TOWNEBANK

2007 Annual Report

TowneBank

TABLE OF CONTENTS

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 controlled divisions and subsidiaries that include TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, Inc. (“Towne Insurance”), which includes Lawyers Escrow and Title, LLC (“LET”); TowneBank Commercial Mortgage, LLC; TFA Benefits (“TFA”), which encompasses Benefit Design Group (“BDG”) and The Frieden Agency, Inc.; Towne Mortgage, LLC; NewTowne Mortgage, LLC; GSH Residential Real Estate Corporation (“GSH”); 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.

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,	2007	2006	2007/2006 Increase/(Decrease)	
(Dollars in thousands, except per share data)				
Results of Operations:				
Net interest income	$ 85,499	$ 77,042	$ 8,457	10.98%
Noninterest income (1)	36,752	35,561	1,191	3.35%
Noninterest expenses	85,507	76,043	9,464	12.45%
Provision for loan losses	2,743	2,572	171	6.65%
Net income	23,259	21,786	1,473	6.76%
Net income per common share - basic	0.98	0.93	0.05	5.38%
Net income per common share - diluted	0.92	0.86	0.06	6.98%
Period End Data:				
Total assets	$ 2,501,078	$ 2,194,585	$ 306,493	13.97%
Total assets - tangible	2,433,009	2,137,537	295,472	13.82%
Earning assets	2,267,763	2,009,270	258,493	12.87%
Loans (net of unearned income and deferred costs)	1,829,456	1,641,826	187,630	11.43%
Allowance for loan losses	21,323	19,670	1,653	8.40%
Goodwill and other intangibles	68,069	57,048	11,021	19.32%
Noninterest-bearing deposits	439,122	453,451	(14,329)	(3.16%)
Interest-bearing deposits	1,395,224	1,251,248	143,976	11.51%
Total deposits	1,834,346	1,704,699	129,647	7.61%
Shareholders' equity	256,856	230,017	26,839	11.67%
Shareholders' equity - tangible	188,787	172,969	15,818	9.14%
Book value per share	10.66	9.75	0.91	9.33%
Book value per share - tangible	7.83	7.33	0.50	6.82%
Cash dividends declared per share	0.32	0.53	(0.21)	(39.62%)
Daily Average Balances:				
Total assets	$ 2,387,258	$ 1,981,403	$ 405,855	20.48%
Total assets - tangible	2,321,193	1,923,968	397,225	20.65%
Earning assets	2,171,352	1,784,736	386,616	21.66%
Loans (net of unearned income)	1,741,441	1,438,927	302,514	21.02%
Allowance for loan losses	20,401	18,191	2,210	12.15%
Goodwill and other intangibles	66,064	57,435	8,629	15.02%
Noninterest-bearing deposits	453,799	434,490	19,309	4.44%
Interest-bearing deposits	1,325,619	1,148,157	177,462	15.46%
Total deposits	1,779,418	1,582,647	196,771	12.43%
Shareholders' equity	242,186	220,932	21,254	9.62%
Shareholders' equity - tangible	176,122	163,497	12,625	7.72%
Key Ratios:				
Return on average assets	0.97%	1.10%	(0.13%)	(11.82%)
Return on average tangible assets	1.00%	1.13%	(0.13%)	(11.50%)
Return on average equity	9.60%	9.86%	(0.26%)	(2.64%)
Return on average tangible equity	13.21%	13.33%	(0.12%)	(0.90%)
Net interest margin	3.94%	4.32%	(0.38%)	(8.80%)
Efficiency ratio (1)	69.94%	67.53%	2.41%	3.57%
Average earning assets/total average assets	90.96%	90.07%	0.89%	0.99%
Average loans/average deposits	97.87%	90.92%	6.95%	7.64%
Average noninterest deposits/total average deposits	25.50%	27.45%	(1.95%)	(7.10%)
Allowance for loan losses/period end loans	1.17%	1.20%	(0.03%)	(2.50%)
Period end shareholders' equity/period end total assets	10.27%	10.48%	(0.21%)	(2.00%)

Notes:

(1) Excludes investment securities gains and losses.

Period Ended December 31,	2005	2004	2003
(Dollars in thousands, except per share data)			
Results of Operations:			
Net interest income	$ 62,443	$ 44,443	$ 25,997
Noninterest income (1)	34,076	19,260	15,592
Noninterest expenses	66,948	43,617	29,100
Provision for loan losses	2,364	2,604	2,762
Net income	17,680	11,280	6,620
Net income per common share - basic	0.79	0.56	0.42
Net income per common share - diluted	0.74	0.53	0.40
Period End Data:			
Total assets	$ 1,803,182	$ 1,448,359	$ 931,873
Total assets - tangible	1,747,320	1,398,031	930,262
Earning assets	1,625,125	1,302,157	861,666
Loans (net of unearned income and deferred costs)	1,264,492	1,111,001	664,926
Allowance for loan losses	17,071	14,999	8,976
Goodwill and other intangibles	55,862	50,328	1,611
Noninterest-bearing deposits	417,061	325,161	211,104
Interest-bearing deposits	1,050,664	801,058	552,004
Total deposits	1,467,725	1,126,219	763,108
Shareholders' equity	211,986	188,521	80,641
Shareholders' equity - tangible	156,124	138,193	79,030
Book value per share	9.21	8.40	5.04
Book value per share - tangible	6.78	6.16	4.94
Cash dividends declared per share, as restated for 3% stock dividend distributed September 2005	0.126	0.065	0.032
Daily Average Balances:			
Total assets	$ 1,629,425	$ 1,281,919	$ 842,667
Total assets - tangible	1,573,697	1,241,472	841,164
Earning assets	1,457,050	1,152,830	778,214
Loans (net of unearned income)	1,180,150	954,535	580,633
Allowance for loan losses	15,873	13,148	7,788
Goodwill and other intangibles	55,728	40,447	1,503
Noninterest-bearing deposits	389,658	288,124	183,258
Interest-bearing deposits	916,818	730,244	510,497
Total deposits	1,306,476	1,018,368	693,755
Shareholders' equity	202,811	145,998	76,016
Shareholders' equity - tangible	147,083	105,551	74,513
Key Ratios:			
Return on average assets	1.09%	0.88%	0.79%
Return on average tangible assets	1.12%	0.91%	0.79%
Return on average equity	8.72%	7.73%	8.71%
Return on average tangible equity	12.02%	10.69%	8.88%
Net interest margin	4.29%	3.86%	3.34%
Efficiency ratio (1)	69.36%	68.47%	69.97%
Average earning assets/total average assets	89.42%	89.93%	92.35%
Average loans/average deposits	90.33%	93.73%	83.69%
Average noninterest deposits/total average deposits	29.83%	28.29%	26.42%
Allowance for loan losses/period end loans	1.35%	1.35%	1.35%
Period end shareholders' equity/period end total assets	11.76%	13.02%	8.65%

Notes:

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

(1) Excludes investment securities gains and losses.

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.

With a challenging operating environment in 2007, which included a downturn in the national and local real estate industry, we were able to grow diluted earnings per common share by 6.98% over 2006. Additionally, loans, deposits, and our overall customer base continued to grow in 2007, reflecting our commitment to customer service. Because of our conservative credit culture, our company has had minimal risk associated with the sub-prime issues currently affecting the financial services industry. Furthermore, we have no exposure to collateralized debt obligations backed by sub-prime residential mortgages.

The following is a summary of the Company's 2007 financial performance:

- Net income increased to $23.26 million, or $0.92 per common diluted share, compared with $21.79 million, or $0.86 per common diluted share, in 2006.

- Net interest income increased $8.46 million, or 10.98%, due to an increase in average earning assets of 21.66% and a restructuring of our investment portfolio in the 4th quarter of 2006 that resulted in a $3.7 million positive rate variance in 2007. Net interest margin declined 36 basis points to 3.98% due to spread compression driven primarily by a shift in the mix of deposits to higher cost products, with certificates of deposits increasing more quickly than other deposit products. The average earning asset yield increased 12 basis points compared to 2006 while the average interest-bearing liability cost increased 43 basis points, resulting in a 31 basis point decline in interest rate spread.

- Noninterest income improved $3.00 million, or 8.87%, compared to 2006. Excluding gains and losses on securities available for sale, noninterest income increased by $1.19 million, or 3.35%, over 2006. This increase was driven by strong growth in our Insurance segment, primarily due to the acquisition of the benefit companies, as described below. The increase was partially offset by a decline in real estate and residential mortgage brokerage.

- Noninterest expense increased $9.46 million, or 12.45%, compared to 2006. The increase was driven by increased marketing expenses, higher Federal Deposit Insurance Corporation ("FDIC") insurance assessments, and higher personnel costs.

2007 Acquisitions and Ventures: Effective January 1, 2007, Towne Insurance acquired The Frieden Agency, Inc. ("Frieden"), an employee benefits provider. The purchase price for Frieden was $8.00 million in cash.

Effective May 31, 2007, Towne Insurance acquired most of the assets and operations of B. Martin Weber, Inc. ("Weber"), a group benefits agency. The purchase price for Weber was $2.53 million in cash.

Also in 2007, we entered into a business arrangement with William E. Wood & Associates ("Wood") to form Towne Mortgage, LLC, a mortgage brokerage and mortgage lending business. This was a reorganization of a previous business relationship. Additionally, we entered into a joint venture with McCardle Realty in 2007. The resultant company, NewTowne Mortgage, LLC, is engaged in the residential mortgage banking business.

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 Statement of Financial Accounting Standards No. ("SFAS") 141, *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 page 14) 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.

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, and changes in discount rates, 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, 2007, 2006, and 2005 of $23.26 million, $21.79 million, and $17.68 million, respectively. Diluted earnings per share was $0.92, $0.86, and $0.74 for the years ended December 31, 2007, 2006, and 2005, respectively.

Profitability, as measured by our return on average assets ("ROA") was 0.97%, 1.10%, and 1.09% for the years ended December 31, 2007, 2006, and 2005, respectively. Return on average tangible assets was 1.00%, 1.13%, and 1.12% for the same respective periods. ROA was impacted by the 20.48%, or $405.86 million, increase in average assets from the prior year.

Return on average equity ("ROE") was 9.60%, 9.86%, and 8.72% for years ended December 31, 2007, 2006, and 2005, respectively; while return on average tangible equity was 13.21%, 13.33%, and 12.02% for the same respective years. ROE was impacted by the 6.76% increase in net income from 2006 as compared to an increase in average equity of 9.62%, or $21.25 million, from year ended December 31, 2006.

Our operating margin, calculated by dividing income before taxes by operating revenue (net interest income plus noninterest income, excluding securities gains/losses), was 27.88% for the year ended December 31, 2007, while it was 28.64% and 28.20% for 2006 and 2005, respectively.

Net Interest Income: Net interest income, a major component of our earnings, is the income generated by interest-earning assets reduced by the total interest cost of the funds incurred to carry them. It is impacted by the market interest rates and the mix and volume of earning assets and interest-bearing liabilities. Our management team strives to maximize net interest income through prudent balance sheet administration, maintaining appropriate risk levels as determined by our Asset and Liability Committee ("ALCO") and the Board of Directors. The yields and rates in this discussion and in the following tables 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.

Net interest income was $85.50 million for the year ended December 31, 2007, an increase of 10.98% over 2006. In comparison, net interest income was 23.38% higher for the year ended December 31, 2006 over comparative 2005. The primary factor contributing to our increase in net interest income was loan growth, particularly the commercial real estate loan portfolio and the restructuring of our investment portfolio in the 4th quarter of 2006 that resulted in a $3.7 million positive rate variance in 2007. As of December 31, 2007, average loans increased $302.51 million over comparative 2006, which saw an increase of $258.78 million, or 21.93%, over 2005.

Net interest margin on a tax-equivalent basis, defined as net interest income as a percentage of average earning assets, decreased 36 basis points in 2007 to 3.98% from 4.34% in the year ended December 31 2006. Net interest margin on a tax-equivalent basis was 4.30% for 2005. The decrease in 2007 was the result of several factors, including higher funding costs, which was primarily attributable to the continuing migration in the deposit mix from noninterest-bearing deposits to interest-bearing deposits. There was a migration to higher cost certificates of deposit, which comprised 61.72% of average interest-bearing deposits in 2007 as compared to 56.27% in 2006, while growth in demand deposits slowed from prior periods. The current falling rate environment presents repricing opportunities for certificates of deposit as they mature and are renewed. Net interest margin was also affected by the growth in our utilization of advances from the Federal Home Loan Bank ("FHLB"), which were more competitively priced as a source of liquidity as compared to the higher cost certificates of deposit. The increase in advances was necessary to cost-effectively fund our loan growth in a competitive funding market. An additional factor was the timing effect of the Federal Reserve Board's ("FRB") 100-basis point decrease in short-term rates in the last four months of 2007, which immediately affected our prime-based loan portfolio.

Total average earning assets for the year ended December 31, 2007 were $2.17 billion, which was an increase of $386.62 million over 2006. Loan growth represented 78.25% of that increase. The yield on earning assets increased 12 basis points to 7.22% in 2007 from 7.10% in 2006. For the same period ended 2006, total average earning assets increased $327.69 million over 2005, and the yield increased 95 basis points from 6.15% in 2005.

Total average interest-bearing liabilities for the year ended 2007 were $1.66 billion, reflecting an increase of $365.28 million and an average cost of funds increase of 43 basis points. For 2006, total average interest-bearing liabilities increased $275.96 million over 2005, and the cost of average interest-bearing liabilities increased 116 basis points in 2006 from 2.66% in 2005. The increase in balances is attributable to the overall growth in the deposit base and in borrowings. The average increase in the cost of funds is primarily attributable to the factors mentioned in the above discussion regarding net interest margin.

