FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D. C. 20429

FORM 10-Q

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

For the quarterly period ended **September 30, 2008**

FDIC Insurance Cert. Number: 35095

TOWNEBANK
(Exact name of registrant as specified in its charter)

VIRGINIA (State or other jurisdiction of incorporation or organization)	54-1910608 (I.R.S. Employer Identification No.)
5716 High Street, Portsmouth, Virginia (Address of principal executive offices)	23703 (Zip Code)

(757) 638-7500
(Registrant's telephone number, including area code)

No Change
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The number of shares of the Company's common stock outstanding as of October 28, 2008 was 24,660,386 shares.

TOWNEBANK

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	September 30, 2008 (unaudited)	September 30, 2007 (unaudited)	December 31, 2007 (audited)
ASSETS			
Cash and due from banks	$ 218,197	$ 44,987	$ 33,400
Interest bearing deposits in financial institutions	20,448	120,543	35,935
Federal funds sold	30,000	-	-
Total Cash and Cash Equivalents	268,645	165,530	69,335
Securities available-for-sale, at fair value (amortized cost of $213,922, $266,615, and $277,240, respectively)	212,109	266,295	280,428
Securities held-to-maturity, at amortized cost (fair value of $106,234, $89,826, and $98,267, respectively)	107,607	89,343	99,716
Total Securities	319,716	355,638	380,144
Mortgage loans held for sale	19,787	19,292	22,953
Loans, net of unearned income and deferred costs:			
Real estate-residential 1-4 family	538,472	418,869	439,676
Real estate-commercial	694,377	507,056	561,341
Real estate-construction and development	593,325	553,090	522,780
Real estate-multi-family	29,939	34,147	27,515
Commercial	297,831	210,058	218,082
Consumer and other loans	45,542	60,416	60,062
Loans, net of unearned income and deferred costs	2,199,486	1,783,636	1,829,456
Less: Allowance for loan losses	(25,452)	(20,749)	(21,323)
Net Loans	2,174,034	1,762,887	1,808,133
Premises and equipment, net	78,907	72,023	74,931
Goodwill	60,127	55,533	56,334
Intangible assets, net	12,765	11,812	11,735
Bank-owned life insurance policies	43,933	6,044	42,521
Other assets	37,592	34,585	34,992
TOTAL ASSETS	$ 3,015,506	$ 2,483,344	$ 2,501,078
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits:			
Noninterest-bearing demand	$ 561,040	$ 466,254	$ 439,122
Interest-bearing:			
Demand and money market accounts	503,982	488,638	508,028
Savings	61,346	24,271	24,361
Certificates of deposit	1,071,992	863,872	862,835
Total Deposits	2,198,360	1,843,035	1,834,346
Advances from the Federal Home Loan Bank	363,886	296,716	296,665
Convertible subordinated capital debentures	41,186	41,762	41,669
Repurchase agreements and other borrowings	45,299	17,301	36,660
Total Borrowings	450,371	355,779	374,994
Other liabilities	33,403	37,345	34,882
TOTAL LIABILITIES	2,682,134	2,236,159	2,244,222
Shareholders' Equity			
Preferred stock, $5.00 par value: 2,000,000 shares authorized 598,542 issued and outstanding at September 30, 2008	2,993	-	-
Common stock, $1.667 par: 45,000,000 shares authorized 24,378,263 issued and outstanding at September 30, 2008 and 24,009,657 issued and outstanding at September 30, 2007 and 24,104,418 issued and outstanding at December 31, 2007	40,639	40,024	40,182
Capital surplus	232,138	165,108	168,364
Retained earnings	58,770	42,321	46,227
Accumulated other comprehensive income (loss)	(1,168)	(268)	2,083
TOTAL SHAREHOLDERS' EQUITY	333,372	247,185	256,856
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 3,015,506	$ 2,483,344	$ 2,501,078

See accompanying Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF INCOME (unaudited)

(Dollars in thousands, except share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
INTEREST INCOME:				
Loans, including fees	$ 33,566	$ 34,140	$ 96,505	$ 99,417
Investment securities	4,179	4,715	13,590	14,223
Interest bearing deposits in financial institutions and federal funds sold	430	1,433	1,018	1,767
Mortgage loans held for sale	335	215	947	1,023
Total Interest Income	38,510	40,503	112,060	116,430
INTEREST EXPENSE:				
Deposits	10,888	14,399	33,930	40,225
Advances from the Federal Home Loan Bank	3,896	3,403	10,888	8,988
Convertible subordinated capital debentures	566	563	1,615	1,693
Repurchase agreements and other borrowings	233	182	812	1,109
Total Interest Expense	15,583	18,547	47,245	52,015
Net Interest Income	22,927	21,956	64,815	64,415
PROVISION FOR LOAN LOSSES	1,568	266	4,531	1,912
Net Interest Income after Provision for Loan Losses	21,359	21,690	60,284	62,503
NONINTEREST INCOME:				
Residential mortgage brokerage income, net	1,328	1,345	4,048	4,966
Real estate brokerage and property management income, net	2,768	1,575	6,828	4,280
Insurance commissions and other title fees and income, net	3,214	3,467	10,289	10,009
Service charges on deposit accounts	1,486	1,344	4,358	4,082
Credit card merchant fees, net	500	454	1,450	1,288
Other income	1,625	1,058	4,738	3,113
Gain (loss) on securities available-for-sale	804	-	2,960	(10)
Total Noninterest Income	11,725	9,243	34,671	27,728
NONINTEREST EXPENSE:				
Salaries and employee benefits	14,606	13,256	41,486	38,105
Occupancy expense	2,205	1,955	6,307	5,650
Furniture and equipment	1,299	1,233	3,894	3,634
Other expenses	5,930	5,670	17,255	17,180
Total Noninterest Expense	24,040	22,114	68,942	64,569
Income before income tax expense and minority interest	9,044	8,819	26,013	25,662
Minority interest in net loss of unconsolidated subsidiaries	(15)	-	(54)	-
Income before income tax expense	9,029	8,819	25,959	25,662
Provision for income tax expense	2,614	2,830	7,510	8,270
Net Income	$ 6,415	$ 5,989	$ 18,449	$ 17,392
Per common share information				
Basic earnings	$ 0.26	$ 0.25	$ 0.76	$ 0.74
Diluted earnings	$ 0.25	$ 0.24	$ 0.73	$ 0.69
Cash dividends declared	$ 0.08	$ 0.08	$ 0.24	$ 0.24

See accompanying Notes to Consolidated Financial Statements.

TOWNEBANK

CONSOLIDATED STATEMENTS OF CASH FLOW (unaudited)

(Dollars in thousands)	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
OPERATING ACTIVITIES:		
Net income	$ 18,449	$ 17,392
Adjustments to reconcile net income to net cash from operating activities:		
Net accretion of securities	(228)	(184)
Investment securities (gains) losses	(2,960)	10
Depreciation, amortization, and other intangible amortization	6,468	5,246
Provision for loan losses	4,531	1,912
Share-based compensation expense	1,278	1,256
Loans held for sale	3,166	(2,575)
Changes in:		
Interest receivable	1,533	(1,009)
Other assets	(4,264)	(7,104)
Interest payable	(1,234)	2,048
Other liabilities	3,250	(553)
Net cash from operating activities	29,989	16,439
INVESTING ACTIVITIES:		
Purchase of available-for-sale securities	(101,829)	(35,835)
Purchase of held-to-maturity securities	(15,139)	(4,150)
Sale of available-for-sale securities	128,122	3,619
Proceeds from maturities, calls, and prepayments of securities	47,460	24,297
Net increase in loans	(370,458)	(142,833)
Net purchase of premises and equipment	(7,278)	(8,711)
Acquisition of business, net of cash acquired	(7,225)	(8,473)
Net cash used for investing activities	(326,347)	(172,086)
FINANCING ACTIVITIES:		
Net increase in deposit accounts	364,014	138,336
Net change in borrowings	75,348	136,057
Proceeds from issuance of common stock	2,588	6,174
Proceeds from issuance of preferred stock	59,608	-
Cash dividends paid	(5,890)	(10,991)
Net cash from financing activities	495,668	269,576
Change in cash and cash equivalents	199,310	113,929
Cash and cash equivalents at beginning of year	69,335	51,601
Cash and cash equivalents at end of period	$ 268,645	$ 165,530
Supplemental cash flow information:		
Cash paid for interest	$ 46,011	$ 49,967
Cash paid for income taxes	$ 8,105	$ 9,059
Noncash financing and investing activities:		
Net unrealized loss on available-for-sale securities	$ (3,251)	$ (1,185)
Common stock issued in connection with business acquisition	$ -	$ 1,200
Common stock issued in connection with conversion of convertible subordinated capital debentures	$ 241	$ 491

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)

(Dollars in thousands)	Common Shares	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Comprehensive Income	Total
Balance, January 1, 2008	24,104,418	$ -	$ 40,182	$ 168,364	$ 46,227	$ 2,083	$ -	$ 256,856
Net income	-	-	-	-	18,449	-	18,449	18,449
Unrealized loss on securities net of tax expense	-	-	-	-	-	(3,251)	(3,251)	(3,251)
Cash dividends declared					(5,906)			(5,906)
Issuance of preferred stock	-	2,993	-	56,615	-	-	-	59,608
Issuance of common stock	214,491	-	357	3,017	-	-	-	3,374
Issuance of common stock-stock compensation plans	99,973	-	169	563	-	-	-	732
Director's deferred compensation	(40,619)	-	(69)	3,579	-	-	-	3,510
Balance, September 30, 2008	24,378,263	$ 2,993	$ 40,639	$ 232,138	$ 58,770	$ (1,168)	$ 15,198	$ 333,372

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all of the disclosures and notes required by accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the financial statements reflect all adjustments, which are of a normal reoccurring nature, that are necessary for a fair presentation for the periods presented as required by Regulation S-X, Rule 10-01. These statements should be read in conjunction with the Company's 2007 audited Consolidated Financial Statements and the 2007 Annual Report on Form 10-K. Results of operations for the quarter ended September 30, 2008 are not necessarily indicative of the results of operations for the full year or any other interim periods. The financial statements contained in this Form 10-Q have been subject to a review by Goodman & Company, LLP, independent certified public accountants, as described in their report included as Exhibit 99.

To maintain consistency and comparability, certain amounts from prior periods have been reclassified to conform to current period presentation.

Significant Accounting Pronouncements

On October 10, 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 157-3, *"Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active."* The FSP clarifies the application of Statement of Financial Accounting Standards No. ("SFAS") 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. The provisions of FSP FAS 157-3 did not have an impact on the Company's consolidated financial position or results of operations.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This Statement is effective 60 days following the approval by the Securities and Exchange Commission of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The adoption of SFAS 162 is not expected to have a material impact on the Company's consolidated financial position and results of operation.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of SFAS 133.* The standard requires enhanced disclosures about derivative instruments and hedged items that are accounted for under SFAS 133 and related interpretations. The standard will be effective for periods beginning after November 15, 2008, with early adoption permitted. The standard expands the disclosure requirements for derivatives and hedged items and is not expected to have a material impact on the Company's consolidated financial position and results of operations.

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.

Effective January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements* and SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The adoption of SFAS 157 and SFAS 159 did not have a material impact on the Company's consolidated results of operations and financial position. For additional information on the fair value of certain financial assets and liabilities, see Note 10 to the Consolidated Financial Statements.

Note 2. Earnings per Share

Earnings per share are computed by dividing net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted earnings per share is determined by dividing net income available to common shareholders by the weighted average shares outstanding, assuming all securities that could be converted to common stock have been converted or exercised.

