TOWNEBANK

2010 Annual Report

TowneBank
TABLE OF CONTENTS

BUSINESS PROFILE AND CORPORATE MISSION STATEMENT 1

SELECTED FINANCIAL HIGHLIGHTS 2

MANAGEMENT'S DISCUSSION AND ANALYSIS 4

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM 36

MANAGEMENT'S REPORT ON INTERNAL CONTROL 38

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES 40

SHAREHOLDER INFORMATION 92

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; Out of Town, LLC, d/b/a Red Sky Travel Insurance ("Red Sky"); Towne Mortgage, LLC; NewTowne Mortgage, LLC; Towne Mortgage of the Carolinas, LLC; Corolla Classic Vacations, LLC ("Corolla"); Towne 1031 Exchange, LLC ("Towne 1031 Exchange"); Towne New Markets CDE, Inc.; and Prudential Towne Realty ("PTR"), which includes Lawyers Escrow and Title, LLC, d/b/a Virginia Home Title and Settlements ("Virginia Home Title"); 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 3, 2010, we acquired the six banking offices of The Bank of Currituck, including all deposit accounts and selected assets. The former Bank of Currituck was reopened as a member of TowneBank's Hometown Banking Group under the name of TowneBank of Currituck serving Moyock, Grandy, Camden, Southern Shores, Corolla, and Kill Devil Hills, North Carolina. The acquisition allows us to expand our style of hometown banking into northeastern North Carolina and fits into our strategic goal of serving those communities within the reach of the Hampton Roads media market stretching from Williamsburg to the Outer Banks.

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,	2010	2009	2010/2009 Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 122,635	$ 100,343	$ 22,292	22.22%
Noninterest income (1)	60,089	51,589	8,500	16.48%
Noninterest expenses	122,745	111,791	10,954	9.80%
Provision for loan losses	22,565	12,891	9,674	75.05%
Net income	30,276	26,759	3,517	13.14%
Net income per common share - basic	0.74	0.67	0.07	10.45%
Net income per common share - diluted	0.73	0.66	0.07	10.61%
Period End Data:				
Total assets	$ 3,871,018	$ 3,606,451	$ 264,567	7.34%
Total assets - tangible	3,762,072	3,506,514	255,558	7.29%
Earning assets (2)	3,527,232	3,287,139	240,093	7.30%
Loans (net of unearned income and deferred costs)	2,731,352	2,565,910	165,442	6.45%
Allowance for loan losses	38,660	33,793	4,867	14.40%
Goodwill and other intangibles	108,946	99,937	9,009	9.02%
Noninterest-bearing deposits	706,040	572,228	133,812	23.38%
Interest-bearing deposits	2,248,474	1,989,474	259,000	13.02%
Total deposits	2,954,514	2,561,702	392,812	15.33%
Equity	499,512	464,321	35,191	7.58%
Equity - tangible	390,566	364,384	26,182	7.19%
Book value per share	12.46	11.87	0.59	4.97%
Book value per share - tangible	8.69	8.23	0.46	5.59%
Cash dividends declared per share	0.32	0.32	-	-
Daily Average Balances:				
Total assets	$ 3,721,155	$ 3,432,368	$ 288,787	8.41%
Total assets - tangible	3,622,944	3,350,603	272,341	8.13%
Earning assets (2)	3,383,057	3,190,132	192,925	6.05%
Loans (net of unearned income)	2,587,287	2,439,006	148,281	6.08%
Allowance for loan losses	35,158	28,841	6,317	21.90%
Goodwill and other intangibles	98,211	81,764	16,447	20.11%
Noninterest-bearing deposits	649,840	566,435	83,405	14.72%
Interest-bearing deposits	2,101,692	1,953,497	148,195	7.59%
Total deposits	2,751,532	2,519,931	231,601	9.19%
Total equity	490,572	437,556	53,016	12.12%
Total equity - tangible	392,361	355,792	36,569	10.28%
Key Ratios:				
Return on average assets	0.81%	0.78%	0.03%	3.85%
Return on average tangible assets	0.84%	0.80%	0.04%	5.00%
Return on average equity	6.17%	6.12%	0.05%	0.82%
Return on average tangible equity	7.72%	7.52%	0.20%	2.66%
Net interest margin (2)	3.77%	3.29%	0.48%	14.59%
Efficiency ratio (1)	67.18%	73.58%	(6.40%)	(8.70%)
Average earning assets/total average assets	90.91%	91.64%	(0.73%)	(0.80%)
Average loans/average deposits	94.03%	96.79%	(2.76%)	(2.85%)
Average noninterest deposits/total average deposits	23.62%	22.48%	1.14%	5.07%
Allowance for loan losses/period end loans	1.42%	1.32%	0.10%	7.58%
Period end equity/period end total assets	12.90%	12.87%	0.03%	0.23%

Notes:

(1) Excludes investment securities gains of $5.96 million in 2010 and $11.15 million in 2009.

(2) Includes bank-owned life insurance

TOWNEBANK
SELECTED FINANCIAL HIGHLIGHTS

Period Ended December 31,	**2008**	**2007**	**2006**
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 87,127	$ 85,499	$ 77,042
Noninterest income (1)	40,907	36,752	35,561
Provision for loan losses	7,022	2,743	2,572
Net income	23,894	23,259	21,786
Net income per common share - basic	0.93	0.98	0.93
Net income per common share - diluted	0.89	0.92	0.86
Period End Data:			
Total assets	$ 3,133,578	$ 2,501,078	$ 2,194,585
Total assets - tangible	3,061,545	2,433,009	2,137,537
Earning assets (2)	2,905,349	2,310,284	2,015,188
Loans (net of unearned income and deferred costs)	2,350,186	1,829,456	1,641,826
Allowance for loan losses	27,503	21,323	19,670
Goodwill and other intangibles	72,033	68,069	57,048
Noninterest-bearing deposits	475,290	439,122	453,451
Interest-bearing deposits	1,763,378	1,395,224	1,251,248
Total deposits	2,238,668	1,834,346	1,704,699
Shareholders' equity	419,763	256,856	230,017
Shareholders' equity - tangible	347,730	188,787	172,969
Book value per share	11.74	10.66	9.75
Book value per share - tangible	8.81	7.83	7.33
Cash dividends declared per share	0.32	0.32	0.53
Daily Average Balances:			
Total assets	$ 2,778,722	$ 2,387,258	$ 1,981,403
Total assets - tangible	2,706,140	2,321,193	1,923,968
Earning assets (2)	2,534,447	2,185,581	1,790,461
Loans (net of unearned income)	2,059,351	1,741,441	1,438,927
Allowance for loan losses	23,745	20,401	18,191
Goodwill and other intangibles	72,582	66,064	57,435
Noninterest-bearing deposits	484,735	453,799	434,490
Interest-bearing deposits	1,537,759	1,325,619	1,148,157
Total deposits	2,022,494	1,779,418	1,582,647
Shareholders' equity	296,749	242,186	220,932
Shareholders' equity - tangible	224,167	176,122	163,497
Key Ratios:			
Return on average assets	0.86%	0.97%	1.10%
Return on average tangible assets	0.88%	1.00%	1.13%
Return on average equity	8.05%	9.60%	9.86%
Return on average tangible equity	10.66%	13.21%	13.33%
Net interest margin (2)	3.61%	4.00%	4.32%
Efficiency ratio (1)	71.28%	69.94%	67.53%
Average earning assets/total average assets	89.65%	90.96%	90.07%
Average loans/average deposits	101.82%	97.87%	90.92%
Average noninterest deposits/total average deposits	23.97%	25.50%	27.45%
Allowance for loan losses/period end loans	1.17%	1.17%	1.20%
Period end equity/period end total assets	13.39%	10.27%	10.48%

Notes:

(1) Excludes investment securities gains (losses) of $2.96 million, $70,000, and ($1.74 million) in 2008, 2007, and 2006, respectively

(2) Includes bank-owned life insurance

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 2010, we were able to grow our earnings by $3.52 million over 2009. Additionally, loans, deposits, and our overall customer base continued to grow in 2010, reflecting our commitment to customer service.

The following is a summary of the Company's 2010 financial performance:

- Net income increased to $30.28 million compared with $26.76 million in 2009. Net income available to common shareholders for 2010 was $20.92 million after accretion and preferred dividend payments of $9.36 million. Fully diluted earnings rose to $0.73 per common share as compared to $0.66 per common share in 2009.

- Net interest income increased $22.29 million, or 22.22%, primarily due to the growth in loans and other earning assets as net interest margin, on a tax-equivalent basis, increased 48 basis points from 2009, and a decline in the cost of interest-bearing liabilities.

- The provision for loan losses increased $9.67 million, or 75.05%, over 2009. The increases were driven by loan growth of $165.44 million from 2009, an increase in nonaccrual loans, higher levels of net charge-offs, and current macro-economic conditions. The loan loss reserve increased to 1.42% of loans at December 31, 2010, from 1.32% at year-end 2009.

- Excluding gains on securities available for sale, noninterest income increased by $8.50 million, or 16.48%, over 2009. This increase was driven by strong growth in our Insurance segment, primarily due to our acquisition of Taylor Johnson Insurance Group ("Taylor Johnson") on December 31, 2009. Additionally, the Company realized an increase in residential mortgage brokerage income due to the continued strength in mortgage refinancing and purchase activity.

- Noninterest expense increased $10.95 million, or 9.80%, compared to 2009. The increase was driven by higher personnel costs, primarily related to the Taylor Johnson business combination and increases in employee benefit costs.

- The effective tax rate decreased to 29.15% in 2010 compared to 30.32% in 2009. The decrease was primarily a result of increased federal tax credits from community reinvestment activity, partially offset by an increase in nondeductible expenses, including compensation.

2010 ACQUISITIONS

Effective December 3, 2010, TowneBank acquired all the deposit accounts of The Bank of Currituck and its six banking offices in northeastern North Carolina, including three banking offices on the Outer Banks. Under the terms of the purchase agreement, TowneBank also purchased a substantial portion of the Moyock-headquartered bank's loan portfolio and all of its other banking assets. The purchase price was $7.84 million in cash.

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, 2010, 2009, and 2008 of $30.28 million, $26.76 million, and $23.89 million, respectively. Diluted earnings per share were $0.73, $0.66, and $0.89 for the years ended December 31, 2010, 2009, and 2008, respectively.

Profitability, as measured by our return on average assets ("ROA") was 0.81%, 0.78%, and 0.86% for the years ended December 31, 2010, 2009, and 2008, respectively. Return on average tangible assets was 0.84%, 0.80%, and 0.88% for the same respective periods. ROA was positively affected by the improvement in margin resulting from the repricing of interest-bearing liabilities. ROA was also affected by the 8.41%, or $288.79 million, increase in average assets from the prior year.

Return on average equity ("ROE") was 6.17%, 6.12%, and 8.05% for years ended December 31, 2010, 2009, and 2008, respectively; while return on average tangible equity was 7.72%, 7.52%, and 10.66% for the same respective years. ROE was impacted by the 22.22% increase in net interest income from 2009 as compared to an increase in average equity of 12.12%, or $53.02 million, from the year ended December 31, 2009.

Our operating income, calculated as net interest income and noninterest income less gains on available-for-sale ("AFS") securities, was $182.72 million for the year ended December 31, 2010, compared to $151.93 million and $128.03 million for 2009 and 2008, 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 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. Currently, we are in a liability-sensitive balance sheet position, which implies that liabilities, such as deposits, will reprice more quickly than assets; consequently, net interest margin could be negatively affected in an increasing interest rate environment and positively affected in a decreasing rate environment. We are primarily funded by core deposits, with noninterest-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, including the impact of recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act.

Net interest income, on a tax-equivalent basis, was $127.59 million for the year ended December 31, 2010, which was $22.52 million, or 21.43%, above the previous year's amount of $105.07 million. In comparison to the prior year, net interest income improved primarily as a result of increases in the average volume of interest-earning assets and lower deposit rates. Average earning assets for 2010 increased $192.93 million, or

6.05%, compared to the same period in 2009, of which, $6.02 million was due to the Bank of Currituck acquisition. Over the same time frame, the net interest margin increased 48 basis points to 3.77% in 2010.

Interest income, on a tax-equivalent basis, was $174.15 million for the year ended December 31, 2010, which was $8.34 million, or 5.03%, more than $165.81 million for the year ending December 31, 2009. Average earning assets grew to $3.38 billion in 2010 from $3.19 billion in 2009. The yield on earning assets was 5.15% in the year ended December 31, 2010, which compared to 5.20% in the prior year. Average loan balances, net of unearned income and excluding nonaccrual loans, of $2.59 billion were $147.23 million, or 6.03%, higher in 2010 than in 2009, while loan yields were higher by 1 basis point year over year. Lower yields in investments led to the decrease in the total earning asset yield.

Interest expense, for the year ended December 31, 2010, was down $14.18 million, or 23.34%, at $46.56 million compared to $60.74 million for the year ended December 31, 2009. The balance of interest-bearing liabilities increased to $2.52 billion in 2010 from $2.39 billion in 2009, an increase of 5.59%. The higher balance was offset by a drop in the average rate paid from 2.54% in 2009 to 1.84% in 2010. The decline was driven by repricing opportunities in certificates of deposit as well as payoffs of FHLB advances.

