,964	$ 23,247
Adjustments to reconcile net income to net cash (used for) from operating activities:			
Net accretion of securities	2,015	(287)	(243)
Investment securities (gains)/losses	(11,149)	(2,960)	21
Depreciation, amortization, and other intangible amortization	9,744	9,174	7,160
Provision for loan losses	12,891	7,022	2,743
Share-based compensation expense	1,638	1,741	2,359
Net increase in loans held for sale	(46,337)	(2,931)	(6,236)
Changes in:			
Interest receivable	(1,282)	314	(481)
Other assets	(31,926)	(3,694)	(8,004)
Interest payable	(1,911)	2,396	1,171
Other liabilities	18,126	249	(2,278)
Net cash (used for) from operating activities	(21,439)	34,988	19,459
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(710,312)	(236,504)	(59,930)
Purchase of held-to-maturity securities	(13,093)	(30,057)	(16,650)
Sale of available-for-sale securities	392,267	148,157	3,639
Proceeds from maturities, calls, and prepayments of securities	162,506	40,155	39,911
Net increase in loans	(222,461)	(521,599)	(188,973)
Net purchase of premises and equipment	(16,823)	(9,061)	(13,043)
Net purchase of bank-owned life insurance	-	-	(36,000)
Acquisition of business, net of cash acquired	(10,942)	(7,225)	(10,058)
Net cash used for investing activities	(418,858)	(616,134)	(281,104)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	323,034	404,322	129,647
Net change in borrowings	87,947	66,217	155,710
Proceeds from share-based compensation activity	513	157	1,983
Proceeds from issuance of common stock	20,078	4,583	4,978
Proceeds from issuance of preferred stock	-	135,534	-
Cash dividends paid	(16,298)	(9,255)	(12,939)
Net cash from financing activities	415,274	601,558	279,379
Change in cash and cash equivalents	(25,023)	20,412	17,734
Cash and cash equivalents at beginning of year	89,747	69,335	51,601
Cash and cash equivalents at end of year	$ 64,724	$ 89,747	$ 69,335
Supplemental cash flow information:			
Cash paid for interest	$ 60,738	$ 61,327	$ 69,254
Cash paid for income taxes	$ 12,550	$ 11,582	$ 11,584
Noncash financing and investing activities:			
Net unrealized gain (loss) on available-for-sale securities	$ (5,964)	$ 2,248	$ 1,166
Common stock issued in connection with business acquisition	$ 8,796	$ -	$ 1,259
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 3,554	$ 437	$ 510

See accompanying Notes to Consolidated Financial Statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business: TowneBank (the "Company") was organized and incorporated under the laws of the Commonwealth of Virginia on September 1, 1998, and commenced operations on April 8, 1999. The Company, through its banking and non-banking subsidiaries, provides a diverse range of financial services and products throughout the Hampton Roads region.

Basis of presentation: The consolidated financial statements of TowneBank include the accounts of the Company and its subsidiaries: TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, Inc.; TowneBank Commercial Mortgage, LLC; TFA Benefits; Benefit Design Group, Inc.; and Prudential Towne Realty. The accompanying consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices of the banking industry. All significant intercompany balances and transactions have been eliminated in consolidation. The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

Use of estimates: The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred income taxes, fair value estimates, and goodwill and other intangibles.

Cash and cash equivalents: For purposes of reporting cash flows, the Company considers cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold as cash and cash equivalents. Generally, federal funds and securities purchased under agreements to resell are purchased and sold for one-day periods. The Company is required to maintain average reserve balances in cash with the Federal Reserve Bank of Richmond; required reserves were $4.10 million and $1.88 million at December 31, 2009 and 2008, respectively.

Investment securities: Investment securities are classified in three categories and accounted for as follows:

a. Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.

b. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. The Company's policy restricts the use of trading securities.

c. Debt and equity securities not classified as either held-to-maturity or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized holding gains and losses excluded from earnings and reported as other comprehensive income, a separate component of shareholders' equity, until realized.

Gains and losses on sales of securities are computed based on specific identification of the adjusted cost of each security and included in noninterest income. Amortization of premiums and accretion of discounts are computed by the effective yield method and included in interest income. Other-than-temporary declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost, if any, are included in earnings as realized losses.

Loans: Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, generally are stated at the amount of unpaid principal less net deferred fees and costs on originated loans, unearned income, and participation interests sold to other lending institutions. Interest on loans is accrued and credited to income based upon the principal amount outstanding. Fees collected and costs incurred in connection with loans originated are deferred and recognized as interest income over the term of the loan as an adjustment of yield.

Allowance for loan losses: A loan is considered impaired, based on current information and events, if it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, except that all collateral-dependent loans are measured for impairment based on the fair value of the collateral. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

Management periodically evaluates the adequacy of the allowance for loan losses in order to maintain the allowance at a level that is sufficient to absorb probable credit losses. Management's evaluation of the adequacy of the allowance is based on a review of the known and inherent risks in the loan portfolio, including adverse circumstances that may affect the ability of the borrower to repay interest and/or principal, the estimated value of collateral, and an analysis of the levels and trends of delinquencies, charge-offs, and the internal risk ratings within various loan categories. Such factors as the level and trend of interest rates and the condition of the national and local economies are also considered. In addition, losses incurred by similarly situated banks are considered.

Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Increases and decreases in the allowance due to changes in the measurement of impaired loans, if applicable, are included in the provision for loan losses. Loans continue to be classified as impaired unless they are brought fully current and the collection of scheduled interest and principal is considered probable.

When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance, and subsequent recoveries, if any, are credited to the allowance. Management's ongoing evaluation of the adequacy of the allowance for loan losses includes historical loss experience internally and that of peer banks.

Loans held for sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Premises and equipment: Premises and equipment are stated at cost, less accumulated depreciation. Leasehold improvements are amortized over the lives of the respective leases or the estimated useful life of the leasehold improvement, whichever is less.

For financial reporting purposes, depreciation is computed by the straight-line method over the estimated useful lives of the assets. For income tax purposes, the modified accelerated cost recovery system is used. Costs of maintenance and repairs are charged to expense as incurred. Costs of replacing structural parts of major units are considered individually and are expensed or capitalized as the facts dictate.

Fixed assets may be retired and disposed of by sale, trade, abandonment, or through a casualty loss such as a fire or storm. At retirement, the cost of the asset and its related accumulated depreciation are removed from the accounts. The type of disposal will determine the specific treatment of the asset.

Goodwill and other intangibles: Goodwill is not subject to amortization, but is subject to an annual assessment for impairment by applying a fair-value-based test as required by the Financial Accounting Standards Board (the "FASB") Accounting Standards Codification Topic ("ASC") 350, *Goodwill and Other Intangible Assets*. Additionally, under ASC 350, acquired intangible assets are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful life.

Goodwill is tested for impairment at the reporting unit level on an annual basis, or more often if events or circumstances indicate there may be impairment. Testing is conducted in two steps: identifying the potential impairment and then, if necessary, identifying the amount of impairment. The first step compares the fair value of the reporting segment to its carrying amount. If the fair value is less than the carrying amount, a second test is conducted by comparing the implied fair value of segment goodwill with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess.

Intangible assets are amortized or tested for impairment based on whether they have finite or indefinite lives. Intangibles that have finite lives are amortized on a straight-line basis over their useful life and tested for impairment whenever events or circumstances indicate the carrying amount of the assets may not be recoverable. Intangibles with indefinite lives are tested annually for impairment. Note 6 provides additional information related to goodwill and other intangibles.

Transfers of financial assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the asset has been isolated from the Company, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred asset, and (iii) an agreement to repurchase the transferred asset before its maturity does not exist.

Credit-related financial instruments: In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded. They are considered in calculating the provision for loan losses.

Rate lock commitments: The Company enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). As required by ASC 815, *Derivative and Hedging*, rate lock commitments related to the origination of mortgage loans held for sale and the corresponding forward loan sale commitments are considered to be derivatives. The commitments are generally for periods of 60 days and are at market rates.

In order to mitigate the risk from interest rate fluctuations, the Company enters into forward loan sale commitments on a "best efforts" basis while the loan is in the pipeline. All of the gain on sales generated from mortgage banking activities is recorded in the financials at the time the loan is closed.

Revenue Recognition: Revenue earned on interest-earning assets is recognized based on the effective yield of the financial instrument.

Service charges on deposit accounts are recognized as charged. Credit-related fees, including letter of credit fees, are recognized in noninterest income when earned.

Insurance commission income is recorded as of the effective date of insurance coverage or the billing date, whichever is later. Contingent commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts. The income effects of subsequent premium and fee adjustments are recorded when the adjustments become known.

Real estate commissions are earned by the Company's real estate brokerage business upon the closing of a real estate transaction (i.e., purchase or sale of a home). The real estate commissions are recorded net of commissions paid to real estate agents, which are recognized concurrently with the associated revenues.

The Company provides title and closing services, which include title search procedures for title insurance policies, home sale escrow, and other closing services. Title revenues, which are recorded net of amounts remitted to third-party insurance underwriters, and title and closing service fees are recorded at the time a home sale transaction or refinancing closes.

Fund servicing fees are primarily based on a percentage of the fair value of the fund assets serviced.