(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,								
	2007			2006			2005		
	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	$ 1,741,441	$ 132,993	7.64%	$ 1,438,927	$ 111,032	7.72%	$ 1,180,150	$ 79,369	6.73%
Taxable investment securities	280,557	15,889	5.66%	280,647	12,145	4.33%	192,636	6,536	3.39%
Tax-exempt investment securities	80,995	4,176	5.16%	40,097	1,958	4.88%	17,711	801	4.52%
Interest-bearing deposits	48,854	2,429	4.97%	7,397	368	4.97%	43,058	1,526	3.54%
Mortgage loans held for sale	19,506	1,312	6.73%	17,668	1,217	6.89%	23,495	1,421	6.05%
Total earning assets	2,171,353	156,799	7.22%	1,784,736	126,720	7.10%	1,457,050	89,653	6.15%
Less: allowance for loan losses	(20,401)			(18,191)			(15,873)		
Total nonearning assets	236,306			214,858			188,248		
Total assets	$ 2,387,258			$ 1,981,403			$ 1,629,425		
Liabilities and Equity:									
Interest-bearing deposits									
Demand and money market	$ 483,207	$ 13,444	2.78%	$ 478,947	$ 12,680	2.65%	$ 438,356	$ 7,053	1.61%
Savings	24,246	400	1.65%	23,181	307	1.32%	24,967	198	0.79%
Certificates of deposit	818,166	40,497	4.95%	646,029	28,395	4.40%	453,495	14,891	3.28%
Total interest-bearing deposits	1,325,619	54,341	4.10%	1,148,157	41,382	3.60%	916,818	22,142	2.42%
FHLB advances and repurchase agreements	289,217	13,831	4.78%	100,757	5,642	5.60%	55,506	2,784	5.02%
Convertible subordinated capital debentures	42,119	2,253	5.35%	42,760	2,274	5.32%	43,395	2,110	4.86% (4)
Total interest-bearing liabilities	1,656,955	70,425	4.25%	1,291,674	49,298	3.82%	1,015,719	27,036	2.66%
Noninterest-bearing liabilities									
Demand deposits	453,799			434,490			389,658		
Other noninterest-bearing liabilities	34,318			34,307			21,237		
Total liabilities	2,145,072			1,760,471			1,426,614		
Shareholders' equity	242,186			220,932			202,811		
Total liabilities and equity	$ 2,387,258			$ 1,981,403			$ 1,629,425		
Net interest income (tax-equivalent basis)		$ 86,374			$ 77,422			$ 62,617	
Tax-equivalent basis adjustment		(875)			(380)			(174)	
Net interest income		$ 85,499			$ 77,042			$ 62,443	
Interest rate spread (2)			2.97%			3.28%			3.49%
Interest expense as a percent of average earning assets			3.24%			2.76%			1.86%
Net interest margin (tax-equivalent basis) (3)			3.98%			4.34%			4.30%
Total cost of deposits			3.05%			2.61%			1.69%

(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.
(4) Excluding the one-time adjustment to the debenture premium of $176,000, the average cost of these debentures would be 5.27%.

(in thousands)	2007 vs 2006 Increase (Decrease) Due to Changes In			2006 vs 2005 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	$ 23,114	$ (1,153)	$ 21,961	$ 18,937	$ 12,726	$ 31,663
Taxable investment securities	(4)	3,748	3,744	3,499	2,110	5,609
Tax-exempt investment securities	2,103	115	2,218	1,088	69	1,157
Interest-bearing deposits	2,061	-	2,061	(1,605)	447	(1,158)
Loans held for sale	124	(29)	95	(384)	180	(204)
Total earning assets	27,398	2,681	30,079	21,535	15,532	37,067
Liabilities and Equity:						
Interest-bearing deposits:						
Demand and money market accounts	113	651	764	706	4,921	5,627
Savings	15	78	93	(15)	124	109
Certificates of deposit	8,214	3,888	12,102	7,513	5,991	13,504
Total interest-bearing deposits	8,342	4,617	12,959	8,204	11,036	19,240
FHLB advances and repurchase agreements	9,124	(935)	8,189	2,501	357	2,858
Convertible subordinated capital debentures	(34)	13	(21)	(31)	195	164
Total interest-bearing liabilities	17,432	3,695	21,127	10,674	11,588	22,262
Net interest income (tax equivalent basis)	$ 9,966	$ (1,014)	$ 8,952	$ 10,861	$ 3,944	$ 14,805

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

Provision for Loan Losses: A provision for loan losses is charged against earnings in order to establish and maintain the allowance for loan losses at a level that reflects management's evaluation of the risk inherent in the portfolio. Management considers continuing assessments of nonperforming and "watch list" loans, analytical reviews of loan loss experience (including internal and peer) 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 provision for loan losses recorded in 2007, 2006, and 2005 were $2.74 million, $2.57 million, and $2.36 million, respectively. Net charge-offs were $1.01 million and $292,000 for 2007 and 2005, respectively. In 2006, there were net recoveries of $27,000.

Noninterest Income: Total noninterest income for the year ended December 31, 2007 was $36.82 million, or $3.00 million and 8.87%, higher than 2006. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $1.19 million, or 3.35%, over 2006. Total noninterest income for the year ended December 31, 2006 was $33.82 million, representing a $269,000, or 0.79%, decrease from 2005. Excluding gains and losses on available-for-sale securities, total noninterest income increased by $1.49 million, or 4.36%, over 2005. Included in noninterest income were gains on securities available-for-sale of $70,000 for 2007 and losses of $1.74 million for 2006. There was a gain of $14,000 on available-for-sale securities in 2005. Noninterest income, excluding securities gains or losses, for the year ended December 31, 2007 was 30.06% of total operating income compared with 31.58% for 2006 and 35.30% for 2005.

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

				2007/2006 Increase/(Decrease)		2006/2005 Increase/(Decrease)	
For the year ended December 31,	**2007**	**2006**	**2005**	**Amount**	**%**	**Amount**	**%**
Residential mortgage brokerage income, net	$ 6,164	$ 8,846	$ 8,808	$ (2,682)	(30.32%)	$ 38	0.43%
Real estate brokerage and property management income, net	5,462	6,333	7,493	(871)	(13.75%)	(1,160)	(15.48%)
Insurance commissions and other title fees and income, net	13,101	10,004	8,700	3,097	30.96%	1,304	14.99%
Service charges on deposit accounts	5,554	5,479	4,370	75	1.37%	1,109	25.38%
Credit card merchant fees	1,710	1,417	1,136	293	20.68%	281	24.74%
Other income							
Other	1,287	810	586	477	58.89%	224	38.23%
Towne Investment income, net	1,056	877	652	179	20.41%	225	34.51%
Bank-owned life insurance income	709	312	519	397	127.24%	(207)	(39.88%)
Service fees on loans	687	870	1,036	(183)	(21.03%)	(166)	(16.02%)
Towne Mortgage income, net	432	-	-	432	N/M	-	N/M
Commerical mortgage brokerage fees, net	379	392	402	(13)	(3.32%)	(10)	(2.49%)
Other real estate income	211	221	374	(10)	(4.52%)	(153)	(40.91%)
Total other income	4,761	3,482	3,569	1,279	36.74%	(87)	(2.44%)
Noninterest income before securities gain/(loss)	36,752	35,561	34,076	1,191	3.35%	1,485	4.36%
Gain/(loss) on securities available-for-sale	70	(1,740)	14	1,810	N/M	(1,754)	N/M
Total noninterest income	$ 36,822	$ 33,821	$ 34,090	$ 3,001	8.87%	$ (269)	(0.79%)

N/M = not meaningful

For the year ended December 31, 2007, residential mortgage brokerage income, net of commission expense was $6.16 million, reflecting a decrease of $2.68 million, or 30.32%, compared to 2006, which was $38,000, or 0.43%, higher than 2005. The majority of the decrease in net mortgage brokerage income in 2007 due to the formation and accounting treatment of Towne Mortgage, LLC ("Towne Mortgage"), a joint venture with William E. Wood & Associates. This was a change to a previous business relationship whereby revenues and expenses were reported gross in the Consolidated Statements of Income in 2006. Beginning in 2007, the results of Towne Mortgage are reported on a net basis of our ownership in Other Income. The remainder of the decrease in mortgage brokerage income is attributable to the downturn in the real estate market that resulted in a decrease in the volume of loan originations. For further information, refer to our discussion of the Realty segment on page 16 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 2007 was $5.46 million in 2007, a decrease of $871,000, or 13.75%, from 2006, which was $1.16 million, or 15.48%, less than 2005. The decrease in both years is attributable to the slowdown in the local housing market, which led to a lower number of home sales recorded in each successive year.

For the year ended December 31, 2007, insurance commissions and other title income, net of commission expense was $13.10 million, which was $3.10 million, or 30.96%, higher than comparative 2006. The acquisition of several group benefit agencies in 2007 accounted for $3.59 million of insurance commissions and other title income, net of commission expense. These acquisitions contributed $596,000 to net income and $3.85 million to revenue. The year ended December 31, 2007 included contingency income from property and casualty insurance of $576,000 compared to $432,000 and $417,000 for 2006 and 2005. When compared to 2005, insurance commissions for the year ended December 31, 2006 were $1.30 million, or 14.99%, higher.

Service charges on deposit accounts were $5.55 million for 2007, compared with $5.48 million and $4.37 million for 2006 and 2005, respectively. During 2007, expenses relating to debit cards of $447,000 that were previously recorded in Outside Processing Expense were reclassified to serve as a reduction of service charge revenue. Excluding these amounts from 2007, net service charges on deposits for the year ended December 31, 2007 increased $521,000, or 9.51%, compared to the same period in 2006.

The growth in credit card merchant fees reflected continued development of this service and a corresponding increase in the number of merchant accounts and the transaction volume from these accounts. For the year ended December 31, 2007, fees totaled $1.71 million, which was $293,000, or 20.68%, above comparative 2006, which was $281,000, or 24.74%, more than 2005.

Other noninterest income for the year ended December 31, 2007 was $4.76 million and included income generated by TowneBank Commercial Mortgage and Towne Investment Group, net of commission expense. For the year ended December 31, 2007, net commission income totaled $379,000 and $1.06 million for TowneBank Commercial Mortgage and Towne Investment Group, respectively. In comparison, net commission income for years ended December 31, 2006 and 2005 were $392,000 and $402,000 for TowneBank Commercial Mortgage and $877,000 and $652,000 for Towne Investment Group.

Noninterest Expense: Total noninterest expense for 2007 was $85.51 million, which was $9.46 million and 12.45% higher than 2006. The primary components of 2007 noninterest expense were salaries and employee benefits of $50.08 million, occupancy expenses of $7.69 million, furniture and equipment expenses of $4.87 million, and advertising and marketing expenses of $4.62 million. Total noninterest expense for the year ended December 31, 2006 was $76.04 million compared with $66.95 million for the year ended December 31, 2005, representing a 13.59% increase. Total noninterest expense to total operating revenue, excluding securities gains and losses, was 69.94% for the year ended December 31, 2007 compared with 67.53% for 2006 and 69.36% for 2005.

(continued on next page)

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

				2007/2006 Increase/(Decrease)		2006/2005 Increase/(Decrease)	
For the year ended December 31,	**2007**	**2006**	**2005**	**Amount**	**%**	**Amount**	**%**
Salaries and benefits	$ 50,083	$ 46,285	$ 40,553	$ 3,798	8.21%	$ 5,732	14.13%
Occupancy	7,694	6,837	6,063	857	12.53%	774	12.77%
Furniture and equipment	4,872	4,538	3,945	334	7.36%	593	15.01%
Other expenses							
Advertising and marketing	4,621	3,316	3,310	1,305	39.35%	6	0.18%
Charitable contributions	1,726	1,289	564	437	33.90%	725	128.55%
Telephone and postage	1,910	1,777	1,758	133	7.48%	19	1.08%
Outside processing	1,860	1,601	1,395	259	16.18%	206	14.77%
Professional fees	1,792	1,421	1,443	371	26.11%	(22)	(1.52%)
Other	1,741	1,166	1,533	575	49.31%	(367)	(23.94%)
Stationery and office supplies	1,707	1,712	1,420	(5)	(0.29%)	292	20.56%
Amortization expense of intangibles	1,591	1,169	1,169	422	36.10%	-	N/M
FDIC and other insurance	1,536	623	535	913	146.55%	88	16.45%
Software expense	1,363	1,057	932	306	28.95%	125	13.41%
Travel/Meals/Entertainment	1,107	963	696	144	14.95%	267	38.36%
Directors' expense	1,056	1,326	712	(270)	(20.36%)	614	86.24%
Bank franchise tax/SCC fees	848	963	920	(115)	(11.94%)	43	4.67%
Total other expenses	22,858	18,383	16,387	4,475	24.34%	1,996	12.18%
Total noninterest expense	$ 85,507	$ 76,043	$ 66,948	$ 9,464	12.45%	$ 9,095	13.59%

A portion of the increase in total noninterest expense in 2007 is due to the acquisitions of Frieden and the assets and operations of Weber. These acquisitions contributed additional expenses compared to 2006, primarily in salaries and benefits and occupancy (refer to the Insurance segment discussion and the table on page 20 for additional information regarding the financial impact of these acquisitions). Advertising and marketing expenses increased in the Banking and Realty segments as new advertising campaigns were created and implemented. Also FDIC insurance expense increased as the FDIC increased assessments to replenish the deposit insurance fund.

Salaries and employee benefits, the largest portion of noninterest expense, was $50.08 million, representing 58.57% of total noninterest expense for the year ended December 31, 2007. This was an 8.21% increase over 2006 due to the addition of employees to create and service customer growth and the addition of approximately 20 staff members resulting from the Frieden and Weber acquisitions. The increase was partially offset by the net reporting of the results of Towne Mortgage in 2007. Reporting revenues and expenditures on a gross basis would have resulted in additional salaries and benefits expenses of approximately $570,000. Salaries and benefits expense for the year ended December 31, 2006 was $46.29 million, up 14.13%, or $5.73 million, over 2005.

The number of full-time equivalent employees, excluding GSH sales agents, was 660 at December 31, 2007, as compared to 607 and 567 at December 31, 2006 and 2005, respectively. GSH sales agents are independent contractors, and therefore, not included as the Company's employees. There were 323 GSH sales agents at December 31, 2007. Total operating revenue, excluding securities gains and losses per full-time equivalent employee, was approximately $185,000, $186,000, and $170,000 for the years ended December 31, 2007, 2006, and 2005, respectively.

For the year ended December 31, 2007, occupancy expense totaled $7.69 million, representing an increase of $857,000, or 12.53%, over comparative 2006. Occupancy expense for 2006 was $774,000, or 12.77%, over the 2005 amount of $6.06 million. The acquisitions of businesses in 2007, as previously discussed, were responsible for $88,000 of the increase in occupancy expense. An additional factor in the increase was the reduction of the estimated lives of some of our leasehold improvements, resulting in an increase of amortization expense. These increases were partially offset by the effect of reporting the results of Towne Mortgage's operations on a net basis. In 2006, the Company recorded approximately $120,000 in occupancy expense related to its previous business relationship with William E. Wood & Associates.

Furniture and equipment expense was $4.87 million for 2007, or $334,000 and 7.36%, higher than 2006. Furniture and equipment expense was $4.54 million for 2006, or $593,000 and 15.01%, higher than comparative 2005. Increases in costs for equipment repair and maintenance and maintenance contracts were the largest sources of these increases. Computer equipment depreciation also increased as we replaced our older computers and servers to support newer versions of our core processing software.

Other expenses for 2007 were $22.86 million, which was $4.48 million, or 24.34%, higher than the 2006 amount of $18.38 million. Approximately one-third of the increase was due to increased marketing while the remainder of the increase reflects the growth in customer base and the resulting expenses incurred to support customer service. Other expenses for 2006 were $2.00 million, or 12.18%, higher than the 2005 amount of $16.39 million.