Net interest margin, which is net interest income expressed as a percentage of average earning assets, was 3.77% in the year ended December 31, 2010, which was 48 basis points higher than the 3.29% a year ago. The improvement was driven by the decline in the cost of interest-bearing liabilities. 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,								
	2010			2009			2008		
	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	$ 2,587,287	$ 148,500	5.74%	$ 2,440,060	$ 139,882	5.73%	$ 2,059,351	$ 130,742	6.35%
Taxable investment securities	442,504	12,305	2.78%	385,297	13,966	3.62%	257,666	13,649	5.30%
Tax-exempt investment securities	115,237	6,144	5.33%	107,943	5,741	5.32%	101,265	5,369	5.30%
Interest-bearing deposits	107,307	298	0.28%	153,328	403	0.26%	51,723	1,221	2.36%
Mortgage loans held for sale	83,015	3,617	4.36%	58,694	2,565	4.37%	21,044	1,196	5.68%
Bank-owned life insurance	47,707	3,285	6.88%	44,810	3,251	7.25%	43,398	3,089	7.12%
Total earning assets	3,383,057	174,149	5.15%	3,190,132	165,808	5.20%	2,534,447	155,266	6.13%
Less: allowance for loan losses	(35,158)			(28,841)			(23,745)		
Total nonearning assets	373,256			271,077			268,020		
Total assets	$ 3,721,155			$ 3,432,368			$ 2,778,722		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 613,746	$ 3,074	0.50%	$ 509,654	$ 2,860	0.56%	$ 500,273	$ 6,161	1.23%
Savings	89,954	667	0.74%	64,057	610	0.95%	45,108	757	1.68%
Certificates of deposit	1,397,992	26,383	1.89%	1,379,786	39,107	2.83%	992,378	38,901	3.92%
Total interest-bearing deposits	2,101,692	30,124	1.43%	1,953,497	42,577	2.18%	1,537,759	45,819	2.98%
FHLB advances and repurchase agreements	393,360	14,214	3.61%	394,289	15,672	3.97%	384,845	15,737	4.09%
Convertible subordinated capital debentures	29,311	2,222	7.58%	42,920	2,489	5.80%	41,301	2,168	5.25%
Total interest-bearing liabilities	2,524,363	46,560	1.84%	2,390,706	60,738	2.54%	1,963,905	63,724	3.24%
Noninterest-bearing liabilities									
Demand deposits	649,840			566,434			484,735		
Other noninterest-bearing liabilities	56,380			37,672			33,333		
Total liabilities	3,230,583			2,994,812			2,481,973		
Shareholders' equity	490,572			437,556			296,749		
Total liabilities and equity	$ 3,721,155			$ 3,432,368			$ 2,778,722		
Net interest income (tax-equivalent basis)		$ 127,589			$ 105,070			$ 91,542	
Reconcilement of Non-GAAP Financial Measures									
Bank-owned life insurance		(3,285)			(3,251)			(3,089)	
Tax-equivalent basis adjustment		(1,669)			(1,476)			(1,326)	
Net interest income (GAAP)		$ 122,635			$ 100,343			$ 87,127	
Interest rate spread (2)			3.31%			2.66%			2.89%
Interest expense as a percent of average earning assets			1.38%			1.90%			2.51%
Net interest margin (tax-equivalent basis) (3)			3.77%			3.29%			3.61%
Total cost of deposits			1.09%			1.69%			2.27%

(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)	2010 vs 2009 Increase (Decrease) Due to Changes In			2009 vs 2008 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	$ 8,450	$ 168	$ 8,618	$ 22,632	$ (13,492)	$ 9,140
Taxable investment securities	1,886	(3,548)	(1,662)	5,458	(5,141)	317
Tax-exempt investment securities	389	14	403	355	17	372
Interest-bearing deposits	(127)	22	(105)	931	(1,749)	(818)
Loans held for sale	1,060	(8)	1,052	1,701	(332)	1,369
Bank-owned life insurance	204	(170)	34	102	60	162
Total earning assets	11,862	(3,522)	8,340	31,179	(20,637)	10,542
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	543	(329)	214	113	(3,414)	(3,301)
Savings	211	(155)	56	250	(397)	(147)
Certificates of deposit	509	(13,233)	(12,724)	12,726	(12,520)	206
Total interest-bearing deposits	1,263	(13,717)	(12,454)	13,089	(16,331)	(3,242)
FHLB advances and repurchase agreements	(37)	(1,421)	(1,458)	381	(446)	(65)
Convertible subordinated capital debentures	(912)	645	(267)	87	234	321
Total interest-bearing liabilities	314	(14,493)	(14,179)	13,557	(16,543)	(2,986)
Net interest income (tax equivalent basis)	$ 11,548	$ 10,971	$ 22,519	$ 17,622	$ (4,094)	$ 13,528

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

Provision for Loan Losses: The 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 2010, 2009, and 2008 were $22.57 million, $12.89 million, and $7.02 million, respectively. Net charge-offs were $17.70 million, $6.60 million, and $842,000 for 2010, 2009, and 2008. The increase in the provision for loan losses in 2010 was due to loan growth of $165.44 million, or 6.45%, over 2009 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 1.42% and 1.32% at December 31, 2010 and 2009. For further discussion and analysis of the loan portfolio and the allowance for loan losses, see the "Analysis of Financial Condition" section found later in this report. Also, see Note 4 "Loans and Allowance for Loan Losses" to the consolidated financial statements.

Noninterest Income: Total noninterest income for the year ended December 31, 2010, was $66.05 million, or $3.31 million and 5.28% higher than 2009. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $8.50 million, or 16.48%, over 2009. Total noninterest income for the year ended December 31, 2009, was $62.74 million, representing an $18.87 million, or 43.02%, increase from 2008. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $10.68 million, or 26.11%, over 2008. Included in noninterest income were gains on securities available for

sale of $5.96 million in 2010 and $11.15 million in 2009. There was a gain of $2.96 million on available-for-sale securities in 2008. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2010, was 32.89% of total operating income, compared with 33.96% for 2009 and 31.95% for 2008.

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

				2010/2009 Increase/(Decrease)		2009/2008 Increase/(Decrease)	
For the Year Ended December 31,	2010	2009	2008	Amount	%	Amount	%
Residential mortgage brokerage income, net	$ 12,998	$ 11,910	$ 5,319	$ 1,088	9.14%	$ 6,591	123.91%
Real estate brokerage and property management income, net	11,155	11,725	7,778	(570)	(4.86%)	3,947	50.75%
Insurance commissions and other title fees and income, net	19,501	13,264	13,154	6,237	47.02%	110	0.84%
Service charges on deposit accounts	6,556	6,342	5,845	214	3.37%	497	8.50%
Credit card merchant fees	2,261	1,823	1,824	438	24.03%	(1)	(0.05%)
Other income							
Other	2,406	1,762	1,901	644	36.55%	(139)	(7.31%)
Towne Investment income, net	1,342	1,132	1,217	210	18.55%	(85)	(6.98%)
Bank-owned life insurance income	2,157	2,113	2,008	44	2.08%	105	5.23%
Service fees on loans	813	683	780	130	19.03%	(97)	(12.44%)
Towne Mortgage LLC income, net	703	631	658	72	11.41%	(27)	(4.10%)
Commerical mortgage brokerage fees, net	148	170	295	(22)	(12.94%)	(125)	(42.37%)
Other real estate income	49	34	128	15	44.12%	(94)	(73.44%)
Total other income	7,618	6,525	6,987	1,093	16.75%	(462)	(6.61%)
Noninterest income before securities gain/(loss)	60,089	51,589	40,907	8,500	16.48%	10,682	26.11%
Gain/(loss) on securities available for sale	5,961	11,149	2,960	(5,188)	(46.53%)	8,189	276.66%
Total noninterest income	$ 66,050	$ 62,738	$ 43,867	$ 3,312	5.28%	$ 18,871	43.02%

For the year ended December 31, 2010, residential mortgage brokerage income, net of commission expense, was $13.00 million, reflecting an increase of $1.09 million, or 9.14%, compared to 2009, which was $6.59 million, or 123.91%, higher than 2008. The majority of the increase in net mortgage brokerage income in 2010 is attributable to the higher volume in purchase transactions, which increased 12.96%. 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, 2010, was $11.16 million, a decrease of $570,000, or 4.86%, from 2009, which was $3.95 million, or 50.75%, greater than 2008. The decrease from the prior year is primarily attributable to the continued softness in the residential real estate market, while the increase in 2009 over 2008 was 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, 2010, insurance commissions and other title income, net of commission expense, was $19.50 million, which was $6.24 million, or 47.02%, higher than comparative 2009. The increase from the comparative period of the prior year was largely due to the acquisition of Taylor Johnson, which contributed commission income of $6.00 million. Additionally, travel insurance revenue increased by $534,000 to $688,000 in 2010. The year ended December 31, 2010, included contingency income from property and casualty insurance of $1.75 million compared to $752,000 and $936,000 for 2009 and 2008.

When compared to 2008, insurance commissions for the year ended December 31, 2009, were $110,000, or 0.84%, higher.

Service charges on deposit accounts were $6.56 million for 2010, compared with $6.34 million and $5.85 million for 2009 and 2008, respectively. The increase reflects the 9.19% increase in average deposits over the year ended December 31, 2009.

For the year ended December 31, 2010, credit card merchant fees totaled $2.26 million, which was $438,000, or 24.03%, above comparative 2009, which was $1,000, or 0.05%, less than 2008.

Other noninterest income for the year ended December 31, 2010, was $7.62 million and included income generated by Towne Investment Group, net of commission expense, compared with $6.53 million for the year ended December 31, 2009.

Noninterest Expense: Total noninterest expense for 2010 was $122.75 million, which was $10.95 million and 9.80% higher than 2009. The primary components of 2010 noninterest expense were salaries and employee benefits of $69.09 million, occupancy expenses of $11.93 million, furniture and equipment expenses of $5.31 million, FDIC and other insurance expenses of $4.53 million, and advertising and marketing expenses of $4.06 million. In comparison to 2009, a significant portion of the increase in total noninterest expense is due to the December 31, 2009, acquisition of Taylor Johnson Insurance Group, an independent insurance agency that is affiliated with Towne Insurance. The acquisition resulted in additional expenses of $4.46 million compared to 2009, primarily in salaries and benefits, occupancy, advertising, and amortization of intangible assets. Additionally, effective December 3, 2010, TowneBank acquired the deposit accounts of The Bank of Currituck and its six banking offices in northeastern North Carolina. The acquisition resulted in transaction costs of $548,000 and additional expenses of $501,000, primarily in salaries and benefits, and occupancy. Excluding expenses associated with the acquisitions, noninterest expense increased $5.44 million, or 4.87%.

Also contributing to the increase in salaries and benefits expense were increased health care benefit expenses and an increase in the Company's 401(k) match. The increases in total noninterest expense for the year were partially offset by a decrease in Federal Deposit Insurance Corporation ("FDIC") and other insurance fees of $813,000 due to the FDIC's special assessment of $1.57 million incurred in the third quarter of 2009. Total noninterest expense for the year ended December 31, 2009, was $111.79 million compared with $91.26 million for the year ended December 31, 2008, representing a 22.50% increase. Total noninterest expense to total operating revenue, excluding securities gains and losses, was 67.18% for the year ended December 31, 2010, compared with 73.58% for 2009 and 71.28% for 2008.

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

For the year ended December 31,	2010	2009	2008	2010/2009 Increase/(Decrease) Amount	2010/2009 Increase/(Decrease) %	2009/2008 Increase/(Decrease) Amount	2009/2008 Increase/(Decrease) %
Salaries and benefits	$ 69,085	$ 61,818	$ 54,615	$ 7,267	11.76%	$ 7,203	13.19%
Occupancy	11,931	11,335	8,506	596	5.26%	2,829	33.26%
Furniture and equipment	5,312	5,194	5,152	118	2.27%	42	0.82%
Other expenses							
Advertising and marketing	4,056	3,665	2,908	391	10.67%	757	26.03%
Charitable contributions	2,704	2,193	2,012	511	23.30%	181	9.00%
Telephone and postage	2,731	2,574	2,254	157	6.10%	320	14.20%
Outside processing	2,446	2,491	2,093	(45)	(1.81%)	398	19.02%
Professional fees	2,963	2,981	1,617	(18)	(0.60%)	1,364	84.35%
Other	5,342	3,393	1,345	1,949	57.44%	2,048	152.27%
Stationery and office supplies	1,775	1,674	1,458	101	6.03%	216	14.81%
Amortization expense of intangibles	2,991	2,803	2,488	188	6.71%	315	12.66%
FDIC and other insurance	4,525	5,338	1,622	(813)	(15.23%)	3,716	229.10%
Software expense	3,120	2,529	2,028	591	23.37%	501	24.70%
Travel/Meals/Entertainment	655	611	549	44	7.20%	62	11.29%
Directors' expense	944	952	1,436	(8)	(0.84%)	(484)	(33.70%)
Bank franchise tax/SCC fees	2,165	2,240	1,174	(75)	(3.35%)	1,066	90.80%
Total other expenses	36,417	33,444	22,984	2,973	8.89%	10,460	45.51%
Total noninterest expense	$ 122,745	$ 111,791	$ 91,257	$ 10,954	9.80%	$ 20,534	22.50%

Salaries and employee benefits, the largest portion of noninterest expense, were $69.09 million, representing 56.28% of total noninterest expense for the year ended December 31, 2010. This was an 11.76% increase over 2009 due to the addition of employees to create and service customer growth in new banking centers, the addition of staff resulting from the Taylor Johnson business combination on December 31, 2009, an increase in health care benefit expenses, and an increase in the Company's 401(k) match. Salaries and benefits expense for the year ended December 31, 2009, was $61.82 million, up 13.19%, or $7.20 million, over 2008.

In our Banking segment we had a total of 581 full-time equivalent employees ("FTE") at December 31, 2010, which was up from 497 and 480 at December 31, 2009 and 2008, respectively. In our non-Banking segments at December 31, 2010, we had a total of 413 FTEs, excluding real estate sales agents, which was up from 378 and 294 at December 31, 2009 and 2008, respectively. Real estate agents are independent contractors and, therefore, not included as the Company's employees. There were 446 real estate agents at December 31, 2010. Total operating revenue, excluding securities gains and losses per full-time equivalent employee, was approximately $183,000, $174,000, and $166,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

For the year ended December 31, 2010, occupancy expense totaled $11.93 million, representing an increase of $596,000, or 5.26%, over comparative 2009. Occupancy expense for 2009 was $11.34 million, or 33.26%, over the 2008 amount of $8.51 million. The primary driver of the increase in occupancy expense was the opening of offices in our Pavilion Center facility in Virginia Beach, the opening of our third banking center in Williamsburg, and the opening of our Harbour View Financial Center in Suffolk.

Furniture and equipment expense was $5.31 million for 2010, or $118,000 and 2.27%, higher than 2009. Furniture and equipment expense was $5.19 million for 2009, or $42,000 and 0.82%, higher than comparative 2008. Increases related to furnishing new facilities were partially offset by decreases in other areas, including equipment lease expenses.

Other expenses for 2010 were $36.42 million, which was $2.97 million, or 8.89%, higher than the 2009 amount of $33.44 million. The primary drivers of the increase were increases in software expense, charitable contributions, and an increase in other expenses that included a $1.42 million increase in expenses related to our loan portfolio. Other expenses for 2009 were $10.46 million, or 45.51%, higher than the 2008 amount of $22.98 million.

Income Taxes: Income taxes for the year ended December 31, 2010, were $12.46 million. This was $809,000 higher than the 2009 amount of $11.65 million, which was $2.90 million higher than the 2008 amount of $8.75 million. The effective tax rate for 2010 was 29.15% versus 30.32% for 2009 and 26.81% for 2008. The rate decrease was primarily a result of increased federal tax credits from community reinvestment activity, partially offset by an increase in nondeductible expenses, including compensation. Refer to Note 19 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 23 in the Notes to Consolidated Financial Statements.

