VILLAGE BANK
AND TRUST FINANCIAL CORP.

Dear Shareholder,

Thank you for your support in 2016. We are pleased with the progress we made during the year and grateful for the diligent work of the Village team members who helped us to achieve so much during 2016.

- We grew core commercial and consumer loans (excludes acquired student and USDA loans) by 13.6% in the product categories we are emphasizing strategically;
- We increased low cost relationship deposits (checking, savings and money market accounts) 13.6% by adding and building business and consumer relationships;
- Village Bank Mortgage Corporation increased loans purchased by investors by 4.9% leading to 21.4% growth in pretax earnings;
- Nonperforming assets and classified assets were reduced by 47% and 32%, respectively, so that our asset quality metrics now fall comfortably in line with our peer group;
- We sold our former headquarters building and terminated the last of the regulatory agreements under which we were operating; and
- Our stock price increased by 41% from December 31, 2015 to December 31, 2016 and as of this writing sits at $27.30, an increase of 97% from the offering price in our rights offering on March 27, 2015.

While we are pleased with our progress, we are intensely focused on the journey ahead. Please take a moment to read the strategy section of our 10-K for information on both our destination and our plans for getting there. During 2016, we made several strategic hires to ensure that we have the talent and depth to accomplish our aspirations.

- We restructured our executive team to consolidate risk, technology and operations functions under Jay Hendricks, a proven leader in team building and exceptional execution, to help ensure that we excel in these critical areas;
- We hired Price Beazley, an innovative and agile technology leader from Capital One. As our Chief Technology Officer, we believe he can help us develop differentiated strategies for meeting the needs of our clients and team members;
- We hired a talented digital marketing manager, Jim Dingus, to strengthen our marketing team and extend our reach;
- We hired Kim Branco, who brings extensive operations experience to help lead our compliance and risk management function;
- We successfully navigated a leadership transition in human resources and were fortunate to attract Lindsay Cheatham to serve as Director of Human Resources. We believe she has the expertise to help us attract, develop and inspire the talented team members we will need to achieve our aspirations; and
- We hired George Karousos, a seasoned mortgage industry leader in our market, to succeed Jerry Mabry, who retired in January from his position as Village Bank Mortgage Corporation President. Jerry leaves behind a legacy of success and a strong team. We believe that George has the vision and skills to grow our mortgage banking team and

footprint, streamline processes, explore ways to better serve the mortgage needs of bank clients, and increase margins in the business.

During 2017, we plan to:

- Launch the ability to open deposit accounts and apply for consumer loans online;
- Enhance the impact of our Customer Care Team by expanding staffing and upgrading technology to deliver a world class customer contact center;
- Launch updated websites for the Bank and the Mortgage Company;
- Hire additional relationship managers to grow our commercial banking team;
- Expand our consumer loan offerings with a portfolio residential mortgage product;
- Implement an end to end paperless loan origination process in mortgage banking;
- Implement a new junior loan officer program and make strategic loan officer hires in mortgage banking to grow production;
- Increase our digital marketing reach and brand building effectiveness by fully utilizing social media platforms;
- Achieve core loan and low cost deposit growth comparable to 2016;
- Improve our efficiency ratio through a combination of productivity initiatives and revenue growth;
- Reduce the burden of preferred stock dividends on earnings available to common shareholders by redeeming preferred shares as rapidly as we believe is prudent. In February, we paid all accrued, unpaid dividends on the preferred stock and redeemed 688 shares. These actions alone will reduce preferred dividends in 2017 by $313,000, or $.22 per common share, from what they otherwise would have been;
- Commit to a strategy for serving the financial advisory and investment needs of our consumer and business owner clients;
- Prepare and position for successful growth through mergers and acquisitions that can complement solid, sustainable organic growth; and
- Continue to strengthen the value proposition for our Village teammates by helping them to be fit to thrive on their journey through life. We plan to offer an enhanced 401k plan, financial education and planning and wellness initiatives.

It seems that the list of tasks and priorities never gets shorter.

As we look to the future, we want to honor two members of our board of directors who have made a lasting and positive difference for the Company.