Income Taxes: Income taxes for the year ended December 31, 2007 were $10.82 million. This was $362,000 higher than the 2006 amount of $10.46 million, which was $921,000 higher than the 2005 amount of $9.54 million. The effective tax rate for 2007 was 31.76% versus 32.44% for 2006 and 35.05% for 2005. The 2007 effective tax rate was reduced by tax advantaged income and tax credits. Refer to Note 17 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 21 in the Notes to Consolidated Financial Statements.

Banking Segment. For the year ended December 31, 2007, the Banking segment represented 89.59%, or $20.84 million, of our total consolidated net income compared to 88.19% and 81.07% for comparative 2006 and 2005.

Pre-tax earnings for the year ended December 31, 2007 for the Banking segment was $30.34 million, increasing $2.07 million, or 7.32%, over comparative 2006. The increase was primarily due to an $8.28 million, or 10.83%, increase in net interest income from 2006 to 2007. Comparatively, pre-tax earnings for the year ended December 31, 2006 for the Banking segment was $28.27 million, increasing $6.27 million, or 28.47%, over comparative 2005.

This increase was partially offset by increases in noninterest expenses as we continued to grow and expand. The largest component of the increase in expenses was a $3.59 million increase in salaries and benefits as we hired seasoned banking professionals in order to attract additional business. The Banking segment also recorded a $1.23 million increase in advertising and marketing expenses and a $955,000 increase in FDIC insurance assessments. Also the segment's provision for loan losses increased $171,000 as our loan portfolio continued to grow, contributing to an increase in loan losses.

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

	Year Ended December 31,			Increase/(Decrease) 2007 over 2006		2006 over 2005	
	2007	**2006**	**2005**	**Amount**	**Percent**	**Amount**	**Percent**
Revenue							
Net interest income	$ 84,715	$ 76,440	$ 61,608	$ 8,275	10.83%	$ 14,832	24.07%
Service charges on deposit accounts	5,554	5,479	4,370	75	1.37%	1,109	25.38%
Credit card merchant fees	1,710	1,417	1,136	293	20.68%	281	24.74%
Other income	4,041	3,480	3,332	561	16.12%	148	4.44%
Subtotal	11,305	10,376	8,838	929	8.95%	1,538	17.40%
Gain (loss) on available for sale	70	(1,740)	14	1,810	N/M	(1,754)	N/M
Total noninterest income	11,375	8,636	8,852	2,739	31.72%	(216)	(2.44%)
Total revenue	96,090	85,076	70,460	11,014	12.95%	14,616	20.74%
Provision for loan losses	2,743	2,572	2,364	171	6.65%	208	8.80%
Expenses							
Salaries and employee benefits	36,386	32,798	27,346	3,588	10.94%	5,452	19.94%
Occupancy expense	5,215	4,664	4,082	551	11.81%	582	14.26%
Furniture and equipment	3,986	3,676	3,123	310	8.43%	553	17.71%
Advertising and marketing	3,299	2,067	2,302	1,232	59.60%	(235)	(10.21%)
Charitable contributions	1,692	1,268	564	424	33.44%	704	124.82%
Outside processing	1,602	1,473	1,257	129	8.76%	216	17.18%
FDIC and other insurance	1,426	471	444	955	202.76%	27	6.08%
Professional fees	1,326	974	1,151	352	36.14%	(177)	(15.38%)
Telephone and postage	1,284	1,105	1,115	179	16.20%	(10)	(0.90%)
Other expenses	6,807	5,740	4,709	1,067	18.59%	1,031	21.89%
Total expenses	63,023	54,236	46,093	8,787	16.20%	8,143	17.67%
Income before income tax expense and minority interest	30,324	28,268	22,003	2,056	7.27%	6,265	28.47%
Minority interest in subsidiaries	12	-	-	12	N/M	-	N/M
Income before income tax expense	30,336	28,268	22,003	2,068	7.32%	6,265	28.47%
Provision for income tax expense	9,499	9,055	7,670	444	4.90%	1,385	18.06%
Net income	$ 20,837	$ 19,213	$ 14,333	$ 1,624	8.45%	$ 4,880	34.05%

Realty Segment. For the year ended December 31, 2007, the Realty segment represented 3.92%, or $912,000, of total consolidated net income compared to 9.20%, or $2.01 million, for 2006 and 15.96%, or $2.82 million, for respective 2005. Real estate brokerage and property management income for the years ended December 31, 2007, 2006, and 2005 was reported net of commission expense totaling $10.83 million, $12.01 million, and $13.65 million, respectively, while residential mortgage brokerage income was reported net of commission expense of $3.29 million, $7.26 million, and $9.49 million for the same respective periods.

Pre-tax earnings for the year ended December 31, 2007 for the Realty segment were $1.24 million, decreasing $1.80 million, or 59.18%, over comparative 2006, which decreased $1.31 million, or 30.10%, over comparative 2005. The decrease in the earnings for the Realty segment was due to the continued overall softening of the residential real estate market in our market area compared to the record-setting levels experienced in prior years.

Additionally, we changed the way we classify the revenues and expenses in our business relationship with William E. Wood, which is now accounted for as a joint venture and is presented on a net basis. This impacted our presentation of mortgage brokerage revenue and expenses. A table providing a comparison of our joint mortgage operations with all affiliates is included in this section under "Mortgage." The following chart presents the revenue and expenses for the Realty segment (dollars in thousands).

	Year Ended December 31,			Increase/(Decrease) 2007 over 2006		Increase/(Decrease) 2006 over 2005	
	2007	2006	2005	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage brokerage income, net	$ 5,855	$ 8,495	$ 8,366	$ (2,640)	(31.08%)	$ 129	1.54%
Real estate brokerage income, net	4,530	5,529	6,700	(999)	(18.07%)	(1,171)	(17.48%)
Title insurance and settlement fees	2,695	3,517	3,756	(822)	(23.37%)	(239)	(6.36%)
Property management fees, net	932	804	793	128	15.92%	11	1.39%
Income from Towne Mortgage, net	432	-	-	432	N/M	-	N/M
Net interest and other income	937	1,071	1,455	(134)	(12.51%)	(384)	(26.39%)
Total revenue	15,381	19,416	21,070	(4,035)	(20.78%)	(1,654)	(7.85%)
Expenses							
Salaries and employee benefits	7,566	9,215	9,996	(1,649)	(17.89%)	(781)	(7.81%)
Occupancy expense	2,030	1,977	1,839	53	2.68%	138	7.50%
Furniture and equipment	626	666	676	(40)	(6.01%)	(10)	(1.48%)
Amortization of intangible assets	449	475	650	(26)	(5.47%)	(175)	(26.92%)
Other expenses	3,470	4,045	3,563	(575)	(14.22%)	482	13.53%
Total expenses	14,141	16,378	16,724	(2,237)	(13.66%)	(346)	(2.07%)
Income before income tax expense	1,240	3,038	4,346	(1,798)	(59.18%)	(1,308)	(30.10%)
Provision for income tax expense	328	1,033	1,524	(705)	(68.25%)	(491)	(32.22%)
Net income	$ 912	$ 2,005	$ 2,822	$ (1,093)	(54.51%)	$ (817)	(28.95%)

The following chart shows the key data for the Realty segment.

	Year Ended December 31,			Increase/(Decrease) 2007 over 2006		Increase/(Decrease) 2006 over 2005	
	2007	**2006**	**2005**	**Amount**	**Percent**	**Amount**	**Percent**
Key data							
Number of homes sold	2,161	2,630	3,416	(469)	(17.83%)	(786)	(23.01%)
Volume of homes sold ($ in thousands)	$ 216,168	$ 248,255	$ 295,764	$ (32,087)	(12.93%)	$ (47,509)	(16.06%)
Number of real estate agents	323	313	324	10	3.19%	(11)	(3.40%)
Loans originated, mortgage	$ 383,731	$ 625,732	$ 698,667	$ (242,001)	(38.67%)	$ (72,935)	(10.44%)
Loans originated, joint venture	196,415	-	-	196,415	N/M	-	N/M
Total loans originated	$ 580,146	$ 625,732	$ 698,667	$ (45,586)	(7.29%)	$ (72,935)	(10.44%)
Number of loans, mortgage	1,596	2,887	3,616	(1,291)	(44.72%)	(729)	(20.16%)
Number of loans, joint venture	877	-	-	877	N/M	-	N/M
Total number of loans	2,473	2,887	3,616	(414)	(14.34%)	(729)	(20.16%)
Average loan amount, mortgage	$ 240	$ 217	$ 193	$ 23	10.60%	$ 24	12.44%
Average loan amount, joint venture	224	-	-	224	N/M	-	N/M
Average loan amount	$ 235	$ 217	$ 193	$ 18	8.29%	$ 24	12.44%
Average number of originators, mortgage	26	41	41	(15)	(36.59%)	-	-
Average number of originators, joint venture	17	-	-	17	N/M	-	N/M
Average number of originators	43	41	41	2	4.88%	-	N/M

Mortgage. The loan volume for the combined mortgage operations decreased for the year ended December 31, 2007 compared to the same period 2006 as a result of the continual softening of the residential real estate market compared to record-setting levels experienced in prior years. Total loans originated in 2007 were $580.15 million, a 7.29% decrease, or $45.59 million, from $625.73 million in 2006. This was a $72.94 million, or 10.44%, decrease compared to the 2005 volume of $698.67 million.

Combined mortgage operations pre-tax net income for 2007 was $2.03 million, or 0.35%, of closed loan volume compared to $2.14 million, or 0.34%, of closed loan volume for 2006. While our pre-tax income decreased for 2007, pre-tax net income as a percentage of closed loan volume was comparable to 2006.

The following table provides an analysis of the total production, revenue, and expenses of our combined mortgage operations along with payments to affiliates for revenue sharing (dollars in thousands).

For the year ended December 31,	2007		2006		2007 vs 2006 Change	
Revenue	Consolidated	% of closed volume	Consolidated	% of closed volume	$	%
Total mortgage brokerage income	$ 14,768	2.55%	$ 16,514	2.64%	$ (1,746)	(10.57%)
Total cost of loans sold	5,240	0.90%	6,185	0.99%	(945)	(15.28%)
Net mortgage-related income	9,528	1.65%	10,329	1.65%	(801)	(7.75%)
Net interest income	533	0.09%	547	0.09%	(14)	(2.56%)
Total revenue	10,061	1.74%	10,876	1.74%	(815)	(7.49%)
Expenses						
Salaries and benefits	4,208	0.73%	4,094	0.65%	114	2.78%
Occupancy	443	0.08%	528	0.09%	(85)	(16.10%)
Furniture, fixtures, & equipment	377	0.06%	375	0.06%	2	0.53%
Other	1,338	0.23%	1,577	0.25%	(239)	(15.16%)
Total expenses	6,366	1.10%	6,574	1.05%	(208)	(3.16%)
Net income before revenue sharing agreements and income tax expense	3,695	0.64%	4,302	0.69%	(607)	(14.11%)

Real Estate. As a result of home sales slowing in our market area, net real estate brokerage income decreased $1.00 million, or 18.08%, for the year ended December 31, 2007 compared to the same period in 2006. The number of home sales sold decreased 17.83% and the dollar volume of these home sales decreased 12.93%. This slowing resulted in an increase in rentals, which had a positive impact on property management, as net property management income increased $128,000, or 15.92%, for the year ended December 31, 2007 compared to 2006. The decrease in the number of home sales also resulted in an $822,000, or 23.37%, decrease in title insurance and settlement fees.

The following chart shows the revenue and expenses from the real estate reporting unit (dollars in thousands).

	Year Ended December			Increase/(Decrease)			
				2007 over 2006		2006 over 2005	
	2007	2006	2005	Amount	Percent	Amount	Percent
Revenue							
Residential mortgage brokerage income, net	$ 290	$ 333	$ 388	$ (43)	(12.91%)	$ (55)	(14.18%)
Real estate brokerage income, net	4,530	5,530	6,700	(1,000)	(18.08%)	(1,170)	(17.46%)
Title insurance and settlement fees	2,695	3,517	3,756	(822)	(23.37%)	(239)	(6.36%)
Property management fees, net	932	804	792	128	15.92%	12	1.52%
Net interest and other income	374	524	653	(150)	(28.63%)	(129)	(19.75%)
Total revenue	8,821	10,708	12,289	(1,887)	(17.62%)	(1,581)	(12.87%)
Expenses							
Salaries and employee benefits	4,623	5,121	6,074	(498)	(9.72%)	(953)	(15.69%)
Occupancy expense	1,617	1,449	1,310	168	11.59%	139	10.61%
Furniture and equipment	381	291	274	90	30.93%	17	6.20%
Amortization of intangible assets	449	475	650	(26)	(5.47%)	(175)	(26.92%)
Other expenses	2,527	2,469	2,146	58	2.35%	323	15.05%
Total expenses	9,597	9,805	10,454	(208)	(2.12%)	(649)	(6.21%)
Net income before tax expense	(776)	903	1,835	(1,679)	(185.94%)	(932)	(50.79%)
Provision for income tax expense	(309)	358	730	(667)	(186.31%)	(372)	(50.96%)
Net income	$ (467)	$ 545	$ 1,105	$ (1,012)	(185.69%)	$ (560)	(50.68%)

Insurance Segment. The Insurance segment is comprised of property and casualty and group benefits divisions. Several group benefit agencies were acquired in 2007 that resulted in substantial growth for this division as shown in the table on page 20 (refer to Note 2, Mergers and Acquisitions, of the Notes to Consolidated Financial Statements).

The Insurance segment represented 6.49%, or $1.51 million, of total consolidated net income in 2007; 2.61%, or $568,000, in 2006; and 2.97%, or $525,000, in 2005. Insurance commissions for the years ended December 31, 2007, 2006, and 2005 are reported net of commission expense of $1.91 million, $1.34 million, and $804,000, respectively.

Pre-tax earnings for the Insurance segment were $2.51 million in 2007, increasing $1.57 million, or 166.14%, over 2006. The increase in the pre-tax earnings for the Insurance segment was attributable to organic growth in continuing operations, which increased by $579,000 and earnings of $991,000 related to the acquisitions made during this period.

Net commissions for our property and casualty division increased $402,000 for the year ended December 31, 2007 compared to the same period of 2006. For our group benefits division, the increase was $3.61 million, mainly due to the 2007 acquisitions.