Banking Segment. For the year ended December 31, 2010, the Banking segment represented 80.38%, or $24.34 million, of our total consolidated net income, compared to 88.80% and 92.72% for 2009 and 2008.

Earnings for the year ended December 31, 2010, for the Banking segment were $24.34 million, increasing $575,000, or 2.42%, from 2009. The increase was primarily due to a $21.27 million, or 21.44%, increase in net interest income. Comparatively, earnings for the year ended December 31, 2009, for the Banking segment were $23.76 million, increasing $1.61 million, or 7.26%, over 2008.

Pre-tax earnings were offset by an increase in the provision for loan losses of $9.79 million, or 76.59%, a $5.19 million, or 46.54%, decrease in the gain on sale of securities, and an increase in noninterest expenses of $7.03 million, or 9.09%. The primary factors in the increase were increases in salaries and benefits of $3.71 million; an increase in occupancy expenses of $975,000, or 13.50%, due to the opening of new banking centers; and increases in other noninterest expenses, including software expense.

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

	Year Ended December 31,			Increase/(Decrease)			
				2010 over 2009		2009 over 2008	
	2010	2009	2008	Amount	Percent	Amount	Percent
Revenue							
Net interest income	$ 120,485	$ 99,216	$ 86,337	$ 21,269	21.44%	$ 12,879	14.92%
Noninterest income							
Service charges on deposit accounts	6,556	6,342	5,845	214	3.37%	497	8.50%
Credit card merchant fees	2,261	1,823	1,824	438	24.03%	(1)	(0.05%)
Other income	4,337	4,076	4,944	261	6.40%	(868)	(17.56%)
Subtotal	13,154	12,241	12,613	913	7.46%	(372)	(2.95%)
Gain (loss) on available for sale	5,961	11,149	2,960	(5,188)	(46.53%)	8,189	276.66%
Total noninterest income	19,115	23,390	15,573	(4,275)	(18.28%)	7,817	50.20%
Total revenue	139,600	122,606	101,910	16,994	13.86%	20,696	20.31%
Provision for loan losses	22,565	12,778	7,022	9,787	76.59%	5,756	81.97%
Expenses							
Salaries and employee benefits	46,581	42,867	39,521	3,714	8.66%	3,346	8.47%
Occupancy expense	8,195	7,220	5,999	975	13.50%	1,221	20.35%
Furniture and equipment	3,895	3,808	4,112	87	2.28%	(304)	(7.39%)
Advertising and marketing	2,299	1,848	1,537	451	24.40%	311	20.23%
Charitable contributions	2,595	2,118	1,955	477	22.52%	163	8.34%
Outside processing	2,068	2,148	1,746	(80)	(3.72%)	402	23.02%
FDIC and other insurance	4,453	4,934	1,523	(481)	(9.75%)	3,411	223.97%
Professional fees	1,744	1,506	1,157	238	15.80%	349	30.16%
Telephone and postage	1,714	1,468	1,497	246	16.76%	(29)	(1.94%)
Other expenses	10,840	9,433	7,074	1,407	14.92%	2,359	33.35%
Total expenses	84,384	77,350	66,121	7,034	9.09%	11,229	16.98%
Income before income tax expense and corporate allocation	32,651	32,478	28,767	173	0.53%	3,711	12.90%
Corporate allocation	483	1,226	1,074	(743)	(60.60%)	152	14.15%
Income before income tax provision	33,134	33,704	29,841	(570)	(1.69%)	3,863	12.95%
Provision for income tax expense	(8,797)	(9,942)	(7,688)	1,145	(11.52%)	(2,254)	29.32%
Net income	$ 24,337	$ 23,762	$ 22,153	$ 575	2.42%	$ 1,609	7.26%

Realty Segment. For the year ended December 31, 2010, the Realty segment represented 10.35%, or $3.13 million, of total consolidated net income compared to 6.42%, or $1.72 million, for 2009 and a net loss of 0.05%, or $11,000, for 2008. Real estate brokerage income for the years ended December 31, 2010, 2009, and 2008 was reported net of commission expense totaling $5.57 million, $6.38 million, and $3.36 million, respectively, while residential mortgage brokerage income was reported net of commission expense of $13.29 million, $12.22 million, and $5.99 million for the same respective periods.

Earnings before income tax provision and noncontrolling interest for the year ended December 31, 2010, for the Realty segment were $5.38 million, increasing 113.96% from comparative 2009, which increased 100% from comparative 2008. Total revenue increased to $30.20 million in 2010 from $28.85 million and $17.54 million in 2009 and 2008, 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 decreased 4.00%, or $1.02 million, when compared to 2009, which increased 51.11%, or $8.64 million, when compared to 2008. The decrease from 2009 is primarily due to a decrease in occupancy expense and a decrease in amortization of intangible assets, which had been accelerated subsequent to the Prudential Towne Realty business combination in the first quarter of 2009.

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

	Year Ended December 31,			Increase/(Decrease)			
				2010 over 2009		2009 over 2008	
	2010	2009	2008	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage brokerage income, net	$ 13,293	$ 12,221	$ 5,985	$ 1,072	8.77%	$ 6,236	104.19%
Real estate brokerage income, net	5,571	6,381	3,357	(810)	(12.69%)	3,024	90.08%
Title insurance and settlement fees	1,913	2,401	2,117	(488)	(20.32%)	284	13.42%
Property management fees, net	5,584	5,344	4,421	240	4.49%	923	20.88%
Income from unconsolidated subsidiary	703	631	658	72	11.41%	(27)	(4.10%)
Net interest and other income	3,137	1,875	1,004	1,262	67.31%	871	86.75%
Total revenue	30,201	28,853	17,542	1,348	4.67%	11,311	64.48%
Expenses							
Salaries and employee benefits	13,024	12,879	9,198	145	1.13%	3,681	40.02%
Occupancy expense	2,919	3,646	2,010	(727)	(19.94%)	1,636	81.39%
Furniture and equipment	921	1,112	764	(191)	(17.18%)	348	45.55%
Amortization of intangible assets	1,155	1,460	1,175	(305)	(20.89%)	285	24.26%
Other expenses	6,492	6,436	3,750	56	0.87%	2,686	71.63%
Total expenses	24,511	25,533	16,897	(1,022)	(4.00%)	8,636	51.11%
Income before income tax, corporate allocation, and noncontrolling interest	5,690	3,320	645	2,370	71.39%	2,675	414.73%
Corporate allocation	(309)	(805)	(645)	496	(61.61%)	(160)	24.81%
Income before income tax provision and noncontrolling interest	5,381	2,515	-	2,866	113.96%	2,515	N/M
Provision for income tax	(1,768)	(807)	55	(961)	119.08%	(862)	N/M
Net income	3,613	1,708	55	1,905	111.53%	1,653	N/M
Noncontrolling interest	(480)	9	(66)	(489)	N/M	75	(113.64%)
Net income (loss) attributable to TowneBank	$ 3,133	$ 1,717	$ (11)	$ 1,416	82.47%	$ 1,728	N/M

N/M = not meaningful

(continued on next page)

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

	Year Ended December 31,			Increase/(Decrease)			
				2010 over 2009		2009 over 2008	
	2010	2009	2008	Amount	Percent	Amount	Percent
Key data							
Number of homes sold	2,883	3,126	1,531	(243)	(7.77%)	1,595	104.18%
Volume of homes sold	$ 817,049	$ 881,707	$ 246,253	$ (64,658)	(7.33%)	$ 635,454	258.05%
Number of real estate agents	431	460	291	(29)	(6.30%)	169	58.08%
Loans originated, mortgage	$ 461,673	$ 544,612	$ 324,045	$ (82,939)	(15.23%)	$ 220,567	68.07%
Loans originated, joint ventures	487,201	453,916	227,919	33,285	7.33%	225,997	99.16%
Total loans originated	$ 948,874	$ 998,528	$ 551,964	$ (49,654)	(4.97%)	$ 446,564	80.90%
Number of loans, mortgage	1,886	2,248	1,285	(362)	(16.10%)	963	74.94%
Number of loans, joint ventures	2,151	1,979	1,435	172	8.69%	544	37.91%
Total number of loans	4,037	4,227	2,720	(190)	(4.49%)	1,507	55.40%
Average loan amount, mortgage	$ 245	$ 242	$ 252	$ 3	1.24%	$ (10)	(3.97%)
Average loan amount, joint ventures	226	229	159	(3)	(1.31%)	70	44.03%
Average loan amount	$ 235	$ 236	$ 203	$ (1)	(0.42%)	$ 33	16.26%
Average number of originators, mortgage	28	32	31	(4)	(12.50%)	1	3.23%
Average number of originators, joint ventures	31	27	19	4	14.81%	8	42.11%
Average number of originators	59	59	50	-	0.00%	9	18.00%

Mortgage. The loan volume for the combined mortgage operations showed continued strength during the year ended December 31, 2010, as compared to the record-setting year in 2009. Total loans originated in 2010 were $948.87 million, a 4.97%, or $49.65 million decrease from $998.53 million in 2009. This was a $446.56 million, or 80.90%, increase compared to the 2008 volume of $551.96 million. Refinance activity comprised $331.21 million of loan volume for the year ended December 31, 2010, while purchases accounted for the remaining $617.66 million in loan volume for the year. For the years ended December 31, 2009 and 2008, refinance volume was $451.74 and $138.11 million, respectively, while purchase volume was $546.79 and $413.85, 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 is affiliated with Towne Insurance.

The Insurance segment represented 9.27%, or $2.81 million, of total consolidated net income in 2010; 4.78%, or $1.28 million, in 2009; and 7.33%, or $1.75 million, in 2008. Insurance commissions for the years ended December 31, 2010, 2009, and 2008 were reported net of commission expense totaling $4.35 million, $2.90 million, and $2.68 million, respectively.

Earnings before taxes and noncontrolling interest for the Insurance segment were $4.86 million in 2010, increasing $2.68 million, or 122.98%, from 2009. The increase was primarily attributable to the Taylor Johnson acquisition, which resulted in additional commission and contingency income of $6.00 million. The increase in revenues was partially offset by increases in salaries and employee benefits and other operating expenses over 2009 due to the Taylor Johnson acquisition. Also contributing was an increase in contingency and bonus revenue of $1.31 million, or 161.36%, of which $254,000 was related to our travel insurance business. 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.

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

	Year Ended December 31,			Increase/(Decrease)			
				2010 over 2009		2009 over 2008	
	2010	2009	2008	Amount	Percent	Amount	Percent
Revenue							
Net commission and fee income							
Property and casualty	$ 10,291	$ 4,965	$ 4,985	$ 5,326	107.27%	$ (20)	(0.40%)
Group benefits	5,435	5,087	5,068	348	6.84%	19	0.37%
Specialized benefit services	406	289	227	117	40.48%	62	27.31%
Total net commissions and fees	16,132	10,341	10,280	5,791	56.00%	61	0.59%
Contingency and bonus revenue	2,117	810	984	1,307	161.36%	(174)	(17.68%)
Other income	635	358	279	277	77.37%	79	28.32%
Total revenue	18,884	11,509	11,543	7,375	64.08%	(34)	(0.29%)
Expenses							
Salaries and employee benefits	9,480	6,072	5,895	3,408	56.13%	177	3.00%
Occupancy expense	817	470	497	347	73.83%	(27)	(5.43%)
Furniture and equipment	496	275	276	221	80.36%	(1)	(0.36%)
Amortization of intangible assets	988	499	469	489	98.00%	30	6.40%
Other expenses	2,069	1,592	1,102	477	29.96%	490	44.46%
Total expenses	13,850	8,908	8,239	4,942	55.48%	669	8.12%
Income before income tax, corporate allocation, and noncontrolling interest	5,034	2,601	3,304	2,433	93.54%	(703)	(21.28%)
Corporate allocation	(174)	(421)	(430)	247	(58.67%)	9	(2.09%)
Income before income tax provision and noncontrolling interest	4,860	2,180	2,874	2,680	122.94%	(694)	(24.15%)
Provision for income tax expense	(1,891)	(898)	(1,118)	(993)	110.58%	220	(19.68%)
Net income	2,969	1,282	1,756	1,687	131.59%	(474)	(26.99%)
Noncontrolling interest	(163)	(2)	(4)	(161)	N/M	2	(50.00%)
Net income attributable to TowneBank	$ 2,806	$ 1,280	$ 1,752	$ 1,526	119.22%	$ (472)	(26.94%)

Salaries and employee benefits expense increased $3.41 million, or 56.13%, when comparing 2010 to 2009, which increased $177,000, or 3.00%, compared to 2008. Approximately $2.98 million of the increase was due to the Taylor Johnson business combination.

Occupancy expense increased $347,000, or 73.83%, when comparing 2010 to 2009, which decreased $27,000, or 5.43%, over 2008.

Amortization of intangible assets increased $489,000, or 98.00%, during the year ended December 31, 2010, compared to 2009, which was $30,000, or 6.40%, more than 2008. The current year increase was driven by the amortization of intangible assets related to the Taylor Johnson acquisition.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $264.57 million, or 7.34%, to $3.87 billion at December 31, 2010, from $3.61 billion at December 31, 2009. The increase was supported by growth in the loan portfolio, which increased $165.44 million, or 6.45%, to $2.73 billion at December 31, 2010, from $2.57 billion at December 31, 2009, and an increase of $154.85 million due to the Bank of Currituck acquisition.

Our total average assets were $3.72 billion for 2010, reflecting an increase of $288.79 million, or 8.41%, compared to the 2009 average of $3.43 billion. Total average assets for 2009 increased $653.65 million, or 23.52%, compared to the 2008 average of $2.78 billion. Major balance sheet categories with increases in average balances include loans, up $147.23 million, or 6.03%, and securities available for sale, which increased $49.03 million, or 13.01%, over 2009. Additionally, average earning assets were $3.38 billion, including BOLI assets, in 2010, reflecting an increase of $192.93 million, or 6.05%, compared to 2009.

Our average total deposits were $2.75 billion in 2010, reflecting growth of $231.60 million, or 9.19%, compared to 2009. Noninterest-bearing deposits, which increased $83.41 million, or 14.72%, grew at a higher rate than interest-bearing deposits in 2010, which grew $148.20 million, or 7.59%.

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 $595.25 million as of December 31, 2010, with a balance of $446.01 million in available-for-sale and $149.24 million in held-to-maturity. Average yield on available-for-sale securities was 2.68% at December 31, 2010, compared with 2.53% at December 31, 2009, and 3.77% at December 31, 2008. Average yield on held-to-maturity securities was 4.47% at December 31, 2010, compared to 4.82% at December 31, 2009, and 4.72% at December 31, 2008.