The following table summarizes the basic and diluted earnings per share calculations (dollars in thousands, except share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Basic				
Net income available to shareholders, as reported	$ 6,415	$ 5,989	$ 18,449	$ 17,392
Average common shares outstanding	24,240,840	23,821,574	24,125,004	23,657,212
Basic earnings per share amount	$ 0.26	$ 0.25	$ 0.76	$ 0.74
Diluted				
Net income available to shareholders, as reported	$ 6,415	$ 5,989	$ 18,449	$ 17,392
Add: interest applicable to 6% subordinated debt, net of tax (1)	243	248	724	736
Net income available to shareholders, for diluted EPS	6,658	6,237	19,173	18,128
Average common shares outstanding	24,240,840	23,821,574	24,125,004	23,657,212
Add shares if converted:				
stock compensation plans, net of tax benefit	408,690	517,396	416,879	664,112
6% convertible subordinated debentures (2)	1,894,134	1,923,954	1,894,134	1,923,954
Average diluted shares outstanding	26,543,664	26,262,924	26,436,017	26,245,278
Diluted earning per share amount	$ 0.25	$ 0.24	$ 0.73	$ 0.69

(1) Annualized interest on both 6% convertible subordinated capital debentures (net of tax) is added to net income since this interest would not be paid if the debentures were converted to common stock.
(2) Shares assumed to have been converted since the beginning of the period.

At September 30, 2008, the TowneBank Series II convertible subordinated capital notes entitled the holders to convert their notes into 547,647 shares of common stock. These shares were not included in the computation of diluted earnings per share as the effect was antidilutive for the period.

At September 30, 2008, the TowneBank 8% Non-Cumulative Convertible Preferred Stock, Series A entitled the holders to convert their shares into 3,224,900 shares of common stock. These shares were not included in the computation of diluted earnings per share as the effect was antidilutive for the period.

Note 3. 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. Comprehensive income is as follows (in thousands).

	Nine Months Ended September 30, 2008	2007
Unrealized losses on securities:		
Unrealized holding losses arising during the period	$ (2,042)	$ (1,834)
Realized (gains) losses reclassified into earnings	(2,960)	10
Net unrealized losses	(5,002)	(1,824)
Income tax benefit	1,751	639
Net unrealized other comprehensive loss	$ (3,251)	$ (1,185)

Note 4. Investment Securities

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

	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury obligations and direct obligations of US government agencies	$ 38,012	$ 988	$ -	$ -	$ 38,012	$ 988
Municipal securities	16,357	1,147	987	15	17,344	1,162
Federal agency mortgage backed securities	275	2	54	1	329	3
Corporate obligations	11,308	3,023	-	-	11,308	3,023
Total temporarily impaired securities	$ 65,952	$ 5,160	$ 1,041	$ 16	$ 66,993	$ 5,176

As of September 30, 2008, management does not believe any unrealized losses, individually or in the aggregate, represent other-than-temporary impairment.

Note 5. 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 Residential Real Estate Corporation with TowneBank Mortgage; Corolla Classic Vacations; Corolla Real Estate; Lawyers Escrow and Title, LLC; NewTowne Mortgage, LLC; and Towne Mortgage, LLC, 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 reportable 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.

The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in the Company's 2007 audited Consolidated Financial Statements. 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.

The following tables provide information about reportable segments and reconciliation of such information to the consolidated financial statements (dollars in thousands).

Three Months Ended September 30, 2008	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 22,665	$ 259	$ 3	$ 22,927
Provision for loan losses	1,568	-	-	1,568
Net interest income after provision for loan losses	21,097	259	3	21,359
Residential mortgage brokerage income, net	(647)	1,975	-	1,328
Real estate brokerage and property management income, net	-	2,768	-	2,768
Insurance commissions and other title fees and income, net	-	580	2,634	3,214
Other noninterest income	4,083	236	96	4,415
Noninterest expense	17,710	4,282	2,048	24,040
Income before income tax, corporate allocation and minority interest	6,823	1,536	685	9,044
Corporate allocation	301	(177)	(124)	-
Minority interest	-	(15)	-	(15)
Income before income tax provision	7,124	1,344	561	9,029
Provision for income tax expense (benefit)	1,895	500	219	2,614
Net income	$ 5,229	$ 844	$ 342	$ 6,415
Net income as percentage of total	81.5%	13.2%	5.3%	100.0%

Three Months Ended September 30, 2007	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 21,642	$ 287	$ 27	$ 21,956
Provision for loan losses	266	-	-	266
Net interest income after provision for loan losses	21,376	287	27	21,690
Residential mortgage brokerage income, net	73	1,272	-	1,345
Real estate brokerage and property management income, net	-	1,575	-	1,575
Insurance commissions and other title fees and income, net	-	745	2,722	3,467
Other noninterest income	2,561	216	79	2,856
Noninterest expense	16,324	3,547	2,243	22,114
Income before income tax and corporate allocation	7,686	548	585	8,819
Corporate allocation	313	(187)	(126)	-
Income before income tax provision	7,999	361	459	8,819
Provision for income tax expense (benefit)	2,621	16	193	2,830
Net income	$ 5,378	$ 345	$ 266	$ 5,989
Net income as percentage of total	89.8%	5.8%	4.4%	100.0%

Nine Months Ended September 30, 2008	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 64,212	$ 589	$ 14	$ 64,815
Provision for loan losses	4,531	-	-	4,531
Net interest income after provision for loan losses	59,681	589	14	60,284
Residential mortgage brokerage income, net	(507)	4,555	-	4,048
Real estate brokerage and property management income, net	-	6,828	-	6,828
Insurance commissions and other title fees and income, net	-	1,688	8,601	10,289
Other noninterest income	12,506	723	277	13,506
Noninterest expense	50,545	12,288	6,109	68,942
Income before income tax, corporate allocation and minority interest	21,135	2,095	2,783	26,013
Corporate allocation	808	(486)	(322)	-
Minority interest	-	(54)	-	(54)
Income before income tax provision	21,943	1,555	2,461	25,959
Provision for income tax expense (benefit)	5,980	572	958	7,510
Net income	$ 15,963	$ 983	$ 1,503	$ 18,449
Net income as percentage of total	86.5%	5.3%	8.1%	100.0%

Nine Months Ended September 30, 2007	Banking	Realty	Insurance	Consolidated Totals
Net interest income	$ 63,799	$ 573	$ 43	$ 64,415
Provision for loan losses	1,912	-	-	1,912
Net interest income after provision for loan losses	61,887	573	43	62,503
Residential mortgage brokerage income, net	242	4,725	-	4,967
Real estate brokerage and property management income, net	-	4,280	-	4,280
Insurance commissions and other title fees and income, net	-	2,075	7,934	10,009
Other noninterest income	7,629	574	269	8,472
Noninterest expense	47,586	10,803	6,180	64,569
Income before income tax and corporate allocation	22,172	1,424	2,066	25,662
Corporate allocation	866	(532)	(334)	-
Income before income tax provision	23,038	892	1,732	25,662
Provision for income tax expense (benefit)	7,274	285	711	8,270
Net income	$ 15,764	$ 607	$ 1,021	$ 17,392
Net income as percentage of total	90.6%	3.5%	5.9%	100.0%

Note 6. Commitments and Contingencies

Commitments to extend credit are agreements to lend to customers provided there are no violations of any conditions set forth in the contracts. Commitments are evaluated on a case by case basis based on the customer's credit worthiness. They tend to have fixed expiration dates and may expire without being completely utilized. Therefore, the total commitment amounts may not necessarily represent future cash requirements. At September 30, 2008, the amounts of off-balance sheet commitments to extend credit were $949.4 million.

Standby letters of credit are written conditional commitments issued by us to guarantee the performance of customers to third parties. The credit risk involved is similar to the risk involved in extending loans to customers. At September 30, 2008, standby letters of credit and financial guarantees were $27.3 million.

Additionally, the Company had $314.0 million in mortgage loans sold to investors with various recourse and warranty provisions. The Company provided an allowance for estimated losses from such provisions that management considered adequate at September 30, 2008.

Rate lock commitments, which are designed to mitigate the Company's exposure to fluctuations in interest rates associated with rate lock commitments and loans held for sale, are related to the origination of mortgage loans held for sale and the corresponding forward loan sale commitments are considered derivative instruments and totaled $40.4 million at September 30, 2008. All of the gain on sale generated from mortgage banking activities is recorded in the financials at the time the loan is closed.

Note 7. Mergers and Acquisitions

Effective January 3, 2008, TowneBank acquired both Corolla Classic Vacations, a resort property management company, and Corolla Real Estate, a realty company. The acquisition was accounted for as a business combination under the purchase method of accounting in accordance with SFAS 141, *Business Combinations,* and, as such, the assets and liabilities of the acquired companies were recorded at their respective fair values as of the acquisition date. The results of operations of the acquired businesses were included in the Company's Consolidated Statements of Income commencing January 3, 2008. The purchase price was $7.2 million, including transaction costs. The preliminary allocation of the purchase price resulted in tangible assets of $1.6 million, goodwill of $3.3 million, and other intangible assets, including customer lists and non-compete agreements of $2.3 million. These amounts are preliminary and subject to change pending finalization of the purchase price allocation.

Note 8. Goodwill and Other Intangibles

Goodwill and intangible assets with an indefinite life are subject to impairment testing at least annually or more often if events or circumstances suggest potential impairment. Other acquired intangible assets determined to have a finite life are amortized over their estimated useful life in a manner that best reflects the economic benefits of the intangible asset. Intangible assets with a finite life are periodically reviewed for other than temporary impairment. See *Note 2 – Accounting Policies* and *Note 6 – Goodwill and Other Intangibles* of the 2007 Annual Report to the Shareholders for more information on the Company's goodwill and other intangibles. Management was not aware of any events that would indicate impairment at September 30, 2008. The gross carrying amount and accumulated depreciation for the Company's intangible assets follows (in thousands).

	September 30,			
	2008		2007	
	Carrying amount	Accumulated Amortization	Carrying amount	Accumulated Amortization
Core deposit intangible	$ 3,677	$ 2,023	$ 3,677	$ 1,578
Non-compete agreements	1,651	677	1,361	410
Property management contracts	620	549	620	465
Customer lists	6,811	1,180	4,558	523
Total intangible assets subject to amortization	12,759	4,429	10,216	2,976
Title plant	704	-	841	-
Trade name	500	-	500	-
Contractual agreements	3,231	-	3,231	-
Total intangible assets not subject to amortization	4,435	-	4,572	-
Total intangible assets	$ 17,194	$ 4,429	$ 14,788	$ 2,976

Changes in the net carrying amount of goodwill related to each of the Company's segments since December 31, 2007 are as follows (in thousands).

	Banking	Realty	Insurance	Consolidated Totals
Balance, December 31, 2007	$ 45,520	$ 4,833	$ 5,981	$ 56,334
Additions to goodwill	-	3,316	477	3,793
Balance, September 30, 2008	$ 45,520	$ 8,149	$ 6,458	$ 60,127

Note 9. 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 is intended to provide retirement benefits and postretirement health benefits to the executives covered under the plan once implemented.

Note 10. Fair Value Disclosures

Effective January 1, 2008, the Company adopted SFAS 157, which provides a framework for measuring fair value under GAAP. As described more fully below, SFAS 157 also eliminated the deferral of gains and losses at inception of certain derivative contracts whose fair value was not evidenced by market observable data. SFAS 157 requires that the impact of this change in accounting for derivative contracts be recorded as an adjustment to beginning retained earnings in the period of adoption.

The Company also adopted SFAS 159 on January 1, 2008. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. SFAS 159 requires that the difference between the carrying value before election of the fair value option and the fair value of these instruments be recorded as an adjustment to beginning retained earnings in the period of adoption. The Company has not elected to adopt the fair value option for any financial instruments.

Fair Value Measurement

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.