Income recognition on impaired and nonaccrual loans: Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 120 days, unless such loans are well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is generally classified as nonaccrual. Loans that are on a current payment status or past due less than 120 days may also be classified as nonaccrual, if repayment in full of principal and/or interest is unlikely.

While a loan is classified as nonaccrual and the probability of collecting the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. When the

probability of collecting the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower in accordance with the contractual terms of interest and principal.

Advertising costs: Advertising costs are expensed as incurred.

Segment information: Operating segments as defined by ASC 280, *Segment Reporting*, are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. The accounting policies of operating segments are the same as those described elsewhere in this footnote. Revenue for all segments is derived from external sources. See Note 22 for further discussion of the Company's operating segments.

Mergers and acquisitions: Mergers and acquisitions are accounted for using the purchase method, as required by ASC 805, *Business Combinations*. Under this method, the cost of the acquired entity will be allocated to the assets acquired and liabilities assumed based on their fair values at the date of acquisition. The excess of the cost over the fair value of the acquired net assets is recognized as goodwill. See Note 2 for further discussion on the Company's mergers and acquisitions.

Income taxes: Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities that result in future taxable or deductible amounts. The effect on deferred taxes of a change in tax rates is recognized in the year of enactment and is measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized in the near term. Note 18 provides additional information on the Company's income taxes.

Comprehensive income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income or loss. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with the operating net income or loss, are components of comprehensive income or loss. The only component of other comprehensive income or loss consists of unrealized gains and losses on available-for-sale securities.

Share-based compensation: The Company has a share-based employee compensation plan, which is described in more detail in Note 12. The Company accounts for the plan using the fair value method, which requires that compensation cost relating to stock-based payment transactions be recognized in the financial statements. The compensation cost is measured based on the fair value of the instruments issued.

Earnings per share: Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the year, less the average number of nonvested restricted stock awards. Diluted earnings per share reflect the potential dilution from the issuance of additional shares of common stock caused by the exercise of stock options and restricted stock awards. Also considered in the calculation is the impact of the convertible subordinated capital debentures on earnings available to shareholders and weighted-average common shares outstanding. See Note 23 for further discussion on the Company's earnings per share.

Recent accounting pronouncements

Effective January 1, 2009, the Company adopted the new accounting guidance incorporated into Financial Accounting Standards Board (the "FASB") Accounting Standards Codification Topic ("ASC") 805 (issued as Statement of Financial Accounting Standards No. ("SFAS") 141(R), *Business Combinations*). The guidance replaces prior guidance on the subject and establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, as well as the goodwill acquired in the business combination or a gain from a bargain purchase. ASC 805 also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. The adoption of this guidance did not have a material impact on the Company's consolidated financial position and results of operations.

Effective January 1, 2009, the Company adopted the new accounting guidance incorporated into ASC 810 (formerly SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51)*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. ASC 810 also establishes expanded disclosure requirements that clearly identify and distinguish between the interest of the parent's owners and the interests of the noncontrolling owners of a subsidiary. As a result of the adoption, amounts reported or included in prior periods have not changed but have been reclassified to conform with the current period presentation. Earnings per share continue to be based on earnings attributable to TowneBank.

Effective January 1, 2009, the Company adopted the new accounting guidance incorporated into ASC 260 (issued as FASB Staff Position ("FSP") EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities)*. ASC 260-10 affects entities that accrue cash dividends (whether paid or unpaid) on share-based payment awards during the award's service period for dividends that are nonforfeitable. The FASB concluded that unvested awards containing rights to nonforfeitable dividends are participating securities. Because unvested awards containing such rights are considered participating securities, we are required to compute basic and diluted earnings per share under the two-class method. The adoption of this guidance did not have a material impact on the Company's consolidated financial position and results of operations.

In April 2009, the FASB issued new accounting guidance to be included in ASC 820 (issued as FSP SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly).* ASC 820 affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. ASC 820 requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. This guidance amended prior guidance by expanding certain disclosure requirements. The new provisions of ASC 820 were effective for the Company beginning in the interim period ending on June 30, 2009. The adoption of this guidance did not have a material impact on the Company's consolidated financial position and results of operations.

In April 2009, the FASB issued new accounting guidance to be included in ASC 320 (issued as FSP SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments).* The guidance (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. Under this guidance, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. The new provisions of ASC 320 were effective for the Company beginning in the interim period ending on June 30, 2009. The adoption of this guidance did not have a material impact on the Company's consolidated financial position and results of operations.

In April 2009, the FASB issued new accounting guidance to be included in ASC 825 (issued as FSP SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments).* The new guidance amends prior guidance to require an entity to provide disclosures about fair value of financial instruments in interim financial information and to require those disclosures in summarized financial information at interim reporting periods. Under ASC 825, a publicly traded company shall include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. In addition, entities must disclose, in the body or in the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for annual reporting periods, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position. The new interim disclosures required by this guidance were included in the Company's interim financial statements beginning in the second quarter of 2009.

Effective June 30, 2009, the Company adopted ASC 855 (formerly SFAS 165, *Subsequent Events).* ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. ASC 855 became effective for the Company's financial statements for periods ending

after June 15, 2009. The adoption of ASC 855 did not have a significant impact on the Company's financial statements.

In June 2009, the FASB issued Accounting Standard Update No. ("ASU") 2009-16 (formerly SFAS 166*, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140).* ASU 2009-16 amends SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. ASU 2009-16 eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. ASU 2009-16 also requires additional disclosures about all continuing involvements with transferred financial assets, including information about gains and losses resulting from transfers during the period. ASU 2009-16 will be effective January 1, 2010, and is not expected to have a significant impact on the Company's financial statements.

In June 2009, the FASB issued ASU 2009-17 (formerly SFAS 167*, Amendments to FASB Interpretation No. 46(R)).* ASU 2009-17 amends FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities,* to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. ASU 2009-17 requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement, as well as its effect on the entity's financial statements. ASU 2009-17 will be effective January 1, 2010, and is not expected to have a significant impact on the Company's financial statements.

In June 2009, the FASB issued ASC 105 (originally issued as SFAS 168*, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a Replacement of FASB Statement No. 162).* ASC 105 establishes the FASB Accounting Standards Codification (the "Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed non-authoritative. The guidance is effective for the Company's financial statements for periods ending after September 15, 2009. The adoption of this guidance did not have a significant impact on the Company's financial statements.

In October 2009, the FASB issued Accounting Standard Update No. ("ASU") 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force*. ASU 2009-13 addresses the accounting for sales arrangements that include multiple products or services by revising the criteria for when deliverables may be accounted for separately rather than as a combined unit. Specifically, this guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is necessary to separately account for each product or service. This hierarchy provides more options for establishing selling price than existing guidance. ASU 2009-13 is required to be applied prospectively to new or materially modified revenue arrangements in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company does not expect adoption of this standard to have a material impact on its consolidated results of operations and financial condition.

NOTE 2: MERGERS AND ACQUISITIONS

Effective December 31, 2009, TowneBank acquired Taylor Johnson Insurance Group, an independent insurance agency that will be affiliated with Towne Insurance. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations,* and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses were included in the Company's Consolidated Statements of Income commencing January 1, 2010. The purchase price was $16.91 million in cash and stock. Acquisition-related costs were $453 thousand and were included in noninterest expense in the consolidated statement of income for the year ended December 31, 2009. The preliminary allocation of the purchase price resulted in goodwill of $11.50 million, and other intangible assets, including customer lists and non-compete agreements of $5.41 million. These amounts are preliminary and subject to change pending finalization of the purchase price allocation.

Effective January 16, 2009, TowneBank contributed certain wholly-owned subsidiaries and $5.7 million in cash into a joint venture with Virginia Beach-based Prudential Decker Realty and Prudential McCardle Realty of Williamsburg. TowneBank owns 65% of the resulting new company, Prudential Towne Realty. The former owners of Prudential Decker and Prudential McCardle collectively own the balance of the shares of Prudential Towne Realty. The acquisition was accounted for as a business combination under the acquisition method of accounting in accordance with ASC 805, *Business Combinations,* and, as such, the assets acquired and liabilities assumed in the transaction were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses were included in the Company's Consolidated Statements of Income commencing January 16, 2009. The value of the transaction was $18.5 million. Acquisition-related costs were $1.2 million and were included in noninterest expense in the consolidated statement of income for the year ended December 31, 2009. The allocation of the purchase price resulted in tangible assets of $1.6 million, goodwill of $14.6 million, and other intangible assets, including customer lists and non-compete agreements of $2.3 million, and assumed liabilities of $236 thousand.

Corolla Companies: Effective January 3, 2008, TowneBank acquired both Corolla Classic Vacations, a resort property management company, and Corolla Real Estate, a realty company (the "Corolla companies"). The acquisition was accounted for as a business combination under the purchase method of accounting and, as such, the assets and liabilities of the Corolla companies were recorded at their respective fair values as of the acquisition date. The results of operations of the Corolla companies were included in the Company's Consolidated Statements of Income commencing January 3, 2008. The purchase price was $7.2 million in cash, including transaction costs. The allocation of the purchase price resulted in tangible assets of $1.6 million, goodwill of $3.3 million, and other intangible assets, including customer lists and non-compete agreements of $2.3 million.