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

	Year Ended December 31,			Increase/(Decrease)			
				2007 over 2006		2006 over 2005	
	2007	2006	2005	Amount	Percent	Amount	Percent
Revenue							
Net commission and fee income							
Property and casualty	$ 5,450	$ 5,048	$ 3,609	$ 402	7.96%	$ 1,439	39.87%
Group benefits	4,335	730	676	3,605	493.84%	54	7.99%
Specialized Benefit Services	131	-	-	131	N/M	-	N/M
Total net commissions and fees	9,916	5,778	4,285	4,138	71.62%	1,493	34.84%
Contingency and bonus revenue	621	487	417	134	27.52%	70	16.79%
Other income	313	106	301	207	195.28%	(195)	(64.78%)
Total revenue	10,850	6,371	5,003	4,479	70.30%	1,368	27.34%
Expenses							
Salaries and employee benefits	6,058	4,201	3,148	1,857	44.20%	1,053	33.45%
Occupancy expense	449	196	142	253	129.08%	54	38.03%
Furniture and equipment	260	196	146	64	32.65%	50	34.25%
Amortization of intangible assets	381	125	150	256	204.80%	(25)	(16.67%)
Other expenses	1,195	711	545	484	68.07%	166	30.46%
Total expenses	8,343	5,429	4,131	2,914	53.67%	1,298	31.42%
Income before income tax expense	2,507	942	872	1,565	166.14%	70	8.03%
Provision for income tax expense	997	374	347	623	166.58%	27	7.78%
Net income	$ 1,510	$ 568	$ 525	$ 942	165.85%	$ 43	8.19%

We acquired several employee benefit agencies in 2007. The following table shows the results of operations of these newly acquired companies as included in our Consolidated Statements of Income for the year ended December 31, 2007 (in thousands).

Net commission and fees - group benefits	$ 3,587
Specialized benefit services	131
Other income	133
Total revenue	3,851
Salaries and employee benefits	2,072
Occupancy expense	88
Furniture and equipment	32
Amortization of intangible assets	263
Other expenses	405
Total expenses	2,860
Income before income tax expense	991
Provision for income tax expense	395
Net income	$ 596

Salaries and employee benefits expense increased $1.86 million, or 44.20%, when comparing 2007 to 2006, which increased $1.05 million, or 33.45%, compared to 2005. This increase is due mainly to acquisitions, which caused an increase of $2.07 million, but was partially offset by the restructuring of compensation for certain employees. This restructuring resulted in the reclassification of compensation expense from salaries to commission expense, causing a decrease in salaries of $200,000.

Occupancy expense increased $253,000, or 129.08%, when comparing 2007 to 2006, which increased $54,000, or 38.03%, over 2005. Additional office space to house property and casualty agents contributed $140,000 to this expense. Some of these agents have relocated to our bank branches to further enhance the cross-sell opportunities between the bank, insurance, and other segments. As shown on the table on page 20, the benefit agency acquisitions accounted for $88,000 of the increase.

Other expenses increased $484,000, 68.07%, during the year ended December 31, 2007 compared to the same period in 2006, which increased $166,000, or 30.46%, over 2005. Of this increase, $405,000 was attributable to the 2007 acquisitions.

ANALYSIS OF FINANCIAL CONDITION

Overview: Our total assets increased $306.49 million, or 13.97%, to $2.50 billion at December 31, 2007 from $2.19 billion at December 31, 2006. The increase was supported by growth in the loan portfolio, which increased $187.63 million, or 11.43%, to $1.83 billion at December 31, 2007 from $1.64 billion at December 31, 2006.

Our total average assets were $2.39 billion for 2007, reflecting an increase of $405.86 million, or 20.48%, compared to the 2006 average of $1.98 billion. Total average assets for 2006 increased $351.98 million, or 21.60%, compared to the 2005 average of $1.63 billion. Major balance sheet categories with increases in average balances include loans, up $302.51 million, or 21.02%, and securities, which increased $40.81 million, or 12.72%, over 2006. Additionally, average earning assets were $2.17 billion in 2007, reflecting an increase of $386.62 million, or 21.66%, compared to 2006.

Our average total deposits were $1.78 billion in 2007, reflecting growth of $196.77 million, or 12.43%, compared to 2006. Interest-bearing deposits, which increased $177.46 million, or 15.46%, grew at a higher rate than noninterest-bearing deposits in 2007.

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 of 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, as of December 31, 2007, totaled $380.14 million, reflecting a balance of $280.43 million in securities available-for-sale and $99.72 million of securities held-to-maturity. Average yield on available-for-sale securities was 5.62% in 2007, 5.52% in 2006, and 3.70% in 2005. Average yield on held-to-maturity investments was 4.45% in 2007 as compared to 4.72% in 2006 and 4.73% in 2005.

During the fourth quarter of 2006, we restructured our investment portfolio to take advantage of the yield curve environment, which partially accounts for the increase in 2007 yields and resulted in a $3.7 million positive rate variance in 2007.

Our available-for-sale portfolio consisted of agency securities, municipal securities, mortgage-backed securities, and equity securities, while the held-to-maturity portfolio consisted of trust preferred corporate debt, treasuries, municipal bonds, and industrial revenue bonds. Our investment activities are governed internally by a written, board-approved investment policy, which is carried out by our 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,	2007			2006			2005		
	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	$ 125,760	$ 126,974	5.49%	$ 127,865	$ 128,343	5.31%	$ 253,314	$ 249,791	3.61%
U.S. Treasury notes	-	-	-	-	-	-	999	998	2.60%
Municipal securities	2,740	2,859	5.23%	3,749	3,850	6.90%	3,750	3,800	5.07%
Corporate obligations	-	-	-	605	605	9.63%	605	607	9.63%
Other investments	161	86	-	126	88	-	242	199	-
FHLBank stock[1]	17,305	17,305	6.00%	10,013	10,013	5.90%	4,781	4,781	4.60%
Mortgage-backed securities	131,274	133,204	5.71%	111,905	112,775	5.66%	13,392	13,247	4.65%
Total securities available-for-sale	277,240	280,428	5.62%	254,263	255,674	5.52%	277,083	273,423	3.70%
Securities Held-to-Maturity:									
U.S. Treasury securities	2,001	2,026	4.78%	3,993	3,984	4.17%	3,948	3,934	4.17%
Trust preferred	5,524	5,998	8.99%	5,520	6,213	8.96%	5,517	6,208	9.00%
Municipal bonds	16,863	16,867	3.53%	16,694	16,517	3.36%	15,603	15,326	3.30%
Industrial revenue bonds	75,328	73,376	4.32%	63,329	63,329	4.26%	11,116	11,116	4.75%
Total securities held-to-maturity	99,716	98,267	4.45%	89,536	90,043	4.72%	36,184	36,584	4.73%
Total Portfolio	$ 376,956	$ 378,695	5.31%	$ 343,799	$ 345,717	5.22%	$ 313,267	$ 310,007	3.82%

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

The following table indicates the maturities of securities at December 31, 2007 (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	$ -	$ -	-	$ 2,001	$ 2,026	4.87%
After one year through five years	61,979	62,174	5.31%	-	-	-
After five years through ten years	48,960	49,576	5.66%	-	-	-
After ten years	14,821	15,224	5.78%	-	-	-
Municipal securities						
Due in one year or less	-	-	-	2,960	2,951	2.95%
After one year through five years	-	-	-	10,395	10,374	3.51%
After five years through ten years	500	504	4.13%	780	785	4.23%
After ten years	2,240	2,355	5.48%	2,728	2,757	4.02%
Mortgage-backed securities						
Due in one year or less	272	272	4.58%	-	-	-
After one year through five years	1,330	1,311	4.00%	-	-	-
After five years through ten years	1,857	1,861	4.62%	-	-	-
After ten years	127,815	129,760	5.81%	-	-	-
Trust preferred						
After ten years	-	-	-	5,524	5,998	8.99%
Industrial revenue bonds						
Due in one year or less	-	-	-	4,952	4,952	4.29%
After one year through five years	-	-	-	9,284	9,016	4.07%
After five years through ten years	-	-	-	10,812	10,500	4.40%
After ten years	-	-	-	50,280	48,908	4.36%
Other securities						
No stated maturity	17,466	17,391	5.94%	-	-	-
Total Portfolio	$ 277,240	$ 280,428	5.62%	$ 99,716	$ 98,267	4.45%

Loans Held for Sale: At December 31, 2007, we held $22.95 million in mortgage loans originated and intended for sale in the secondary market, compared with $16.72 million at December 31, 2006. Average loans held for sale were 0.90% and 0.99% of average earning assets for the years ended December 31, 2007 and 2006, 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 $1.81 billion on December 31, 2007. As a percentage of total average earning assets, average loans were 80.20% in 2007 compared with 80.62% in 2006 and 81.00% in 2005. Lending activities represent our primary source of income. Factors that contributed to the increase in our loan demand were our local economy and the efforts of our experienced loan officers in developing new loan relationships combined with the support of existing customers. The following tables provide the balance and composition of the loan portfolio by major classification (dollars in thousands).

Year ended December 31,	2007	2006	2005	2004	2003
Real estate loans					
Residential 1-4 family	$ 439,676	$ 362,034	$ 297,452	$ 278,660	$ 171,044
Commercial	561,341	364,657	275,027	253,597	144,374
Construction	522,780	529,933	377,246	279,591	151,809
Multifamily	27,515	17,919	8,247	11,716	5,662
Total real estate loans	1,551,312	1,274,543	957,972	823,564	472,889
Commercial Loans	218,082	306,437	256,776	237,504	152,014
Consumer installment loans					
Personal	42,702	41,784	30,160	33,045	24,565
Credit lines	17,360	18,885	19,382	16,659	14,808
Total consumer installment loans	60,062	60,669	49,542	49,704	39,373
Agriculture loans	-	177	202	229	650
Loans, net of unearned income and deferred costs	$ 1,829,456	$ 1,641,826	$ 1,264,492	$ 1,111,001	$ 664,926

Year ended December 31,	2007	2006	2005	2004	2003
Real estate loans					
Residential 1-4 family	24.03%	22.05%	23.52%	25.08%	25.72%
Commercial	30.68%	22.21%	21.75%	22.83%	21.71%
Construction	28.58%	32.28%	29.83%	25.17%	22.83%
Multifamily	1.50%	1.09%	0.65%	1.05%	0.85%
Total real estate loans	84.80%	77.63%	75.75%	74.13%	71.12%
Commercial Loans	11.92%	18.66%	20.31%	21.38%	22.86%
Consumer installment loans					
Personal	2.33%	2.54%	2.39%	2.97%	3.69%
Credit lines	0.95%	1.15%	1.53%	1.50%	2.23%
Total consumer installment loans	3.28%	3.71%	3.92%	4.47%	5.92%
Agriculture loans	-	-	0.02%	0.02%	0.10%
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, 2007 (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	$ 63,334	$ 51,239	$ 325,103	$ 439,676	$ 205,933	$ 170,409
Commercial	179,667	211,148	170,526	561,341	346,154	35,520
Construction	391,770	119,896	11,114	522,780	51,081	79,929
Multifamily	10,598	9,806	7,111	27,515	16,862	55
Total real estate loans	645,369	392,089	513,854	1,551,312	620,030	285,913
Commercial Loans	118,354	73,711	26,017	218,082	83,361	16,367
Consumer installment loans						
Personal	10,218	28,658	3,826	42,702	30,504	1,980
Credit lines	16,169	1,190	1	17,360	457	734
Total consumer installment loans	26,387	29,848	3,827	60,062	30,961	2,714
Loans, net of unearned income and deferred costs	$ 790,110	$ 495,648	$ 543,698	$ 1,829,456	$ 734,352	$ 304,994

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 and peer bank reviews. 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 economic conditions, historical loan loss experience (internal and of peer banks), and other current factors that warrant consideration in determining an adequate allowance. It is our policy to assign internal risk grades to all loans as a component of the approval process. Based on the size of the loan, senior credit officers and the loan committee may review the classification to ensure accuracy and consistency of classification.

Loan classifications are internally reviewed to determine if any changes in the circumstances of the loan require a different risk grade. To determine the most appropriate risk grade classification for each loan, the credit officers examine the borrower's liquidity level, asset quality, the amount of the borrower's other indebtedness, cash flow, earnings, sources of financing, and existing lending relationships.

The allowance for loan losses at December 31, 2007, 2006, and 2005 was $21.32 million, $19.67 million, and $17.07 million, respectively. The allowance was equal to 1.17% of total loans outstanding at December 31, 2007, compared with 1.20% and 1.35% for 2006 and 2005, respectively.

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

Year ended December 31,	**2007**	**2006**	**2005**	**2004**	**2003**
Balance beginning of period	$ 19,670	$ 17,071	$ 14,999	$ 8,976	$ 6,877
Loans charged-off:					
Residential 1-4 family	(474)	(7)	(5)	(59)	(59)
Construction	-	(6)	(3)	(120)	(28)
Commercial	(409)	(153)	(483)	(933)	(505)
Consumer	(285)	(48)	(65)	(104)	(206)
Total	(1,168)	(214)	(556)	(1,216)	(798)
Loans recovered:					
Residential 1-4 family	2	32	60	4	94
Construction	-	-	16	28	-
Commercial	50	176	117	581	18
Consumer	26	33	71	113	23
Total	78	241	264	726	135
Net loans (charged-off)/recovered	(1,090)	27	(292)	(490)	(663)
Provision for loan losses	2,743	2,572	2,364	2,604	2,762
Balance end of period	$ 21,323	$ 19,670	$ 17,071	$ 14,999	$ 8,976
Nonperforming assets:					
Nonperforming loans	$ 726	$ 636	$ 213	$ 309	$ 203
Foreclosed property	1,570	400	400	400	150
Total nonperforming assets	$ 2,296	$ 1,036	$ 613	$ 709	$ 353
Loans past due 90 days accruing interest	$ 32	$ 459	$ 145	$ 14	$ 53
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	29.37x	30.93x	80.15x	48.54x	44.21x
Allowance for loan losses to period end loans	1.17%	1.20%	1.35%	1.35%	1.35%
Nonperforming loans to period end loans	0.04%	0.04%	0.02%	0.03%	0.03%
Nonperforming assets to period end assets	0.09%	0.05%	0.03%	0.05%	0.04%
Net (charge-offs)/recoveries to average loans	(0.06%)	-	(0.02%)	(0.05%)	(0.11%)

Nonperforming assets include nonaccrual loans, foreclosed real estate, and other repossessed collateral. It is our policy to place commercial loans on nonaccrual status when full collection of principal and interest becomes doubtful, or when any portion of principal or interest becomes 120 days past due, whichever occurs first, unless the debt is both well-secured and in the process of collection. When loans are placed on nonaccrual status, interest receivable is reversed against interest income recognized in the current period, and any prior year unpaid interest is charged off against the allowance for loan losses. Interest payments received thereafter are applied as a reduction of the remaining principal balance so long as doubt exists as to the ultimate collection of the principal. Loans are removed from nonaccrual status when they become current as to both principal and interest and when the collection of principal or interest is no longer doubtful. Similarly, mortgage loans and other consumer loans are also placed on nonaccrual status when full collection of principal and interest becomes doubtful, or they become delinquent for a specified period of time.