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

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

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Assets/Liabilities at Fair Value
Available-for-sale securities	$ 20	$ 212,089	-	$ 212,109

Certain assets and liabilities are measured at fair value on a non-recurring basis and, therefore, are not included in the tables above. These include assets such as loans held-for-sale that are measured at the lower of cost or market, goodwill and other intangible assets. There were no fair value adjustments to assets and liabilities measured at fair value on a non-recurring basis during the three- and nine-month periods ended September 30, 2008.

Note 11. Series A Convertible Preferred Stock

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12. Subsequent Event

On October 10, 2008 TowneBank declared the first cash dividend of $2.33 per share on its preferred stock for the period August 15, 2008 through November 30, 2008. The dividend is payable on December 1, 2008 to shareholders of record on November 17, 2008.

TOWNEBANK

Selected Quarterly Information (unaudited)

(Dollars in thousands, except per share data)	Third Quarter 2008	Second Quarter 2008	First Quarter 2008	Fourth Quarter 2007	Third Quarter 2007
Results of Operations:					
Interest income	$ 38,510	$ 36,416	$ 37,133	$ 39,493	$ 40,503
Interest expense	15,583	14,754	16,908	18,409	18,547
Net interest income	22,927	21,662	20,225	21,084	21,956
Provision for loan losses	1,568	2,068	895	831	266
Net interest income after provision for loan losses	21,359	19,594	19,330	20,253	21,690
Noninterest income:					
Residential mortgage brokerage income, net	1,328	1,433	1,287	1,197	1,345
Real estate brokerage and property management income, net	2,768	2,240	1,821	1,182	1,575
Insurance commissions and other title fees and income, net	3,214	3,220	3,855	3,092	3,467
Service charges on deposit accounts	1,486	1,450	1,422	1,472	1,344
Credit card merchant fees, net	500	506	444	422	454
Other income	1,625	1,659	1,453	1,649	1,058
Gain on sale of securities available-for-sale	804	678	1,478	79	-
Total noninterest income	11,725	11,186	11,760	9,093	9,243
Noninterest expense:					
Salaries and benefits	14,606	13,464	13,416	11,978	13,256
Occupancy expense	2,205	2,077	2,025	2,044	1,955
Furniture and equipment	1,299	1,287	1,307	1,237	1,233
Other expenses	5,930	5,522	5,804	5,679	5,670
Total noninterest expense	24,040	22,350	22,552	20,938	22,114
Income before minority subs and income taxes	9,044	8,430	8,538	8,408	8,819
Income (loss) from unconsolidated minority subs	(15)	(29)	(9)	12	-
Income before income taxes	9,029	8,401	8,529	8,420	8,819
Provision for income tax expense	2,614	2,360	2,536	2,553	2,830
Net income	$ 6,415	$ 6,041	$ 5,993	$ 5,867	$ 5,989
Per Share Data:					
Net income:					
Basic	$ 0.26	$ 0.25	$ 0.25	$ 0.25	$ 0.25
Diluted	0.25	0.24	0.24	0.23	0.24
Book value at period end	11.23	10.87	10.95	10.66	10.30
Tangible book value at period end	8.24	7.87	7.92	7.83	7.49
Cash dividends paid	0.08	0.08	0.08	0.08	0.08
Cash dividends declared	0.08	0.08	0.08	0.08	0.08
Common Stock Closing Price:					
High	$ 26.68	$ 19.80	$ 18.19	$ 21.30	$ 19.75
Low	12.86	14.83	14.49	15.50	16.50
Close	22.00	15.06	14.69	16.10	18.59
Selected Financial Ratios:					
Return on average assets	0.89%	0.92%	0.94%	0.93%	0.96%
Return on average tangible assets	0.91%	0.94%	0.97%	0.96%	0.99%
Return on average equity	8.32%	9.14%	9.22%	9.25%	9.74%
Return on average tangible equity	10.92%	12.60%	12.71%	12.63%	13.43%
Net interest margin	3.52%	3.65%	3.52%	3.71%	3.87%
Net interest margin (tax-equivalent basis)	3.57%	3.70%	3.58%	3.75%	3.91%
Daily Averages:					
Total assets	$ 2,862,793	$ 2,649,180	$ 2,562,010	$ 2,497,178	$ 2,464,961
Total tangible assets	2,789,811	2,576,101	2,490,434	2,429,907	2,397,905
Loans, net of unearned income, excluding nonaccrual loans	2,139,210	1,976,214	1,861,245	1,806,149	1,765,908
Total earning assets	2,593,447	2,390,103	2,308,539	2,256,534	2,252,124
Total deposits	2,069,723	1,938,326	1,873,761	1,842,059	1,834,021
FHLB advances	358,158	317,151	310,485	296,689	296,739
Shareholders' equity	306,702	265,927	261,293	251,624	243,946
Tangible shareholders' equity	233,720	192,847	189,717	184,347	176,890
Basic weighted average shares outstanding	24,240,840	24,144,485	24,035,674	23,905,006	23,821,574
Diluted weighted average shares outstanding	26,543,664	26,447,279	26,406,695	26,324,857	26,262,924

PART I. FINANCIAL INFORMATION

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to assist readers in understanding and evaluating our consolidated results of operations and financial condition. The following should be read in conjunction with our 2007 audited Consolidated Financial Statements and the 2007 Annual Report on Form 10-K.

Forward-Looking Statements. *This quarterly report on Form 10-Q contains certain forward-looking statements with respect to our financial condition, results of operations, and business. These forward-looking statements involve certain risks and uncertainties and are based on the beliefs and assumptions of our management. When used in this quarterly report or future regulatory filings, in press releases or other public shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," "believe," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. We wish to caution the readers and users of this information not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors including regional and national economic conditions, changes in the levels of market rates of interest, credit risk and lending activities, competitive and legislative or regulatory factors, and other factors described in our 2007 Annual Report on Form 10-K could affect our financial performance and could cause actual results for future periods to differ materially from those anticipated or projected.*

We do not undertake and specifically disclaim any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

<u>Overview</u>

TowneBank ("Company," "we," "us") is a retail and commercial banking business serving the Greater Hampton Roads area. We place special emphasis on serving the financial needs of small- and medium-size businesses, professionals, and individuals in our geographic footprint. We offer a full range of banking and related financial services through our controlled divisions and subsidiaries.

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.

Diluted earnings per common share grew by 4.2% in the third quarter and by 5.8% in the first nine months of 2008 as compared to the same periods in 2007, despite the continuation of stress in the financial markets. Additionally, loans and deposits continued to grow, increasing by 23.3% and 19.3%, respectively, as compared to the period ended September 30, 2007.

Management's Discussion and Analysis

The following is a summary of the Company's financial performance in the quarter and nine months ended September 30, 2008:

- Net income for the three months ended September 30, 2008 was $6.4 million, or $0.25 per common diluted share, compared with $6.0 million, or $0.24 per diluted share, in the same period in 2007. Net income for the nine months ended September 30, 2008 was $18.4 million, or $0.73 per common diluted share, compared with $17.4 million, or $0.69 per diluted share, in the nine months ended September 30, 2007.

- Net interest income increased $971,000, or 4.4%, in the third quarter and $400,000, or 0.6% in the nine months ended September 30, 2008 from the comparable periods in 2007. The increase was primarily due to the growth in loans and other earning assets and the positive effect of the repricing of interest bearing liabilities, which lag the series of rate cuts that began in the third quarter of 2007. The interest rate spread decreased in the third quarter of 2008 by 12 basis points from the second quarter of 2008 and was 1 basis point lower, on a tax-equivalent basis, than the comparative period in 2007.

- Noninterest income for the third quarter and first nine months of 2008 increased $2.5 million, or 26.9%, and $6.9 million, or 25.0%, respectively, over the comparative periods in 2007. Excluding gains and losses on securities available for sale, noninterest income increased by $1.7 million, or 18.1%, over the third quarter of 2007 and $4.0 million, or 14.3% as compared to the first nine months of 2007. The increase was driven by the first quarter 2008 acquisition of Corolla Classic Vacations and Corolla Real Estate, which contributed revenue of $1.6 million and $3.4 million in the three- and nine-month periods ended September 30, 2008, respectively. The increases in noninterest income were partially offset by a decline in real estate and residential mortgage brokerage.

- For the three- and nine-month periods ended September 30, 2008, noninterest expense increased $1.9 million, or 8.7%, and $4.4 million, or 6.8%, respectively, compared to the comparative periods in 2007. The increase was driven primarily by increased occupancy expenses and higher personnel costs.

- Our effective tax rate decreased to 29.0% in the third quarter of 2008 compared to 32.1% for the same period in 2007. For the first nine months of 2008, the effective tax rate decreased to 28.9% compared to 32.2% for the same period in 2007. The decrease resulted from several factors including the acquisition of bank-owned life insurance, additional tax exempt interest income and a decrease in disallowed expenses.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America 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, and estimates of fair value to be critical accounting policies. Refer to our 2007 Annual Report to the Shareholders for further discussion of these policies.

ANALYSIS OF RESULTS OF OPERATIONS

Consolidated Performance Summary

Profitability as measured by our annualized return on average assets ("ROA") was 0.89% for the third quarter of 2008 compared to 0.96% for the third quarter of 2007, and 0.92% for the second quarter of 2008. The annualized return on average tangible assets was 0.91%, 0.99%, and 0.94% for the same respective periods. ROA for the nine months ended September 30, 2008 was 0.92% compared to 0.99% for nine months ended September 30, 2007. ROA was impacted by the 6.1% increase in net income and an increase in average assets of $341.7 million, or 14.5%, from September 30, 2007 to September 30, 2008.

The annualized return on average equity ("ROE") was 8.32% for the third quarter of 2008, 9.74% for the third quarter of 2007, and 9.14% for the second quarter of 2008, while the annualized return on average tangible equity was 10.92%, 13.43%, and 12.60% for the same respective periods. ROE for the nine months ended September 30, 2008 was 8.86% compared to 9.73% for nine months ended September 30, 2007, while the annualized return on average tangible equity was 11.99%, and 13.41% for the same respective periods.

Operating income, calculated as net interest income and noninterest income less gains on available-for-sale securities, was $33.8 million for the quarter ended September 30, 2008, which increased $2.6 million, or 8.5%, compared to the quarter ended September 30, 2007. Operating income was $32.2 million for the quarter ended June 30, 2008. For the nine months ended September 30, 2008, operating income was $96.5 million reflecting an increase of $4.4 million, or 4.7% over comparative 2007.

Basic earnings per share for the three months ended September 30, 2008 increased to $0.26 as compared to $0.25 in the same period in 2007, while basic earnings per share for the nine months ended September 30, 2008 increased to $0.76 from $0.74 in comparative 2007. Diluted earnings per share in the third quarter increased over comparative 2007 to $0.25 from $0.24, while diluted earnings per share for the nine months ended September 30, 2008 increased to $0.73 from $0.69 in comparative 2007.

Net Interest Income. Net interest income, the major source of our earnings, is the income generated by interest earning assets reduced by the total interest cost of the funds incurred to carry them. It is impacted by the market interest rates and the mix and volume of earning assets and interest bearing liabilities. The yields and rates in this discussion and in the following tables 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.