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,	2010			2009			2008		
	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	$ 100,982	$ 100,425	2.16%	$ 245,474	$ 243,435	1.96%	$ 70,002	$ 71,532	4.53%
U.S. Treasury notes	-	-	-	-	-	-	77,000	77,000	(0.07%)
Municipal securities	26,795	27,077	4.21%	21,481	21,410	4.21%	12,341	11,836	5.74%
Trust preferred	6,985	7,341	7.92%	6,990	6,755	7.80%	6,995	6,305	7.84%
Other investments	250	250	3.13%	94	20	-	131	57	-
FHLB stock[(1)]	24,202	24,202	0.48%	26,063	26,063	-	20,877	20,877	0.50%
Mortgage-backed securities	286,362	286,711	2.78%	213,191	213,083	3.16%	153,746	160,133	5.46%
Total securities available for sale	445,576	446,006	2.68%	513,293	510,766	2.53%	341,092	347,740	3.77%
Securities Held to Maturity:									
Trust preferred	19,470	20,361	7.83%	19,456	19,039	7.83%	9,357	8,688	8.20%
Municipal bonds	52,739	49,576	3.81%	17,977	18,259	4.53%	20,970	20,904	4.74%
Industrial revenue bonds	77,032	77,032	4.08%	85,491	85,491	4.19%	87,033	87,219	4.34%
Total securities held to maturity	149,241	146,969	4.47%	122,924	122,789	4.82%	117,360	116,811	4.72%
Total Portfolio	$ 594,817	$ 592,975	3.13%	$ 636,217	$ 633,555	2.97%	$ 458,452	$ 464,551	4.01%

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

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The following table indicates the maturities of securities at December 31, 2010 (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	90,423	90,231	2.06%	-	-	-
After five years through ten years	8,639	8,227	2.74%	-	-	-
After ten years	1,920	1,967	4.20%	-	-	-
Municipal securities						
Due in one year or less	-	-	-	3,345	3,373	3.48%
After one year through five years	9,852	10,152	3.88%	530	553	4.04%
After five years through ten years	7,910	7,915	4.17%	3,842	3,783	4.47%
After ten years	9,033	9,010	4.60%	45,022	41,867	3.78%
Mortgage-backed securities						
Due in one year or less	-	-	-	-	-	-
After one year through five years	-	-	-	-	-	-
After five years through ten years	69,823	70,452	2.57%	-	-	-
After ten years	216,539	216,259	2.84%	-	-	-
Trust preferred						
After ten years	6,985	7,341	7.92%	19,470	20,361	7.83%
Industrial revenue bonds						
Due in one year or less	-	-	-	4,343	4,343	1.00%
After one year through five years	-	-	-	21,584	21,584	4.06%
After five years through ten years	-	-	-	10,394	10,394	3.99%
After ten years	-	-	-	40,711	40,711	4.45%
Other securities						
Due in one year or less	-	-	-	-	-	-
After one year through five years	250	250	3.13%	-	-	-
After five years through ten years	-	-	-	-	-	-
After ten years	-	-	-	-	-	-
No stated maturity	24,202	24,202	0.48%	-	-	-
Total Portfolio	$ 445,576	$ 446,006	2.68%	$ 149,241	$ 146,969	4.47%

Loans Held for Sale: At December 31, 2010, we held $65.03 million in mortgage loans originated and intended for sale in the secondary market, compared with $72.22 million at December 31, 2009. Average loans held for sale were 2.45% and 1.87% of average earning assets for the years ended December 31, 2010 and 2009, 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 $2.69 billion on December 31, 2010. As a percentage of total average earning assets, average loans were 76.48% in 2010 compared with 76.49% in 2009 and 82.67% in 2008. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were loans acquired in the Bank of Currituck transaction, our local economy, and the efforts of our experienced loan officers in developing new loan relationships, combined with the support of existing customers and directors. 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,	2010	2009	2008	2007	2006
Real estate loans					
Residential 1-4 family	$ 714,122	$ 634,960	$ 589,075	$ 439,676	$ 362,034
Commercial	952,727	866,165	737,244	561,341	364,657
Construction	657,341	652,221	617,390	522,780	529,933
Multifamily	41,441	41,652	30,079	27,515	17,919
Total real estate loans	2,365,631	2,194,998	1,973,788	1,551,312	1,274,543
Commercial loans	322,027	321,498	329,716	218,082	306,437
Consumer installment loans					
Personal	24,970	31,099	27,752	42,702	41,784
Credit lines	17,726	17,652	18,890	17,360	18,885
Total consumer installment loans	42,696	48,751	46,642	60,062	60,669
Agriculture loans	998	663	40	-	177
Loans, net of unearned income and deferred costs	$2,731,352	$2,565,910	$ 2,350,186	$ 1,829,456	$ 1,641,826

Year Ended December 31,	2010	2009	2008	2007	2006
Real estate loans					
Residential 1-4 family	26.14%	24.74%	25.06%	24.03%	22.05%
Commercial	34.88%	33.76%	31.37%	30.68%	22.21%
Construction	24.07%	25.42%	26.27%	28.59%	32.28%
Multifamily	1.52%	1.62%	1.28%	1.50%	1.09%
Total real estate loans	86.61%	85.54%	83.98%	84.80%	77.63%
Commercial loans	11.79%	12.53%	14.03%	11.92%	18.66%
Consumer installment loans					
Personal	0.91%	1.21%	1.18%	2.33%	2.55%
Credit lines	0.65%	0.69%	0.80%	0.95%	1.15%
Total consumer installment loans	1.56%	1.90%	1.98%	3.28%	3.70%
Agriculture loans	0.04%	0.03%	0.01%	-	0.01%
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, 2010 (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	$ 102,201	$ 90,376	$ 521,545	$ 714,122	$ 261,039	$ 350,882
Commercial	112,517	102,940	737,270	952,727	720,420	119,790
Construction	502,985	108,254	46,102	657,341	87,766	66,590
Multifamily	6,128	2,346	32,967	41,441	31,321	3,992
Total real estate loans	723,831	303,916	1,337,884	2,365,631	1,100,546	541,254
Commercial loans	153,492	123,136	45,399	322,027	111,200	57,335
Consumer installment loans						
Personal	6,248	13,408	5,314	24,970	17,025	1,697
Credit lines	17,033	356	337	17,726	32	661
Total consumer installment loans	23,281	13,764	5,651	42,696	17,057	2,358
Agriculture loans	31	262	705	998	127	840
Loans, net of unearned income and deferred costs	$ 900,635	$ 441,078	$ 1,389,639	$ 2,731,352	$ 1,228,930	$ 601,787

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 peer review committees may review the classification to ensure accuracy and consistency of classifications, which are then validated by the chief credit officer. 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. 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 updated quarterly 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 construction and land development loans, commercial real estate loans, commercial and industrial business loans, 1-4 family residential real estate loans, multifamily real estate loans, and consumer and other 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 Company'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 effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends 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 monthly basis to determine an appropriate general valuation allowance.

The allowance for loan losses at December 31, 2010, 2009, and 2008 was $38.66 million, $33.79 million, and $27.50 million, respectively. The allowance was equal to 1.42% of total loans outstanding at December 31, 2010, compared with 1.32% and 1.17% for 2009 and 2008. On certain loans the Company charges off the amount of impairment at the time of impairment, rather than placing the impaired loan amount in a specific reserve. At December 31, 2010, cumulative partial charge-offs associated with collateral dependent impaired loans on the Company's balance sheet totaled $18.46 million. Had the Company recorded a specific valuation allowance associated with these loans, the allowance for loan losses would have been $57.12 million, or 2.09% of total loans outstanding at December 31, 2010.

(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,	**2010**	**2009**	**2008**	**2007**	**2006**
Balance beginning of period	$ 33,793	$ 27,503	$ 21,323	$ 19,670	$ 17,071
Loans charged off:					
Residential 1-4 family	(5,932)	(1,749)	(385)	(474)	(7)
Construction	(7,294)	(4,050)	(22)	-	(6)
Commercial	(3,419)	(1,032)	(279)	(409)	(153)
Consumer	(1,750)	(310)	(284)	(285)	(48)
Total	(18,395)	(7,141)	(970)	(1,168)	(214)
Loans recovered:					
Residential 1-4 family	123	156	7	2	32
Construction	332	215	-	-	-
Commercial	209	148	89	50	176
Consumer	33	21	32	26	33
Total	697	540	128	78	241
Net loans (charged off)/recovered	(17,698)	(6,601)	(842)	(1,090)	27
Provision for loan losses	22,565	12,891	7,022	2,743	2,572
Balance end of period	$ 38,660	$ 33,793	$ 27,503	$ 21,323	$ 19,670
Nonperforming assets:					
Nonperforming loans	$ 57,167	$ 42,150	$ 2,817	$ 726	$ 636
Foreclosed property	20,452	2,043	980	1,570	400
Total nonperforming assets	$ 77,619	$ 44,193	$ 3,797	$ 2,296	$ 1,036
Loans past due 90 days accruing interest	$ 1,229	$ 1,702	$ 847	$ 32	$ 459
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	.68x	.80x	9.76x	29.37x	30.93x
Allowance to nonperforming assets	.50x	.76x	7.24x	9.29x	18.99x
Allowance for loan losses to period end loans	1.42%	1.32%	1.17%	1.17%	1.20%
Allowance for loan losses to period end loans excluding purchased loans	1.46%	1.32%	1.17%	1.17%	1.20%
Nonperforming loans to period end loans	2.09%	1.64%	0.12%	0.04%	0.04%
Nonperforming assets to period end assets	2.01%	1.23%	0.12%	0.07%	0.05%
Net charge-offs to average loans	0.67%	0.27%	0.04%	0.06%	-

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.

At December 31, 2010, we had $77.62 million in nonperforming assets, which amounted to 2.00% of total assets. Nonperforming assets consist of $57.17 million in nonperforming loans as well as $20.45 million in foreclosed property at December 31, 2010. Foreclosed property consists of 22 residential properties, 18 construction and development properties, and 5 commercial properties. Additionally, loans past due 90 days or more that are accruing interest totaled $1.23 million. The increasing trend in nonperforming assets is reflective of the current soft residential real estate market and is likely to continue until there is a recovery in the market.

At December 31, 2010, loans 60 to 89 days delinquent, including nonperforming loans, totaled $6.80 million. Additionally, there are other performing loans, totaling $62.68 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 $6.82 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.

In order to maximize the collection of loan balances, we evaluate troubled loan accounts on a case-by-case basis to determine if a loan modification would be appropriate. We may pursue loan modifications when there is a reasonable chance that an appropriate modification would allow our clients to continue servicing the debt. Because some troubled debt restructurings ("TDRs") may not ultimately result in the complete collection of principal and interest (as modified by the terms of the restructuring), additional incremental losses could result. These potential incremental losses have been factored into our overall allowance for loan losses estimate.

At December 31, 2010, nonaccruing TDRs, which are included in nonperforming loans, totaled $3.89 million and accruing TDRs totaled $20.29 million. Nonaccruing loans that are modified can be placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

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

	December 31, 2010	December 31, 2009
Real estate-residential 1-4 family	$ 5,186	$ 923
Real estate-commercial	7,295	9,622
Real estate-construction and development	43,878	30,251
Real estate-multi-family	-	733
Commercial	707	618
Consumer and other loans	101	3
Total nonperforming loans	$ 57,167	$ 42,150

Allocation of the Allowance for Loan Losses: 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, 2010, 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,	2010	2009	2008	2007	2006
Real estate loans:					
Residential 1-4 family	$ 9,543	$ 7,094	$ 5,457	$ 3,846	$ 3,242
Commercial	12,827	10,018	7,104	5,129	3,520
Construction	10,984	7,726	6,423	5,810	5,116
Multifamily	557	416	248	228	155
Total real estate loans	33,911	25,254	19,232	15,013	12,033
Commercial loans	4,008	7,330	7,187	4,895	6,207
Loans to individuals and other	741	1,209	1,084	1,415	1,430
Total	$ 38,660	$ 33,793	$ 27,503	$ 21,323	$ 19,670

In the opinion of management, the allowance was adequate at December 31, 2010, 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.

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Allowance for Loan Losses Policy and Methodology: Our allowance for loan loss methodology is based on guidance provided by various regulatory agencies 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. Additionally, construction and development lending involves an elevated degree of risk because loans are generally made to builders for specific construction projects and successful repayment of these types of loans is generally dependent upon the sale of the constructed property. 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, low average 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, 2010, totaled $2.95 billion. This represented an increase of $392.81 million, or 15.33%, over 2009, which was $323.03 million, or 14.43%, over 2008. Overall growth in deposits is primarily attributed to the acquisition of $154.68 million in deposits from the Bank of Currituck, 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 $119.76 million and CDARS deposits of $178.58 million at December 31, 2010.

The following tables provide the average balance and cost rate of interest-bearing deposits in addition to maturities of certificates of deposit of $100,000 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,	**2010**	**2009**	**2008**	**2010**	**2009**	**2008**
Noninterest-bearing demand deposits	$ 649,840	$ 566,434	$ 484,735	-	-	-
Demand and money markets	613,746	509,654	500,273	0.50%	0.56%	1.23%
Savings	89,954	64,057	45,108	0.74%	0.95%	1.68%
Certificates of deposit:						
Less than $100,000	629,409	624,331	434,354	1.90%	3.10%	3.81%
$100,000 or more	768,583	755,455	558,024	1.88%	2.62%	4.01%
Total interest-bearing deposits	2,101,692	1,953,497	1,537,759	1.43%	2.18%	2.98%
Total deposits	$2,751,532	$2,519,931	$2,022,494	1.09%	1.69%	2.27%

Maturities of CDs $100,000 and Greater at December 31, 2010

	Amount	Percent
Three months or less	$ 353,820	39.94%
Over three months through twelve months	349,259	39.43%
Over twelve months through three years	139,814	15.78%
Over three years	42,970	4.85%
Total	$ 885,863	100.00%

Average noninterest-bearing demand deposits were 23.62% of average total deposits during the year ended December 31, 2010, and 22.48% and 23.97% during the same period in 2009 and 2008, respectively. This change is attributable to historically low rates and is consistent with the decrease in the Company's cost of funds. The average cost of interest-bearing deposits was 1.43% for the year ended December 31, 2010, compared with 2.18% for 2009 and 2.98% for 2008.

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 $371.13 million and $366.16 million for the years ended December 31, 2010 and 2009, respectively. The balance at December 31, 2010, of $330.80 million, decreased $123.04 million from the balance at December 31, 2009, of $453.84 million. 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, 2010, were $13.84 million. At December 31, 2009, the debentures totaled $50.76 million. Average total convertible subordinated capital debentures for the year ended December 31, 2010, were $29.31 million, compared with $42.92 million for 2009. The average cost of these debentures was 7.58% and 5.80%, respectively. The decrease in the liability balance and the increase in the average rate in 2010 were due to the Series I and Series II notes that the Company called during the first and second quarters of 2010 and the issuance of the 8% Series III notes in October 2009. 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 $107.31 million outstanding in overnight interest-bearing deposits during 2010, compared with $153.33 million for 2009. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2010, we primarily funded our growth in total assets with deposit growth.