B. Martin Weber, Inc.: On May 31, 2007, Towne Insurance acquired most of the assets and operations of B. Martin Weber, Inc. ("Weber"), a group benefits agency. The acquisition was accounted for as a business combination under the purchase method of accounting and, as such, the assets and liabilities of Weber were recorded at their respective fair values as of the acquisition date. The results of operations of Weber were included in the Company's Consolidated Statements of Income commencing May 31, 2007. The purchase price for Weber was $2.53 million in cash and common stock, including transaction costs. The major components of the purchase price are intangible assets, including customer lists and non-competes of $1.79 million, and goodwill of $706 thousand. The remaining $30 thousand includes tangible assets acquired.

The Frieden Agency, Inc.: Towne Insurance acquired The Frieden Agency, Inc. ("Frieden"), an employee benefits provider, on January 1, 2007. The acquisition was accounted for as a business combination under the purchase method of accounting and, as such, the assets and liabilities of Frieden were recorded at their respective fair values as of the acquisition date. The results of operations of Frieden were included in the Company's Consolidated Statements of Income commencing January 1, 2007. The purchase price was $8 million in cash, including transaction costs. The allocation of the purchase price resulted in the recording of $3.13 million in goodwill and $5.14 million in intangible assets.

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

NOTE 3: INVESTMENT SECURITIES

Available-for-sale securities

The following chart indicates the amortized cost and fair values of available-for-sale securities for the periods indicated (in thousands).

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 245,474	$ 250	$ (2,289)	$ 243,435
Municipal securities	21,481	207	(278)	21,410
Total debt securities	266,955	457	(2,567)	264,845
Other investments	7,084	-	(309)	6,775
Federal Home Loan Bank stock	26,063	-	-	26,063
Mortgage-backed securities	213,191	751	(859)	213,083
Total equity securities	246,338	751	(1,168)	245,921
Total available-for-sale securities	$ 513,293	$ 1,208	$ (3,735)	$ 510,766

December 31, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 70,002	$ 1,530	$ -	$ 71,532
U.S. Treasury notes	77,000	-	-	77,000
Municipal securities	12,341	93	(598)	11,836
Corporate obligations	-	-	-	-
Total debt securities	159,343	1,623	(598)	160,368
Other investments	7,126	-	(764)	6,362
Federal Home Loan Bank stock	20,877	-	-	20,877
Mortgage-backed securities	153,746	6,389	(2)	160,133
Total equity securities	181,749	6,389	(766)	187,372
Total available-for-sale securities	$ 341,092	$ 8,012	$ (1,364)	$ 347,740

Federal Home Loan Bank of Atlanta ("FHLB") stock is stated at cost, as this is a restricted security without a readily determinable fair value.

For the year ended December 31, 2009, proceeds from securities available for sale were $392.27 million and resulted in realized gains of $11.15 million. For the years ended December 31, 2008 and 2007, proceeds from securities available for sale amounted to $159.14 million, and $0, excluding prepayments related to mortgage-backed securities, and resulted in gains of $2.96 million and $70 thousand, respectively.

Held-to-maturity securities

The amortized cost and fair values of held-to-maturity investment securities for the periods indicated (in thousands):

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Other investments	$ 19,456	$ 177	$ (594)	$ 19,039
Municipal bonds	17,977	362	(80)	18,259
Industrial revenue bonds	85,491	-	-	85,491
Total held-to-maturity securities	$ 122,924	$ 539	$ (674)	$ 122,789

December 31, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trust Preferred	$ 9,357	$ 709	$ (1,378)	$ 8,688
Municipal bonds	20,970	368	(434)	20,904
Industrial revenue bonds	87,033	186	-	87,219
Total held-to-maturity securities	$ 117,360	$ 1,263	$ (1,812)	$ 116,811

Maturities of investment 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 investment securities are shown by contractual maturity (including mortgage-backed securities) in the following tables (in thousands).

December 31, 2009	**Available for Sale**		**Held to Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 484	$ 487	$ 8,754	$ 8,787
Due after one year through five years	252,558	250,456	20,629	20,703
Due after five years through 10 years	93,489	93,057	22,234	22,243
Due after 10 years	140,605	140,683	71,307	71,056
	487,136	484,683	122,924	122,789
Federal Home Loan Bank stock	26,063	26,063	-	-
Other equity securities	94	20	-	-
	$ 513,293	$ 510,766	$ 122,924	$ 122,789

December 31, 2008	**Available for Sale**		**Held to Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 77,237	$ 77,236	$ 7,128	$ 7,111
Due after one year through five years	50,787	51,820	17,898	17,804
Due after five years through 10 years	11,751	12,018	12,703	12,644
Due after 10 years	180,310	185,733	79,631	79,252
	320,085	326,807	117,360	116,811
Federal Home Loan Bank stock	20,877	20,877	-	-
Other equity securities	130	56	-	-
	$ 341,092	$ 347,740	$ 117,360	$ 116,811

Pledged securities

At December 31, 2009 and 2008, the Company had investment securities with carrying values of $106.44 million and $84.72 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had no investment securities pledged to secure borrowings from the Federal Reserve Bank of Richmond ("FRB") at December 31, 2009. Comparatively, the Company had no investment securities pledged to secure borrowings from the FRB at December 31, 2008. The Company also had $27.07 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2009, compared to $49.90 million at December 31, 2008.

Reconciliation to net unrealized gains

The following table reconciles the reclassification adjustment and the tax effect component of other comprehensive income to net unrealized gains (losses) for the years ended December 31 (in thousands):

	2009	2008	2007
Unrealized gains on securities:			
Unrealized holding gains arising during the period	$ 20,324	$ 6,396	$ 1,843
Other than temporary impairment of available-for-sale securities	-	23	20
Reclassification adjustment for gains on available-for-sale securities included in income	(11,149)	(2,960)	(70)
Total other comprehensive income before income tax expense	9,175	3,459	1,793
Income tax expense	(3,211)	(1,211)	(627)
Net unrealized gains (losses)	$ (5,964)	$ 2,248	$ 1,166

(continued on next page)

Unrealized losses

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

December 31, 2009	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	$ 208,383	$ 2,289	$ -	$ -	$ 208,383	$ 2,289
Municipal securities	$ 6,557	$ 22	$ 4,580	$ 336	$ 11,137	$ 358
Federal agency mortgage-backed securities	72,604	859	-	-	72,604	859
Corporate obligations	10,979	362	10,342	467	21,321	829
Subtotal, debt securities	298,523	3,532	14,922	803	313,445	4,335
Other investments, including common stock	-	-	20	74	20	74
Total temporarily impaired securities	$ 298,523	$ 3,532	$ 14,942	$ 877	$ 313,465	$ 4,409

December 31, 2008	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal securities	$ 17,567	$ 1,006	$ 976	$ 26	$ 18,543	$ 1,032
Federal agency mortgage-backed securities	235	1	54	1	289	2
Corporate obligations	9,712	2,068	-	-	9,712	2,068
Subtotal, debt securities	27,514	3,075	1,030	27	28,544	3,102
Other investments, including common stock	-	-	56	74	56	74
Total temporarily impaired securities	$ 27,514	$ 3,075	$ 1,086	$ 101	$ 28,600	$ 3,176

U.S. Treasury obligations

The Company's unrealized losses on government agency obligations were caused by interest rate fluctuations. On December 31, 2009, sixteen securities had a total unrealized loss of $2.289 million. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities are government agencies and the Company has the ability and intent to hold them for a period of time sufficient to allow for an anticipated recovery, they are not considered to be other than temporarily impaired.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At December 31, 2009, twelve securities had a total unrealized loss of $358 thousand. Based on the credit quality of the issuers and the Company's ability and intent to hold these securities until a market price recovery or maturity, the Company does not consider these investments other than temporarily impaired.

Federal agency mortgage-backed securities

The Company's unrealized losses on investments in federal agency mortgage-backed securities were caused by interest rate fluctuations. At December 31, 2009, six securities experienced a total unrealized loss of $859 thousand. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities are government agencies and the Company has the ability and intent to hold them for a period of time sufficient to allow for an anticipated recovery, they are not considered to be other than temporarily impaired.

Corporate obligations

The Company's unrealized losses on corporate obligations were caused by interest rate fluctuations. At December 31, 2009, nine securities had an unrealized loss of $829 thousand. Based on the credit quality of the issuer and the Company's ability and intent to hold these securities until a market price recovery or maturity, the Company does not consider these investments other than temporarily impaired.

Other investments, including common stock

At December 31, 2009, one equity security experienced a total unrealized loss of $73 thousand. This loss was the result of fluctuating market conditions in the local economy. The Company monitors this security and has the ability and intent to hold the investment to allow for an anticipated recovery.

NOTE 4: LOANS AND ALLOWANCE FOR LOAN LOSSES

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. Of total loans, $863.09 million were pledged as collateral to secure overnight borrowings with the FHLB and $74.69 million were pledged to secure borrowings from the discount window at the FRB at December 31, 2009.

A summary of loan balances by major classification (in thousands):

December 31,	2009	2008
Real estate loans		
Residential 1-4 family	$ 634,960	$ 589,075
Commercial	866,165	737,244
Construction	652,221	617,390
Multifamily	41,652	30,079
Total real estate loans	2,194,998	1,973,788
Commercial loans	321,498	329,716
Consumer installment loans		
Personal installment	31,099	27,752
Credit cards and revolving credit	17,652	18,890
Total consumer installment loans	48,751	46,642
Agriculture loans	663	40
Loans, net of unearned income and deferred costs	$ 2,565,910	$ 2,350,186

Unearned loan income was $981 thousand in excess of deferred loan costs at December 31, 2009, and $939 thousand at December 31, 2008. There were $42.15 million and $2.82 million in nonaccrual loans at December 31, 2009 and 2008. The Company would have earned $1.48 million in 2009 and $38 thousand in 2008 if interest on the loans had been accrued.