We reported net interest income, on a tax-equivalent basis, of $23.3 million for the quarter ended September 30, 2008, which was $1.1 million or 4.9% above the year ago period and $1.3 million or 5.8% above the quarter ended June 30, 2008. In the year to date period, net interest income, on a tax-equivalent basis, was $65.8 million, which was $712 thousand or 1.1% more than the comparable year to date period. Starting late in the third quarter of 2007, the Federal Reserve began a series of short term rate cuts that had cumulatively resulted in the Prime rate falling by 325 basis points thru September 30, 2008. These rapid and dramatic cuts had an immediate effect on our Prime based lending portfolio. The effects on other accounts, particularly deposits, occurred with a lag. The improvement in our margin since the first quarter of this year is mainly attributable to the positive effect of this lag catching up with the Prime rate change. Assets such as Fed Funds and short term bank deposits are highly liquid, but have lower yields than loans or investments. Due to uncertainty among depositors and the cost and uncertainties of alternative funding we made the decision to increase our liquidity position at quarter-end. We will reevaluate the size of our liquidity position as the fourth quarter progresses and results of government stabilization and stimulus become evident.

Interest income, on a tax-equivalent basis, was $38.8 million for the quarter ended September 30, 2008, which was $1.9 million or 4.6% less than the comparable 2007 quarter and $2.1 million or 5.7% above the quarter ended June 30, 2008. In the year to date periods, tax-equivalent interest income was $113.0 million thru September 30, 2008, down $4.1 million or 3.5% from September 30, 2007. Although interest rates were down in the 2008 periods, interest income was helped by strong growth of loans and earning assets.

Interest expense, for the quarter ended September 30, 2008, was $15.6 million, which was $3.0 million or 16.0% below the year ago quarter, and $828 thousand or 5.6% above the quarter ended June 30, 2008. Interest expense for the year to date was $47.2 million at September 30, 2008, $4.8 million or 9.2% below the year earlier amount. In the linked quarter comparison, while rates on interest bearing liabilities continued to decline, the expense rose on strong deposit growth.

Net interest margin, on a tax-equivalent basis, which is net interest income expressed as a percentage of average earning assets, was 3.57% in the quarter ended September 30, 2008, which was 34 basis points lower than the September 30, 2007 quarter and 13 basis points lower than the June 30, 2008 quarter, on a tax-equivalent basis. In the year to date periods, net interest margin was 3.61% for September 30, 2008, a decrease of 45 basis points from the year earlier period.

The following tables depict our interest income on earning assets and related average yields as well as interest expense on interest bearing liabilities and related average rates paid for the periods presented. Also presented for the three-month periods are the changes in interest income and expense caused by variations in the volume and mix of these assets and liabilities, as well as changes in interest rates when compared to the previous three-month period (dollars in thousands).

	Three Months Ended September 30, 2008			Three Months Ended June 30, 2008			Three Months Ended September 30, 2007		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 2,139,210	$ 33,589	6.25%	$ 1,976,213	$ 31,362	6.38%	$ 1,765,908	$ 34,140	7.67%
Taxable investment securities	238,644	3,123	5.21%	261,758	3,543	5.44%	274,950	3,914	5.69%
Tax-exempt investment securities	103,994	1,357	5.19%	103,536	1,351	5.25%	80,188	1,013	5.05%
Interest bearing deposits	86,962	430	1.97%	24,724	149	2.42%	110,750	1,433	5.13%
Loans held for sale	24,637	335	5.40%	23,872	332	5.59%	20,328	215	4.23%
Total earning assets	2,593,447	38,834	5.96%	2,390,103	36,737	6.18%	2,252,124	40,715	7.17%
Less allowance for loan losses	(24,562)			(22,843)			(20,580)		
Total nonearning assets	293,908			281,920			233,417		
Total Assets	$ 2,862,793			$ 2,649,180			$ 2,464,961		
Liabilities and Equity:									
Interest bearing deposits									
Demand and money market	$ 496,788	$ 1,430	1.15%	$ 505,701	$ 1,445	1.15%	$ 492,815	$ 3,565	2.87%
Savings	59,054	295	1.99%	35,307	122	1.39%	26,209	125	1.89%
Certificates of deposit	1,007,205	9,163	3.62%	914,343	8,926	3.93%	846,195	10,709	5.02%
Total interest bearing deposits	1,563,047	10,888	2.77%	1,455,351	10,493	2.90%	1,365,219	14,399	4.18%
Borrowings	410,432	4,129	4.00%	369,578	3,771	4.10%	311,097	3,585	4.57%
Subordinated debentures	41,233	566	5.46%	41,407	491	4.77%	42,049	563	5.36%
Total interest bearing liabilities	2,014,712	15,583	3.08%	1,866,336	14,755	3.18%	1,718,365	18,547	4.28%
Demand deposits	506,676			482,975			468,802		
Other noninterest bearing liabilities	34,703			33,942			33,848		
Total liabilities	2,556,091			2,383,253			2,221,015		
Shareholders' equity	306,702			265,927			243,946		
Total liabilities and equity	$ 2,862,793			$ 2,649,180			$ 2,464,961		
Net interest income (tax-equivalent basis)		23,251			21,982			22,168	
Tax-equivalent basis adjustment		(324)			(320)			(212)	
Net interest income		$ 22,927			$ 21,662			$ 21,956	
Interest rate spread (1)			2.88%			3.00%			2.89%
Interest expense as a percent of average earning assets			2.39%			2.48%			3.27%
Net interest margin (2)			3.57%			3.70%			3.91%
Total cost of deposits			2.09%			2.18%			3.11%

(1) Interest spread is the average yield earned on earning assets less the average rate paid on interest bearing liabilities. Fully tax equivalent
(2) Net interest margin is net interest income expressed as a percentage of average earning assets. Fully tax equivalent

(Dollars in thousands)	Increase/(Decrease) Three Months Ended September 30, 2008 Compared to Three Months Ended June 30, 2008			Increase/(Decrease) Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007		
	Volume	Rate (1)	Total	Volume	Rate (1)	Total
Assets:						
Loans	$ 5,985	$ (3,758)	$ 2,227	$ 26,478	$ (27,029)	$ (551)
Taxable investment securities	(281)	(139)	(420)	(481)	(310)	(791)
Tax-exempt investment securities	36	(30)	6	314	30	344
Interest bearing deposits	470	(189)	281	(260)	(743)	(1,003)
Loans held for sale	45	(42)	3	53	67	120
Total earning assets	6,255	(4,158)	2,097	26,104	(27,985)	(1,881)
Liabilities and Equity:						
Interest bearing deposits						
Demand and money market	(12)	(3)	(15)	197	(2,332)	(2,135)
Savings	106	67	173	163	7	170
Certificates of deposit	3,329	(3,092)	237	8,985	(10,531)	(1,546)
Total interest bearing deposits	3,423	(3,028)	395	9,345	(12,856)	(3,511)
Borrowings	906	(548)	358	2,935	(2,391)	544
Subordinated debentures	(14)	89	75	(42)	45	3
Total interest bearing liabilities	4,315	(3,487)	828	12,238	(15,202)	(2,964)
Net interest income	$ 1,940	$ (671)	$ 1,269	$ 13,866	$ (12,783)	$ 1,083

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

(Dollars in thousands)	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007			Nine Months Ended September 30, 2008 Compared with September 30, 2007		
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Increase (Decrease)	Change due to Rate	Change due to Volume
Assets:									
Loans (net of unearned income and deferred costs), excluding nonaccrual loans	$ 1,992,759	$ 96,573	6.47%	$ 1,719,634	$ 99,417	7.73%	$ (2,844)	$ (22,797)	$ 19,953
Taxable investment securities	259,345	10,508	5.41%	277,222	11,820	5.68%	(1,312)	(554)	(758)
Tax-exempt investment securities	100,588	3,961	5.26%	79,854	3,037	5.07%	924	117	807
Interest bearing deposits	56,520	1,017	2.40%	45,802	1,767	5.16%	(750)	(1,291)	541
Loans held for sale	22,078	947	5.73%	20,134	1,023	6.78%	(76)	(209)	133
Total earning assets	2,431,290	113,006	6.21%	2,142,646	117,064	7.30%	(4,058)	(24,734)	20,676
Less: allowance for loan losses	(23,020)			(20,218)					
Total nonearning assets	283,684			227,788					
Total Assets	$ 2,691,954			$ 2,350,216					
Liabilities and Equity:									
Interest bearing deposits									
Demand and money market	$ 502,377	$ 5,077	1.35%	$ 476,252	$ 10,109	2.84%	$ (5,032)	$ (5,899)	$ 867
Savings	40,082	506	1.69%	24,003	299	1.67%	207	3	204
Certificates of deposit	939,655	28,347	4.03%	803,643	29,817	4.96%	(1,470)	(7,865)	6,395
Total interest bearing deposits	1,482,114	33,930	3.06%	1,303,898	40,225	4.12%	(6,295)	(13,761)	7,466
Borrowings	377,965	11,700	4.13%	276,507	10,097	4.88%	1,603	(2,439)	4,042
Subordinated debentures	41,403	1,615	5.21%	42,233	1,693	5.34%	(78)	(43)	(35)
Total interest bearing liabilities	1,901,482	47,245	3.32%	1,622,638	52,015	4.29%	(4,770)	(16,243)	11,473
Demand deposits	478,887			454,410					
Other noninterest bearing liabilities	33,506			34,163					
Total liabilities	2,413,875			2,111,211					
Shareholders' equity	278,079			239,005					
Total liabilities and equity	$ 2,691,954			$ 2,350,216					
Net interest income (tax-equivalent basis)		65,761			65,049				
Tax-equivalent basis adjustment		(946)			(634)				
Net interest income		$ 64,815			$ 64,415		$ 712	$ (8,491)	$ 9,203
Interest rate spread (1)			2.89%			3.02%			
Interest expense as a percent of average earning assets			2.60%			3.25%			
Net interest margin (2)			3.61%			4.06%			
Total cost of deposits			2.31%			3.06%			

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

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

Noninterest Income. Total noninterest income for the quarter ended September 30, 2008 was $11.7 million, an increase of $2.5 million, or 26.8%, compared to the same period in 2007 and an increase of $539,000, or 4.8%, compared to the second quarter of 2008. As a percentage of total operating income, noninterest income for the third quarter of 2008 was 34.6%, compared with 29.6% for comparative 2007 and 34.8% for the second quarter of 2008. For the nine-month period ended September 30, 2008, noninterest income was 35.9% of total operating income compared with 30.1% for comparative 2007.

Our noninterest income primarily consists of fee income produced by our three reportable segments, less applicable commission expenses. The following tables provide an analysis of noninterest income (dollars in thousands).

	Three Months Ended September 30,		Increase/(Decrease) 2008 over 2007	
	2008	2007	Amount	Percent
Residential mortgage brokerage income, net	$ 1,328	$ 1,345	$ (17)	(1.3%)
Real estate brokerage and property management, net	2,768	1,575	1,193	75.7%
Insurance commissions and other title fees and income, net	3,214	3,467	(253)	(7.3%)
Service charges on deposit accounts	1,486	1,344	142	10.5%
Credit card merchant fees, net	500	454	46	10.1%
Other income	1,625	1,058	567	53.6%
Subtotal before gain on sale of investment securities	10,921	9,243	1,678	18.2%
Gain on available-for-sale securities	804	-	804	N/M
Total noninterest income	$ 11,725	$ 9,243	$ 2,482	26.9%

	Three Months Ended		Increase/(Decrease) Third Quarter 2008 over Second Quarter 2008	
	September 30, 2008	June 30, 2008	Amount	Percent
Residential mortgage brokerage income, net	$ 1,328	$ 1,433	$ (105)	(7.3%)
Real estate brokerage and property management, net	2,768	2,240	528	23.6%
Insurance commissions and other title fees and income, net	3,214	3,220	(6)	(0.2%)
Service charges on deposit accounts	1,486	1,450	36	2.5%
Credit card merchant fees, net	500	506	(7)	(1.3%)
Other income	1,625	1,659	(34)	(2.0%)
Subtotal before gain on sale of investment securities	10,921	10,508	413	3.9%
Gain on available-for-sale securities	804	678	126	18.6%
Total noninterest income	$ 11,725	$ 11,186	$ 539	4.8%

	Nine Months Ended September 30,		Increase/(Decrease) 2008 Over 2007	
	2008	2007	Amount	Percent
Residential mortgage brokerage income, net	$ 4,048	$ 4,966	$ (918)	(18.5%)
Real estate brokerage and property management, net	6,828	4,280	2,548	59.5%
Insurance commissions and other title fees and income, net	10,289	10,009	280	2.8%
Service charges on deposit accounts	4,358	4,082	276	6.8%
Credit card merchant fees, net	1,450	1,288	162	12.6%
Other income	4,738	3,113	1,625	52.2%
Subtotal before gain on sale of investment securities	31,711	27,738	3,974	14.3%
Gain (loss) on available-for-sale securities	2,960	(10)	2,970	N/M
Total noninterest income	$ 34,671	$ 27,728	$ 6,944	25.0%

For the third quarter of 2008, residential mortgage brokerage income, net of commission expense was $1.3 million, reflecting a decrease of $17,000, or 1.3%, compared to the third quarter of 2007 and a decrease of $105,000, or 7.3%, compared to the second quarter of 2008. The majority of the decrease in net mortgage brokerage income is the result of a decreased volume in loan closings.