Nonperforming assets consist of $726,000 in nonperforming loans as well as $1.57 million in foreclosed property at December 31, 2007. Foreclosed property consists of four different residential properties; one of which is currently under a contract to sell. Additionally, loans past due 90 days or more that are accruing interest totaled $32,000. As of December 31, 2007, all loans 60 to 89 days delinquent, including nonperforming loans, totaled $189,000. Additionally, there are other performing loans, totaling $33.64 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 $1.59 million, which represents management's estimate of total potential loss of these loans, these loans are generally secured with appraised values that exceed the remaining principal balances on such loans.

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

At December 31, 2007, 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 (in thousands).

Year Ended December 31,	**2007**	**2006**	**2005**	**2004**	**2003**
Real estate loans:					
Residential 1-4 family	$ 3,846	$ 3,242	$ 3,055	$ 2,814	$ 1,664
Commercial	5,129	3,520	3,018	2,738	1,506
Construction	5,810	5,116	4,139	3,019	1,584
Multifamily	228	155	82	115	53
Total real estate loans	15,013	12,033	10,294	8,686	4,807
Commercial Loans	4,895	6,207	5,539	5,082	3,197
Consumer installment loans:					
Personal	1,007	972	741	806	590
Credit lines	408	455	493	420	368
Total consumer installment loans	1,415	1,427	1,234	1,226	958
Agriculture loans	-	3	4	5	14
Total	$ 21,323	$ 19,670	$ 17,071	$ 14,999	$ 8,976

In the opinion of management, the allowance was adequate at December 31, 2007, based on known conditions. However, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, and changes in general economic conditions and other risk factors.

Allowance for Loan Losses Policy and Methodology: Our objective is to maintain a loan portfolio that is diverse in terms of loan type, industry concentration, and borrower concentration in order to reduce overall credit risk by minimizing the adverse impact of any single event or combination of related events.

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

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

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

Deposit accounts held as of December 31, 2007 totaled $1.83 billion. This represented an increase of $129.65 million, or 7.61%, over 2006, which was $236.97 million, or 16.15%, over 2005. Overall growth in deposits is primarily attributed to an increase in the Banking segment customer base and in the number of accounts. Deposit accounts represent our primary source of funds and are provided by individuals, professionals, and small- to medium-sized businesses in the Greater Hampton Roads area. The deposits consist of demand deposits, interest-bearing checking accounts, money market deposit accounts, and time deposits. We have no brokered deposits.

(continued on next page)

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 (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,	**2007**	**2006**	**2005**	**2007**	**2006**	**2005**
Noninterest-bearing demand deposits	$ 453,799	$ 434,490	$ 389,658	-	-	-
Demand and money markets	483,207	478,947	438,356	2.78%	2.65%	1.61%
Savings	24,246	23,181	24,967	1.65%	1.32%	0.79%
Certificates of deposit:						
Less than $100,000	336,729	305,603	251,172	4.74%	4.20%	3.39%
$100,000 or more	481,437	340,426	202,323	4.91%	4.57%	3.15%
Total interest-bearing deposits	1,325,619	1,148,157	916,818	4.10%	3.60%	2.42%
Total deposits	$1,779,418	$1,582,647	$1,306,476	3.05%	2.61%	1.69%

Maturities of CD's $100,000 and Greater at December 31, 2007

	Amount	Percent
Three months or less	$ 215,166	41.35%
Over three months through twelve months	287,661	55.29%
Over twelve months through three years	15,173	2.92%
Over three years	2,306	0.44%
Total	$ 520,306	100.00%

Average noninterest-bearing demand deposits as a percentage of average total deposits were 25.50% during the year ended December 31, 2007 and 27.45% and 29.83% during the same period in 2006 and 2005, respectively. This change is attributed to more competition for funds within the community and has led to an increased cost of funds due to a change in funding mix towards a higher proportion of certificates of deposit. The average cost of interest-bearing deposits was 4.10% for the year ended December 31, 2007 compared with 3.60% for 2006 and 2.42% for 2005.

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 $261.04 million and $82.30 million for the years ended December 31, 2007 and 2006, respectively. The increase in borrowed funds was primarily due to the need to fund loan growth, which outpaced deposit growth during 2007. During the second quarter of 2007, we restructured our borrowings at the FHLB, which decreased our average borrowing cost 112 basis points over comparative 2006. 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, 2007 were $41.67 million and included a convertible debenture premium of $542,000 recorded as part of our acquisition of Harbor Bank in 2004. At December 31, 2006, the debentures totaled $42.47 million and included a convertible debenture premium of $829,000. Average total convertible subordinated capital debentures for the year ended December 31, 2007 were $42.12 million compared with $42.76 million for 2006. The average cost of these debentures was 5.35% and 5.32%, respectively. Refer to Note 9 of the Notes to Consolidated Financial Statements for information on convertible subordinated capital debentures.

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

We maintained an average of $48.85 million outstanding in overnight interest-bearing deposits during 2007 compared with $7.40 million for 2006. We intend to maintain sufficient liquidity at all times to meet our funding commitments and growth plans. During 2007, we funded our growth in total assets with deposit growth and increased borrowings.

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. 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, 2007 (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	$ 34,462	$ 3,704	$ 7,636	$ 7,105	$ 16,017
Other long-term liabilities reflected on the registrant's balance sheet under GAAP					
FHLB Advances	296,665	2,753	33,000	912	260,000
Convertible subordinated capital debentures	41,669	-	542	-	41,127
Other commitments					
Standby letters of credit	21,700	21,700	-	-	-
Commitments to extend credit	992,061	992,061	-	-	-
Total contractual obligations	$ 1,386,557	$ 1,020,218	$ 41,178	$ 8,017	$ 317,144

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 the operating income to average total assets and average shareholders' equity and average equity to average assets are as follows.

Year ended December 31,	2007	2006	2005
Return on average assets	0.97%	1.10%	1.09%
Return on average equity	9.60%	9.86%	8.72%
Average equity to average assets	10.14%	11.15%	12.45%
Dividend payout ratio, as a percentage of previous year's net income	26.68%	30.64%	25.63%

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, 2007, we had $470.93 million more assets than liabilities subject to repricing within one year, and therefore, were in an asset-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	3.99%
- 200 basis points	(5.37%)

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 the 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	$ 16,250
- 200 basis points	$ (66,382)

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,	2007	2006
Return on average assets (GAAP basis)	0.97%	1.10%
Impact of excluding average goodwill and other intangibles and amortization	0.03%	0.03%
Return on average tangible assets	1.00%	1.13%
Return on average equity (GAAP basis)	9.60%	9.86%
Impact of excluding average goodwill and other intangibles and amortization	3.61%	3.47%
Return on average tangible equity	13.21%	13.33%

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,	2007	2006
Book value (GAAP basis)	$ 10.66	$ 9.75
Impact of excluding average goodwill and other intangibles and amortization	(2.83)	(2.42)
Tangible book value	$ 7.83	$ 7.33

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,	2007	2006
Efficiency ratio (GAAP basis)	69.90%	68.59%
Impact of excluding securities gains/(losses)	0.04%	(1.06%)
Efficiency ratio, as reported	69.94%	67.53%

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
TowneBank

We have audited the accompanying consolidated balance sheets of ***TowneBank*** and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. ***TowneBank's*** management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ***TowneBank*** as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), ***TowneBank's*** internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 29, 2008 expressed an unqualified opinion.

/s/ Goodman and Company, LLP

Norfolk, Virginia
February 29, 2008

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. 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, 2007, 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, 2007.

Financial Statements

Our management is responsible for the preparation, integrity, and fair presentation of our published consolidated financial statements as of December 31, 2007 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 the 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, 2007.

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.

February 29, 2008

/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

TOWNEBANK

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except share data)
December 31, 2007 and 2006

ASSETS

	2007	2006
Cash and due from banks	$ 33,400	$ 45,448
Interest-bearing deposits in financial institutions	35,935	5,324
Federal funds sold	-	829
Total Cash and Cash Equivalents	69,335	51,601
Securities available-for-sale, at fair value	280,428	255,674
Securities held-to-maturity, at amortized cost	99,716	89,536
Total Securities	380,144	345,210
Mortgage loans held for sale	22,953	16,717
Loans, net of unearned income	1,829,456	1,641,826
Less: allowance for loan losses	(21,323)	(19,670)
Net Loans	1,808,133	1,622,156
Premises and equipment, net	74,931	67,226
Goodwill	56,334	51,245
Other intangibles	11,735	5,803
Bank-owned life insurance policies	42,521	5,918
Other assets	34,992	28,709
TOTAL ASSETS	$ 2,501,078	$ 2,194,585

LIABILITIES AND SHAREHOLDERS' EQUITY

	2007	2006
Deposits:		
Noninterest-bearing demand	$ 439,122	$ 453,451
Interest-bearing:		
Demand and money market accounts	508,028	498,431
Savings	24,361	21,868
Certificates of deposit:		
Less than $100,000	342,529	311,909
$100,000 and more	520,306	419,040
Total Deposits	1,834,346	1,704,699
Advances from the Federal Home Loan Bank	296,665	142,363
Convertible subordinated capital debentures	41,669	42,469
Repurchase agreements and other borrowings	36,660	34,674
Total Borrowings	374,994	219,506
Other liabilities	34,882	40,363
TOTAL LIABILITIES	2,244,222	1,964,568
Preferred stock, $5.00 par value		
Authorized and unissued shares - 2,000,000	-	-
Common stock, $1.667 par value		
Authorized shares - 45,000,000		
Issued and outstanding shares 24,104,418 in 2007		
and 23,601,356 in 2006	40,182	39,343
Capital surplus	168,364	159,023
Retained earnings	46,227	30,734
Accumulated other comprehensive income	2,083	917
TOTAL SHAREHOLDERS' EQUITY	256,856	230,017
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 2,501,078	$ 2,194,585

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, 2007, 2006, and 2005

	2007	2006	2005
INTEREST INCOME:			
Loans, including fees	$ 132,993	$ 111,032	$ 79,369
Investment securities	19,190	13,723	7,163
Interest-bearing deposits in financial institutions and federal funds sold	2,429	368	1,526
Mortgage loans held for sale	1,312	1,217	1,421
Total interest income	155,924	126,340	89,479
INTEREST EXPENSE:			
Deposits	54,341	41,382	22,142
Advances from the Federal Home Loan Bank	12,391	4,688	2,481
Convertible subordinated capital debentures	2,253	2,274	2,110
Repurchase agreements and other borrowings	1,440	954	303
Total interest expense	70,425	49,298	27,036
Net interest income	85,499	77,042	62,443
PROVISION FOR LOAN LOSSES	2,743	2,572	2,364
Net interest income after provision for loan losses	82,756	74,470	60,079
NONINTEREST INCOME:			
Residential mortgage brokerage income, net	6,164	8,846	8,808
Real estate brokerage and property management income, net	5,462	6,333	7,493
Insurance commissions and other title fees and income, net	13,101	10,004	8,700
Service charges on deposit accounts	5,554	5,479	4,370
Credit card merchant fees, net	1,710	1,417	1,136
Other income	4,761	3,482	3,569
Gain/(loss) on securities available-for-sale	70	(1,740)	14
Total noninterest income	36,822	33,821	34,090
NONINTEREST EXPENSE:			
Salaries and employee benefits	50,083	46,285	40,553
Occupancy	7,694	6,837	6,063
Furniture and equipment	4,872	4,538	3,945
Other expenses	22,858	18,383	16,387
Total noninterest expense	85,507	76,043	66,948
Income before income tax expense & minority interest	34,071	32,248	27,221
Minority interest in net income of unconsolidated subsidiaries	12	-	-
Income before income tax expense	34,083	32,248	27,221
Provision for income tax expense	10,824	10,462	9,541
Net income	$ 23,259	$ 21,786	$ 17,680
Per common share information			
Basic earnings	$ 0.98	$ 0.93	$ 0.790
Diluted earnings	$ 0.92	$ 0.86	$ 0.740
Cash dividends declared	$ 0.32	$ 0.53	$ 0.126

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(dollars in thousands, except share data)
For the Years Ended December 31, 2007, 2006, and 2005

	Common Shares	Common Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total
Balance, December 31, 2004	**21,782,010**	**$ 36,311**	**$ 131,689**	**$ 21,427**	**$ (906)**	**$ 10,306**	**$ 188,521**
Net Income	-	-	-	17,680	-	17,680	17,680
Unrealized loss on securities, net of tax benefit of $791	-	-	-	-	(1,474)	(1,474)	(1,474)
Cash dividends declared	-	-	-	(2,891)	-	-	(2,891)
Distribution of stock dividend	669,259	1,115	13,639	(14,783)	-	-	(29)
Director's deferred compensation	(125,709)	(210)	(1,818)	-	-	-	(2,028)
Issuance of common stock - stock compensation plans	279,568	466	2,854	-	-	-	3,320
Issuance of common stock	406,398	678	8,209	-	-	-	8,887
Balance, December 31, 2005	**23,011,526**	**38,360**	**154,573**	**21,433**	**(2,380)**	**16,206**	**211,986**
Net Income	-	-	-	21,786	-	21,786	21,786
Unrealized gain on securities, net of tax expense of $1,775	-	-	-	-	3,297	3,297	3,297
Cash dividends declared	-	-	-	(12,545)	-	-	(12,545)
Director's deferred compensation	(32,749)	(55)	(618)	-	-	-	(673)
Issuance of common stock - stock compensation plans	478,878	797	2,325	-	-	-	3,122
Issuance of common stock	143,701	241	2,743	60	-	-	3,044
Balance, December 31, 2006	**23,601,356**	**39,343**	**159,023**	**30,734**	**917**	**25,083**	**230,017**
Net Income	-	-	-	23,259	-	23,259	23,259
Unrealized gain on securities, net of tax expense of $627	-	-	-	-	1,166	1,166	1,166
Cash dividends declared	-	-	-	(7,766)	-	-	(7,766)
Director's deferred compensation	(42,178)	(70)	(739)	-	-	-	(809)
Issuance of common stock - stock compensation plans	143,867	241	3,351	-	-	-	3,592
Issuance of common stock - business acquisition	65,480	115	1,144	-	-	-	1,259
Issuance of common stock	335,893	553	5,585	-	-	-	6,138
Balance, December 31, 2007	**24,104,418**	**$ 40,182**	**$ 168,364**	**$ 46,227**	**$ 2,083**	**$ 24,425**	**$ 256,856**

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
For the Years Ended December 31, 2007, 2006, and 2005