Cal Esleeck passed away in October of 2016 after a short battle with cancer. Cal had an accountant's business savvy combined with a generous spirit. A proud Marine who served in Vietnam, he had a great appreciation for the importance of confident and effective leadership and was a trusted coach to more than one executive and board member. He was a founding member of the Families of the Wounded Fund, a nonprofit that provides financial resources to families of active duty wounded service members who are being treated at Richmond VA Medical Center in Richmond. In honor of Cal's lifelong efforts to serve others in our community, we have created the Cal Esleeck community champion award in his honor. The "CAL Award" will be awarded annually to recognize a Village team member who goes above and beyond to generously invest his or her time and talents to make a difference in our community.

As announced earlier, Bill Chandler has chosen not to stand for reelection at this shareholder meeting. Bill has made numerous important contributions as a director. With his engineering and production background, he brings a focus on the critical details that drive performance. As a successful business owner, he is always sensitive to the things that impact the customer experience, and he cares deeply about how we invest in our people and at the same time hold them accountable to our high expectations. Perhaps the most important qualities these two gentlemen shared are their authenticity and their willingness to speak their minds on difficult matters. We will dearly miss both of them.

We apologize for the lengthy report, but we believe that you deserve a comprehensive review of our progress and our plans. Because we have included statements about our plans and objectives for the future, you will notice below the forward-looking disclaimer that we would typically include in our earnings press releases. Please join us at our annual shareholder meeting on May 30th at 10:00 a.m. at Brandermill Country Club to hear more of our story. We hope to see you there.

Regards,

William G. Foster
President and Chief Executive Officer

Craig D. Bell
Chairman, Board of Directors

Forward-Looking Statements

In addition to historical information, this letter may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy and financial and other goals. Forward-looking statements often use words such as “believes,” “expects,” “plans,” “may,” “will,” “should,” “projects,” “contemplates,” “anticipates,” “forecasts,” “intends” or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

Additional Information

This letter may be deemed to be solicitation material in respect of the Company’s 2017 annual meeting of shareholders. The Company filed a definitive proxy statement with the Securities and Exchange Commission (the “SEC”) on April 17, 2017 in connection with the annual meeting. Shareholders are urged to read the proxy statement and any other relevant documents that the Company files with the SEC because they will contain important information. The Company, its directors and certain of its executive officers will be participants in the solicitation of proxies from shareholders in connection with the annual meeting. Information about the Company’s directors and executive officers is included in the proxy statement. Investors and shareholders may obtain a copy of the proxy statement and other documents filed by the Company free of charge from the SEC’s website at www.sec.gov. Shareholders may obtain a copy of the proxy statement free of charge by writing to C. Harril Whitehurst, Jr., Executive Vice President and Chief Financial Officer, whose address is P.O. Box 330, Midlothian, Virginia, 23113-0330, or from the Company’s website at www.villagebank.com.

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2016

Commission file number 0-50765

VILLAGE BANK AND TRUST FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	**16-1694602** (I.R.S. Employer Identification No.)
13319 Midlothian Turnpike, Midlothian, Virginia (Address of principal executive offices)	**23113** (Zip Code)

Issuer's telephone number: **804-897-3900**

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, $4.00 par value	The Nasdaq Stock Market

Securities registered under Section 12(g) of the Exchange Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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☑ No☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes☑ No☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form10-K or any amendment to this Form 10-K.[ ]

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☐
Non-Accelerated Filer ☐ (Do not check if 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 ☑

The aggregate market value of common stock held by non-affiliates of the registrant as of the last business day of the Registrant's most recent completed second fiscal quarter was approximately $14,696,000.

The number of shares of common stock outstanding as of February 28, 2017 was 1,428,261.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be used in conjunction with the 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

Village Bank and Trust Financial Corp.
Form 10-K

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PART I

In addition to historical information, the following report contains forward-looking statements that are subject to risks and uncertainties that could cause Village Bank and Trust Financial Corp.'s actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of the report. For discussion of factors that may cause our actual future results to differ materially from those anticipated, please see "ITEM 7 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" herein.

ITEM 1. BUSINESS

Village Bank and Trust Financial Corp. ("Company") was incorporated in January 2003 and was organized under the laws of the Commonwealth of Virginia as a bank holding company. The Company has three active wholly owned subsidiaries: Village Bank (the "Bank"), Southern Community Financial Capital Trust I, and Village Financial Statutory Trust II. The Bank has one active wholly owned subsidiary: Village Bank Mortgage Corporation ("the mortgage company"), a full service mortgage banking company. The Company is the holding company of and successor to the Bank. Effective April 30, 2004, the Company acquired all of the outstanding stock of the Bank in a statutory share exchange transaction. Unless the context suggest otherwise, the terms "we", "us" and "our" refer collectively to the Company, the Bank, and the Mortgage Company.