Real estate brokerage and property management income, net of commission expense, for the third quarter of 2008 was $2.8 million, which was $1.2 million, or 75.7%, more than comparative 2007 and $528,000, or 23.6%, more than the second quarter of 2008. The increase is attributable to property management revenue of $1.7 million from Corolla Classic Vacations, which was acquired in January 2008. The increase was partially offset by a decline in real estate mortgage brokerage revenue.

For the third quarter of 2008, insurance commissions and other title income, net of commission expense was $3.2 million, which was $253,000, or 7.3%, lower than comparative 2007, and $6,000, or 0.2%, lower than second quarter of 2008.

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 third quarter of 2008, fees totaled $500,000, which was $46,000, or 10.1%, above comparative 2007, but $6,000, or 0.2%, less than the second quarter of 2008.

Other noninterest income for the quarter ended September 30, 2008 was $1.6 million and included income generated by TowneBank Commercial Mortgage and Towne Investment Group, net of commission expense. For the three months ended September 30, 2008, net commission income totaled $86,000 and $334,000 for TowneBank Commercial Mortgage and Towne Investment Group, respectively. This compares to $96,000 and $68,000 for TowneBank Commercial Mortgage and $247,000 and $336,000 for Towne Investment Group for the third quarter of 2007 and second quarter of 2008, respectively.

During the third quarter of 2008, we sold $27.2 million dollars of investment securities from our available-for-sale securities portfolio. The sold securities were comprised of callable agencies securities and mortgage-backed securities. As a result of the sale, we recognized security gains of $804,000 during the period.

Noninterest Expense. For the quarter ended September 30, 2008, total noninterest expense was $24.0 million, which was $1.9 million, or 8.7%, higher than comparative 2007 and $1.7 million, or 7.6%, higher than the quarter ended June 30, 2008. For the nine months ended September 30, 2008, total noninterest expense increased $4.4 million, or 6.8% from comparative 2007 to $68.9 million.

As a percentage of operating income, noninterest expense was 71.0% for the third quarter of 2008, 70.9% for comparative 2007, and 69.5% for the quarter ended June 30, 2008. For the nine-month period ended September 30, 2008, total noninterest expense as a percentage of operating income was 71.4% compared with 70.1% for comparative 2007. In comparison to the nine-month period ended September 30, 2007, a portion of the increase in total noninterest expense is due to the May 31, 2007 acquisition of the assets and operations of B. Martin Weber Inc. ("Weber"), a group benefits agency. The acquisition contributed additional expenses compared to 2007, primarily in salaries and benefits and occupancy. The acquisition of Corolla Classic Vacations and Corolla Real Estate in January 2008 also contributed to the increase in non-interest expenses, primarily in salaries and benefits, and advertising expenses. Advertising and marketing expenses decreased as new advertising campaigns were implemented and completed in 2007. FDIC insurance expense increased as the FDIC increased assessments to replenish the Deposit Insurance Fund.

The following table provides an analysis of quarterly total noninterest expense by line item (dollars in thousands).

	Three Months Ended			Increase/(Decrease)			
				September 30, 2008 over September 30, 2007		September 30, 2008 over June 30, 2008	
	September 30,		June 30,				
	2008	2007	2008	Amount	Percent	Amount	Percent
Salaries and benefits	$ 14,606	$ 13,256	$ 13,464	$ 1,350	10.2%	$ 1,142	8.5%
Occupancy expense	2,205	1,955	2,077	250	12.8%	128	6.2%
Furniture and equipment	1,299	1,233	1,287	66	5.4%	12	0.9%
Other							
Advertising and marketing	862	1,193	845	(331)	(27.7%)	17	2.0%
Other	230	577	306	(347)	(60.2%)	(76)	(24.9%)
Charitable Contributions	480	460	569	20	4.4%	(89)	(15.5%)
Outside processing	524	447	494	77	17.3%	30	6.2%
Professional fees	440	421	282	19	4.5%	158	56.0%
Stationery and supplies	424	392	308	32	8.2%	116	37.7%
FDIC and other insurance	426	389	387	37	9.5%	39	10.0%
Software expense	604	382	495	222	58.1%	109	22.0%
Telephone and postage	617	367	538	250	68.2%	79	14.7%
Amortization - Intangibles	493	349	493	144	41.3%	(0)	-
Bank franchise tax/SCC fees	302	222	298	80	36.0%	4	1.6%
Directors fees and expenses	405	258	373	147	57.0%	32	8.5%
Travel/meals/entertainment	122	213	134	(91)	(42.7%)	(12)	(9.4%)
Total other expenses	5,930	5,670	5,522	260	4.6%	408	7.4%
Total noninterest expense	$ 24,040	$ 22,114	$ 22,350	$ 1,926	8.7%	$ 1,690	7.6%

Management's Discussion and Analysis

	Nine Months Ended September 30,		Increase/(Decrease) 2008 over 2007	
	2008	2007	Amount	Percent
Salaries and benefits	$ 41,486	$ 38,105	$ 3,381	8.9%
Occupancy expense	6,307	5,650	657	11.6%
Furniture and equipment	3,894	3,634	260	7.2%
Other				
Advertising and marketing	2,555	3,679	(1,124)	(30.6%)
Other	1,205	1,302	(97)	(7.4%)
Charitable contributions	1,471	1,251	220	17.6%
Outside processing	1,447	1,237	210	17.0%
Professional fees	1,163	1,420	(257)	(18.1%)
Stationery and supplies	1,112	1,343	(231)	(17.2%)
FDIC and other insurance	1,226	1,190	36	3.0%
Software expense	1,544	990	554	55.9%
Telephone and postage	1,635	1,368	267	19.5%
Amortization - Intangibles	1,479	1,164	315	27.1%
Bank franchise tax/SCC fees	872	644	228	35.4%
Directors fees and expenses	1,142	798	344	43.1%
Travel/meals/entertainment	404	794	(390)	(49.1%)
Total other expenses	17,255	17,180	75	0.4%
Total noninterest expense	$ 68,942	$ 64,569	$ 4,373	6.8%

Salary and benefits expense, the largest portion of noninterest expense, was $14.6 million, representing 60.8% of total noninterest expense for the quarter ended September 30, 2008. Salary and benefits expense increased $1.4 million, or 10.2%, over the comparative period in 2007 and $1.1 million, or 8.5% over the second quarter of 2008. Increases are due to annual merit increases, the addition of employees to create and service customer growth, the implementation of a Supplemental Executive Retirement Plan, and the addition of staff resulting from the business acquisitions in 2007 and 2008. The acquisition of Corolla Classic Vacations and Corolla Real Estate resulted in additional salary and benefit expense of $1.2 million in the nine months ended September 30, 2008, while TFA Benefits had an increase in salary and benefits expense of $390,000 over the same nine-month period in the prior year, which was primarily due to the Weber acquisition.

At September 30, 2008, we had a total of 784 full-time equivalent employees ("FTE"), excluding agents of GSH Residential Real Estate Corporation ("GSH"), which was up from 707 at September 30, 2007 and down from 789 at June 30, 2008. GSH agents are independent contractors, and therefore, not included as our employees. Total operating income per FTE was $43,000 for the quarter ended September 30, 2008 compared to $44,000 and $41,000 for the periods ended September 30, 2007 and June 30, 2008, respectively.

Occupancy expense for the third quarter of 2008 experienced a 12.8% increase over comparative 2007 and a 6.2% increase over second quarter 2008. The increase from the third quarter of the prior year was a result of the acquisitions previously discussed and the reduction of the estimated lives of some of our leasehold improvements, which increased amortization expense.

For quarter ended September 30, 2008, furniture and equipment expense increased by 5.4% over comparative 2007 and by 0.9% from the second quarter of 2008. Vehicle depreciation and fuel expense were the largest sources of the increase from the prior year. Computer equipment depreciation also increased as we replaced our older computers and servers to support newer versions of our core processing software. The increase in expense from the second quarter of 2008 was primarily due to increases in expenses related to equipment maintenance and company owned vehicles.

Other noninterest expenses for the third quarter of 2008 saw a decrease of $347,000, or 60.2%, compared to the same period in 2007 and a decrease of $76,000, or 24.9%, when compared to second quarter 2008.

Provision for Income Taxes. We reported a provision for income tax expense of $2.6 million, representing an effective rate of 29.0% for the third quarter of 2008. The provision for income tax expense was $2.8 million for the third quarter of 2007 with an effective rate of 32.1%. The decrease in the rate was attributable to several factors including the acquisition of bank-owned life insurance, additional tax exempt interest income and a decrease in disallowed expenses.

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 5 – Segment Reporting* of the Notes to Consolidated Financial Statements in this report.

Banking Segment. For the three months ended September 30, 2008, the Banking segment represented 81.5%, or $5.2 million, of our total consolidated net income compared to 88.0%, or $5.3 million, for comparative 2007. For the nine months ended September 30, 2008, the Banking segment represented 86.5%, or $16.0 million, of our total consolidated net income compared to 87.2%, or $15.2 million, for comparative 2007.

Pre-tax earnings for the three months ended September 30, 2008 for the Banking segment were $7.1 million, increasing $561,000, or 7.3%, from comparative 2007. The increase was primarily due a $1.0 million, or 4.7%, increase in net interest income and a gain on the sale of investment securities of $840,000. The Banking segment's income from bank-owned life insurance also increased $389,000 from 2008 to 2007.

Noninterest expenses increased by $10.4 million, or 8.5%, in the third quarter of 2008 compared to the third quarter of 2007. The primary factor in the increase was an increase in salaries and benefits of 840,000, or 8.6%, as we continued to attract and hire seasoned banking professionals who could bring additional business. Additional factors in the increase include an increase in occupancy expense of $274,000 and an increase of $252,000 reduction in other noninterest expenses, which included increases in software expense; telephone and postage; and directors' fees and expenses.

The following charts present the revenue and expenses for the Banking segment as well as changes between periods (dollars in thousands).