Transactions affecting the allowance for loan losses (in thousands):

Years Ended December 31,	2009	2008	2007
Balance, beginning of year	$ 27,503	$ 21,323	$ 19,670
Loans charged off			
Residential 1-4 family	(1,749)	(385)	(474)
Construction	(4,050)	(22)	-
Commercial	(1,032)	(279)	(409)
Consumer	(310)	(284)	(285)
Total	(7,141)	(970)	(1,168)
Loans recovered			
Residential 1-4 family	156	7	2
Construction	215	-	-
Commercial	148	89	50
Consumer	21	32	26
Total	540	128	78
Net loans recovered (charged off)	(6,601)	(842)	(1,090)
Provision for loan losses	12,891	7,022	2,743
Balance, end of year	$ 33,793	$ 27,503	$ 21,323

It is the opinion of management that the allowance was adequate at December 31, 2009 based on conditions reasonably known to them; however, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, changes in general economic conditions, or other risk factors.

NOTE 5: PREMISES, EQUIPMENT, AND LEASES

A summary of the cost and accumulated depreciation of premises and equipment is as follows (in thousands):

December 31,	2009	2008
Land and improvements	$ 16,932	$ 16,539
Buildings and improvements	35,971	32,451
Autos	2,908	2,947
Computer and communication equipment	7,625	7,035
Equipment	8,755	8,041
Furniture and fixtures	22,646	19,448
Leasehold improvements	17,482	14,553
Construction in progress	7,585	2,496
	119,904	103,510
Less accumulated depreciation	(30,146)	(24,519)
Net premises and equipment	$ 89,758	$ 78,991

Depreciation and leasehold amortization expense for the years ended December 31, 2009, 2008, and 2007 was $6.12 million, $5.97 million, and $4.94 million, respectively.

Various facilities and equipment are leased under noncancellable operating leases with initial remaining terms in excess of one year and an option for renewal. In addition to minimum rentals, certain leases have escalation clauses and include provisions for additional payments to cover taxes, insurance, and maintenance. The effects of scheduled rent increases, which are included in the minimum lease payments, are recognized on a straight-line basis over the lease term. Rental expense was $6.41 million for 2009, compared to $4.20 million for 2008, and $4.00 million for 2007. Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2009, are listed in the following chart (in thousands):

2010	$ 5,598
2011	5,205
2012	4,937
2013	4,783
2014	4,137
Thereafter	15,471
	$ 40,131

Rental income for the year ended December 31, 2009, was $363 thousand, compared to $338 thousand for 2008 and $282 thousand for 2007. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2009 (in thousands):

2010	$	268
2011	$	245
2012	$	194
2013	$	153
2014	$	112
Thereafter	$	380
	$	1,352

NOTE 6: GOODWILL AND INTANGIBLE ASSETS

The gross carrying amount and accumulated amortization for the Company's intangible assets (in thousands):

	December 31,			
	2009		2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 3,677	$ 2,579	$ 3,677	$ 2,134
Non-compete agreements	2,181	1,284	1,651	803
Property management contracts	620	620	620	620
Customer lists	15,662	2,281	6,811	1,360
Total intangible assets subject to amortization	22,140	6,764	12,759	4,917
Intangible assets not subject to amortization				
Title plant	146	-	428	-
Trade names	538	-	334	-
Contractual agreements	3,231	-	3,231	-
Total intangible assets not subject to amortization	3,915	-	3,993	-
Total intangible assets	$ 26,055	$ 6,764	$ 16,752	$ 4,917

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2009, was $2.49 million, compared to $2.17 million for 2008 and $1.14 million for 2007. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2009, are as follows: 2010, $1.75 million; 2011, $1.47 million; 2012, $1.24 million; 2013, $1.03 million; and 2014, $922 thousand.

During 2009, the Company recorded $20.45 million in goodwill and $9.66 million in intangible assets. This represents acquisitions of the two companies in 2009 and certain other adjustments to goodwill. The intangible assets acquired are finite-lived assets consisting of non-compete agreements and customer lists,

which are amortized over four and eight year periods, respectively. The majority of these assets are included in the Company's Realty and Insurance segments.

During 2009 and 2008, the Company recorded $282 thousand and $376 thousand, respectively, of impairment charges for the title plant due to obsolescence. Also during 2007, the Company recorded $5.09 million in goodwill and $7.21 million in intangible assets primarily for the acquisition of benefit agencies. The intangible assets included contracts with an indefinite life and other intangibles with defined lives. These finite-lived assets include customer lists and non-compete agreements, which are both amortized over eight years. These assets are included in the Insurance segment.

Impairment testing indicated that goodwill was not impaired in 2009 or 2008. Changes in the carrying amount of goodwill related to each of the Company's segments are as follows (in thousands):

	Bank	Realty	Insurance	Consolidated Totals
Balance, December 31, 2007	$ 45,520	$ 4,833	5,981	$ 56,334
Additions to goodwill	-	3,362	502	3,864
Balance, December 31, 2008	$ 45,520	$ 8,195	$ 6,483	$ 60,198
Additions to goodwill	-	7,756	12,713	20,469
Other adjustments	-	(21)	-	(21)
Balance, December 31, 2009	$ 45,520	$ 15,930	$ 19,196	$ 80,646

NOTE 7: BANK-OWNED LIFE INSURANCE POLICIES

During the fourth quarter of 2007, the Company invested $36 million in bank-owned life insurance policies with the intent to fund a newly-created Supplemental Executive Retirement Plan ("SERP") for certain executives. The SERP, which was implemented in the fourth quarter of 2008, as discussed in Note 11, provides retirement benefits and post-retirement health benefits to the executives covered under the plan.

NOTE 8: DEPOSITS

A summary of time deposits by maturity at December 31, 2009, is shown in the following chart (dollars in thousands).

Maturity	Total
2010	$1,031,255
2011	276,219
2012	27,003
2013	27,399
2014 and thereafter	32,620
	$1,394,496

At year-end 2009, TowneBank had a total of $649.97 million in no-penalty time deposits as compared to $396.41 million for 2008. Some of the Company's officers and directors and the respective companies in which the officers and directors have a financial interest have deposit relationships with the Company. Related party deposits amounted to approximately $35.63 million and $34.68 million at December 31, 2009 and 2008, respectively.

NOTE 9: BORROWINGS

TowneBank is a member of the FHLB and may borrow funds based on criteria established by the FHLB. The FHLB may call these borrowings if the adjusted collateral balance falls below the borrowing level. The borrowing arrangements available from the FHLB could be either short- or long-term, depending on our related cost and needs.

Advances from the FHLB for the years ended December 31 are summarized as follows (dollars in thousands):

	2009	2008
Balance outstanding at end of year	$ 453,840	$ 363,877
Average balance outstanding	$ 366,161	$ 337,548
Maximum outstanding at any month-end	$ 453,840	$ 363,892
Average interest rate during the year	4.29%	4.40%
Average interest rate at end of year	3.51%	4.25%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2009 are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Call Date	Outstanding Amount
02/09/2010	6.45%	-	$ 25,000
03/31/2010	0.29%	-	15,000
11/10/2010	5.43%	02/10/2010	8,000
12/21/2010	0.59%	-	75,000
06/29/2011	5.17%	-	840
07/15/2011	3.25%	07/15/2010	50,000
03/06/2017	4.08%	03/08/2010	100,000
05/18/2017	4.35%	02/18/2010	80,000
05/18/2017	4.48%	05/18/2010	80,000
01/29/2018	3.05%	01/30/2012	13,000
01/29/2018	3.05%	01/30/2012	7,000
			$ 453,840

Total interest expense on FHLB advances for the years ended December 31, 2009, 2008, and 2007 was $15.70 million, $14.84 million, and $12.39 million, respectively.

Information concerning securities sold under agreements to repurchase and federal funds purchased is summarized as follows (dollars in thousands):

	2009	2008
Balance outstanding at end of year	$ 21,524	$ 36,248
Average balance outstanding	$ 23,910	$ 47,509
Maximum outstanding at any month-end	$ 28,625	$ 69,268
Average interest rate during the year	0.57%	1.82%
Average interest rate at end of year	0.64%	0.53%

Repurchase agreements totaled $21.52 million at December 31, 2009. They are classified as secured borrowings and generally mature within one business day from the transaction date. They are reflected as the amount of cash received in connection with the transaction. In addition, federal funds lines with other financial institutions were available at December 31, 2009, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2009 and 2008, the Company had $628.10 million and $576.40 million, respectively, unused line of credit with the FHLB. The FHLB advances are secured by a blanket floating lien on certain 1-4 family residential, multifamily, HELOCS, second mortgages, and commercial mortgages with carrying values of $863.09 million at December 31, 2009.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2009, which provide potential additional funding.