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, 2010 (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	$ 40,082	$ 5,672	$ 10,834	$ 8,589	$ 14,987
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB advances	330,801	50,801	-	-	280,000
Convertible subordinated capital debentures	13,842	-	-	-	13,842
Other commitments					
Standby letters of credit	43,726	43,726	-	-	-
Commitments to extend credit	779,521	779,521	-	-	-
Total contractual obligations	$ 1,207,972	$ 879,720	$ 10,834	$ 8,589	$ 308,829

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,	2010	2009	2008
Return on average assets	0.81%	0.78%	0.86%
Return on average equity	6.17%	6.12%	8.05%
Average equity to average assets	13.18%	12.75%	10.68%

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, 2010, we had $288.04 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	1.13%
- 200 basis points	(14.01%)

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	$ (67,881)
- 200 basis points	$ (8,728)

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,	2010	2009
Return on average assets (GAAP basis)	0.81%	0.78%
Impact of excluding average goodwill and other intangibles	0.03%	0.02%
Return on average tangible assets	0.84%	0.80%
Return on average equity (GAAP basis)	6.17%	6.12%
Impact of excluding average goodwill and other intangibles	1.55%	1.40%
Return on average tangible equity	7.72%	7.52%

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,	2010	2009
Book value (GAAP basis)	$ 12.46	$ 11.87
Impact of excluding average goodwill and other intangibles	(3.77)	(3.64)
Tangible book value	$ 8.69	$ 8.23

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,	2010	2009
Efficiency ratio (GAAP basis)	65.05%	69.90%
Impact of excluding securities gains/(losses)	2.13%	3.68%
Efficiency ratio, as reported	67.18%	73.58%

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, 2010 and 2009, and the related consolidated statements of income, equity, and cash flows for each of the years in the three-year period ended December 31, 2010. We also have audited ***TowneBank's*** internal control over financial reporting as of December 31, 2010, 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, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, 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, 2010, 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, 2011

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 and Risk Management Committee of the Board of Directors participates in the adequacy of the system of internal controls and financial reporting. The Audit and Risk Management Committee consists of independent directors who meet regularly with management, the internal auditor, the Chief Risk Officer, 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, 2010. 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, 2010, 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, 2010.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2010, 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, 2010.

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, 2011

/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, 2010 and 2009

ASSETS	2010	2009
Cash and due from banks	$ 144,825	$ 55,748
Interest-bearing deposits in financial institutions	5,651	8,976
Total Cash and Cash Equivalents	150,476	64,724
Securities available for sale, at fair value	446,006	510,766
Securities held to maturity, at amortized cost	149,241	122,924
Total Securities	595,247	633,690
Mortgage loans held for sale	65,028	72,221
Loans, net of unearned income and deferred costs:	2,731,352	2,565,910
Less: allowance for loan losses	(38,660)	(33,793)
Net Loans	2,692,692	2,532,117
Premises and equipment, net	115,298	89,758
Goodwill	91,953	80,646
Other intangible assessts, net	16,993	19,291
Bank-owned life insurance policies	52,737	46,642
Other assets	90,594	67,362
TOTAL ASSETS	$ 3,871,018	$ 3,606,451
LIABILITIES AND EQUITY		
Deposits:		
Noninterest-bearing demand	$ 706,040	$ 572,228
Interest-bearing:		
Demand and money market accounts	770,505	532,348
Savings	134,314	62,630
Certificates of deposit:		
Less than $100,000	457,792	447,765
$100,000 and more	885,863	946,731
Total Deposits	2,954,514	2,561,702
Advances from the Federal Home Loan Bank	330,801	453,840
Convertible subordinated capital debentures	13,842	50,755
Repurchase agreements and other borrowings	14,076	21,524
Total Borrowings	358,719	526,119
Other liabilities	58,273	54,309
TOTAL LIABILITIES	3,371,506	3,142,130
Preferred stock, $5.00 par value		
Authorized shares - 2,000,000		
Issued and outstanding shares 662,590 in 2010 and 665,750 in 2009	3,313	3,329
Common stock, $1.667 par value		
Authorized shares - 45,000,000		
Issued and outstanding shares 28,893,660 in 2010 and 27,451,172 in 2009	48,166	45,762
Capital surplus	359,564	340,825
Retained earnings	81,000	69,341
Accumulated other comprehensive income	288	(1,633)
TOTAL SHAREHOLDERS' EQUITY	492,331	457,624
Noncontrolling interest	7,181	6,697
TOTAL EQUITY	499,512	464,321
TOTAL LIABILITIES AND EQUITY	$ 3,871,018	$ 3,606,451

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, 2010, 2009, and 2008

	2010	2009	2008
INTEREST INCOME:			
Loans, including fees	$ 148,353	$ 139,758	$ 130,633
Investment securities	16,927	18,356	17,801
Interest-bearing deposits in financial institutions and federal funds sold	298	403	1,221
Mortgage loans held for sale	3,617	2,564	1,195
Total interest income	169,195	161,081	150,850
INTEREST EXPENSE:			
Deposits	30,124	42,577	45,818
Advances from the Federal Home Loan Bank	14,308	15,504	14,840
Convertible subordinated capital debentures	2,222	2,489	2,168
Repurchase agreements and other borrowings	(94)	168	897
Total interest expense	46,560	60,738	63,723
Net interest income	122,635	100,343	87,127
PROVISION FOR LOAN LOSSES	22,565	12,891	7,022
Net interest income after provision for loan losses	100,070	87,452	80,105
NONINTEREST INCOME:			
Residential mortgage brokerage income, net	12,998	11,910	5,319
Real estate brokerage and property management income, net	11,155	11,725	7,778
Insurance commissions and other title fees and income, net	19,501	13,264	13,154
Service charges on deposit accounts	6,556	6,342	5,845
Credit card merchant fees, net	2,261	1,823	1,824
Other income	7,618	6,525	6,987
Gain on securities available for sale	5,961	11,149	2,960
Total noninterest income	66,050	62,738	43,867
NONINTEREST EXPENSE:			
Salaries and employee benefits	69,085	61,818	54,615
Occupancy	11,931	11,335	8,506
Furniture and equipment	5,312	5,194	5,152
Other expenses	36,417	33,444	22,984
Total noninterest expense	122,745	111,791	91,257
Income before income tax expense & noncontrolling interest	43,375	38,399	32,715
Provision for income tax expense	12,456	11,647	8,751
Net income	$ 30,919	$ 26,752	$ 23,964
Net (income) loss attributable to noncontrolling interest	(643)	7	(70)
Net income attributable to TowneBank	30,276	26,759	23,894
Preferred stock dividends and accretion	9,355	10,044	1,396
Net income applicable to common shareholders	$ 20,921	$ 16,715	$ 22,498
Per common share information			
Basic earnings	$ 0.74	$ 0.67	$ 0.93
Diluted earnings	$ 0.73	$ 0.66	$ 0.89
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, 2010, 2009, and 2008

	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Noncontrolling Interest	Total
Balance, December 31, 2007	**24,104,418**	**$ -**	**$ 40,182**	**$ 168,364**	**$ 46,227**	**$ 2,083**	**$ -**	**$ 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**
Net Income		-	-	-	30,276	-	30,919	643	30,919
Unrealized gain on securities, net of tax expense of $1,034	-	-	-	-	-	1,921	1,921	-	1,921
Cash dividends declared on common stock	-	-	-	-	(9,262)	-	-	-	(9,262)
Cash dividends declared on preferred stock	-	-	-	-	(8,527)	-	-	-	(8,527)
Directors' deferred compensation	(68,095)	-	(113)	113	-	-	-	-	-
Distribution of interests in joint ventures	-	-	-	-	-	-	-	(159)	(159)
Conversion of preferred stock into common stock	17,018	(16)	27	(8)	-	-	-	-	3
Accretion of preferred stock discount	-	-	-	828	(828)	-	-	-	-
Issuance of common stock - stock compensation plans	215,776	-	363	1,946	-	-	-	-	2,309
Conversion of convertible debt into common stock	1,115,740	-	1,857	14,240	-	-	-	-	16,097
Issuance of common stock	162,049	-	270	1,620	-	-	-	-	1,890
Balance, December 31, 2010	**28,893,660**	**$ 3,313**	**$ 48,166**	**$ 359,564**	**$ 81,000**	**$ 288**	**$ 32,840**	**$ 7,181**	**$ 499,512**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

For the Years Ended December 31, 2010, 2009, and 2008

OPERATING ACTIVITIES:	2010	2009	2008
Net income	$ 30,919	$ 26,752	$ 23,964
Adjustments to reconcile net income to net cash (used for) from operating activities:			
Net accretion of securities	2,810	2,015	(287)
Investment securities (gains)/losses	(5,961)	(11,149)	(2,960)
Depreciation, amortization, and other intangible amortization	9,781	9,744	9,174
Provision for loan losses	22,565	12,891	7,022
Share-based compensation expense	1,012	1,638	1,741
Net increase in loans held for sale	7,193	(46,337)	(2,931)
Changes in:			
Interest receivable	(269)	(1,282)	314
Other assets	(23,891)	(31,926)	(3,694)
Interest payable	(2,155)	(1,911)	2,396
Other liabilities	4,752	18,126	249
Net cash (used for) from operating activities	46,754	(21,439)	34,988
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(435,186)	(710,312)	(236,504)
Purchase of held-to-maturity securities	(51,627)	(13,093)	(30,057)
Sale of available-for-sale securities	437,451	392,267	148,157
Proceeds from maturities, calls, and prepayments of securities	110,695	162,506	40,155
Net increase in loans	(104,268)	(222,461)	(521,599)
Net purchase of premises and equipment	(25,723)	(16,823)	(9,061)
Distribution of interest in joint ventures	(158)	-	-
Acquisition of business, net of cash acquired	34,927	(10,942)	(7,225)
Net cash used for investing activities	(33,889)	(418,858)	(616,134)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	238,126	323,034	404,322
Net change in borrowings	(150,893)	87,947	66,217
Proceeds from share-based compensation activity	1,371	513	157
Proceeds from issuance of common stock	1,893	20,078	4,583
Proceeds from issuance of preferred stock	-	-	135,534
Cash dividends paid	(17,610)	(16,298)	(9,255)
Net cash from financing activities	72,887	415,274	601,558
Change in cash and cash equivalents	85,752	(25,023)	20,412
Cash and cash equivalents at beginning of year	64,724	89,747	69,335
Cash and cash equivalents at end of year	$ 150,476	$ 64,724	$ 89,747
Supplemental cash flow information:			
Cash paid for interest	$ 48,716	$ 62,649	$ 61,327
Cash paid for income taxes	$ 16,000	$ 12,550	$ 11,582
Noncash financing and investing activities:			
Net unrealized gain (loss) on available-for-sale securities	$ 1,921	$ (5,964)	$ 2,248
Common stock issued in connection with business acquisition	$ -	$ 8,796	$ -
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 16,097	$ 3,554	$ 437

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 include the accounts of the Company and all other entities in which the Company has a controlling financial interest. 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 at December 31, 2010 and 2009.

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 outstanding principal less unamortized 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: 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 Accounting Standards Codification Topic (“ASC”) 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 peer review committees may review the classification to ensure accuracy and consistency of classifications, which are then validated by the chief credit officer. 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. 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 updated quarterly 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 construction and land development loans, commercial real estate loans, commercial and industrial business loans, 1-4 family residential real estate loans, multifamily real estate loans, and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Company'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 effectiveness of the internal loan review function; (vii) the impact of national economic trends on portfolio risks; and (viii) the impact of local economic trends 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. Management considers the current level of allowance for loan losses adequate to absorb losses inherent in the loan portfolio. Management's determination of the adequacy of the allowance for loan losses, which is based on the factors and risk identification procedures previously discussed, requires the use of judgments and estimations that may change in the future. Changes in the factors used by management to determine the adequacy of the allowance or the availability of new information could cause the allowance for loan losses to be adjusted in future periods.

Loans Acquired: Loans acquired through the completion of a transfer, including loans acquired in a business combination, that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable, are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance. Loans are evaluated individually to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "nonaccretable difference," are not recognized as a yield adjustment or as a loss accrual or a valuation allowance. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized immediately as impairment. If the Company does not have the information necessary to reasonably estimate cash flows to be expected, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

For purchased loans acquired on or after January 1, 2009, that are not deemed impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value. Loans may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Subsequent to the purchase date, the methods utilized to estimate the required allowance for credit losses for these loans is similar to originated loans; however, the Company records a provision for loan losses only when the required allowance exceeds any remaining credit discounts. The remaining differences between the purchase price and the unpaid principal balance at the date of acquisition are recorded in interest income over the life of the loans.

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") 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.

Other Real Estate Owned: Other real estate owned ("OREO"), which is included in other assets on the balance sheet, consists of primarily of commercial and residential real estate that has been obtained in partial or full satisfaction of loan obligations. OREO is carried at the lower of the amount of the loan balance or the fair value of the property, less anticipated selling costs, with any difference between the fair value of the property and the carrying value of the loan recorded through a charge to the allowance for loan losses. Subsequent write-downs required for declines in value are recorded through a valuation allowance, or taken directly to the asset, charged to other non-interest expense.

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.

Investment 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 23 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 19 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 over the vesting period. 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 24 for further discussion on the Company's earnings per share.

Recent accounting pronouncements

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. 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. 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.

In June 2009, the FASB issued Accounting Standard Update No. ("ASU") 2009-16*, 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 was effective January 1, 2010, and did not have a significant impact on the Company's financial statements.

In June 2009, the FASB issued ASU 2009-17, *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 was adopted on January 1, 2010, and did not 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 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. ASU 2009-13 was effective January 1, 2010, and its adoption did not have a material net effect on revenue for the full year ended December 31, 2010.

In January 2010, the FASB issued ASU 2010-06*, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements.* ASU 2010-06 was issued to improve disclosures about fair value measurements on the basis of input received from the users of financial statements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the provisions of ASU 2010-06 to have a material effect on the Company's financial statements.

In February 2010, the FASB issued ASU 2010-09, *Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements*, which amends Accounting Standards Codification ("ASC") Topic 855 to address certain implementation issues related to an entity's requirement to perform and disclose subsequent events procedures. The amendments in ASU 2010-09 remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. The new guidance became effective for the Company on February 24, 2010, and did not have an impact on the Company's financial statements.