OPERATING ACTIVITIES:	**2007**	**2006**	**2005**
Net income	$ 23,259	$ 21,786	$ 17,680
Adjustments to reconcile net income to net cash from operating activities:			
Net amortization/(accretion) of securities	(243)	(553)	2,066
Investment securities (gains)/losses	21	1,804	(14)
Depreciation, amortization, and other intangible amortization	7,160	6,366	4,846
Provision for loan losses	2,743	2,572	2,364
Restricted stock awards accrual	2,359	2,098	3,073
Net (increase) decrease in loans held for sale	(6,236)	11,056	(8,589)
Changes in:			
Interest receivable	(481)	(1,912)	(3,041)
Other assets	(8,004)	(5,174)	469
Interest payable	1,171	(2,142)	(1,096)
Other liabilities	(2,290)	5,865	11,700
Net cash from operating activities	19,459	41,766	29,458
INVESTING ACTIVITIES:			
Purchase of available-for-sale securities	(59,930)	(249,606)	(138,588)
Purchase of held-to-maturity securities	(16,650)	(53,729)	(25,775)
Sale of available-for-sale securities	3,639	201,371	14,110
Proceeds from maturities, calls, and prepayments of securities	39,911	70,276	6,486
Net increase in loans	(188,973)	(377,560)	(154,036)
Net purchase of premises and equipment	(13,043)	(7,953)	(13,149)
Net purchase of bank-owned life insurance	(36,000)	-	-
Acquisition of business, net of cash acquired	(10,058)	-	-
Cash acquired in business acquisition	-	348	1,761
Net cash from investing activities	(281,104)	(416,853)	(309,191)
FINANCING ACTIVITIES:			
Net increase in deposit accounts	129,647	236,974	340,890
Net change in borrowings	155,710	124,205	(26,529)
Proceeds from share-based compensation activity	1,983	1,127	81
Proceeds from issuance of common stock	4,978	242	954
Cash dividends paid	(12,939)	(5,418)	(2,891)
Net cash from financing activities	279,379	357,130	312,505
Change in cash and cash equivalents	17,734	(17,957)	32,772
Cash and cash equivalents at beginning of year	51,601	69,558	36,786
Cash and cash equivalents at end of year	$ 69,335	$ 51,601	$ 69,558
Supplemental cash flow information:			
Cash paid for interest	$ 69,254	$ 47,156	$ 25,940
Cash paid for income taxes	$ 11,584	$ 10,357	$ 7,800
Noncash financing and investing activities:			
Net unrealized gain/(loss) on available-for-sale securities	$ 1,166	$ 3,297	$ (1,474)
Common stock issued in connection with business acquisition	$ 1,259	$ 2,351	$ 7,876
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 510	$ 349	$ 193

See accompanying Notes to Consolidated Financial Statements.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Basis of presentation: The consolidated financial statements of TowneBank include the accounts of the Company and its wholly-owned subsidiaries: TowneBank Investment Corporation; Towne Investments, LLC; Towne Insurance Agency, Inc.; TowneBank Commercial Mortgage, LLC; TFA Benefits; Benefit Design Group, Inc. (“BDG”); and GSH Residential Real Estate Corporation (“GSH”). 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; required reserves were $864,000 at December 31, 2007 and 2006.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Goodwill and other intangibles: Goodwill is not subject to amortization, but is subject to an annual assessment for impairment by applying a fair value based test as required by Statement of Financial Accounting Standards No. (“SFAS”) 142, *Goodwill and Other Intangible Assets*. Additionally, under SFAS 142, acquired intangible assets are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful life.

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

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

Transfers of financial assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the asset has been isolated from the Company, (2) 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 (3) 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 SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, rate lock commitments related to the origination of mortgage loans held for sale and the corresponding forward loan sale commitments are considered to be derivatives. The commitments are generally for periods of 60 days and are at market rates.

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

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

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

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

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

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

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

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

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

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

Advertising costs: Advertising costs are expensed as incurred.

Segment information: Operating segments as defined by SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, 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 21 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 SFAS 141, *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 17 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, according to SFAS 123R, *Share-Based Payment*, which requires that compensation cost relating to stock-based payment transactions be recognized in the financial statements. The scope of SFAS 123R includes stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. 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 22 for further discussion on the Company's earnings per share.

Recent accounting pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS 157, *Fair Value Measurements*, which establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurement. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has evaluated the impact of this statement and does not expect the adoption of this standard to have a material impact on the Company's consolidated results of operations and financial position.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, and also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company has evaluated the impact of this statement and does not expect the adoption of this standard to have a material impact on the Company's consolidated results of operations and financial position.

In December 2007, the FASB issued SFAS 141(R), *Business Combinations*, which replaces SFAS 141, *Business Combinations*. This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree as well as the goodwill acquired in the business combination or a gain from a bargain purchase. SFAS 141(R) also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact of the adoption of SFAS 141(R) on the Company's consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51*, which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes expanded disclosure requirements that clearly identify and distinguish between the interest of the parent's owners and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on the Company's consolidated financial position and results of operations.

NOTE 2: MERGERS AND ACQUISITIONS

B. Martin Weber, Inc.: On May 31, 2007, Towne Insurance acquired most of the assets and operations of B. Martin Weber, Inc. ("Weber"), a group benefits agency. The acquisition was accounted for under the purchase method of accounting and, accordingly, the results of operations have been included in the Company's consolidated financial statements since that date. The purchase price for Weber was $2.53 million in cash and common stock, including transaction costs. The major components of the purchase price are intangible assets, including customer lists and non-competes of $1.79 million, and goodwill of $706,000. The remaining $30,000 includes tangible assets acquired. These amounts are preliminary and subject to change pending finalization of the purchase price allocation.

The Frieden Agency, Inc.: Towne Insurance acquired The Frieden Agency, Inc. ("Frieden"), an employee benefits provider, on January 1, 2007. The acquisition was accounted for under the purchase method of accounting under accounting principles generally accepted in the United States of America. Under this method, the assets and liabilities of Frieden as of the acquisition date were recorded at their respective fair values and added to the Company's consolidated financials. The purchase price was $8 million in cash, including transaction costs. A preliminary allocation of the purchase price resulted in the recording of $3.13 million in goodwill and $5.14 million in intangible assets. These amounts are subject to change pending finalization of the purchase price allocation.

Brooks Agency, Inc.: On January 9, 2006, TowneBank announced the addition of the Brooks Agency, Inc. ("Brooks"), as a division of Towne Insurance. The merger was accounted for under the purchase method of accounting, and accordingly, the results of operations for Brooks have been included in the consolidated financial statements since that date. Brooks was an independent insurance agency operating in Williamsburg, Virginia and serving customers throughout Hampton Roads. Through this acquisition, the Company adds to its existing insurance and bond services. The aggregate purchase price of $2.35 million consisted of common stock. In accordance with the merger agreement, Brooks' shareholders received 115,951 TowneBank common shares. The shares were valued at $20.27 per share, determined by an average market price of our common shares. Including other capitalized merger costs and $189,000 in net assets acquired, the Company recorded $1.54 million in goodwill and $678,000 in intangible assets.

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

NOTE 3: INVESTMENT SECURITIES

Available-for-sale securities

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

December 31, 2007	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. agency securities	$ 125,760	$ 1,227	$ (13)	$ 126,974
Municipal securities	2,740	119	-	2,859
Total debt securities	128,500	1,346	(13)	129,833
Other investments	161	-	(75)	86
Federal Home Loan Bank Stock	17,305	-	-	17,305
Mortgage-backed securities	131,274	1,950	(20)	133,204
Total equity securities	148,740	1,950	(95)	150,595
Total available-for-sale securities	$ 277,240	$ 3,296	$ (108)	$ 280,428

December 31, 2006	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. agency securities	$ 127,865	$ 605	$ (127)	$ 128,343
Municipal securities	3,749	101	-	3,850
Corporate obligations	605	-	-	605
Total debt securities	132,219	706	(127)	132,798
Other investments	126	-	(38)	88
Federal Home Loan Bank Stock	10,013	-	-	10,013
Mortgage-backed securities	111,905	1,054	(184)	112,775
Total equity securities	122,044	1,054	(222)	122,876
Total available-for-sale securities	$ 254,263	$ 1,760	$ (349)	$ 255,674

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

For the year ended December 31, 2007, there were no proceeds from securities available-for-sale, other than prepayments related to mortgage-backed securities. There were realized gains of $70,000 and an impairment loss of $20,000 in the year ended December 31, 2007. For the years ended December 31, 2006 and 2005, proceeds from securities available-for-sale amounted to $168.93 million and $5.32 million and resulted in losses of $1.74 million and gains of $14,000, respectively. The tax benefit charged against income for the 2006 loss amounted to $631,000, and the expense charged against income for the 2005 gain amounted to $5,000.

Held-to-maturity securities

The amortized cost and fair values of held-to-maturity investment securities (in thousands).

December 31, 2007	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 2,001	$ 25	$ -	$ 2,026
Trust Preferred	5,524	474	-	5,998
Municipal bonds	16,863	60	(56)	16,867
Industrial revenue bonds	75,328	-	(1,952)	73,376
Total held-to-maturity securities	$ 99,716	$ 559	$ (2,008)	$ 98,267

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities	$ 3,993	$ -	$ (9)	$ 3,984
Trust Preferred	5,520	693	-	6,213
Municipal bonds	16,694	14	(191)	16,517
Industrial revenue bonds	63,329	-	-	63,329
Total held-to-maturity securities	$ 89,536	$ 707	$ (200)	$ 90,043

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, 2007	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 272	$ 271	$ 9,913	$ 9,929
Due after one year through five years	63,309	63,486	19,679	19,390
Due after five years through 10 years	51,317	51,941	11,592	11,285
Due after 10 years	144,876	147,339	58,532	57,663
	259,774	263,037	99,716	98,267
Federal Home Loan Bank Stock	17,305	17,305	-	-
Other equity securities	161	86	-	-
	$ 277,240	$ 280,428	$ 99,716	$ 98,267

December 31, 2006	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 5,904	$ 5,892	$ 10,948	$ 10,922
Due after one year through five years	63,046	62,876	30,443	30,272
Due after five years through 10 years	49,325	49,554	2,524	2,522
Due after 10 years	125,849	127,251	45,621	46,327
	244,124	245,573	89,536	90,043
Federal Home Loan Bank Stock	10,013	10,013	-	-
Other equity securities	126	88	-	-
	$ 254,263	$ 255,674	$ 89,536	$ 90,043

Pledged securities

At December 31, 2007 and 2006, the Company had investment securities with carrying values of $76.19 million and $64.20 million, respectively, pledged to secure federal, state, and municipal deposits. Additionally, the Company had $10.07 million in investment securities pledged to secure borrowings from the Federal Reserve Bank ("FRB") at December 31, 2007. Comparatively, the Company had $75.56 million and $10.02 million in investment securities pledged to secure borrowings from the FHLB and FRB at December 31, 2006, respectively. The Company also had $55.47 million in investment securities pledged against repurchase agreements with commercial customers at December 31, 2007, compared to $15.07 million at December 31, 2006.

Reconciliation to net unrealized gains (losses)

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):

	2007	2006	2005
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during the period	$ 1,843	$ 3,332	$ (2,251)
Other than temporary impairment of available-for-sale securities	20	-	-
Reclassification adjustment for (gains) losses on available-for-sale securities included in income	(70)	1,740	(14)
Total other comprehensive income (loss) before income tax (expense) benefit	1,793	5,072	(2,265)
Income tax (expense) benefit	(627)	(1,775)	791
Net unrealized gains (losses)	$ 1,166	$ 3,297	$ (1,474)

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 (in thousands).

December 31, 2007	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	$ 24,987	$ 13	$ -	$ -	$ 24,987	$ 13
Municipal securities	-	-	11,558	56	11,558	56
Federal agency mortgage-backed securities	-	-	1,530	20	1,530	20
Subtotal, debt securities	24,987	13	13,088	76	38,075	89
Other investments, including common stock	-	-	29	75	29	75
Total temporarily impaired securities	$ 24,987	$ 13	$ 13,117	$ 151	$ 38,104	$ 164

December 31, 2006	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	$ 9,965	$ 36	$ 25,903	$ 100	$ 35,868	$ 136
Municipal securities	-	-	13,910	191	13,910	191
Federal agency mortgage-backed securities	7,804	42	5,219	142	13,023	184
Subtotal, debt securities	17,769	78	45,032	433	62,801	511
Other investments, including common stock	-	-	87	38	87	38
Total temporarily impaired securities	$ 17,769	$ 78	$ 45,119	$ 471	$ 62,888	$ 549

U.S. Treasury obligations

The unrealized losses on the Company's investments in U.S. Treasury obligations and direct obligations of U.S. government agencies were caused by interest rate fluctuations. At December 31, 2007, four securities experienced total unrealized losses of $13,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities in this category are government agencies with AAA credit ratings and have average maturities of three years or less, the Company considers these unrealized losses to be temporary in nature.

Municipal securities

The Company's unrealized losses on municipal securities were caused by interest rate fluctuations. At December 31, 2007, nine securities experienced total unrealized losses of $56,000. Based on the credit quality of the issuer and the Company's ability and intent to hold these securities until a market price recovery or maturity, the Company does not consider these investments other than temporarily impaired.

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, 2007, five securities experienced total unrealized losses of $20,000. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. Because the securities are government agencies and the Company has the ability and intent to hold them for a period of time sufficient to allow for an anticipated recovery, they are not considered to be other than temporarily impaired.

Corporate obligations

The Company did not have any unrealized losses on investments in corporate obligations at December 31, 2007.

Other investments, including common stock

At December 31, 2007, one equity security experienced a total unrealized loss of $75,000. This loss was the result of fluctuating market conditions in the local economy. The Company monitors this security and has the ability and intent to hold the investment to allow for an anticipated recovery.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company grants commercial, real estate, and consumer loans to customers throughout our lending area. Although the Company has a diversified loan portfolio, a substantial portion of the Company's debtors' abilities to honor their contracts is dependent upon the economic environment of the lending area. Of total loans, $547.48 million were pledged as collateral to secure overnight borrowings with the FHLB at December 31, 2007.

(continued on next page)

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

December 31,	2007	2006
Real estate loans		
Residential 1-4 family	$ 439,676	$ 362,034
Commercial	561,341	364,657
Construction	522,780	529,933
Multifamily	27,515	17,919
Total real estate loans	1,551,312	1,274,543
Commercial loans	218,082	306,437
Consumer installment loans		
Personal installment	42,702	41,784
Credit cards and revolving credit	17,360	18,885
Total consumer installment loans	60,062	60,669
Agriculture loans	-	177
Loans, net of unearned income and deferred costs	$ 1,829,456	$ 1,641,826

Unearned loan income was $727,000 in excess of deferred loan costs at December 31, 2007 and $1.10 million at December 31, 2006. There were $726,000 and $636,000 in nonaccrual loans at December 31, 2007 and 2006. The Company would have earned $124,000 in 2007 and $214,000 in 2006 if interest on the loans had been accrued.