The Company has three different convertible subordinated capital debentures: (i) Series I Towne Investment Note, (ii) Series II Towne Investment Note, and (iii) Series III Towne Investment Note. At year-end 2009, all three debentures accrued and paid interest. Collectively, interest expense on the debentures for the year ended December 31, 2009, was $2.49 million. Total convertible subordinated capital debentures at December 31, 2009, were $50.76 million.

In early March 2002, TowneBank offered Series I Towne Investment Units (“Series I units”) to existing shareholders and customers in a subscription offering. Each Series I unit consists of 84.97 shares of common stock priced at $11.77 per share and $1,000 in the aggregate and one 15-year 6% convertible subordinated capital note in the principal amount of $1,000. Beginning in May 2004, the unit’s note and equity began trading separately. The convertible subordinated notes are convertible into common stock at the discretion of the note holder at a conversion price of $14.38 per share (equal to a conversion rate of 69.54 shares per $1,000 principal amount of notes).

The Company sold 22,498 units, for aggregate proceeds of $45.0 million in the offering, and closed the offering during April 2002, which resulted in $22.5 million in convertible subordinated capital notes. At year-end 2009 and 2008, the Company had $20.90 million and $21.15 million, respectively, in Series I convertible subordinated notes. The Company may redeem the notes in whole or in part after May 15, 2009, at its option and with the approval of the FDIC at 100% of the principal amount, together with accrued interest to the date of redemption.

In connection with the acquisition of Harbor Bank in 2004, TowneBank assumed the obligations of Harbor Bank under the outstanding 6% convertible subordinated bond (a "Harbor Bond") in the principal amount of $1,000. At year-end 2009 and 2008, the Company had $0 and $3.48 million, respectively, in Harbor Bonds. The Harbor Bonds were convertible into TowneBank common stock at a conversion price of $8.51 per $1,000 principal amount of bonds (equal to a conversion rate of 117.51 shares per $1,000 principal of bonds). In November 2009, the Harbor Bonds were retired by the Company, resulting in the issuance of approximately 375 thousand shares of TowneBank common stock.

During August 2004, TowneBank raised $48.95 million through the sale of Series II Towne Investment Units ("Series II units") to existing shareholders and customers in a subscription offering. Each Series II unit consisted of 82.4 shares of common stock priced at $24.27 per share and $2,000 in the aggregate and one 15-year 6.25% convertible subordinated capital note ("6.25% Note") in the principal amount of $1,000.

The 6.25% Note is convertible into common stock at a conversion price of $29.42 per share (equal to a conversion rate of 33.99 shares per $1,000 principal amount of notes). The Company sold 16,316 units and closed the offering in August 2004, resulting in $16.32 million in Series II convertible subordinated notes. The common stock and notes were issued separately in early October 2004. The note began accruing interest on October 1, 2004, and the first interest payment was made on May 15, 2005. At year-end 2009 and 2008, the Company had $15.98 million and $16.04 million, respectively, in Series II convertible subordinated notes. The Company may redeem the notes in whole or in part after November 15, 2009, at its option and with the approval of the FDIC at 100% of the principal amount, together with accrued interest to the date of redemption.

In October 2009, TowneBank raised $27.77 million through the sale of Series III Towne Investment Units ("Series III units") to existing shareholders and customers in a subscription offering. Each Series III unit consisted of 150 shares of common stock priced at $13.38 per share and $2,000 in the aggregate and one 10-year 8% convertible subordinated capital note ("8% Note") in the principal amount of $2,000.

The 8% Note is convertible into common stock at a conversion price of $13.38 per share (equal to a conversion rate of 149.47 shares per $2,000 principal amount of notes). The Company sold 6,942 units and closed the offering in October 2009, resulting in $13.88 million in Series III convertible subordinated notes. The common stock and notes were issued separately in late October 2009. The note began accruing interest on October 20, 2009, and the first interest payment will be made on May 1, 2010. At year-end 2009, the Company had $13.88 million in Series III convertible subordinated notes. On and after October 1, 2011, the Company may, at its option, convert some or all of the notes into shares of common stock at the applicable conversion price. The Company may exercise this conversion right if, for 20 trading days within any period of 30 consecutive trading days, the closing price of the Company's common stock exceeds 100% of the applicable conversion price.

NOTE 10: COMMITMENTS

TowneBank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk, which have not been recognized in the balance sheet. The contract amount of these instruments reflects the extent of the Company's involvement or "credit risk."

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Unless noted otherwise, collateral or other security is required to support financial instruments with credit risk.

Our contractual amounts are as follows (in thousands):

December 31,	2009	2008
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 1,335,707	$ 914,624
Standby letters of credit	36,570	30,677
	$ 1,372,277	$ 945,301

Commitments to extend credit are agreements to lend to a customer as long as there is not a violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and real estate.

Standby letters of credit are conditional commitments issued to guarantee performance of a customer to a third party. The letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral supporting those commitments is generally held, if deemed necessary. The Company provides an allowance for estimated losses from such provisions that management considered adequate at December 31, 2009. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

NOTE 11: RETIREMENT PLANS

Defined Contribution Plan

The Company has a defined contribution 401(k) plan. All employees who are at least 18 years of age and have completed one quarter of a year of service are eligible to participate. Under the plan, employees may contribute a percentage of their annual salary, subject to statutory limitations, and the Company will match 100% of the employees' contributions up to 3% of their salary. The Company may also make an additional discretionary contribution; there was a discretionary contribution matching 100% of employees' contributions up to 1.5% of their salary for the year ended December 31, 2009. There were no discretionary contributions for the years ended December 31, 2008 and 2007.

The Company made matching contributions of $1.88 million, $2.11 million, and $2.22 million for the years ended December 31, 2009, 2008, and 2007, respectively. The Company's matching contribution is in the form of the Company's stock, which the Company issues or purchases on the open market at the prevailing prices.

Supplemental Executive Retirement Plan

On December 1, 2008, the Company implemented a noncontributory, unfunded Supplemental Executive Retirement Plan ("SERP") for certain officers and key employees. The SERP is intended to provide retirement benefits and post-retirement health benefits to the individuals covered under the plan. The SERP agreements with the officers provide that upon attainment of retirement age, generally at age 65, the participating officer will be entitled to receive a retirement benefit equal to either (i) a designated percentage, ranging from 30% to 50% of their 2007 base salary depending on their level of seniority, with an annual 4% increase until retirement, or (ii) a fixed targeted benefit amount. The retirement benefit is payable over a 15 year period, beginning at attainment of contractual retirement age. The SERP agreements provide for an annual vesting schedule until the participating officer reaches retirement age. In the case of a participating officer's voluntary termination of employment, disability, or termination for cause, the annual amount payable under the SERP is equal to the amount of the vested benefit earned as of the date of termination of employment. In the case of involuntary termination without cause or termination of employment for good reason by the participating officer, the participating officer becomes fully vested in the full retirement benefit. Upon termination of employment, payment of the retirement benefit does not begin until the participating officer reaches the designated retirement age set forth in the SERP agreement. In the event of death, the full amount of the retirement benefit is payable.

The following table sets forth changes in benefit obligations and financial status (in thousands).

December 31,	**2009**	**2008**
Change in benefit obligation		
Benefit obligation, beginning of year	$ 245	$ -
Service cost	3,051	245
Interest cost	14	-
Benefit obligation, end of year	$ 3,310	$ 245
Accumulated benefit obligation, end of year	$ 2,871	$ 203

The components of the net periodic benefit cost for the SERP are as follows (in thousands):

	2009	**2008**
Service cost	$ 3,051	$ 245
Interest cost	14	-
Net periodic benefit cost	$ 3,065	$ 245

The Company used certain weighted average assumptions to determine benefit obligations and net benefit costs, including discount rate and rate of increase in future compensation levels. The discount rate used to determine net periodic benefit cost and benefit obligation was 5.75% in 2009 and 2008. The rate of increase in future compensation levels used for 2009 and 2008 was 4.0%. The discount rate assumption used was a blended rate based on the Moody's Aa rate and the Citigroup Liability Pension Curve.

The following table sets forth expected future benefit payments, which reflect expected future service, for the periods indicated (in thousands).

Year	SERP
2010	-
2011	-
2012	651
2013	954
2014	1,048
2015-2019	6,606

NOTE 12: SHARE-BASED COMPENSATION

The Company maintains a share-based compensation plan ("Plan") that provides for the granting of incentive and non-statutory stock options and restricted common stock. The Plan is administered by the Compensation Committee of the Board of Directors (the "Compensation Committee"). The maximum number of shares reserved under the Plan is equal to 20% of the fully diluted number of shares of the Company's common stock outstanding or such lesser number of shares as the Compensation Committee shall determine. The Company has a policy of using authorized and unissued common shares to satisfy share option exercises and vesting of restricted stock awards. At December 31, 2009, approximately 2.43 million common shares were available for issuance under the Plan.

Stock options: For stock options granted under the Plan, the stock option price cannot be less than the fair market value of the stock on the date granted. The Compensation Committee determines the exercise price for certain awards, and it can be based on future service. An option's maximum contractual term is ten years from the date of grant. Options and awards granted under the Plan are subject to vesting requirements ranging from two to ten years.

The following tables summarize our stock option activity and related information.