In July 2010, the FASB issued ASU No. 2010-20, *Receivables (Topic 830) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.* ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses, and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual, and past due loans and credit quality indicators. ASU 2010-20 will be effective for the Company's financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period are included in the Company's financial statements that include periods beginning on or after January 1, 2011.

In December 2010, the FASB issued ASU No. 2010-28*, Intangibles—Goodwill and Other (Topic 350)—When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts.* ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

ASU 2010-28 will be effective for the Company on January 1, 2011, and is not expected have a significant impact on the Company's financial statements.

In December 2010, the FASB issued ASU No. 2010-29*, Business Combinations (Topic 805)—Disclosure of Supplementary Pro Forma Information for Business Combinations.* ASU 2010-29 provides clarification regarding the acquisition date that should be used for reporting the pro forma financial information disclosures required by Topic 805 when comparative financial statements are presented. ASU 2010-29 also requires entities to provide a description of the nature and amount of material, nonrecurring pro forma adjustments that are directly attributable to the business combination. ASU 2010-29 is effective for the Company prospectively for business combinations occurring after December 31, 2010.

In January 2011, the FASB issued ASU 2011-01, *Receivables (Topic 310)—Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20.* ASU 2011-01 temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of a proposed accounting standards update related to troubled debt restructurings, which is currently expected to be effective for periods ending after June 15, 2011.

NOTE 2: MERGERS AND ACQUISITIONS

The Bank of Currituck: Effective December 3, 2010, TowneBank acquired all the deposit accounts of The Bank of Currituck ("Currituck") and its six banking offices in northeastern North Carolina, including three banking offices on the Outer Banks. Under the terms of the purchase agreement, TowneBank also purchased a substantial portion of the Moyock-headquartered bank's loan portfolio and all of its other banking assets. 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. In accordance with the purchase agreement, TowneBank also was required to purchase and sell back certain loans in the amount of $21.15 million. However, because the transfer of the loans did not meet sale treatment under the accounting provisions of ASC 860, the transfer was treated as a secured borrowing, which was repaid at the time of the business combination. The results of operations of the acquired business are included in the Company's Consolidated Statements of Income after the acquisition date of December 3, 2010. The purchase price was $7.84 million in cash. Acquisition-related costs were $548,000 and were included in noninterest expense in the consolidated statement of income for the year ended December 31, 2010. Following the closing of the transaction, The Bank of Currituck ceased operation as a commercial bank and is operating as Currituck Resolution Properties, Inc. (the "Resolution Company") in order to manage the assets it retained in this transaction, including certain loans and other real estate owned. Also in accordance with the purchase agreement, TowneBank entered into a secured credit facility with the Resolution Company, which consists of three components, (i) a revolving line of credit in the principal amount of $1.0 million to be used for working capital purposes; (ii) a second revolving line of credit in the principal amount of $1.0 million to be used as an interest reserve to support the interest owed on the loan; and (iii) a term loan, in the amount of $14.07 million, which will be used to fund and support the Resolution Company's asset base and operations.

The assets acquired and the liabilities assumed were recorded at fair value on the date of acquisition, as summarized in the following table (in thousands):

Total cash consideration paid	$	7,842
Recognized amounts of identifiable assets acquired and (liabilities assumed), at fair value:		
Cash and cash equivalents	$	42,770
Investment securities		16,778
Net loans		78,820
Core deposit intangible		417
Other real estate		1,511
Premises and equipment		6,975
Other assets		4,184
Deposits		(154,686)
Other Liabilities		(703)
Goodwill	$	11,776

The core deposit intangible asset recognized as part of the acquisition merger is being amortized over its estimated useful life of approximately eight years. The goodwill, which is not amortized for book purposes, was assigned to our banking segment.

Certificates of deposit were valued by comparing the contractual cost of the portfolio to an identical portfolio bearing current market rates. The projected cash flows from maturing certificates were calculated based on contractual rates. The fair value of the certificates of deposit was calculated by discounting their contractual cash flows at a market rate for a certificate of deposit with a corresponding maturity.

We estimated the fair value for most loans acquired from Currituck by utilizing a methodology wherein loans with comparable characteristics were aggregated by type of collateral, remaining maturity, and repricing terms. Cash flows for each pool were determined by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. To estimate the fair value of the remaining loans, we analyzed the value of the underlying collateral of the loans, assuming the fair values of the loans were derived from the eventual sale of the collateral. The value of the collateral was based on recently completed appraisals adjusted to the valuation date based on recognized industry indices. We discounted those values using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of Currituck's allowance for credit losses associated with the loans we acquired, as the loans were initially recorded at fair value.

Information about the acquired loan portfolio as of December 3, 2010, is as follows (in thousands):

Contractually required principal and interest at acquisition	$ 93,030
Nonaccretable yield (contractual cash flows not expected to be collected)	10,153
Expected cash flows at acquisition	82,877
Accretable yield (interest component of expected cash flows)	4,057
Fair value of acquired loans	$ **78,820**

Taylor Johnson Insurance Group: Effective December 31, 2009, TowneBank acquired Taylor Johnson Insurance Group, an independent insurance agency that is 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 $453,000 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 $160,000, goodwill of $11.34 million, and other intangible assets, including customer lists and non-compete agreements of $5.41 million.

Prudential Towne Realty: Effective January 16, 2009, TowneBank contributed certain wholly-owned subsidiaries and $5.74 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 $18.50 million. Acquisition-related costs were $1.21 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 $1.51 million, goodwill of $12.59 million, and other intangible assets, including agent relationships and non-compete agreements of $4.64 million, and assumed liabilities of $236,000.

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.

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, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. agency securities	$ 100,982	$ 374	$ (931)	$ 100,425
Municipal securities	26,794	432	(148)	27,078
Total debt securities	127,776	806	(1,079)	127,503
Other investments	7,566	355	-	7,921
Federal Home Loan Bank stock	23,871	-	-	23,871
Mortgage-backed securities	286,362	1,168	(819)	286,711
Total equity securities	317,799	1,523	(819)	318,503
Total available-for-sale securities	$ 445,575	$ 2,329	$ (1,898)	$ 446,006

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

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, 2010, proceeds from securities available for sale were $437.45 million and resulted in realized gains of $5.96 million. For the years ended December 31, 2009 and 2008, proceeds from securities available for sale amounted to $392.27 million and $159.14 million, excluding prepayments related to mortgage-backed securities, and resulted in gains of $11.15 million and $2.96 million, 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, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Other investments	$ 19,470	$ 1,009	$ (118)	$ 20,361
Municipal bonds	52,739	255	(3,418)	49,576
Industrial revenue bonds	77,032	-	-	77,032
Total held-to-maturity securities	$ 149,241	$ 1,264	$ (3,536)	$ 146,969

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

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, 2010	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ 7,688	$ 7,716
Due after one year through five years	100,275	100,383	22,114	22,137
Due after five years through 10 years	86,371	86,595	14,236	14,177
Due after 10 years	234,480	234,576	105,203	102,939
	421,126	421,554	149,241	146,969
Federal Home Loan Bank stock	23,871	23,871	-	-
Other equity securities	578	581	-	-
	$ 445,575	$ 446,006	$ 149,241	$ 146,969

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

Pledged securities

At December 31, 2010 and 2009, the Company had investment securities with market values of $153.43 million and $106.44 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, 2010 or 2009. The Company also had $29.29 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2010, compared to $27.07 million at December 31, 2009.

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):

	2010	2009	2008
Unrealized gains on securities:			
Unrealized holding gains arising during the period	$ 8,916	$ 1,974	$ 6,396
Other than temporary impairment of available-for-sale securities	-	-	23
Reclassification adjustment for gains on available-for-sale securities included in income	(5,961)	(11,149)	(2,960)
Total other comprehensive income (loss) before income tax benefit (expense)	2,955	(9,175)	3,459
Income tax benefit (expense)	(1,034)	3,211	(1,211)
Net unrealized gains (losses)	$ 1,921	$ (5,964)	$ 2,248

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, 2010	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	$ 78,208	$ 931	$ -	$ -	$ 78,208	$ 931
Municipal securities	45,024	3,566	-	-	45,024	3,566
Federal agency mortgage-backed securities	152,376	819	-	-	152,376	819
Corporate obligations	2,925	118	-	-	2,925	118
Total temporarily impaired securities	$ 278,533	$ 5,434	$ -	$ -	$ 278,533	$ 5,434

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

U.S. Treasury obligations

The Company's unrealized losses on government agency obligations were caused by interest rate fluctuations. On December 31, 2010, nine securities had a total unrealized loss of $931,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities are obligations of government agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At December 31, 2010, 47 securities had a total unrealized loss of $3.57 million. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, 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, 2010, 32 securities experienced a total unrealized loss of $819,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities are obligations of government agencies, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Corporate obligations

The Company's unrealized losses on corporate obligations were caused by interest rate fluctuations. At December 31, 2010, one security had an unrealized loss of $118,000. Based on the credit quality of the issuers, and because it is the Company's intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Company will not be required to sell the securities before their anticipated recovery, the Company does not consider these investments other than temporarily impaired.

Other investments, including common stock

The Company had no unrealized losses in other investments or common stocks at December 31, 2010.

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, $712.98 million were pledged as collateral to secure overnight borrowings with the FHLB, and $61.24 million were pledged to secure borrowings from the discount window at the FRB at December 31, 2010.

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

December 31,	2010	2009
Real estate loans		
Residential 1-4 family	$ 714,122	$ 634,960
Commercial	952,727	866,165
Construction	657,341	652,221
Multifamily	41,441	41,652
Total real estate loans	2,365,631	2,194,998
Commercial loans	322,027	321,498
Consumer installment loans		
Personal installment	24,970	31,099
Credit cards and revolving credit	17,726	17,652
Total consumer installment loans	42,696	48,751
Agriculture loans	998	663
Loans, net of unearned income and deferred costs	$ 2,731,352	$ 2,565,910

Unearned loan income was $1.65 million in excess of deferred loan costs at December 31, 2010, and $981,000 at December 31, 2009. There were $57.17 million and $42.15 million in nonaccrual loans at December 31, 2010 and 2009. The Company would have earned $3.07 million in 2010 and $1.48 million in 2009 if interest on the loans had been accrued.

Allowance for Loan Losses

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of $38.66 million adequate to cover loan losses inherent in the loan portfolio at December 31, 2010.

The following table presents, by portfolio segment, the changes in the allowance for loan losses and the allocation of the allowance for loan losses for the year ended December 31, 2010 (in thousands):

December 31, 2010	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Unallocated	Total
Allowance for loan losses:								
Balance, beginning of year	$ 7,726	$ 10,018	$ 416	$ 7,094	$ 7,330	$ 1,209	$ -	$ 33,793
Provision charged to expense	10,220	4,678	236	8,258	(2,205)	1,378	-	22,565
Losses charged off	(7,294)	(1,933)	(95)	(5,932)	(1,274)	(1,867)		(18,395)
Recoveries	332	64	-	123	157	21	-	697
Balance, end of year	$ 10,984	$ 12,827	$ 557	$ 9,543	$ 4,008	$ 741	$ -	$ 38,660
Period-end balance allocated to:								
Loans individually evaluated for impairment	$ 2,355	$ 949	$ -	$ 490	$ 543	$ -	$ -	$ 4,337
Loans collectively evaluated for impairment	8,629	11,878	557	9,053	3,465	741	-	34,323
Balance, end of year	$ 10,984	$ 12,827	$ 557	$ 9,543	$ 4,008	$ 741	$ -	$ 38,660

Activity in the allowance for loan losses during 2009 and 2008 was as follows (in thousands):

Years Ended December 31,	2009	2008
Balance, beginning of year	$ 27,503	$ 21,323
Loans charged off	(7,141)	(970)
Loans recovered	540	128
Net loans recovered (charged off)	(6,601)	(842)
Provision for loan losses	12,891	7,022
Balance, end of year	$ 33,793	$ 27,503

The following table presents, by portfolio segment, the Company's investment in loans (in thousands):

December 31, 2010	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Ending balance: individually evaluated for impairment	$ 131,382	$ 74,672	$ 4,833	$ 37,793	$ 18,847	$ 1,443	$ 268,970
Ending balance: collectively evaluated for impairment	525,959	878,055	36,608	676,329	303,180	42,251	2,462,382
Ending Balance	$ 657,341	$ 952,727	$ 41,441	$ 714,122	$ 322,027	$ 43,694	$ 2,731,352

Portfolio Quality Indicators

The Company's portfolio grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on numerous factors, including management's experiences with similarly graded loans. Credit risk grades are refreshed each quarter as they become available, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track loan performance.

The Company's internally assigned grades are as follows:

- Special Mention – Loans in this category are considered to have a very high credit risk and servicing needs. The borrower's ability to repay from the primary (intended) sources is currently adequate, but threatened by a potential weakness which may, if not checked or uncorrected, result in the bank being inadequately protected against the risk of loss at some future date.
- Substandard – Loans in this category are considered to have increased credit risk and servicing needs and generally require that the Bank follow their performance very closely. The Borrower's ability to repay is threatened by a clearly defined weakness which jeopardizes ultimate repayment of the loan.
- Doubtful – Loans in this category are considered to be doubtful or a loss to the bank in terms of principal and interest repayment. Borrower's ability to repay in full, on the basis of currently existing facts, conditions and values, is generally highly questionable and improbable.

The following tables represent consumer credit exposures by internally assigned grades of special mention, substandard and doubtful for the year ended December 31, 2010 (in thousands):

	Construction and Land Development	Commercial Real Estate	Multi-Family Real Estate	1-4 Family Residential Real Estate	Commercial and Industrial Business	Consumer Loans and Other	Total
Corporate Credit Exposure Credit Risk Profile by Rating Category							
Special Mention	$ 23,800	$ 25,149	$ 1,074	$ 3,913	$ 1,819	$ 152	$ 55,907
Substandard	85,575	18,693	-	12,872	7,539	671	125,350
Doubtful	1,006	-	-	1,046	440	-	2,492
Total	$ 110,381	$ 43,842	$ 1,074	$ 17,831	$ 9,798	$ 823	$ 183,749

Age Analysis of Past-Due Financing Receivables by Class

Following is a table which includes an aging analysis of the recorded investment of past-due financing receivables as of December 31, 2010. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual (in thousands).