	Quarter Ended			Increase/(Decrease)			
	September 30,		June 30,	2008 over 2007		September over June	
	2008	2007	2008	Amount	Percent	Amount	Percent
Net interest income	$ 22,665	$ 21,642	$ 21,481	$ 1,023	4.7%	$ 1,184	5.5%
Service charges on deposit accounts	1,486	1,344	1,450	142	10.6%	36	2.5%
Credit card merchant fees	500	454	507	46	10.1%	(7)	(1.4%)
Other income	646	840	1,394	(194)	(23.1%)	(748)	(53.7%)
Gain (loss) on available for sale	804	-	678	804	N/M	126	N/M
Total noninterest income	3,436	2,638	4,029	798	30.3%	(593)	(14.7%)
Total revenue	26,101	24,280	25,510	1,821	7.5%	591	2.3%
Provision for loan losses	1,568	266	2,068	1,302	489.5%	(500)	(24.2%)
Salaries and employee benefits	10,607	9,768	9,674	839	8.6%	933	9.6%
Occupancy expense	1,566	1,292	1,458	274	21.2%	108	7.4%
Furniture and equipment	1,033	1,016	1,037	17	1.7%	(4)	(0.4%)
Other expenses	4,504	4,252	3,995	252	5.9%	509	12.7%
Total expenses	17,710	16,328	16,164	1,382	8.5%	1,546	9.6%
Income before income tax expense and corporate allocation	6,823	7,686	7,278	(863)	(11.2%)	(455)	(6.3%)
Corporate allocation	301	313	266	(12)	(3.8%)	35	13.2%
Income before income tax provision	7,124	7,999	7,544	(875)	(10.9%)	(420)	(5.6%)
Provision for income tax expense	1,895	2,621	2,037	(726)	(27.7%)	(142)	(7.0%)
Net income	$ 5,229	$ 5,378	$ 5,507	$ (149)	(2.8%)	$ (278)	(5.1%)

	Nine Months Ended September 30,		Increase/(Decrease) 2008 over 2007	
	2008	2007	Amount	Percent
Net interest income	$ 64,212	$ 63,799	$ 413	0.6%
Service charges on deposit accounts	4,358	4,082	276	6.8%
Credit card merchant fees	1,451	1,288	163	12.7%
Other income	3,230	2,511	719	28.6%
Gain (loss) on available for sale	2,960	(10)	2,970	N/M
Total noninterest income	11,999	7,871	4,128	52.4%
Total revenue	$ 76,211	$ 71,670	$ 4,541	6.3%
Provision for loan losses	$ 4,531	$ 1,912	$ 2,619	137.0%
Salaries and employee benefits	30,352	27,770	2,582	9.3%
Occupancy expense	4,421	3,754	667	17.8%
Furniture and equipment	3,127	2,966	161	5.4%
Other expenses	12,645	13,096	(451)	(3.4%)
Total expenses	50,545	47,586	2,959	6.2%
Income before income tax expense and corporate allocation	21,135	22,172	(1,037)	(4.7%)
Corporate allocation	808	866	(58)	(6.7%)
Income before income tax provision	21,943	23,038	(1,095)	(4.8%)
Provision for income tax expense	5,980	7,274	(1,294)	(17.8%)
Net income	$ 15,963	$ 15,764	$ 199	1.3%

Realty Segment. For the three months ended September 30, 2008, the Realty segment had pre-tax earnings of $1.3 million as compared to pre-tax earnings of $549,000 for the comparative 2007 period, an increase of $793,000. Total revenue increased to $5.8 million in 2008 from $4.1 million in 2007. An increase of $1.6 million in property management fees in the third quarter of 2008, as compared to the same period in 2007, was due primarily to the 2008 acquisition of Corolla Classic Vacations, which recorded revenue of $1.7 million. Additionally, residential mortgage brokerage income increased by $703,000 as a result of increased volume in loan closings. The increases were partially offset by decreases in revenue from real estate brokerage income, a decrease of $405,000, and title insurance and settlement fees, a decrease of $163,000, which were adversely affected by the continued softening in the residential real estate market.

Expenses for the realty segment increased 20.9% or $740,000 when compared to the quarter ended September 30, 2007. The increase was due primarily to expenses related to Corolla Classic Vacations which accounted for $790,000 of the increase including $80,000 of amortization of costs related to the acquisition.

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.

The following charts present the revenue and expenses for the Realty segment (dollars in thousands).

	Three Months Ended			Increase/(Decrease)			
				September 30, 2008 September 30, 2007		September 30, 2008 June 30, 2008	
	September 30,		June 30,				
	2008	2007	2008	Amount	Percent	Amount	Percent
Residential mortgage brokerage income, net	$ 1,975	$ 1,272	$ 1,356	$ 703	55.3%	$ 619	45.7%
Real estate brokerage income, net	943	1,350	1,041	(407)	(30.2%)	(98)	(9.4%)
Title insurance and settlement fees	580	743	614	(163)	(21.9%)	(34)	(5.5%)
Property management fees, net	1,824	227	1,199	1,597	703.5%	625	52.1%
Income from unconsolidated subsidiary	194	166	168	28	16.9%	26	15.5%
Net interest and other income	302	337	249	(35)	(10.4%)	53	21.3%
Total revenue	5,818	4,095	4,627	1,723	42.1%	1,191	25.7%
Salaries and employee benefits	2,558	1,880	2,347	678	36.1%	211	9.0%
Occupancy expense	510	544	489	(34)	(6.3%)	21	4.3%
Furniture and equipment	201	148	180	53	35.8%	21	11.7%
Amortization of intangible assets	165	94	163	71	75.5%	2	1.2%
Other expenses	848	881	976	(33)	(3.8%)	(128)	(13.1%)
Total expenses	4,282	3,547	4,155	735	20.7%	127	3.1%
Income before income tax, minority interest and corporate allocation	1,536	548	472	988	(180.3%)	1,064	(225.4%)
Corporate allocation	(177)	(187)	(162)	10	5.4%	(15)	(9.3%)
Minority interest	(15)	-	(29)	(15)	N/M	14	(48.3%)
Income (loss) before income tax provision	1,344	361	281	983	(272.3%)	1,063	(378.3%)
Provision for income tax expense (benefit)	500	16	99	484	(3025.0%)	401	(405.1%)
Net income (loss)	$ 844	$ 345	$ 182	$ 499	(144.6%)	$ 662	(363.7%)

	Three Months Ended			Increase/(Decrease)			
				September 30, 2008		September 30, 2008	
	September 30,		June 30,	September 30, 2007		June 30, 2008	
	2008	2007	2008	Amount	Percent	Amount	Percent
Key data:							
Number of homes sold	398	523	484	(125)	(23.9%)	(86)	(17.8%)
Volume of homes sold	41,080	$ 52,524	$62,536	$ (11,444)	(21.8%)	$ (21,456)	(34.3%)
Number of real estate agents	284	322	292	(38)	(11.8%)	(8)	(2.7%)
Loans originated, mortgage	88,421	$ 83,226	$ 85,831	$ 5,195	6.2%	$ 2,590	3.0%
Loans originated, joint venture	52,245	57,367	68,745	(5,122)	(8.9%)	(16,500)	(24.0%)
Total loans originated	$ 140,666	$ 140,593	$ 154,576	$ 73	0.1%	$ (13,910)	(9.0%)
Number of loans, mortgage	336	353	358	(17)	(4.8%)	(22)	(6.2%)
Number of loans, joint venture	231	263	296	(32)	(12.2%)	(65)	(22.0%)
Total number of loans	567	616	654	(49)	(8.0%)	(87)	(13.3%)

	Nine Months Ended		Increase/(Decrease)	
	September 30,		2008 over 2007	
	2008	2007	Amount	Percent
Residential mortgage brokerage income, net	$ 4,555	$ 4,725	$ (170)	(3.6%)
Real estate brokerage income, net	2,831	3,582	(751)	(21.0%)
Title insurance and settlement fees	1,688	2,075	(387)	(18.7%)
Property management fees, net	3,997	698	3,299	472.6%
Income from unconsolidated subsidiary	522	360	162	45.0%
Net interest and other income	790	787	3	0.4%
Total revenue	14,383	12,227	2,156	17.6%
Salaries and employee benefits	6,784	5,835	949	16.3%
Occupancy expense	1,505	1,570	(65)	(4.1%)
Furniture and equipment	558	467	91	19.5%
Amortization of intangible assets	494	281	213	75.8%
Other expenses	2,947	2,650	297	11.2%
Total expenses	12,288	10,803	1,485	13.8%
Income before income tax, minority interest and corporate allocation	2,095	1,424	671	47.1%
Corporate allocation	(486)	(532)	46	(8.7%)
Minority interest	(54)	-	(54)	N/M
Income before income tax provision	1,555	892	663	74.3%
Provision for income tax expense	572	285	287	100.7%
Net income	$ 983	$ 607	$ 376	61.9%

	Nine Months Ended September 30,		Increase/(Decrease) 2008 over 2007	
	2008	2007	Amount	Percent
Key data:				
Number of homes sold	1,201	1,790	(589)	(32.9%)
Volume of homes sold	158,670	$ 180,892	$ (22,222)	(12.3%)
Number of real estate agents	284	321	(37)	(11.5%)
Loans originated, mortgage	247,718	$ 307,307	$ (59,589)	(19.4%)
Loans originated, joint venture	183,404	152,601	30,803	20.2%
Total loans originated	$ 431,122	$ 459,908	$ (28,786)	(6.3%)
Number of loans, mortgage	997	1,287	(290)	(22.5%)
Number of loans, joint venture	813	684	129	18.9%
Total number of loans	1,810	1,971	(161)	(8.2%)

Mortgage. The loan volume for the combined mortgage operations showed an increase in the quarter ended September 30, 2008 as compared to the same period in 2007. Total loans originated in the third quarter of 2008 were $140.7 million, a 0.1% increase, or $73,000, from $140.6 million in 2007. This was a $13.9 million, or 9.0%, decrease compared to the volume for the quarter ended June 30, 2008.

Insurance Segment. The Insurance segment is comprised of property and casualty and group benefit divisions. Several group benefit agencies were acquired in 2007 that resulted in substantial growth for the division.

The Insurance segment represented 5.3%, or $342,000, of total consolidated net income for the quarter ended September 30, 2008 and 5.9%, or $353,000, at September 30, 2007. Insurance commissions, for the quarters ended September 30, 2008 and 2007 are reported net of commission expense of $725,000 and $604,000, respectively.

Pre-tax earnings for the three months ended September 30, 2008 for the Insurance segment were $562,000, increasing $103,000, or 22.4% over comparative 2007. The increase was due primarily to a decrease in operating expenses of $194,000. The decrease was partially offset by a reduction in net property and casualty commissions of $88,000 and a decrease in insurance contingency and other income of $41,000 as compared to the quarter ended September 30, 2007.