For the Year Ended December 31,	2009		2008		2007	
	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
Options outstanding, beginning balance	1,189,663	$12.97	1,301,678	$11.78	1,394,626	$10.44
Granted	23,500	13.70	104,500	17.86	110,950	19.17
Exercised	(313,042)	3.40	(159,111)	3.71	(160,808)	3.72
Forfeited	(17,117)	17.91	(57,404)	20.46	(43,090)	17.49
Options outstanding, ending balance	883,004	$16.29	1,189,663	$12.97	1,301,678	$11.78
Options exercisable at December 31,	498,689	$15.33	727,126	$9.99	816,191	$8.20

	Number	Weighted-Average Exercise Price
Unvested stock options, December 31, 2008	462,537	$17.67
Granted	23,500	13.70
Vested	(93,106)	17.23
Forfeited	(8,616)	17.41
Unvested stock options, December 31, 2009	384,315	$17.54

For the years ended December 31, 2009, 2008, and 2007, the weighted-average fair value of stock options granted was $4.33, $5.19, and $8.48, respectively. For the same periods, the total intrinsic value of options exercised was $4.49 million, $2.49 million, and $2.41 million, respectively. Additional information pertaining to options outstanding at December 31, 2009, is as follows:

	Number	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	883,004	$ 16.29	$ 148,191	4.76 years
Options vested or expected to vest	862,928	$ 16.26	$ 148,129	4.72 years
Options exercisable	498,689	$ 15.33	$ 146,087	3.89 years

The grant-date fair value of each option grant is estimated using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs. Expected volatility was calculated based on the historical volatility of the Company's stock over the most recent period of time equal to the expected term of the option. The average expected life was based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior based on historical patterns. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. Forfeitures are estimated based on historical voluntary termination behavior.

The following table summarizes the assumptions used for the following years.

Years Ended December 31,	2009	2008	2007
Dividend yield	2.33%	1.69%	0.60%
Expected life	7.0 years	7.0 years	8.56 years
Expected volatility	36.0%	27.0%	26.9%
Risk-free interest rate	2.79%	3.27%	4.12%

Cash received from exercises of stock options for the year ended December 31, 2009, was $702 thousand. The tax benefit realized for the tax deductions from stock option exercises for the year ended December 31, 2009, was $598 thousand, compared to $414 thousand for 2008 and $172 thousand for 2007. Compensation expense related to stock options for the years ended December 31, 2009, 2008, and 2007 was $511 thousand, $165 thousand, and $766 thousand, respectively. As of December 31, 2009, there was $1.74 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 5.02 years.

Restricted stock awards (RSAs): Under the Plan, grantees of restricted stock awards have full voting rights on the shares and are entitled to receive cash or stock dividends. RSAs granted under the Plan are generally subject to vesting requirements ranging from three to ten years. The shares are subject to forfeiture if vesting and other contractual provision requirements are not met.

The following chart shows a summary of the restricted stock award activity and related information, assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2009.

	Number	Weighted-Average Price
Unvested RSAs, beginning balance	108,474	$ 13.63
Granted	-	-
Vested	(61,938)	11.47
Forfeited	(240)	20.29
Unvested RSAs, ending balance	46,296	$ 16.47

Compensation expense related to the awards for the years ended December 31, 2009, 2008, and 2007 was $478 thousand, $683 thousand, and $763 thousand, respectively. The total fair value of awards vested during 2009, 2008, and 2007 was $710 thousand, $780 thousand, and $768 thousand, respectively. As of December 31, 2009, there was $485,616 of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 3.75 years.

NOTE 13: STOCK PURCHASE PLAN, DIVIDEND REINVESTMENT PLAN, AND DIVIDEND RESTRICTIONS

The Board of Directors approved and adopted the Member Stock Purchase and Dividend Reinvestment Plan to raise additional capital by providing a convenient and cost-effective way for shareholders, customers, and employees to purchase shares of TowneBank common stock. For the year ended December 31, 2008, the Company did not issue any shares in connection with the monthly stock purchase plan. Instead the Company entered the open market and acquired 195,587 shares at an average price of $18.09 per share. For the year ended December 31, 2008, the Company issued 255,572 shares in connection with the dividend reinvestment plan at an average price of $17.49 per share.

In connection with the monthly stock purchase plan for the year ended December 31, 2009, the Company entered the open market and acquired 132,987 shares at an average price of $15.98 per share and issued 74,937 shares at an average price of $12.41 per share. In connection with the dividend reinvestment plan for the year ended December 31, 2009, the Company entered the open market and acquired 108,102 shares at an average price of $15.48 per share and issued 270,990 shares in at an average price of $14.50 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In November 2006, the Company declared a special shareholder cash dividend bonus of $0.30 per common share paid in January 2007. The total dividend paid was $7.13 million. In 2009, 2008, and 2007 the Company declared quarterly cash dividends of $0.08 per common share. The quarterly dividends were paid on April 16, 2007; July 16, 2007; October 11, 2007; January 10, 2008; April 10, 2008; July 10, 2008; October 10, 2008; and January 9, 2009; April 10, 2009; July 10, 2009; October 9, 2009; and January 11, 2010.

Declaration of future cash dividends will depend on our earnings, our capital position, and other factors. 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.

Preferred Stock

In August 2008, the Company issued 598,542 shares of 8% Non-Cumulative Convertible Preferred Stock, Series A (the "Series A Preferred Stock"), at a purchase price of $100 per share. The Series A Preferred Stock will pay a non-cumulative dividend of 8% per year. Dividends are payable quarterly in cash, when, as, and if declared by the Board of Directors, on the first day of March, June, September, and December, commencing on December 1, 2008. Dividends on the Series A Preferred Stock began accruing August 15, 2008.

On October 10, 2008, the Company declared the first cash dividend of $2.33 per Series A preferred share, paid on December 1, 2008, for the period August 15, 2008, through November 30, 2008. In 2009, the Company declared quarterly cash dividends of $2.00 per preferred share. The quarterly dividends were paid on March 2, 2009; June 1, 2009; September 1, 2009; and December 1, 2009.

Each share of the Series A Preferred Stock may be converted at any time, at the option of the holder, into shares of common stock equal to the purchase price divided by $18.56 ("conversion price"). On or after September 11, 2011, the Company may cause some or all of the outstanding shares of the Series A Preferred Stock, at its option, at any time or from time to time, to be converted into shares of common stock if, for 20 trading days during any period of 30 consecutive trading days, the closing price of common stock exceeds 120% of the then-applicable conversion price. On September 1, 2013, all of the then outstanding shares of the Series A Preferred Stock will automatically convert into common shares without regard to the then market price of the common stock.

In December 2008, under the U.S. Treasury's TARP Capital Purchase Program, we issued to the U.S. Treasury 76,458 shares of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B (the "Series B Preferred Stock"), and a ten-year warrant to purchase 538,184 common shares at an exercise price of $21.31 per share, for aggregate proceeds of $76.46 million. The value of the warrants was recorded as $4.14 million and is included on the balance sheet in capital surplus. Non-cumulative dividends on the Series B Preferred Stock are payable at a rate of 5% annually through February 14, 2013, and at a rate of 9% annually thereafter.

On January 28, 2009, the Company declared the first cash dividend of $8.75 per Series B preferred share, paid on February 17, 2009. The Company also declared quarterly cash dividends of $12.50 per preferred share. The quarterly dividends were paid on May 15, 2009; August 17, 2009; November 16, 2009; and February 16, 2010.

NOTE 14: OTHER EXPENSES

The following chart shows a summary of other expenses (in thousands).

Year Ended December 31,	2009	2008	2007
Advertising and marketing	$ 3,665	$ 2,908	$ 4,621
Charitable contributions	2,193	2,012	1,726
Telephone and postage	2,574	2,254	1,910
Outside processing	2,491	2,093	1,860
Professional fees	2,981	1,617	1,792
Other	3,393	1,345	1,741
Stationery and office supplies	1,674	1,458	1,707
Amortization of intangible assets	2,803	2,488	1,591
FDIC and other insurance	5,338	1,622	1,536
Software expense	2,529	2,028	1,363
Travel/Meals/Entertainment	611	549	1,107
Directors' expense	952	1,436	1,056
Bank franchise tax/SCC fees	2,240	1,174	848
	$ 33,444	$ 22,984	$ 22,858

NOTE 15: REGULATORY CAPITAL REQUIREMENTS

The Company is subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by the regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2009, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the FDIC categorized the Company as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized," the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed our category.

A summary of our required and actual capital components follow (dollars in thousands).

As of December 31, 2009	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Total risk-based capital (to risk-weighted assets)	$ 450,492	15.06%	$ 239,290	8.00%	$ 299,113	10.00%
Tier 1 capital (to risk-weighted assets)	$ 365,944	12.23%	$ 119,645	4.00%	$ 179,468	6.00%
Tier 1 leverage ratios (to average assets)	$ 365,944	10.47%	$ 139,860	4.00%	$ 174,825	5.00%

As of December 31, 2008	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio %	Amount	Ratio %	Amount	Ratio %
Total risk-based capital (to risk-weighted assets)	$ 411,971	15.43%	$ 213,632	8.00%	$ 267,040	10.00%
Tier 1 capital (to risk-weighted assets)	$ 343,590	12.87%	$ 106,816	4.00%	$ 160,224	6.00%
Tier 1 leverage ratios (to average assets)	$ 343,590	11.59%	$ 118,618	4.00%	$ 148,272	5.00%

NOTE 16: DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 825, *Financial Instruments* requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent our underlying value.