(continued on next page)

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

Years ended December 31,	2007	2006	2005
Balance, beginning of year	$ 19,670	$ 17,071	$ 14,999
Loans charged off			
Residential 1-4 family	(474)	(7)	(5)
Construction	-	(6)	(3)
Commercial	(409)	(153)	(483)
Consumer	(285)	(48)	(65)
Total	(1,168)	(214)	(556)
Loans recovered			
Residential 1-4 family	2	32	60
Construction	-	-	16
Commercial	50	176	117
Consumer	26	33	71
Total	78	241	264
Net loans recovered (charged off)	(1,090)	27	(292)
Provision for loan losses	2,743	2,572	2,364
Balance, end of year	$ 21,323	$ 19,670	$ 17,071

It is the opinion of management that the allowance was adequate at December 31, 2007 based on conditions reasonably known to them; however, the allowance may be increased or decreased in the future based on loan balances outstanding, changes in internally generated credit quality ratings of the loan portfolio, changes in general economic conditions, or other risk factors.

NOTE 5: PREMISES, EQUIPMENT, AND LEASES

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

December 31,	2007	2006
Land and improvements	$ 13,304	$ 11,324
Buildings and improvements	31,544	30,303
Autos	2,820	2,508
Computer and communication equipment	6,219	5,244
Equipment	8,460	7,337
Furniture and fixtures	17,881	15,778
Leasehold improvements	13,266	9,672
Construction in progress	738	205
	94,232	82,371
Less accumulated depreciation	(19,301)	(15,145)
Net premises and equipment	$ 74,931	$ 67,226

Depreciation and leasehold amortization expense for the years ended December 31, 2007, 2006, and 2005 was $4.94 million, $4.38 million, and $3.79 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 the 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 $4.00 million for 2007, compared to $3.75 million for 2006, and $3.22 million for 2005. Future minimum lease payments, by year and in the aggregate, under noncancellable operating facilities leases at December 31, 2007 are listed in the following chart (in thousands).

2008	$	3,704
2009		3,884
2010		3,752
2011		3,549
2012		3,556
Thereafter		16,017
	$	34,462

Rental income for the year ended December 31, 2007 was $282,000 compared to $260,000 for 2006 and $252,000 for 2005. Future minimum rental income, by year and in the aggregate, under noncancellable operating leases, was as follows at December 31, 2007 (in thousands).

2008	$	129
2009		86
2010		78
2011		56
2012		42
Thereafter		2,256
	$	2,647

(continued on next page)

NOTE 6: GOODWILL AND INTANGIBLE ASSETS

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

	December 31,			
	2007		2006	
	Gross carrying amount	Accumulated Amortization	Gross carrying amount	Accumulated Amortization
Intangible assets subject to amortization				
Core deposit intangible	$ 3,677	$ 1,689	$ 3,677	$ 1,244
Non-compete agreements	1,376	464	724	254
Property management contracts	620	492	620	383
Customer lists	4,814	643	1,490	269
Total intangible assets subject to amortization	10,487	3,288	6,511	2,150
Intangible assets not subject to amortization				
Title plant	805	-	942	-
Trade names	500	-	500	-
Contractual agreements	3,231	-	-	-
Total intangible assets not subject to amortization	4,536	-	1,442	-
Total intangible assets	$ 15,023	$ 3,288	$ 7,953	$ 2,150

The aggregate amortization expense for intangible assets with finite lives for the year ended December 31, 2007 was $1.14 million compared to $902,000 for 2006 and $1.13 million for 2005. The estimated aggregate annual amortization expense for each of the five years subsequent to December 31, 2007 are as follows: 2008, $927,000; 2009, $767,000; 2010, $710,000; 2011, $708,000; and 2012, $708,000.

During 2007, the Company recorded $5.09 million in goodwill and $7.21 in intangible assets. This represents acquisitions of the benefit agencies in 2007 and certain other adjustments to goodwill . The intangible assets included contracts with an indefinite life and other intangibles with defined lives. These finite lived assets include customer lists and non-compete agreements, which are both amortized over eight years. The majority of these assets are included in the Company's Insurance segment.

During 2007 and 2006, the Company recorded $134,000 of impairment charges each year for the title plant due to obsolescence. Also during 2006, the Company recorded $1.54 million in goodwill and $678,000 in intangible assets for the acquisition of Brooks. The intangibles have finite lives and consisted entirely of customer lists with an amortization period of eight years. These assets are included in the Insurance segment.

Impairment testing indicated that goodwill was not impaired in 2007 or 2006. 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, 2005	$ 44,363	$ 4,833	$ 505	$ 49,701
Additions to goodwill	-	-	1,544	1,544
Balance, December 31, 2006	44,363	4,833	2,049	51,245
Additions to goodwill	1,157	-	3,932	5,089
Balance, December 31, 2007	$ 45,520	$ 4,833	$ 5,981	$ 56,334

NOTE 7: BANK-OWNED LIFE INSURANCE POLICIES

During the fourth quarter of 2007, the Company invested $36 million in bank-owned life insurance policies with the intent to fund a newly created Supplemental Executive Retirement Plan ("SERP") for certain executives. The SERP, which is to be implemented beginning in 2008, is intended to provide 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, 2007 is shown in the following chart (dollars in thousands).

Maturity	Total
2008	$ 826,649
2009	20,906
2010	8,435
2011	3,992
2012 and thereafter	2,853
	$ 862,835

At year-end 2007, TowneBank had a total of $685.76 million in no-penalty time deposits as compared to $473.23 million for 2006. 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 $33.62 million and $54.14 million at December 31, 2007 and 2006, 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).

	2007	2006
Balance outstanding at end of year	$ 296,665	$ 142,363
Average balance outstanding	261,044	82,295
Maximum outstanding at any month-end	296,782	142,363
Average interest rate during the year	4.66%	5.70%
Average interest rate at end of year	4.49%	5.61%

The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at December 31, 2007 are summarized as follows (dollars in thousands).

Maturity Date	Interest Rate	Call Date	Outstanding Amount
02/09/2010	6.45%	02/11/2008	$ 25,000
11/10/2010	5.43%	02/11/2008	8,000
04/15/2008	3.30%	-	612
07/09/2008	2.92%	-	2,141
06/29/2011	5.17%	-	912
03/06/2017	4.08%	03/06/2008	100,000
05/18/2017	4.347%	05/18/2009	80,000
05/18/2017	4.475%	05/18/2010	80,000
			$ 296,665

Total interest expense on FHLB advances for the years ended December 31, 2007, 2006, and 2005 was $12.39 million, $4.69 million, and $2.54 million, respectively.

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

	2007	2006
Balance outstanding at end of year	$ 36,660	$ 34,674
Average balance outstanding	28,173	18,462
Maximum outstanding at any month-end	37,046	34,674
Average interest rate during the year	5.01%	5.07%
Average interest rate at end of year	3.80%	5.42%

Repurchase agreements totaled $36.66 million at December 31, 2007. They are classified as secured borrowings and generally mature within one business day from the transaction date. They are reflected at the amount of cash received in connection with the transaction. In addition, federal funds lines with other financial institutions were available at December 31, 2007 for short-term funding needs. Federal funds purchased are overnight, unsecured borrowings.

At December 31, 2007 and 2006, the Company had $453.67 million and $516.01 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 $547.48 million at December 31, 2007.

Further, the Company had loan participation lines and reverse repurchase agreements with various financial institutions available at December 31, 2007, which provide potential additional funding.

The Company has three different convertible subordinated capital debentures: (1) Series I Towne Investment Note, (2) assumed obligation of the Harbor Bank Bonds, and (3) Series II Towne Investment Note. At year-end 2007, all three debentures accrued and paid interest. Collectively, interest expense on the debentures for the year ended December 31, 2007 was $2.25 million. Total convertible subordinated capital debentures at December 31, 2007 were $41.67 million and included a convertible debenture premium of $541.62 million recorded as part of the Harbor Bank acquisition.

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

The Company sold 22,498 units, for aggregate proceeds of $45.0 million in the offering, and closed the offering during April 2002, which resulted in $22.5 million in convertible subordinated capital notes. At year-end 2007, the Company had $21.45 million in Series I convertible subordinated notes. The Company may redeem the notes in whole or in part after May 15, 2009 at its option and with the approval of the FDIC at 100% of the principal amount, together with accrued interest to the date of redemption.

During 2002, Harbor Bank, which was acquired by the Company in 2004, offered Harbor Investment Units (“Harbor units”) in a subscription offering. Each Harbor unit originally consisted of 51.5 shares of common stock priced at $19.42 per share and $1,000 in the aggregate and one 6% convertible subordinated bond (a “Harbor Bond”) in the principal amount of $1,000 that matures November 30, 2017. Harbor Bank sold 4,250 Harbor units, for an aggregate amount of approximately $8.5 million, and closed the offering in November 2002.

In connection with the acquisition of Harbor Bank in 2004, TowneBank assumed the obligations of Harbor Bank under the outstanding Harbor Bonds. Considering the three-for-two stock split distributed on June 17, 2004 and the 3% stock dividend distributed on September 16, 2005, TowneBank common stock will be issued upon conversion of the bonds 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). At year-end 2007, the Company had $3.55 million in Harbor Bonds. The Harbor Bonds may be redeemed in whole or in part after November 30, 2009 at the Company’s option and with the approval of the FDIC at 100% of the principal amount, together with accrued interest to the date of redemption.

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

The 6.25 Note is convertible into common stock at a conversion price of $29.42 per share (equal to a conversion rate of 33.99 shares per $1,000 principal amount of notes). The Company sold 16,316 units and closed the offering in August 2004, resulting in $16.32 million in Series II convertible subordinated notes. The common stock and notes were issued separately in early October 2004. The note began accruing interest on October 1, 2004, and the first interest payment was made on May 15, 2005. At year-end 2007, the Company had $16.13 million in Series II convertible subordinated notes. The Company may redeem the notes in whole or in part after November 15, 2009 at its option and with the approval of the FDIC at 100% of the principal amount, together with accrued interest to the date of redemption.

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,	**2007**	**2006**
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 992,061	$ 1,008,079
Standby letters of credit	21,700	25,793
	$ 1,013,761	$ 1,033,872

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, 2007. Management does not anticipate any material losses will arise from additional disbursements of the aforementioned lines or standby letters of credit.

NOTE 11: EMPLOYEE 401(K) PLAN

The Company has a defined contribution 401(k) plan. All employees who are at least 18 years of age and have completed one quarter of a year of service are eligible to participate. Under the plan, employees may contribute a percentage of their annual salary, subject to statutory limitations, and the Company will match 100% of the employees' contributions up to 6% of their salary. The Company may also make an additional discretionary contribution; there were no discretionary contributions for the years ended December 31, 2007, 2006, and 2005.

The Company made matching contributions of $2.22 million, $2.05 million, and $1.72 million for the years ended December 31, 2007, 2006, and 2005, respectively. The Company's matching contribution is in the form of the Company's stock, which the Company purchases on the open market at the prevailing rates.

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 and Benefits 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 define. 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, 2007, approximately 2.39 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,	2007		2006		2005	
	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
Options outstanding, beginning balance	1,394,626	$10.44	1,885,359	$ 8.29	1,932,255	$ 6.58
Granted	110,950	19.17	72,472	21.01	171,135	21.46
Exercised	(160,808)	3.72	(466,170)	3.45	(218,031)	3.50
Forfeited	(43,090)	17.49	(97,035)	10.15	-	-
Options outstanding, ending balance	1,301,678	$11.78	1,394,626	$10.44	1,885,359	$ 8.29
Options exercisable at December 31,	816,191	$ 8.20	877,311	$ 6.33	1,281,908	$ 4.47

	Number	Weighted-Average Exercise Price
Unvested stock options, December 31, 2006	518,105	$17.43
Granted	110,950	19.17
Vested	(120,694)	17.51
Forfeited	(22,874)	17.26
Unvested stock options, December 31, 2007	485,487	$17.80

For the years ended December 31, 2007, 2006, and 2005, the weighted-average fair value of stock options granted was $8.48, $9.13, and $9.07, respectively. For the same periods, the total intrinsic value of options exercised was $2.41 million, $7.75 million, and $1.65 million, respectively. Additional information pertaining to options outstanding at December 31, 2007 is as follows.

	Number	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Life
Options outstanding	1,301,678	$11.78	$7,579,373	4.53 years
Options vested or expected to vest	1,262,628	11.71	7,562,127	4.51 years
Options exercisable	816,191	8.20	7,004,509	3.11 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,	**2007**	**2006**	**2005**
Dividend yield	0.60%	0.60%	0.60%
Expected life	8.56 years	8.62 years	10 years
Expected volatility	38%	38%	38%
Risk-free interest rate	4.12%	4.07%	4.50%

Cash received from exercises of stock options for the year ended December 31, 2007 was $598,000. The tax benefit realized for the tax deductions from stock option exercises for the year ended December 31, 2007 was $479,000 compared to $3.63 million for 2006 and $2.65 million for 2005.

Restricted stock awards (RSAs): Under the Plan, grantees of restricted stock awards have full voting rights on the shares and are entitled to receive cash or stock dividends. RSAs granted under the Plan are generally subject to vesting requirements ranging from three to ten years. The shares are subject to forfeiture if vesting and other contractual provision requirements are not met. The following chart shows a summary of the restricted stock award activity and related information assuming the weighted-average price being the weighted-average fair value at the date of grant for the year ended December 31, 2007.

	Number	**Weighted-Average Price**
Unvested RSAs, beginning balance	228,986	$ 12.65
Vested	(65,348)	11.75
Forfeited	(927)	21.36
Unvested RSAs, ending balance	162,711	$ 12.73

Compensation expense related to the awards for the years ended December 31, 2007, 2006, and 2005 was $763,000, $762,000, and $690,000, respectively. The total fair value of awards vested during 2007, 2006, and 2005 was $768,000, $780,000, and $466,000, respectively. As of December 31, 2007, there was $1.54 million of total unrecognized compensation cost related to unvested restricted stock awards; that cost is expected to be recognized over a period of 2.83 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 stock. For the year ended December 31, 2007, the Company did not issue any shares in connection with the monthly stock purchase plan. Instead the Company entered the open market and acquired 236,470 shares at an average price of $18.78 per share. For the year ended December 31, 2007, the Company issued 302,642 shares in connection with the dividend reinvestment plan at an average price of $19.12 per share.

TowneBank, as a Virginia banking corporation, may pay cash dividends only out of retained earnings. In 2005, the Company declared a special shareholder cash dividend of $0.126 per common share. The dividend was the third since opening in April 1999. In January 2006, the Company declared a special shareholder cash dividend bonus of $0.23 per common share. In November 2006, the Company declared a special shareholder cash dividend bonus of $0.30 per common share paid in January 2007. The total dividend paid was $7.13 million. On January 25, 2007, the Board of Directors approved the first quarterly cash dividend of $0.08 per common share. The quarterly dividends were paid on April 16, 2007; July 16, 2007; October 11, 2007; and January 10, 2008.

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.