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

	Three Months Ended			Increase/(Decrease)			
				September 30, 2008 September 30, 2007		September 30, 2008 June 30, 2008	
	September 30,		June 30,				
	2008	2007	2008	Amount	Percent	Amount	Percent
Net commission and fee income							
Property and casualty	$ 1,361	$ 1,449	$ 1,348	$ (88)	(6.1%)	$ 13	1.0%
Specialized Benefit Services	58	42	55	16	38.1%	3	5.5%
Employee benefits	1,273	1,255	1,214	18	1.4%	59	4.9%
Total net commissions and fees	2,692	2,746	2,617	(54)	(2.0%)	75	2.9%
Contingency and bonus revenue	-	19	44	(19)	(100.0%)	(44)	(100.0%)
Other income	42	63	50	(21)	(33.3%)	(8)	(16.0%)
Total revenues	$ 2,734	$ 2,828	$ 2,711	$ (94)	(3.3%)	$ 23	0.9%
Salaries and employee benefits	$ 1,439	$ 1,611	$ 1,443	$ (172)	(10.7%)	$ (4)	(0.3%)
Occupancy expense	132	119	129	13	10.9%	3	2.3%
Furniture and equipment	67	69	69	(2)	(2.9%)	(2)	(2.9%)
Amortization of intangible assets	118	126	117	(8)	(6.4%)	1	0.9%
Other expenses	292	318	273	(26)	(8.2%)	19	7.0%
Total operating expenses	2,048	2,243	2,031	(195)	(8.7%)	17	0.8%
Income before income tax and corporate allocation	686	585	680	101	17.3%	6	0.9%
Corporate allocation	(124)	(126)	(104)	2	(1.6%)	(20)	19.2%
Income before income tax provision	562	459	576	103	22.4%	(14)	(2.4%)
Provision for income tax expense	220	193	224	27	14.0%	(4)	(1.8%)
Net income	$ 342	$ 266	$ 352	$ 76	28.6%	$ (10)	(2.8%)

	Nine Months Ended September 30,		Increase/(Decrease) 2008 over 2007	
	2008	2007	Amount	Percent
Net commission and fee income				
Property and casualty	$ 3,907	$ 4,246	$ (339)	(8.0%)
Specialized Benefit Services	166	83	83	100.0%
Employee benefits	3,776	3,090	686	22.2%
Total net commissions and fees	7,849	7,419	430	5.8%
Contingency and bonus revenue	918	603	315	52.2%
Other income	125	224	(99)	(44.2%)
Total revenues	$ 8,892	$ 8,246	$ 646	7.8%
Salaries and employee benefits	$ 4,349	$ 4,504	$ (155)	(3.4%)
Occupancy expense	383	326	57	17.5%
Furniture and equipment	210	201	9	4.5%
Amortization of intangible assets	352	257	95	37.0%
Other expenses	815	892	(77)	(8.6%)
Total operating expenses	6,109	6,180	(71)	(1.2%)
Income before income tax and corporate allocation	2,783	2,066	717	34.7%
Corporate allocation	(322)	(334)	12	(3.6%)
Income before income tax provision	2,461	1,732	729	42.1%
Provision for income tax expense	958	711	247	34.7%
Net income	$ 1,503	$ 1,021	$ 482	47.2%

Salaries and employee benefits expense decreased $356,000, or 22.2%, when comparing the three months ended September 30, 2008 to the same period for 2007.

Occupancy expense increased $13,000, or 10.9%, when comparing the three months ended September 30, 2008 to the same period for 2007. Additional office space to house property and casualty agents contributed to the increase.

ANALYSIS OF FINANCIAL CONDITION

Overview. At September 30, 2008, total assets were $3.0 billion, which is $532.2 million, or 21.4%, greater than the period end balance for comparative 2007 and $299.5 million, or 11.0% greater than the balance at June 30, 2008. Our loan portfolio, less unearned income and deferred costs, made up 72.9% of our period end assets and totaled $2.2 billion at September 30, 2008. Average assets for the quarter ended September 30, 2008 were $2.9 billion, up $397.8 million, or 16.1%, from comparative September 30, 2007 and $213.6 million, or 8.1%, from quarter ended June 30, 2008.

Average earning assets increased $341.3 million, or 15.2%, from $2.3 billion for the third quarter of 2007 to $2.6 billion for the third quarter of 2008. Compared to the second quarter of 2008, average earning assets increased $203.3 million, or 8.5%.

Our average total deposits were $2.1 billion for third quarter 2008 reflecting growth of $235.7 million, or 12.9%, compared to third quarter 2007. Of total average deposits, certificates of deposits experienced the most growth at 19.0% over comparative 2007. This growth is attributable to our promotional rates and the purchase of $120.0 million of brokered certificates of deposits.

Interest Bearing Deposits in Financial Institutions. Interest bearing deposits in other banks and federal funds sold are used for daily cash management purposes, management of short-term interest rate opportunities, and liquidity. Interest bearing deposit balances at September 30, 2008 were $20.4 million and consisted mainly of overnight deposits with the Federal Home Loan Bank of Atlanta.

The average balance of interest bearing deposits in other banks and federal funds sold during the third quarter of 2008 was $87.0 million, or 3.4%, of average total earning assets compared with $110.8 million, or 4.9%, of average total earning assets for comparative 2007. For the second quarter of 2008, the average balance of interest bearing deposits in other banks was $24.7 million, or 1.0%, of average total earning assets.

Securities Available-for-Sale. Our available-for-sale securities portfolio is reported at fair value, which is determined based on market prices of similar instruments. Securities available-for-sale was $212.1 million at September 30, 2008 compared with $266.3 million at September 30, 2007. The average balance for the third quarter of 2008 was $234.8 million compared to the third quarter of 2007 which was $266.9 million and $252.6 million for the second quarter of 2008, or 9.1%, 12.0%, and 10.7% of average earning assets, respectively. During the three- and nine-month periods ended September 30, 2008, we sold $27.2 million and $128.1 million, respectively, in investment securities that were classified as available-for-sale. The sale of these securities resulted in gains of $804,000 and $3.0 million during the respective periods.

The securities are held primarily for earnings, liquidity, and asset/liability management purposes and reviewed quarterly for possible other-than-temporary impairments. During this review, we analyze the length of time the fair value has been below cost, the expectation for that security's performance, the creditworthiness of the issuer, and our intent and ability to hold the security to recovery or maturity. These factors are analyzed on an individual basis.

Securities Held-to-Maturity. Held-to-maturity securities are valued at amortized cost. Securities held-to-maturity were $107.6 million at September 30, 2008, $89.3 million at September 30, 2007, and $108.0 million at June 30, 2008. Our average quarterly balances were $107.8 million, $88.2 million, and $112.7 million for the respective periods, representing 4.2%, 4.0%, and 4.8% of total average earning assets. These securities are held primarily for yield and pledging purposes. Similar to available-for-sale securities, held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment.

Loans Held for Sale. At September 30, 2008, we held $19.8 million in mortgage loans originated and intended for sale in the secondary market, as compared with $19.3 million for comparative 2007 and $31.4 million at June 30, 2008.

Average loans held for sale were 0.9% of average earning assets for each of the quarters ended September 30, 2008 and 2007. Average loans held for sale were 1.0% of average earning assets for the quarter ended June 30, 2008. The majority of mortgage loans held for sale have been pre-committed to by investors, which minimizes 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. Loans, net of unearned income and deferred costs, were $2.2 billion at September 30, 2008, which was $415.9 million, or 23.3%, above the $1.8 billion reported at September 30, 2007 and $128.2 million, or 6.2%, above the $2.1 billion at June 30, 2008. Factors that contributed to the increase in our loan demand were our stable local economy and the efforts of our experienced loan officers in developing new loan relationships combined with the support of existing customers. Additionally, we hired a number of senior level loan officers during 2007, which enabled us to develop relationships with new customers and led to further growth in the loan portfolio. As a percentage of total average earning assets, average loans were 82.5% for the quarter ended September 30, 2008 compared with 78.4% for the same period in 2007 and 82.7% for the quarter ended June 30, 2008.

Allowance for Loan Losses and Asset Quality. The purpose of the allowance for loan losses is to provide for potential losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate. Management considers our internal risk grading, historical loan loss experience (ours and our peers), the size and composition of the loan portfolio, the value and adequacy of collateral and guarantor agreements, non-performing credits, and current and anticipated economic conditions, in determining the adequacy of the allowance, which may necessitate adjustments to our management's estimate. Any differences between actual and estimated loan loss are reflected by adjustments made by either increasing or decreasing the loss provision based upon current measurement criteria. The total $25.5 million in the allowance 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).

	September 30, 2008	September 30, 2007	June 30, 2008
Real estate loans:			
Residential 1-4 family	$ 4,700	$ 3,949	$ 4,223
Commercial	6,636	5,240	5,791
Construction	6,355	5,792	5,817
Multifamily	245	315	198
Total real estate loans	17,936	15,296	16,029
Commercial Loans	6,447	4,009	6,741
Consumer installment loans:			
Personal	595	1,075	614
Credit lines	470	369	458
Total consumer installment loans	1,065	1,444	1,072
Agriculture loans	4	-	87
Total	$ 25,452	$ 20,749	$ 23,929

Nonperforming assets consist of nonaccrual loans, foreclosed real estate, and other repossessed collateral. A nonperforming loan is a loan that is not meeting its stated principal and interest payments. The loan must be more than 120 days past due to be classified in this category. At the point where it is classified as nonperforming, it stops accruing interest. At September 30, 2008, we had $2.7 million in nonperforming assets, which amounted to 0.09% of total assets. Additionally, loans past due 90 days that are accruing interest were $77,000. Nonperforming assets consist of $1.5 million in nonperforming loans as well as $1.2 million in foreclosed property. Foreclosed property consists of four different residential properties.

At September 30, 2008, loans 60-89 days past due totaled $4.3 million. In addition, other performing loans totaling $43.5 million existed that have other potential weaknesses that our management considers potential problem loans and warrant additional management attention. These loans are reviewed on a regular basis and are considered in determining the adequacy of the allowance for loan losses previously discussed. With the exception of $2.5 million, all of these loans are generally secured with collateral having appraised values that exceed the remaining principal balances on such loans.

Management's Discussion and Analysis

The following table provides information on activity for the allowance for loan losses and nonperforming assets (dollars in thousands).

	Three Months Ended			Nine Months Ended	
	September 30,		June 30,	September 30,	September 30,
	2008	2007	2008	2008	2007
Allowance for loan losses					
Balance beginning of period	$ 23,929	$ 20,615	$ 22,199	$ 21,323	$ 19,670
Loans charged off:					
Residential 1-4 family	-	(103)	(136)	(136)	(356)
Construction	-	-	(22)	(22)	-
Commercial	(45)	-	(107)	(188)	(364)
Consumer	(26)	(45)	(100)	(133)	(171)
Total	(71)	(148)	(365)	(479)	(891)
Loans recovered:					
Residential 1-4 family	2	-	1	3	2
Commercial	13	9	21	54	37
Consumer	11	7	5	20	19
Total	26	16	27	77	58
Net loans (charged off)/recovered	(45)	(132)	(338)	(402)	(833)
Provision for loan losses	1,568	266	2,068	4,531	1,912
Balance end of period	$ 25,452	$ 20,749	$ 23,929	$ 25,452	$ 20,749
Nonperforming assets					
Nonperforming loans	$ 1,569	$ 1,145	$ 580	$ 1,569	$ 1,145
Foreclosed property	1,165	1,405	1,534	1,165	1,405
Total nonperforming assets	$ 2,734	$ 2,550	$ 2,114	$ 2,734	$ 2,550
Loans past due 90 days and still accruing interest	$ 77	$ 200	$ 123	$ 77	$ 200
Asset Quality Ratios					
Allowance for loan losses to nonperforming loans	16.22x	18.12x	41.24x	16.22x	18.12x
Allowance for loan losses to period end loans	1.16%	1.16%	1.16%	1.16%	1.16%
Nonperforming loans to period end loans	0.07%	0.06%	0.03%	0.07%	0.06%
Nonperforming assets to period end assets	0.09%	0.10%	0.08%	0.09%	0.10%
Net charge-offs to average loans (annualized)	0.01%	0.03%	0.07%	0.02%	0.06%

Deposits. Total deposits at September 30, 2008 were $2.2 billion, representing an increase of 19.3%, or $355.3 million, over September 30, 2007 and an increase of $215.5 million, or 10.9%, compared to June 30, 2008. Overall growth in deposits is primarily attributed to an increase in the Banking segment customer base and in the number of accounts, and the use of $120.0 million of brokered time deposits. Total average deposits were $2.0 billion during the third quarter of 2008 compared to $1.8 billion during the third quarter of 2007 and $1.9 billion during the second quarter of 2008.

Average noninterest bearing demand deposits as a percentage of average total deposits were 24.5% during the third quarter of 2008 and 25.6% during the same period in 2007. Average noninterest bearing demand deposits were 24.9% of average total deposits for the second quarter of 2008. This change is attributed to more competition for funds within the community and has led to an increasing cost of funds due to a change in funding mix towards a higher proportion of certificates of deposit. The cost of interest bearing deposits was 2.77% for the third quarter of 2008 compared with 4.18% for the third quarter of 2007 and 2.90% for the second quarter of 2008.