	Loans 30 - 59 Days Past Due	Loans 60 - 89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due	Current Loans	Total Loans Receivable	Accruing Loans More Than 90 Days Past Due
December 31, 2010							
Construction and land development	$ 1,691	$ 855	$ 24,203	$ 26,749	$ 630,592	$ 657,341	$ -
Commercial real estate	68	520	7,914	8,502	944,225	952,727	615
Multifamily real estate	279	-	-	279	41,162	41,441	-
1-4 family residential real estate	2,859	3,727	4,676	11,262	702,860	714,122	193
Commercial and industrial business loans	85	1,693	578	2,356	319,671	322,027	34
Consumer loans and other	72	-	488	560	43,134	43,694	387
Total	$ 5,054	$ 6,795	$ 37,859	$ 49,708	$ 2,681,644	$ 2,731,352	$ 1,229

Impaired Loans

Management considers a loan to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs, and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance. On certain loans, the Company charges off the amount of impairment at the time of impairment, rather than placing the impaired loan amount in a specific reserve. At December 31, 2010, cumulative partial charge-offs associated with collateral-dependent impaired loans on the Company's balance sheet totaled $18.46 million.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost-recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable (in thousands):

December 31, 2010	Unpaid Principal Balance	Recorded Balance	Partial Charge-offs (1)	Specific Allowance	Average Investment in Impaired Loans
Loans without a specific valuation allowance					
Construction and land development	$ 34,271	$ 22,084	$ 12,187	$ -	$ 34,608
Commercial real estate	3,292	2,138	1,154	-	7,537
1-4 family residential real estate	6,407	3,947	2,460	-	5,910
Commercial and industrial business loans	897	374	523	-	773
Consumer loans and other	1,867	101	1,766	-	1,235
Total	$ 46,734	$ 28,644	$ 18,090	$ -	$ 50,063
Loans with a specific valuation allowance					
Construction and land development	$ 22,161	$ 21,794	$ 367	$ 2,205	$ 21,132
Commercial real estate	5,157	5,157	-	598	6,291
1-4 family residential real estate	1,239	1,239	-	318	1,264
Commercial and industrial business loans	333	333	-	333	333
Consumer loans and other	-	-	-	-	-
Total	$ 28,890	$ 28,523	$ 367	$ 3,454	$ 29,020
Total impaired loans					
Construction and land development	$ 56,432	$ 43,878	$ 12,554	$ 2,205	$ 55,740
Commercial real estate	8,449	7,295	1,154	598	13,828
1-4 family residential real estate	7,646	5,186	2,460	318	7,174
Commercial and industrial business loans	1,230	707	523	333	1,106
Consumer loans and other	1,867	101	1,766	-	1,235
Total	$ 75,624	$ 57,167	$ 18,457	$ 3,454	$ 79,083

(1) On certain loans, the Company charges off the amount of impairment at the time of impairment, rather than placing the impaired loan amount in a specific reserve.

At December 31, 2009, the recorded balance in loans considered impaired totaled $42.15 million. Impaired loans of $18.66 million had valuation allowances of $2.07 million, while impaired loans of $23.49 million had no valuation allowance at December 31, 2009. For the years ended December 31, 2009 and 2008, the average recorded balance of impaired loans was $18.31 million and $1.09 million, respectively.

Nonaccrual Loans

The Company generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach a certain number of days past due. Commercial loans are placed on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 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.

The following table presents the financing receivables on nonaccrual status as of December 31, 2010 and 2009, respectively:

	2010	2009
Construction and land development	$ 43,878	$ 30,251
Commercial real estate	7,295	9,622
Multifamily real estate	-	733
1-4 family residential real estate	5,186	923
Commercial and industrial business loans	707	618
Consumer loans and other	101	3
Total	$ 57,167	$ 42,150

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,	2010	2009
Land and improvements	$ 21,572	$ 16,932
Buildings and improvements	55,378	35,971
Autos	3,314	2,908
Computer and communication equipment	7,812	7,625
Equipment	9,901	8,755
Furniture and fixtures	27,552	22,646
Leasehold improvements	19,679	17,482
Construction in progress	4,551	7,585
	149,759	119,904
Less accumulated depreciation	(34,461)	(30,146)
Net premises and equipment	$ 115,298	$ 89,758

Depreciation and leasehold amortization expense for the years ended December 31, 2010, 2009, and 2008 was $6.20 million, $6.12 million, and $5.97 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 $6.42 million for 2010, compared to $6.41 million for 2009, and $4.20 million for 2008.

Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2010, are listed in the following chart (in thousands):

2011	5,697
2012	5,613
2013	5,392
2014	4,746
2015	4,117
Thereafter	17,153
	$ 42,718

Rental income for the year ended December 31, 2010, was $466,000, compared to $363,000 for 2009 and $338,000 for 2008. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2010 (in thousands):

2011	545
2012	294
2013	253
2014	216
2015	115
Thereafter	352
	$ 1,775

NOTE 6: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2010		2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 4,094	$ 3,028	$ 3,677	$ 2,579
Non-compete agreements	1,456	937	2,181	1,284
Customer lists	15,451	3,772	15,662	2,281
Total intangible assets subject to amortization	21,001	7,737	21,520	6,144
Intangible assets not subject to amortization				
Title plant	-	-	146	-
Trade names	498	-	538	-
Contractual agreements	3,231	-	3,231	-
Total intangible assets not subject to amortization	3,729	-	3,915	-
Total intangible assets	$ 24,730	$ 7,737	$ 25,435	$ 6,144

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2010, was $2.67 million, compared to $2.49 million for 2009 and $2.17 million for 2008. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2010, are as follows: 2011, $1.95 million; 2012, $1.68 million; 2013, $1.45 million; 2014, $1.32 million; and 2015, $1.25 million.

During 2010, the Company recorded $11.31 million in goodwill and $417,000 in intangible assets. This represents the acquisition of the Bank of Currituck in 2010 and certain other adjustments to goodwill. The intangible assets acquired are finite-lived assets consisting of core deposit intangibles, which are amortized over an eight-year period. The assets are included in the Banking segment.

During 2010 and 2009, the Company recorded $146,000 and $282,000, respectively, of impairment charges for the title plant due to obsolescence. Also during 2009, the Company recorded $20.45 million in goodwill and $9.66 million in intangible assets related to the acquisition of two companies. 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 and four years. These assets are included in the Company's Realty and Insurance segments.

Impairment testing indicated that goodwill was not impaired in 2010 or 2009. 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, 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
Additions to goodwill	11,776	-	-	11,776
Other adjustments	-	(348)	(121)	(469)
Balance, December 31, 2010	$ 57,296	$ 15,582	$ 19,075	$ 91,953

NOTE 7: BANK-OWNED LIFE INSURANCE POLICIES

The total carrying amount of bank-owned life insurance policies ("BOLI") as of December 31, 2010, was $52.74 million. The Company had $46.64 million of BOLI at December 31, 2009. The Company has a related retirement plan, implemented in the fourth quarter of 2008, which provides retirement benefits and postretirement health benefits to the executives covered under the plan.

NOTE 8: DEPOSITS

A summary of time deposits by maturity at December 31, 2010, is shown in the following chart (dollars in thousands):

Maturity	Total
2011	$991,474
2012	224,363
2013	51,720
2014	5,466
2015 and thereafter	70,632
	$1,343,655

At year-end 2010, TowneBank had a total of $499.19 million in no-penalty time deposits as compared to $649.97 million for 2009. 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 $45.63 million and $35.63 million at December 31, 2010 and 2009, 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):

	2010	2009
Balance outstanding at end of year	$ 330,801	$ 453,840
Average balance outstanding	$ 371,134	$ 366,161
Maximum outstanding at any month-end	$ 453,837	$ 453,840
Average interest rate during the year	3.86%	4.29%
Average interest rate at end of year	4.06%	3.51%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2010, are summarized as follows (dollars in thousands):

Maturity Date	Interest Rate	Call Date	Outstanding Amount
06/29/2011	5.17%	-	$ 801
07/15/2011	3.25%	-	50,000
03/06/2017	4.08%	03/07/2011	100,000
05/18/2017	4.35%	02/18/2011	80,000
05/18/2017	4.48%	02/18/2011	80,000
01/29/2018	3.05%	01/30/2012	13,000
01/29/2018	3.05%	01/30/2012	7,000
			$ 330,801

Total interest expense on FHLB advances for the years ended December 31, 2010, 2009, and 2008 was $14.31 million, $15.70 million, and $14.84 million, respectively.

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

	2010	2009
Balance outstanding at end of year	$ 14,076	$ 21,524
Average balance outstanding	$ 22,183	$ 23,910
Maximum outstanding at any month-end	$ 26,129	$ 28,625
Average interest rate during the year	0.54%	0.57%
Average interest rate at end of year	0.48%	0.64%

Repurchase agreements totaled $14.08 million at December 31, 2010. 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, 2010, for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2010 and 2009, the Company had $830.98 million and $628.10 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 $712.98 million at December 31, 2010.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2010, which provide potential additional funding.

At January 1, 2010, the Company had three different convertible subordinated capital debentures: (i) Series I Towne Investment Notes, (ii) Series II Towne Investment Notes, and (iii) Series III Towne Investment Notes. During 2010 two of the debentures were called, and at year-end 2010, the one outstanding debenture accrued and paid interest. Collectively, interest expense on the debentures for the year ended December 31, 2010, was $2.22 million. Total convertible subordinated capital debentures at December 31, 2010, were $13.84 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 consisted 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. At year-end 2010 and 2009, the Company had $0 and $20.90 million, respectively, in accruing Series I convertible subordinated notes. In the first quarter of 2010, TowneBank called the Series I notes. The convertible subordinated capital notes were 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).

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. 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 375,000 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. At year-end 2010 and 2009, the Company had $0 and $15.98 million, respectively, in accruing Series II convertible subordinated notes. During the second quarter of 2010, TowneBank called the Series II Towne Investment Notes ("Series II notes"). The Series II notes were bearing interest at 6.25% and were convertible into common stock at the discretion of the note holder 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).

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 was made on May 1, 2010. At year-end 2010 and 2009, the Company had $13.84 and $13.88 million in Series III convertible subordinated notes, respectively. 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.

At December 31, 2010, the Company had $927,000 in Series I notes and $820,000 in Series II notes outstanding included in other liabilities. The notes were unsecured debt of the Company and were not accruing interest.

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,	2010	2009
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 779,521	$ 1,335,707
Standby letters of credit	43,726	36,570
	$ 823,247	$ 1,372,277

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, 2010. 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 make a discretionary match of the employees' contributions up to 6% of their salary. The Company matched 100% of employee contributions up to 6%, 4.5%, and 6% in the years ended December 31, 2010, 2009, and 2008, respectively. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2010, 2009, 2008.

The Company made matching contributions of $2.58 million, $1.88 million, and $2.11 million for the years ended December 31, 2010, 2009, and 2008, 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,	**2010**	**2009**
Change in benefit obligation		
Benefit obligation, beginning of year	$ 3,310	$ 245
Service cost	3,227	3,051
Interest cost	190	14
Benefit obligation, end of year	$ 6,727	$ 3,310
Accumulated benefit obligation, end of year	$ 5,968	$ 2,871

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

	2010	**2009**
Service cost	$ 3,227	$ 3,051
Interest cost	190	14
Net periodic benefit cost	$ 3,417	$ 3,065

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 2010 and 2009. The rate of increase in future compensation levels used was 4.0% in 2010 and 2009. 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**
2011	-
2012	651
2013	954
2014	1,048
2015	1,048
2016-2020	7,222

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, 2010, approximately 3.69 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,	2010		2009		2008	
	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
Options outstanding, beginning balance	883,004	$16.29	1,189,663	$12.97	1,301,678	$11.78
Granted	10,000	15.26	23,500	13.70	104,500	17.86
Exercised	(32,178)	7.35	(313,042)	3.40	(159,111)	3.71
Forfeited	(15,389)	19.07	(17,117)	17.91	(57,404)	20.46
Options outstanding, ending balance	845,437	$16.57	883,004	$16.29	1,189,663	$12.97
Options exercisable at December 31,	550,056	$16.03	498,689	$15.33	727,126	$9.99

	Number	Weighted-Average Exercise Price
Unvested stock options, December 31, 2009	384,315	$17.54
Granted	10,000	15.26
Vested	(90,703)	17.00
Forfeited	(8,231)	19.52
Unvested stock options, December 31, 2010	295,381	$17.58

For the years ended December 31, 2010, 2009, and 2008, the weighted-average fair value of stock options granted was $4.82, $4.33, and $5.19, respectively. For the same periods, the total intrinsic value of options exercised was $248,000, $4.49 million, and $2.49 million, respectively. Additional information pertaining to options outstanding at December 31, 2010, is as follows**:**

	Number	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	845,437	$ 16.57	$ 1,313,633	3.91 years
Options vested or expected to vest	831,298	$ 15.55	$ 1,304,987	3.87 years
Options exercisable	550,056	$ 16.03	$ 1,070,243	3.25 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,	2010	2009	2008
Dividend yield	2.10%	2.33%	1.69%
Expected life	7.12 years	7.0 years	7.0 years
Expected volatility	34.0%	36.0%	27.0%
Risk-free interest rate	2.76%	2.79%	3.27%

Cash received from exercises of stock options for the year ended December 31, 2010, was $213,000. The tax benefit realized for the tax deductions from stock option exercises for the year ended December 31, 2010, was $51,000, compared to $598,000 for 2009 and $414,000 for 2008. Compensation expense related to stock options for the years ended December 31, 2010, 2009, and 2008 was $423,000, $511,000, and $165,000, respectively. As of December 31, 2010, there was $1.30 million of total unrecognized compensation cost related to unvested stock option awards; that cost is expected to be recognized over a period of 4.39 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 and 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, 2010:

	Number	Weighted-Average Price
Unvested RSAs, beginning balance	46,296	$ 16.47
Granted	112,292	12.87
Vested	(23,272)	17.53
Forfeited	(240)	20.29
Unvested RSAs, ending balance	135,076	$ 13.29

Compensation expense related to the awards for the years ended December 31, 2010, 2009, and 2008 was $592,000, $478,000, and $683,000, respectively. The total fair value of awards vested during 2010, 2009, and 2008 was $408,000, $710,000, and $780,000, respectively. As of December 31, 2010, there was $964,000 of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 3.50 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. In connection with the monthly stock purchase plan for the year ended December 31, 2010, the Company entered the open market and acquired 137,110

shares at an average price of $15.50 per share and issued 56,481 shares at an average price of $12.03 per share. In connection with the dividend reinvestment plan for the year ended December 31, 2010, the Company entered the open market and acquired 293,208 shares at an average price of $15.55 per share and issued 101,985 shares at an average price of $11.62 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 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 2010, 2009, and 2008 the Company declared quarterly cash dividends of $0.08 per common share. The quarterly dividends were paid on 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, April 12, 2010; July 12, 2010; October 12, 2010; and January 11, 2011.

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 pays 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 and 2010, 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; December 1, 2009; March 2, 2010; June 1, 2010; September 1, 2010; and December 1, 2010.