The following methods and assumptions were used in estimating fair value for our financial instruments, as defined by ASC 825.

Cash and due from banks, interest-bearing deposits in financial institutions, and federal funds sold: The carrying amount approximates fair value.

Securities available for sale: Fair values are based on published market prices or dealer quotes. The carrying amount of the FHLB stock approximates fair value. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Securities held to maturity: Fair values are based on published market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans held for sale: 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.

Loans: For credit card and other loan receivables with short-term and/or variable characteristics, the total receivable outstanding approximates fair value. The fair value of other loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Interest receivable and interest payable: The carrying amount approximates fair value.

Deposits: The fair value of noninterest-bearing deposits and deposits with no defined maturity is estimated by discounting anticipated future cash flows using current borrowing rates. The fair value of certificates of deposit is estimated by discounting the future cash flows using the current rates at which similar deposits would be made.

Advances from the FHLB: The fair value of advances from the FHLB is determined using the discounted cash flow method with the discount rate being equal to the rate currently offered on similar products.

Convertible subordinated capital debentures: The fair values of the convertible subordinated capital debentures are estimated using discounted contractual cash flows based on the Company's incremental rate of borrowing that would be currently available for similar types of borrowing arrangements.

Repurchase agreements: The carrying amount approximates fair value.

Federal funds purchased: The carrying amount approximates fair value.

Commitments to extend and standby letters of credit: These financial instruments are generally not sold or traded. The estimated fair values of off-balance-sheet credit commitments, including standby letters of credit and guarantees written, are not readily available due to the lack of cost-effective and reliable measurement methods for these instruments.

Derivative financial instruments: Fair values for on-balance-sheet commitments to originate loans held for sale are based on fees currently charged to enter into similar agreements and, for fixed-rate commitments, also consider the difference between current levels of interest rates and the committed rates.

The estimated fair values of our financial instruments required to be disclosed under ACS 825 are as follows (in thousands):

Year Ended December 31,	2009		2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and due from banks	$ 55,748	$ 55,748	$ 67,280	$ 67,280
Interest-bearing deposits in financial institutions	8,976	8,976	2,467	2,467
Federal funds sold	-	-	20,000	20,000
Securities available for sale	510,766	510,766	347,740	347,740
Securities held to maturity	122,924	122,789	117,360	116,811
Mortgage loans held for sale	72,221	72,109	25,884	25,884
Loans, net	2,532,117	2,575,615	2,322,683	2,357,416
Interest receivable	12,030	12,030	10,748	10,748
Deposits	2,561,702	2,452,927	2,238,668	2,161,120
Advances from the Federal Home Loan Bank of Atlanta	453,840	469,164	363,877	386,748
Convertible subordinated capital debentures	50,755	44,195	40,878	37,681
Repurchase agreements and other borrowings	21,524	21,524	36,248	36,248
Interest payable	6,985	6,985	8,896	8,896

NOTE 17: FAIR VALUE MEASUREMENT

ASC 820, *Fair Value Measurements and Disclosures,* defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC Topic 820 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. ASC Topic 820 was issued to increase consistency and comparability in reporting fair values.

We use fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. We did not have any liabilities that were measured at fair value at December 31, 2009. Our securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets or liabilities on a non-recurring basis. These non-recurring fair value adjustments generally involve the write-down of individual assets due to impairment losses.

In accordance with ASC 820, we group our assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined

using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held for sale.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, asset-backed securities, and highly structured or long-term derivative contracts.

Assets and liabilities measured at fair value on a recurring basis at December 31, 2009, including financial instruments for which the Company has elected the fair value option, are summarized below (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Available-for-sale securities	$ 8	$ 510,758	$ -	$ 510,766

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 year-end, the following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets at December 31, 2009. (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Other real estate owned	$ -	$ 2,043	$ -	$ 2,043

NOTE 18: INCOME TAXES

The provision for income taxes charged to operations is listed in the following chart (in thousands).

For the Year Ended December 31,	2009	2008	2007
Current income tax expense	$ (15,153)	$ (11,607)	$ (12,226)
Deferred income tax benefit	3,506	2,856	1,402
Income tax expense	$ (11,647)	$ (8,751)	$ (10,824)

Differences between income tax expense calculated at the statutory rate and shown on the Consolidated Statements of Income are summarized as follows (dollars in thousands):

For the Year Ended December 31,	2009 $	2009 Rate	2008 $	2008 Rate	2007 $	2007 Rate
Federal income tax expense at statutory rate	$ (13,442)	(35.00%)	$ (11,426)	(35.00%)	$ (11,929)	(35.00%)
State income tax expense, net of federal benefit	(59)	(0.15%)	(31)	(0.09%)	(36)	(0.11%)
Tax advantaged income	1,944	5.06%	1,985	6.08%	1,139	3.34%
Tax credits	636	1.66%	542	1.66%	542	1.59%
162(m) Disallowance	(561)	(1.46%)	-	-	-	-
Other	(165)	(0.43%)	179	0.54%	(540)	(1.58%)
Income tax expense	$ (11,647)	(30.32%)	$ (8,751)	(26.81%)	$ (10,824)	(31.76%)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management believes it is more likely than not that the Company will realize the benefits of the Company's deferred tax assets.

Significant components of deferred tax assets and deferred tax liabilities follow (in thousands).

Year Ended December 31,	2009	2008
Deferred tax assets:		
Allowance for loan losses	$ 11,827	$ 9,232
Stock-based compensation	844	816
Other	837	632
Accrued expenses	669	414
Retirement plan	1,157	-
Deferred compensation	4,133	4,211
Total deferred tax assets	19,467	15,305
Deferred tax liabilities:		
Loan costs	591	1,351
Depreciation	6,084	4,713
Noncompete and intangibles	349	908
Basis differences due to tax credits and partnerships	693	487
Unrealized gain (loss) on securities available for sale	(887)	2,324
Other	404	-
Total deferred tax liabilities	7,234	9,783
Net deferred tax assets	$ 12,233	$ 5,522

The Company recognizes interest and penalties related to unrecognized tax benefits as "Interest Expense" and "Other Expense," respectively, and not as part of the tax provision. The Company did not recognize any interest expense or penalties for the year ended December 31, 2009. Additionally, there were no interest or penalties accrued at December 31, 2009.

The Company is subject to examination for federal and state purposes for the tax years 2006 through 2009.

NOTE 19: LEGAL CONTINGENCIES

Various legal actions arise from time to time in the normal course of our business. There were no significant asserted claims or assessments at December 31, 2009. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2009.

NOTE 20: OTHER RELATED PARTY TRANSACTIONS

Loans are made to the Company's executive officers and directors and their associates during the ordinary course of business. The aggregate amount of loans to such related parties totaled $138.16 million, $110.41 million, and $76.92 million as of December 31, 2009, 2008, and 2007, respectively. During 2009, new advances on all commitments to such parties totaled $348.82 million, adjustments and additions for new related parties totaled $6.43 million and repayments amounted to $327.50 million. In addition at December 31, 2009, we had $32.84 million in unfunded commitments to extend credit to such related parties.

The Company rents space for various financial centers from affiliated companies. Rent expense related to these leases was $1.44 million, $910 thousand, and $747 thousand for the years ended December 31, 2009, 2008, and 2007, respectively.

In October 2000, in connection with the acquisition of Hampton Roads Funding Corporation, TowneBank entered into consulting and non-competition agreements with four individuals, including one of the Company's directors and a member of one of the Company's regional boards of directors. Total amounts expensed under this arrangement with directors were $1.48 million for the year ended December 31, 2006. The agreement with the Company Director was modified for January and February 2007 until Towne Mortgage, LLC, began operations in March 2007. The terms of the agreement were the same as the prior agreement, except payments were to be made to the Bank's partner in Towne Mortgage, LLC, instead of the individuals previously referenced. The amount expensed in 2007 under this modified agreement was $148 thousand.

In the ordinary course of business, the Company acquired certain goods and services from companies associated with its directors. Amounts paid to these companies during the years ended December 31, 2009, 2008, and 2007 approximated $3.43 million, $1.11 million, and $1.64 million, respectively.