The following tables set forth a summary of our various deposit categories and their respective cost rates (dollars in thousands).

	Average Balance/Cost Rate					
	Three Months Ended					
	September 30, 2008		September 30, 2007		June 30, 2008	
Interest bearing demand and money market accounts	$ 496,788	1.1%	$ 492,815	2.9%	$ 505,701	1.2%
Regular savings	59,054	2.0%	26,209	1.9%	35,307	1.4%
Certificates of deposit	1,007,205	3.6%	846,195	5.0%	914,343	3.9%
Total interest bearing	1,563,047	2.8%	1,365,219	4.2%	1,455,351	2.9%
Noninterest bearing	506,676		468,802		482,975	
Total	$ 2,069,723	2.1%	$ 1,834,021	3.1%	$ 1,938,326	2.2%

	Average Balance/Cost Rate			
	Nine Months Ended			
	September 30, 2008		September 30, 2007	
Interest bearing demand and money market accounts	$ 502,377	1.3%	$ 476,252	2.8%
Regular savings	40,082	1.7%	24,003	1.7%
Certificates of deposit	939,655	4.0%	803,643	5.0%
Total interest bearing	1,482,114	3.1%	1,303,898	4.1%
Noninterest bearing	478,887		454,410	
Total	$ 1,961,001	2.3%	$ 1,758,308	3.1%

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

	Average Balance and Composition Three Months Ended					
	September 30,				June 30,	
	2008		2007		2008	
Interest bearing demand and money market accounts	$ 496,788	24.0%	$ 492,815	26.9%	$ 505,701	26.1%
Regular savings	59,054	2.9%	26,209	1.4%	35,307	1.8%
Certificates of deposit	1,007,205	48.7%	846,195	46.1%	914,343	47.2%
Total interest bearing	1,563,047	75.5%	1,365,219	74.4%	1,455,351	75.1%
Noninterest bearing	506,676	24.5%	468,802	25.6%	482,975	24.9%
Total	$ 2,069,723	100.0%	$ 1,834,021	100.0%	$ 1,938,326	100.0%

Advances from the Federal Home Loan Bank of Atlanta. Borrowings of advances from the Federal Home Loan Bank of Atlanta ("FHLB") as of September 30, 2008 were $363.9 million, compared to $296.8 million at September 30, 2007 and $321.9 million at June 30, 2008. The average borrowing cost for the third quarter decreased from June 30, 2008 to 4.25%. This was a 12 basis point improvement from June 30, 2008 and a 24 basis point decrease from comparative 2007. The scheduled maturity dates, call dates, and related fixed interest rates on advances from the FHLB at September 30, 2008 are summarized as follows (dollars in thousands).

Maturity	Interest Rate	Call Date	Outstanding Amount
02/09/10	6.450%	11/10/08	25,000
11/10/10	5.430%	11/10/08	8,000
06/29/11	5.170%	-	886
07/15/11	3.250%	07/15/10	50,000
03/06/17	4.080%	12/08/08	100,000
05/18/17	4.347%	05/18/09	80,000
05/18/17	4.475%	05/18/10	80,000
01/29/18	3.050%	01/30/12	13,000
01/29/18	3.050%	01/30/12	7,000
		Total FHLB Loans	**$ 363,886**

At September 30, 2008, certain residential mortgages, HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $645.2 million collateralized the advances from the FHLB. At September 30, 2007, certain loans with carrying values of $561.4 million collateralized the advances from the FHLB. At June 30, 2008, certain residential HELOCS, second mortgages, and commercial mortgages secured by real estate with carrying values of $605.9 million collateralized the advances from the FHLB.

In addition to borrowings from the FHLB, we maintain various borrowing arrangements with financial institutions to support liquidity needs. As of September 30, 2008, we had no outstanding balances on these borrowing agreements with other financial institutions. Average total borrowings, including FHLB advances, during the third quarter of 2008 were $410.4 million compared with $311.1 million for the third quarter of 2007 and $369.6 million for the second quarter of 2008, while the average cost of these funds was 3.99%, 4.57% and 4.09%, respectively.

Convertible Subordinated Capital Debentures. 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. Total convertible subordinated capital debentures at September 30, 2008 were $41.2 million and included a convertible debenture premium of $271,000. At September 30, 2007, the debentures totaled $41.8 million, and at June 30, 2008, they were $41.3 million.

Average total convertible subordinated capital debentures during the third quarter of 2008 were $41.2 million compared with $42.0 million for the third quarter of 2007 and $41.4 million for the second quarter of 2008, while the average cost of these debentures was 5.44%, 5.32% and 4.75% for the respective periods.

Common Stock and Dividends. For the high and low prices of our common stock, see *Part I: Financial Information, Item 1: Selected Quarterly Information,* in this report.

On February 27, 2008, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on April 10, 2008 to shareholders of record on April 1, 2008. 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.

On May 27, 2008, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on July 10, 2008 to shareholders of record on July 1, 2008. 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.

On August 27, 2008, we declared a quarterly shareholder cash dividend of $0.08 per common share. The dividend was paid on October 10, 2008 to shareholders of record on October 1, 2008. All dividends paid are limited by the requirement to meet capital guidelines issued by regulatory authorities, and future declarations are subject to financial performance and regulatory requirements.

Liquidity and Capital Structure. Liquidity represents our ability to provide funds to meet customer demands for loan and deposit withdrawals. 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.

Risk-based capital guidelines for United States banking organizations have been issued by the Federal Reserve, the FDIC, and the Office of the Comptroller of the Currency. Per these guidelines, we consider our sources of liquidity to be adequate to meet our estimated needs and have sufficient alternative sources of liquidity to meet our funding commitments and growth plans.

An additional measure of capital adequacy is risk-based capital ratios. As indicated below, our risk-based capital ratios at September 30, 2008 are 10.26% for Tier 1 and 12.88% for total capital, which are both well above the required minimums of 4% and 8%, respectively. Under the Federal Reserve rules, we are considered "well capitalized" as of September 30, 2008. To be categorized as "well-capitalized," the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios of 10%, 6% and 5%, respectively. The following table provides information on our risk-based capital position (dollars in thousands).

	September 30, 2008	September 30, 2007	June 30, 2008
Tier I Capital:			
Shareholders' equity (1)(2)	$ 334,455	$ 247,412	$ 264,818
Less: goodwill and intangible assets	72,892	67,345	72,829
Total Tier I	261,563	180,067	191,989
Tier II Capital:			
Convertible subordinated debentures	41,186	41,762	41,298
Qualifying allowance for loan losses (3)	25,452	20,749	23,929
Total Tier II	66,638	62,511	65,227
Total Risk Based Capital	$ 328,201	$ 242,578	$ 257,216
Total Assets	$ 3,015,506	$ 2,483,344	$ 2,716,028
Total risk weighted assets	2,548,615	2,130,863	2,440,371
Average assets for leverage capital purposes	2,789,901	2,397,616	2,576,351
Risk Weighted Assets to Total Assets	84.52%	85.81%	89.85%
Risk Based Capital Ratios:			
Tier I (4% minimum requirement)	10.26%	8.45%	7.87%
Total (8% minimum requirement)	12.88%	11.38%	10.54%
Tier I Leverage Ratio (4% minimum requirement)	9.38%	7.51%	7.45%

(1) Excludes unrealized gains/losses on securities available-for-sale.
(2) Includes adjustments per regulatory guidelines.
(3) Limited to 1.25% of risk weighted assets.

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 the Company's calculation of return on average tangible assets and return on average tangible equity. This adjustment allows management to review the Company's core operating result and core capital position.

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Return on average assets (GAAP basis)	0.89%	0.96%	0.92%	0.99%
Impact of excluding average goodwill and other intangibles and amortization	0.02%	0.03%	0.03%	0.03%
Return on average tangible assets	0.91%	0.99%	0.94%	1.02%

	Three months ended September 30, 2008	Three months ended September 30, 2007	Nine months ended September 30, 2008	Nine months ended September 30, 2007
Return on average equity (GAAP basis)	8.32%	9.74%	8.86%	9.73%
Impact of excluding average goodwill and other intangibles and amortization	2.60%	3.69%	3.13%	3.68%
Return on average tangible equity	10.92%	13.43%	11.99%	13.41%

Management's Discussion and Analysis

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, goodwill and other intangible assets are excluded allowing management to review the Company's core capital position.

	Three months ended September 30, 2008	2007
Book value (GAAP basis)	$ 11.23	$ 10.30
Impact of excluding goodwill and other intangibles and amortization	(2.99)	(2.81)
Tangible book value	$ 8.24	$ 7.49

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

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

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

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

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

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

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

At September 30, 2008, we had $552.3 million more assets than liabilities subject to repricing within one year, and therefore, were in an asset-sensitive position. This is a one-day position, which is continually changing and is not necessarily indicative of our position at any other time. There were no known reported material changes in interest rate risk information from the preceding year-end.

PART I. FINANCIAL INFORMATION
Item 4. Controls and Procedures

Controls and Procedures. As of September 30, 2008, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are adequate and effective.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2008. There were no changes that occurred during the period covered by this Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

In the ordinary course of operations, we are a party to various legal proceedings. Based upon information currently available, management believes that such legal proceedings, in the aggregate, will not have a material adverse effect on our business, financial condition, or results of operations.

Item 1A. Risk Factors.

For information regarding factors that could affect the Company's results of operations, financial condition or liquidity, see the risk factors discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of TowneBank's 2007 Annual Report on Form 10-K. See also "Forward-Looking Statements," included in Item 2 of this Quarterly Report on Form 10-Q. There have been no material changes from the risk factors previously disclosed in TowneBank's 2007 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

None

Item 6. Exhibits.

(31.1) CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(31.2) CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(32) Certification Pursuant to 18 U.S.C. Section 1350 as adopted by Section 906 of the Sarbanes-Oxley Act of 2002
(99) Independent Accountants' Report by Goodman & Company, LLP, dated October 20, 2008

PART II. OTHER INFORMATION

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TOWNEBANK

October 31, 2008	By: /s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer
October 31, 2008	By: /s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

Exhibit (31.1)

CERTIFICATIONS

I, G. Robert Aston, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2008 of TowneBank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors, and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

Exhibit (31.1)
continued

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

October 31, 2008	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer

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

Exhibit (31.2)

CERTIFICATIONS

I, Clyde E. McFarland, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended September 30, 2008 of TowneBank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including our consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors, and the audit committee of the registrant's board of directors:

   (a) All significant deficiencies and material weaknesses in the design or operation of the internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

October 31, 2008	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

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

Exhibit (32)

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED BY SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. §1350, as adopted by §906 of the Sarbanes-Oxley Act of 2002, the undersigned officers of TowneBank do hereby certify, to such officer's knowledge, that:

1. Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, our financial condition and result of operations as of and for the period covered by the Report.

October 31, 2008	/s/ G. Robert Aston, Jr.
Date	G. Robert Aston, Jr. Chairman/Chief Executive Officer
October 31, 2008	/s/ Clyde E. McFarland, Jr.
Date	Clyde E. McFarland, Jr. Senior Executive Vice President/CFO

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

Exhibit (99)

Goodman & COMPANY

Certified Public Accountants
Specialized Services
Business Solutions

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Shareholders of ***TowneBank***

We have reviewed the accompanying consolidated balance sheets of ***TowneBank*** and subsidiaries as of September 30, 2008 and 2007, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the three-month and nine-month periods then ended. These financial statements are the responsibility of the company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of ***TowneBank*** and subsidiaries as of December 31, 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 29, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Goodman + Company, LLP

Norfolk, Virginia
October 20, 2008