NOTE 14: OTHER EXPENSES

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

Year ended December 31,	2007	2006	2005
Advertising and marketing	$ 4,621	$ 3,316	$ 3,310
Charitable contributions	1,726	1,289	564
Telephone and postage	1,910	1,777	1,758
Outside processing	1,860	1,601	1,395
Professional fees	1,792	1,421	1,443
Other	1,741	1,166	1,533
Stationery and office supplies	1,707	1,712	1,420
Amortization of intangible assets	1,591	1,169	1,169
FDIC and other insurance	1,536	623	535
Software expense	1,363	1,057	932
Travel/meals/entertainment	1,107	963	696
Directors' expense	1,056	1,326	712
Bank franchise tax/SCC fees	848	963	920
	$ 22,858	$ 18,383	$ 16,387

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, 2007, that the Company meets all capital adequacy requirements to which it is subject.

As of December 31, 2007, the most recent notification from the FDIC categorized the Company as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized," the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed our category.

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

As of December 31, 2007	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)	$ 249,621	11.34%	$ 176,079	8.00%	$ 220,099	10.00%
Tier 1 capital (to risk-weighted assets)	$ 186,629	8.48%	$ 88,040	4.00%	$ 132,060	6.00%
Tier 1 leverage ratios (to average assets)	$ 186,629	7.68%	$ 97,196	4.00%	$ 121,495	5.00%

As of December 31, 2006	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)	$ 234,152	12.46%	$ 150,360	8.00%	$ 187,950	10.00%
Tier 1 capital (to risk-weighted assets)	$ 172,013	9.15%	$ 75,180	4.00%	$ 112,770	6.00%
Tier 1 leverage ratios (to average assets)	$ 172,013	8.29%	$ 82,963	4.00%	$ 103,704	5.00%

NOTE 16: DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, *Disclosures About Fair Value of 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. SFAS 107 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 SFAS 107.

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.

Loans held for sale: Fair values of loans held for sale is 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 the amount payable on demand at the reporting date. 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 SFAS 107 are as follows (in thousands).

Year ended December 31,	2007		2006	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and due from banks	$ 33,400	$ 33,400	$ 45,448	$ 45,448
Interest-bearing deposits in financial institutions	35,935	35,935	5,324	5,324
Federal funds sold	-	-	829	829
Securities available-for-sale	277,240	280,428	254,263	255,674
Securities held-to-maturity	99,716	98,267	89,536	90,043
Mortgage loans held for sale	22,953	22,953	16,717	16,717
Loans, net	1,808,133	1,796,136	1,622,156	1,623,535
Interest receivable	11,062	11,062	10,581	10,581
Deposits	1,834,346	1,835,280	1,704,699	1,702,236
Advances from the Federal Home Loan Bank of Atlanta	296,665	309,545	142,363	143,623
Convertible subordinated capital debentures	41,669	38,745	42,469	36,716
Repurchase agreements and other borrowings	36,660	36,660	34,674	34,674
Interest payable	6,500	6,500	5,329	5,329

NOTE 17: INCOME TAXES

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

For the year ended December 31,	2007	2006	2005
Current income tax expense	$ (12,226)	$ (11,314)	$ (11,318)
Deferred income tax benefit	1,402	852	1,777
Income tax expense	$ (10,824)	$ (10,462)	$ (9,541)

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).

	2007		2006		2005	
For the year ended December 31,	**$**	**Rate**	**$**	**Rate**	**$**	**Rate**
Federal income tax expense at statutory rate	$ (11,929)	(35.00%)	$ (11,287)	(35.00%)	$ (9,527)	(35.00%)
State income tax expense, net of federal benefit	(36)	(0.11%)	(75)	(0.23%)	(93)	(0.34%)
Tax advantaged income	1,139	3.34%	498	1.54%	188	0.69%
Tax credits	542	1.59%	663	2.06%	-	-
Other	(540)	(1.58%)	(261)	(0.81%)	(109)	(0.40%)
Income tax expense	$ (10,824)	(31.76%)	$ (10,462)	(32.44%)	$ (9,541)	(35.05%)

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,	**2007**	**2006**
Deferred tax assets:		
Allowance for loan losses	$ 7,069	$ 6,491
Stock-based compensation	849	605
Other	127	164
Accrued expenses	463	442
Deferred compensation	3,174	2,548
Total deferred tax assets	11,682	10,250
Deferred tax liabilities:		
Loan costs	1,181	1,343
Depreciation	4,659	4,292
Noncompete and intangibles	1,186	1,361
Unrealized gain on securities available-for-sale	1,114	681
Total deferred tax liabilities	8,140	7,677
Net deferred tax assets	$ 3,542	$ 2,573

The Company adopted the provisions of FASB Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. The adoption of FIN 48 did not have a significant on the financial statements of the Company.

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, 2007. Additionally, there were no interest or penalties accrued at December 31, 2007.

The Company is subject to examination for federal and state purposes for the tax years 2005 through 2006. Tax year 2004 has been examined but technically remains open until March 15, 2008.

NOTE 18: 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, 2007. Management was not aware of any unasserted claims or assessments that may be probable of assertion at December 31, 2007.

NOTE 19: 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 $76.92 million, $67.28 million, and $50.06 million as of December 31, 2007, 2006, and 2005, respectively. During 2007, new advances on all commitments to such parties totaled $83.79 million, and repayments amounted to $74.15 million. In addition at December 31, 2007, we had $35.34 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 $747,000, $640,000, and $566,000 for the years ended December 31, 2007, 2006, and 2005, respectively.

In October 2000, in connection with the acquisition of Hampton Roads Funding Corporation, TowneBank entered into consulting and non-competition agreements with four individuals, including one of the Company's directors and a member of one of the Company's regional boards of directors. Total amounts expensed under this arrangement with directors were $1.48 million and $2.14 million for the years ended December 31, 2006 and 2005, respectively. The agreement with the Company Director was modified for January and February 2007 until Towne Mortgage, LLC began operations in March 2007. The terms of the agreement were the same as the prior agreement, except payments were to be made to the Bank's partner in Towne Mortgage, LLC instead of the individuals previously referenced. The amount expensed in 2007 under this modified agreement was $148,000.

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, 2007, 2006, and 2005 approximated $1.64 million, $1.23 million, and $3.79 million, respectively. The amount in 2005 is largely attributable to payments made to W.M. Jordan Company, Inc. ("W.M. Jordan") in connection with the construction of the certain facilities; the President and Chief Executive Officer of W.M. Jordan is one of the Company's directors. Payments made to W.M. Jordan for the construction of the facilities totaled $521,000, $667,000 and $3.10 million for the years ended December 31, 2007, 2006 and 2005, respectively.

NOTE 20: QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for the years ended December 31, 2007 and 2006 is as follows (in thousands, except per share data).

2007	Fourth	Third	Second	First
Interest income	$ 39,493	$ 40,503	$ 39,055	$ 36,873
Interest expense	18,409	18,547	17,188	16,281
Provision for loan losses	831	266	1,042	604
Noninterest income	9,093	9,243	9,590	8,896
Noninterest expense	20,937	22,114	21,684	20,772
Income before income tax expense minority interest	8,409	8,819	8,731	8,112
Minority interest	12	-	-	-
Income before income tax expense	8,421	8,819	8,731	8,112
Income tax expense	2,554	2,830	2,825	2,615
Net income	$ 5,867	$ 5,989	$ 5,906	$ 5,497
Net income per common share				
Basic	$ 0.25	$ 0.25	$ 0.25	$ 0.23
Diluted	$ 0.23	$ 0.24	$ 0.23	$ 0.22
Comprehensive income	$ 8,218	$ 8,477	$ 2,268	$ 5,462

2006	Fourth	Third	Second	First
Interest income	$ 35,799	$ 33,333	$ 29,970	$ 27,238
Interest expense	14,737	13,604	11,322	9,635
Provision for loan losses	754	831	487	500
Noninterest income	7,103	8,911	9,488	8,319
Noninterest expense	19,049	19,354	19,142	18,498
Income before income tax expense	8,362	8,455	8,507	6,924
Income tax expense	2,127	2,937	2,960	2,438
Net income	$ 6,235	$ 5,518	$ 5,547	$ 4,486
Net income per common share				
Basic	$ 0.26	$ 0.24	$ 0.24	$ 0.19
Diluted	$ 0.25	$ 0.22	$ 0.22	$ 0.18
Comprehensive income	$ 8,579	$ 7,017	$ 5,044	$ 4,443

NOTE 21: SEGMENT REPORTING

The Company has three reportable segments: Banking, Realty, and Insurance. The Banking segment provides loan and deposit services to retail and commercial customers throughout Hampton Roads, Virginia and includes the operations of TowneBank Commercial Mortgage and Towne Investment Group. The Realty segment combines the operations of GSH with TowneBank Mortgage, LET, NewTowne Mortgage, LLC, and

ETC to provide residential real estate services, 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).

For the year ended December 31, 2007	**Bank**	**Realty**	**Insurance**	**Consolidated Totals**
Net interest income	$ 84,715	$ 710	$ 74	$ 85,499
Provision for loan losses	2,743	-	-	2,743
Net interest income after provision for loan losses	81,972	710	74	82,756
Residential mortgage brokerage income, net	309	5,855	-	6,164
Real estate brokerage and property management income, net	-	5,462	-	5,462
Insurance commissions and other title fees and income, net	-	2,695	10,406	13,101
Other noninterest income	11,066	659	370	12,095
Noninterest expense	57,649	13,166	7,834	78,649
Depreciation and Amortization	5,374	975	509	6,858
Income before income tax and minority interest	30,324	1,240	2,507	34,071
Minority interest	12	-	-	12
Income before income tax	30,336	1,240	2,507	34,083
Income tax expense	9,499	328	997	10,824
Net income	$ 20,837	$ 912	$ 1,510	$ 23,259
Net income as percentage of total	89.59%	3.92%	6.49%	100.00%
Assets	$ 2,426,995	$ 44,474	$ 29,609	$ 2,501,078
Efficiency ratio	65.59%	91.94%	76.89%	69.90%

For the year ended December 31, 2006	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 76,440	$ 602	$ -	$ 77,042
Provision for loan losses	2,572	-	-	2,572
Net interest income after provision for loan losses	73,868	602	-	74,470
Residential mortgage brokerage income, net	351	8,495	-	8,846
Real estate brokerage and property management income, net	-	6,333	-	6,333
Insurance commissions and other title fees and income, net	-	3,517	6,265	9,782
Other noninterest income	8,285	469	106	8,860
Noninterest expense	49,508	15,377	4,803	69,688
Depreciation and Amortization	4,728	1,001	626	6,355
Income before income tax	28,268	3,038	942	32,248
Income tax expense	9,055	1,033	374	10,462
Net income	$ 19,213	$ 2,005	$ 568	$ 21,786
Net income as percentage of total	88.19%	9.20%	2.61%	100%
Assets	$ 2,134,857	$ 41,072	$ 18,656	$ 2,194,585
Efficiency ratio	63.75%	84.35%	85.21%	68.59%

For the year ended December 31, 2005	Bank	Realty	Insurance	Consolidated Totals
Net interest income	$ 61,608	$ 835	$ -	$ 62,443
Provision for loan losses	2,364	-	-	2,364
Net interest income after provision for loan losses	59,244	835	-	60,079
Residential mortgage brokerage income, net	442	8,366	-	8,808
Real estate brokerage and property management income, net	-	7,493	-	7,493
Insurance commissions and other title fees and income, net	-	3,756	4,702	8,458
Other noninterest income	8,410	620	301	9,331
Noninterest expense	42,175	15,539	3,882	61,596
Depreciation and Amortization	3,918	1,185	249	5,352
Income before income tax	22,003	4,346	872	27,221
Income tax expense	7,670	1,524	347	9,541
Net income	$ 14,333	$ 2,822	$ 525	$ 17,680
Net income as percentage of total	81.07%	15.96%	2.97%	100%
Assets	$ 1,750,814	$ 45,564	$ 6,804	$ 1,803,182
Efficiency ratio	65.42%	79.37%	82.57%	69.35%

The following table provides the change in net income and total assets for each segment comparing December 31, 2007 and 2006 (dollars in thousands).

	Banking	Realty	Insurance	Consolidated
Net Income ($)	$ 1,624	$ (1,093)	$ 942	$ 1,473
Net Income (%)	8.45%	(54.51%)	165.85%	6.76%
Total Assets ($)	$ 292,138	$ 3,402	$ 10,953	$ 306,493
Total Assets (%)	13.68%	8.28%	58.71%	13.97%

NOTE 22: 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,	2007	2006	2005
Basic			
Net income available to shareholders, as reported	$ 23,259	$ 21,786	$ 17,680
Average common shares outstanding	23,712,692	23,356,687	22,231,652
Basic earnings per share amount	$ 0.98	$ 0.93	$ 0.79
Diluted			
Net income available to shareholders, as reported	$ 23,259	$ 21,786	$ 17,680
Interest applicable to 6% subordinated debt, net of tax (1)	975	990	1,002
Net income available to shareholders, for diluted EPS	24,234	22,776	18,682
Average common shares outstanding	23,712,692	23,356,687	22,231,652
Effect of dilutive securities			
stock compensation plans, net of tax benefit	670,446	1,147,196	948,459
6% convertible subordinated debentures (2)	1,908,606	1,938,188	1,959,196
Average diluted shares outstanding	26,291,744	26,442,071	25,139,307
Diluted earnings per share amount	$ 0.92	$ 0.86	$ 0.74

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

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

In addition, the Series II convertible subordinated capital notes entitle the holders to convert their notes into 548,225 shares of common stock. These shares were not included in the computation of diluted earnings per share, as the effect would have been anti-dilutive.

NOTE 23: SUBSEQUENT EVENTS

On January 3, 2008, the Company acquired Corolla Classic Vacations, LLC for $5.50 million in cash and Corolla Village Realty, LLC for $1.50 million in cash.

TOWNEBANK
SHAREHOLDER INFORMATION

ANNUAL MEETING

TowneBank's Annual Meeting of Stockholders will be held at 11:30 a.m. on Thursday, May 22, 2008, at the Virginia Beach Convention Center, 1000 19th Street, Virginia Beach, Virginia 23451.

COMMON STOCK

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

	2007		2006	
Quarter	**High**	**Low**	**High**	**Low**
First	$20.80	$18.85	$22.50	$19.19
Second	19.25	16.25	23.00	19.40
Third	19.75	16.50	21.00	19.00
Fourth	21.30	15.50	20.10	19.19

INVESTOR RELATIONS

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

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

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

INDEPENDENT AUDITORS

Goodman and Company, LLP
One Commercial Place, Suite 800
P.O. Box 3247
Norfolk, Virginia 23514

TOWNEBANK
SHAREHOLDER INFORMATION

TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016-3572
800-866-1340

CORPORATE COUNSEL

LeClairRyan
999 Waterside Drive, Suite 2525
Norfolk, Virginia 23510

Troutman Sanders L.L.P.
222 Central Park Avenue, Suite 2000
Virginia Beach, Virginia 23462