(continued on next page)

NOTE 21: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2009 and 2008, is as follows (in thousands, except per share data):

2009	Fourth	Third	Second	First
Interest income	$ 41,896	$ 41,415	$ 39,737	$ 38,033
Interest expense	13,805	15,053	15,698	16,182
Provision for loan losses	4,726	3,475	2,720	1,970
Noninterest income	12,043	14,344	13,616	11,586
Gain on securities available for sale	2,863	1,178	2,380	4,728
Noninterest expense	28,111	27,868	28,552	27,260
Income before income tax expense and Noncontrolling interest	10,160	10,541	8,763	8,935
Income tax expense	3,394	3,246	2,339	2,668
Net income	6,766	7,295	6,424	6,267
Noncontrolling interest	(58)	(174)	(97)	336
Net income	$ 6,708	$ 7,121	$ 6,327	$ 6,603
Net income per common share				
Basic	$ 0.17	$ 0.19	$ 0.16	$ 0.15
Diluted	$ 0.17	$ 0.19	$ 0.16	$ 0.14
Comprehensive income	$ 2,494	$ 10,458	$ 4,485	$ 3,351
Dividends	$ 0.08	$ 0.08	$ 0.08	$ 0.08

2008	Fourth	Third	Second	First
Interest income	$ 38,791	$ 38,510	$ 36,416	$ 37,133
Interest expense	16,478	15,583	14,754	16,908
Provision for loan losses	2,491	1,568	2,068	895
Noninterest income	9,196	10,921	10,508	10,282
Gain on securities available for sale	-	804	678	1,478
Noninterest expense	22,315	24,040	22,350	22,552
Income before income tax expense and Noncontrolling interest	6,703	9,044	8,430	8,538
Noncontrolling interest	(17)	(15)	(29)	(9)
Income before income tax expense	6,686	9,029	8,401	8,529
Income tax expense	1,241	2,614	2,360	2,536
Net income	$ 5,445	$ 6,415	$ 6,041	$ 5,993
Net income per common share				
Basic	$ 0.17	$ 0.26	$ 0.25	$ 0.25
Diluted	$ 0.16	$ 0.25	$ 0.24	$ 0.24
Comprehensive income	$ 10,944	$ 6,097	$ 168	$ 8,933
Dividends	$ 0.08	$ 0.08	$ 0.08	$ 0.08

NOTE 22: SEGMENT REPORTING

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Hampton Roads, Virginia, and includes the operations of TowneBank Commercial Mortgage and Towne Investment Group. The Realty segment combines the operations of Prudential Towne Realty with TowneBank Mortgage, LET, NewTowne Mortgage, LLC, and the Corolla companies to provide residential real estate services, resort property management, originations of a variety of mortgage loans, and commercial and residential title insurance. Mortgage loans are originated and sold principally in the secondary market through purchase commitments from investors. The Insurance segment provides full-service commercial and retail insurance and employee benefit services through Towne Insurance, Taylor Johnson, and TFA Benefits.

All the segments are service-based. The Banking segment offers a distribution and referral network for the realty and insurance services, 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 businesses are fee-based businesses, while the Banking segment is driven principally by net interest income.

Segment profit and loss is measured by net income after income tax. Intersegment 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.

Information about reportable segments and reconciliation of such information to the consolidated financial statements follows (dollars in thousands).

(continued on next page)

For the Year Ended December 31, 2009	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 99,216	$ 1,120	$ 7	$ 100,343
Provision for loan losses	12,778	113	-	12,891
Net interest income after provision for loan losses	86,438	1,007	7	87,452
Residential mortgage brokerage income, net	(311)	12,221	-	11,910
Real estate brokerage and property management income, net	-	11,725	-	11,725
Insurance commissions and other title fees and income, net	-	2,401	10,862	13,263
Other noninterest income	23,701	1,499	640	25,840
Noninterest expense	71,597	23,080	8,491	103,168
Depreciation and amortization	5,753	2,453	417	8,623
Income before income tax, corporate allocation, and noncontrolling interest	32,478	3,320	2,601	38,399
Corporate allocation	(1,226)	805	421	-
Income before income tax provision and noncontrolling interest	33,704	2,515	2,180	38,399
Income tax provision	9,942	807	898	11,647
Net income	23,762	1,708	1,282	26,752
Noncontrolling interest	-	9	(2)	7
Net income attributable to TowneBank	$ 23,762	$ 1,717	$ 1,280	$ 26,759
Net income as percentage of total	88.80%	6.42%	4.78%	100.00%
Assets	$ 3,425,498	$ 129,963	$ 50,990	$ 3,606,451
Efficiency ratio	63.09%	88.15%	77.40%	68.55%

For the Year Ended December 31, 2008	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 86,337	$ 774	$ 17	$ 87,128
Provision for loan losses	7,022	-	-	7,022
Net interest income after provision for loan losses	79,315	774	17	80,106
Residential mortgage brokerage income, net	(666)	5,985	-	5,319
Real estate brokerage and property	-	7,778	-	7,778
Insurance commissions and other title fees and income, net	-	2,117	11,264	13,381
Other noninterest income	16,239	888	262	17,389
Noninterest expense	60,282	14,997	7,522	82,801
Depreciation and amortization	5,839	1,900	718	8,457
Income before income tax, corporate allocation, and noncontrolling interest	28,767	645	3,303	32,715
Corporate allocation	(1,075)	645	430	-
Income before income tax provision and noncontrolling interest	29,842	-	2,873	32,715
Income tax provision	7,688	(55)	1,118	8,751
Net income	22,154	55	1,755	23,964
Noncontrolling interest	-	(66)	(4)	(70)
Net income attributable to TowneBank	$ 22,154	$ (11)	$ 1,751	$ 23,894
Net income as percentage of total	92.72%	(0.05%)	7.33%	100.00%
Assets	$ 3,046,757	$ 55,280	$ 31,541	$ 3,133,578
Efficiency ratio	64.88%	96.32%	71.39%	69.67%

For the Year Ended December 31, 2007	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 84,715	$ 710	$ 74	$ 85,499
Provision for loan losses	2,743	-	-	2,743
Net interest income after provision for loan losses	81,972	710	74	82,756
Residential mortgage brokerage income, net	309	5,855	-	6,164
Real estate brokerage and property	-	5,462	-	5,462
Insurance commissions and other title	-	2,695	10,406	13,101
Other noninterest income	11,066	659	370	12,095
Noninterest expense	57,649	13,166	7,834	78,649
Depreciation and amortization	5,374	975	509	6,858
Income before income tax, corporate allocation, and noncontrolling interest	30,324	1,240	2,507	34,071
Corporate allocation	(1,193)	724	469	-
Income before income tax provision and noncontrolling interest	31,517	516	2,038	34,071
Income tax provision	9,499	328	997	10,824
Net income	22,018	188	1,041	23,247
Noncontrolling interest	-	12	-	12
Net income attributable to TowneBank	$ 22,018	$ 200	$ 1,041	$ 23,259
Net income as percentage of total	94.66%	0.86%	4.48%	100.00%
Assets	$ 2,426,995	$ 44,474	$ 29,609	$ 2,501,078

The following table provides the change in net income and total assets for each segment, comparing December 31, 2009 and 2008 (dollars in thousands).

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 1,608	$ 1,728	$ (471)	$ 2,865
Net Income (%)	7.26%	N/M	(26.90%)	11.99%
Total Assets ($)	$ 378,741	$ 74,683	$ 19,449	$ 472,873
Total Assets (%)	12.43%	135.10%	61.66%	15.09%

NOTE 23: EARNINGS PER SHARE

The following chart summarizes information related to the computation of basic and diluted earnings per share (in thousands, except per share data).

Year Ended December 31,	2009	2008	2007
Basic			
Net income, as reported	$ 26,759	$ 23,894	$ 23,259
Preferred stock dividends	(10,044)	(1,396)	-
Net income available to common shareholders	$ 16,715	$ 22,498	$ 23,259
Average common shares outstanding	25,126,604	24,174,069	23,712,692
Basic earnings per common share	$ 0.67	$ 0.93	$ 0.98
Diluted			
Net income available to common shareholders	$ 16,715	$ 22,498	$ 23,259
Interest applicable to 6% subordinated debt, net of tax (1)	815	961	975
Net income available to common shareholders, for diluted EPS	17,530	23,459	24,234
Average common shares outstanding	25,126,604	24,174,069	23,712,692
Effect of dilutive securities			
stock compensation plans, net of tax benefit	134,362	423,837	670,446
6% convertible subordinated debentures (2)	1,452,899	1,880,315	1,908,606
Average diluted shares outstanding	26,713,865	26,478,221	26,291,744
Diluted earnings per common share	$ 0.66	$ 0.89	$ 0.92

(1) Annualized interest on both 6% convertible subordinated capital debentures (net of tax) was added to net income as this interest would not be paid if the debentures were converted to common stock.

(2) Shares are assumed to have been converted since the beginning of the period.

The Series II convertible subordinated capital notes entitle the holders to convert their notes into 543,092 shares of common stock. These shares were not included in the computation of diluted earnings per share, as the effect would have been anti-dilutive.

The TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A entitled the holders to convert their shares into 3,175,105 shares of common stock. These shares were not included in the computation of diluted earnings per share as the effect was anti-dilutive for the period.

TOWNEBANK
SHAREHOLDER INFORMATION

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 19, 2010, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

Effective October 9, 2007, the Company's Common Stock is listed on the NASDAQ Global Select Market under the symbol TOWN. Prior to that date, it was listed on the OTC Bulletin Board, which is a quotation system for equity securities not listed on the NASDAQ Stock Market or stock exchanges. The following are the Company's quarterly high and low closing stock prices for the periods indicated.

	2009		2008	
Quarter	High	Low	High	Low
First	$ 24.95	$ 11.80	$18.19	$14.49
Second	18.90	13.82	19.80	14.83
Third	14.02	12.75	26.68	12.86
Fourth	13.70	11.12	24.79	16.74

INVESTOR RELATIONS

Our Annual Report, Form 10-K, and other corporate publications are available to shareholders on request, without charge, by writing:

Mr. Clyde E. McFarland, Jr.
Senior Executive Vice President and Chief Financial Officer
6001 Harbour View Boulevard
Suffolk, VA 23435
757-638-6801
e-mail: Clyde.McFarland@townebank.net

These reports are also available on our Web site at http://www.townebank.com/inv_documents.asp.

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This document has not been reviewed for accuracy or relevance by the Federal Deposit Insurance Corporation.