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; May 14, 2010; August 16, 2010; and November 15, 2010.

NOTE 14: OTHER EXPENSES

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

Year Ended December 31,	2010	2009	2008
Advertising and marketing	$ 4,056	$ 3,665	$ 2,908
Charitable contributions	2,704	2,193	2,012
Telephone and postage	2,731	2,574	2,254
Outside processing	2,446	2,491	2,093
Professional fees	2,963	2,981	1,617
Other	5,342	3,393	1,345
Stationery and office supplies	1,775	1,674	1,458
Amortization of intangible assets	2,991	2,803	2,488
FDIC and other insurance	4,525	5,338	1,622
Software expense	3,120	2,529	2,028
Travel/Meals/Entertainment	655	611	549
Directors' expense	944	952	1,436
Bank franchise tax/SCC fees	2,165	2,240	1,174
	$ 36,417	$ 33,444	$ 22,984

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, 2010, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2010, the Company was categorized 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, 2010	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)	$ 442,780	13.68%	$ 258,848	8.00%	$ 323,560	10.00%
Tier 1 capital (to risk-weighted assets)	$ 390,278	12.06%	$ 129,424	4.00%	$ 194,136	6.00%
Tier 1 leverage ratios (to average assets)	$ 390,278	10.59%	$ 147,442	4.00%	$ 184,303	5.00%

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%

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,	2010		2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and due from banks	$ 144,825	$ 144,825	$ 55,748	$ 55,748
Interest-bearing deposits in financial institutions	5,651	5,651	8,976	8,976
Securities available for sale	446,006	446,006	510,766	510,766
Securities held to maturity	149,241	146,969	122,924	122,789
Mortgage loans held for sale	65,028	65,002	72,221	72,109
Loans, net	2,692,692	2,743,310	2,532,117	2,575,615
Interest receivable	12,299	12,299	12,030	12,030
Deposits	2,954,514	2,709,353	2,561,702	2,452,927
Advances from the Federal Home Loan Bank of Atlanta	330,801	364,350	453,840	469,164
Convertible subordinated capital debentures	13,842	14,149	50,755	44,195
Repurchase agreements and other borrowings	14,076	14,076	21,524	21,524
Interest payable	4,830	4,830	6,985	6,985

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, 2010. 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, 2010 and 2009, including financial instruments for which the Company has elected the fair value option, are summarized below (in thousands):

Available-for-sale securities	**December 31, 2010**			
	Level 1	**Level 2**	**Level 3**	**Total**
US Treasury obligations and direct obligations of U.S. government agencies	$ -	$ 100,425	$ -	$ 100,425
Municipal securities	-	27,078	-	27,078
Federal agency mortgage-backed securities	-	286,711	-	286,711
FHLB stock	-	23,871	-	23,871
Other	3	7,918	-	7,921
Total available-for-sale securities	$ 3	$ 446,003	$ -	$ 446,006

Available-for-sale securities	**December 31, 2009**			
	Level 1	**Level 2**	**Level 3**	**Total**
US Treasury obligations and direct obligations of U.S. government agencies	$ -	$ 243,435	$ -	$ 243,435
Municipal securities	-	21,410	-	21,410
Federal agency mortgage-backed securities	-	213,083	-	213,083
FHLB stock	-	26,063	-	26,063
Other	8	6,767	-	6,775
Total 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, 2010 and 2009. (in thousands):

December 31, 2010	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ -	$ 57,167	$ -	$ 57,167
Other real estate owned	$ -	$ 20,452	$ -	$ 20,452

December 31, 2009	**Level 1**	**Level 2**	**Level 3**	**Fair Value**
Impaired loans	$ -	$ 42,150	$ -	$ 42,150
Other real estate owned	$ -	$ 2,043	$ -	$ 2,043

NOTE 18: VARIABLE INTEREST ENTITIES

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

Low Income Housing Tax Credit Partnerships

As part of its community reinvestment initiatives, the Company invests within its footprint in multi-family affordable housing developments as a limited partner. The Company receives tax credits for its partnership investments. The Company has determined that these partnerships are VIEs when it does not own 100% of the entity because the holders of the equity investment at risk do not have the power through voting rights or similar rights to direct the activities of the entity that most significantly impact the entity's economic performance. Accordingly, the Company's limited partner interests are variable interests that the Company evaluates for purposes of determining whether the Company is the primary beneficiary.

For each of the partnerships, the Company acts strictly in a limited partnership capacity. The Company has determined that it is not the primary beneficiary of these partnerships because it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company accounts for its limited partner interests in accordance with the accounting guidance for investments in affordable housing projects. Partnership assets of $20.40 million and $18.67 million in these

partnerships were not included in the Consolidated Balance Sheets at December 31, 2010 and 2009, respectively. These limited partner interests had carrying values of $5.65 million and $4.25 million at December 31, 2010 and 2009, respectively, and are recorded in other assets on the Company's Consolidated Balance Sheets. The Company's maximum exposure to loss for these limited partner investments totaled $5.65 million and $4.25 million at December 31, 2010 and 2009, respectively.

Currituck Resolution Properties, Inc.

Following the Company's acquisition of the banking offices of The Bank of Currituck, the remaining entity ceased operation as a commercial bank and is operating as a North Carolina corporation under the name Currituck Resolution Properties, Inc. The sole purpose of the Resolution Company is to liquidate its remaining assets, pay its remaining liabilities, and wind down its business affairs. The Resolution Company continues to be managed by its existing board of directors and operates with minimal employees. At the closing of the purchase transaction, the Company entered into a secured credit facility with the Resolution Company, consisting of three components: (i) a revolving line of credit in the principal amount of $1.0 million to be used for working capital purposes; (ii) a second revolving line of credit in the principal amount of $1.0 million to be used as an interest reserve to support the interest owed on the loan; and (iii) a term loan, of approximately $14 million, which was to be used to fund and support the Resolution Company's asset base and operations.

The Company concluded that the Resolution Company is a VIE because the equity investors do not have sufficient equity at risk for the entity to independently finance its activities as evidenced by the amount of subordinated support provided by the Company. However, the Company determined that it is not the primary beneficiary of the Resolution Company as it does not have the power to direct the activities of the entity that most significantly impact the entity's economic performance. The Company does not have any contractual obligation to provide additional support to this entity, and its maximum exposure to loss at December 31, 2010, was limited to (i) the current outstanding balance of the term loan, which was $14.07 million, and (ii) the commitments on the two revolving lines of credit, which had not been drawn on as of December 31, 2010. The total unconsolidated assets of the Resolution Company as of December 31, 2010, were $30.94 million.

NOTE 19: INCOME TAXES

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

For the Year Ended December 31,	2010	2009	2008
Current income tax expense	$ (16,488)	$ (15,153)	$ (11,607)
Deferred income tax benefit	4,032	3,506	2,856
Income tax expense	$ (12,456)	$ (11,647)	$ (8,751)

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,	2010 $	2010 Rate	2009 $	2009 Rate	2008 $	2008 Rate
Federal income tax expense at statutory rate	$ (14,956)	(35.00%)	$ (13,442)	(35.00%)	$ (11,426)	(35.00%)
State income tax expense, net of federal benefit	(282)	(0.66%)	(59)	(0.15%)	(31)	(0.09%)
Tax advantaged income	2,363	5.53%	1,944	5.06%	1,985	6.08%
Tax credits	1,170	2.74%	636	1.66%	542	1.66%
Section 162(m) disallowance	(552)	(1.29%)	(561)	(1.46%)	-	-
Other	(199)	(0.47%)	(165)	(0.43%)	179	0.54%
Income tax expense	$ (12,456)	(29.15%)	$ (11,647)	(30.32%)	$ (8,751)	(26.81%)

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,	2010	2009
Deferred tax assets:		
Allowance for loan losses	$ 12,779	$ 11,827
Stock-based compensation	1,022	844
Other	2,078	837
Accrued expenses	1,169	669
Retirement plan	4,547	1,157
Deferred compensation	2,440	4,133
Total deferred tax assets	24,035	19,467
Deferred tax liabilities:		
Loan costs	295	591
Depreciation	6,811	6,084
Noncompete and intangibles	344	349
Basis differences due to tax credits and partnerships	1,013	693
Unrealized gain (loss) on securities available for sale	147	(887)
Other	229	404
Total deferred tax liabilities	8,839	7,234
Net deferred tax assets	$ 15,196	$ 12,233

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, 2010. Additionally, there were no interest or penalties accrued at December 31, 2010.

The Company is subject to examination for federal and state purposes for the tax years 2006 through 2010.

NOTE 20: 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, 2010. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2010.

NOTE 21: 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 $169.81 million, $138.16 million, and $110.41 million as of December 31, 2010, 2009, and 2008, respectively. During 2010, new advances on all commitments to such parties totaled $21.26 million, adjustments and additions for new related parties totaled $14.06 million, and repayments amounted to $295.55 million. In addition at December 31, 2010, we had $35.78 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 $2.20 million, $1.44 million, and $910,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

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, 2010, 2009, and 2008 approximated $6.22 million, $3.43 million, and $1.11 million, respectively.

(continued on next page)

NOTE 22: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2010 and 2009, is as follows (in thousands, except per share data):

2010	Fourth	Third	Second	First
Interest income	$ 43,863	$ 41,857	$ 41,892	$ 41,583
Interest expense	10,435	11,241	12,165	12,719
Provision for loan losses	7,480	7,304	7,326	2,605
Noninterest income	13,399	15,691	15,891	15,108
Gain on securities available for sale	3	3,479	1,979	500
Noninterest expense	28,523	31,435	30,152	30,485
Income before income tax expense and Noncontrolling interest	10,827	11,047	10,119	11,382
Income tax expense	2,951	3,250	2,849	3,406
Net income	7,876	7,797	7,270	7,976
Noncontrolling interest	(41)	(263)	(391)	52
Net income	$ 7,835	$ 7,534	$ 6,879	$ 8,028
Net income per common share				
Basic	$ 0.19	$ 0.18	$ 0.16	$ 0.21
Diluted	$ 0.19	$ 0.18	$ 0.16	$ 0.20
Comprehensive income	$ 5,522	$ 7,030	$ 9,494	$ 10,794
Dividends	$ 0.08	$ 0.08	$ 0.08	$ 0.08

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

NOTE 23: 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 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, Virginia Home Title, NewTowne Mortgage, LLC, and Corolla Classic Vacations 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 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, 2010	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 120,485	$ 2,129	$ 21	$ 122,635
Provision for loan losses	22,565	-	-	22,565
Net interest income after provision for loan losses	97,920	2,129	21	100,070
Residential mortgage brokerage income, net	(295)	13,293	-	12,998
Real estate brokerage and property management income, net	-	11,155	-	11,155
Insurance commissions and other title fees and income, net	-	1,913	17,588	19,501
Other noninterest income	19,410	1,711	1,275	22,396
Noninterest expense	78,490	22,541	12,522	113,553
Depreciation and amortization	5,894	1,970	1,328	9,192
Income before income tax, corporate allocation, and noncontrolling interest	32,651	5,690	5,034	43,375
Corporate allocation	(483)	309	174	-
Income before income tax provision and noncontrolling interest	33,134	5,381	4,860	43,375
Income tax provision	8,797	1,768	1,891	12,456
Net income	24,337	3,613	2,969	30,919
Noncontrolling interest	-	(480)	(163)	(643)
Net income attributable to TowneBank	$ 24,337	$ 3,133	$ 2,806	$ 30,276
Net income as percentage of total	80.38%	10.35%	9.27%	100.00%
Assets	$ 3,697,894	$ 115,704	$ 57,420	$ 3,871,018
Efficiency ratio	60.45%	81.16%	73.34%	65.05%

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	-	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	-	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%

The following table provides the change in net income and total assets for each segment, comparing December 31, 2010 and 2009 (dollars in thousands):

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 575	$ 1,416	$ 1,526	$ 3,517
Net Income (%)	2.42%	82.47%	119.22%	13.14%
Total Assets ($)	$ 272,396	$ (14,259)	$ 6,430	$ 264,567
Total Assets (%)	7.95%	(10.97%)	12.61%	7.34%

NOTE 24: 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,	2010	2009	2008
Basic			
Net income, as reported	$ 30,276	$ 26,759	$ 23,894
Preferred stock dividends	(9,355)	(10,044)	(1,396)
Net income available to common shareholders	$ 20,921	$ 16,715	$ 22,498
Average common shares outstanding	28,376,422	25,126,604	24,174,069
Basic earnings per common share	$ 0.74	$ 0.67	$ 0.93
Diluted			
Net income available to common shareholders	$ 20,921	$ 16,715	$ 22,498
Interest applicable to subordinated debt, net of tax (1)	720	815	961
Net income available to common shareholders, for diluted EPS	21,641	17,530	23,459
Average common shares outstanding	28,376,422	25,126,604	24,174,069
Effect of dilutive securities:			
Stock compensation plans, net of tax benefit	75,296	134,362	423,837
Convertible subordinated debentures (2)	1,034,551	1,452,899	1,880,315
Average diluted shares outstanding	29,486,269	26,713,865	26,478,221
Diluted earnings per common share	$ 0.73	$ 0.66	$ 0.89

(1) Annualized interest on 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 TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A entitled the holders to convert their shares into 3,158,079 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.

In conjunction with the Company's issuance of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B to the U.S. Treasury, the Company issued a ten-year warrant to purchase 538,184 common shares at an exercise price of $21.31 per share. These shares were not included in the computation of diluted earnings per share as the effect was anti-dilutive for the period.

NOTE 25: SUBSEQUENT EVENTS

On January 14, 2011, the Company acquired W. T. Chapin Inc. insurance agency, which will be affiliated with Towne Insurance Agency, a wholly-owned subsidiary of TowneBank. The purchase price was approximately $4 million in cash and common stock.

TOWNEBANK
SHAREHOLDER INFORMATION

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Wednesday, May 25, 2011, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

The Company's Common Stock is listed on the NASDAQ Global Select Market under the symbol TOWN. The following are the Company's quarterly high and low closing stock prices for the periods indicated.

	2010		2009	
Quarter	High	Low	High	Low
First	$ 14.95	$ 10.54	$24.95	$11.80
Second	17.16	13.44	18.90	13.82
Third	16.45	13.48	14.02	12.75
Fourth	16.44	14.39	13.70	11.12

INVESTOR RELATIONS

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

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Senior Executive Vice President and Chief Financial Officer
TowneBank
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Suffolk, VA 23435
757-638-6801
e-mail: Clyde.McFarland@townebank.net

These reports are also available on our website at http://www.townebank.com/investor_relations.

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TOWNEBANK
SHAREHOLDER INFORMATION

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