The Bank is the primary operating business of the Company. The Bank offers a wide range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans, primarily in the Richmond, Virginia metropolitan area. The Bank was organized in 1999 as a Virginia chartered bank to engage in a general banking business to serve the communities in and around Richmond, Virginia. Deposits with the Bank are insured to the maximum amount provided by the Federal Deposit Insurance Corporation ("FDIC"). The Bank offers a comprehensive range of financial services and products and specializes in providing customized financial services to small and medium sized businesses, professionals, and individuals. The Bank provides its customers with personal customized service utilizing the latest technology and delivery channels.

Bank revenues are derived from interest and fees received in connection with loans, deposits, and mortgage services. Administrative and operating expenses are the major expenses, followed by interest paid on deposits and borrowings. Revenues from the mortgage company consist primarily of gains from the sale of loans and loan origination fees and its major expenses consist of personnel, occupancy, data processing, and other operating expenses. In 2016, revenue (after intercompany eliminations) generated by the Bank totaled $19.5 million and the mortgage company generated $7.6 million in revenue.

Segment Reporting

In previous reports, the Company concluded that it had one operating and reportable segment, "Community Banking". This conclusion was based on the fact that the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities supports the others. The Company has re-assessed its segment reporting and decided to report two segments: traditional commercial banking and mortgage banking, as management has changed the information it reviews to make decisions. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the commercial banking segment's cost of funds. Additionally, the mortgage banking segment leases premises from the commercial banking segment. These transactions are eliminated in the consolidation process.

Business Strategy

We are implementing strategies that we believe will help us achieve our goal of delivering long-term total shareholder returns that rank in the top quartile of a nationwide peer group. To achieve this goal, we believe that we will need to become a top performer in return on equity, produce sustainable earnings growth, achieve best quartile earnings volatility in our industry and deliver best quartile asset quality in the worst part of the economic cycle. Our current business strategies include the following:

- *Build full service banking relationships with high quality local companies by being problem solvers and business builders, not just bankers.* We will continue to build a team of bankers and leaders who are both great bankers and exceptional business people. We will have the capital, capabilities and connections to help business owners achieve their goals and overcome obstacles to their success. We target win-win outcomes. We expect to be disciplined lenders during the good times so that during difficult times we can support our good clients, win high quality relationships and recruit talented bankers while other banks focus on their own challenges. Real estate lending will continue to be an important part of our business. We intend to be diligent in managing overall portfolio concentrations, and we will focus on real estate sectors and sponsors that we expect to perform better during difficult times. We will understand the needs and goals of our business clients and their owners so that we can help them fulfill those needs and achieve those goals. We will target deposit only relationships as actively as we will target full loan and deposit relationships. Wherever possible and prudent, we will purchase products and services from the companies that do business with us to support our clients and thank them for their business.

- *Build long-term, mutually beneficial banking relationships with individuals and families in our market area.* We will offer the basic financial products and services individuals and families in our communities need backed by exceptionally professional and caring service. We offer convenience and flexibility through in person, online, mobile and telephonic options for enrolling in new services, handling transactions and seeking service. We want to help our clients thrive on their journey through life. Through our own team members and business partners, we will help clients develop plans for handling the big moments they will encounter along the way. We will be experts at using technology to understand our clients and our markets, serving their needs and growing our business.

- *Grow Village Bank Mortgage Corporation's profitability and positive contribution to our brand.* We intend to add loan officers and production teams, more fully identify and serve the mortgage needs of bank clients, fully leverage available grant programs, introduce portfolio mortgage products, enhance our marketing efforts and streamline our processes. We plan to continue to treat mortgage banking as a specialty line of business. We will continue to differentiate ourselves by treating the homeowners who work with us to exceptionally professional and caring service.

- *Improve the economics of our balance sheet, income statement and business model:*

    - Expand our Net Interest Margin by improving the mix of both assets and funding. We will improve the mix of our assets by growing core loans, allowing guaranteed student loans to run off and operating with a loan to earning assets mix at the higher end of industry peers. We intend to improve our funding mix by developing deposit relationships that produce low cost transaction deposits.
    - Improve asset productivity by increasing the proportion of earning assets to total assets.
    - Build and grow other non-interest income services to leverage our return on assets ("ROA") and return on equity ("ROE").

- Streamline and rationalize our processes and organization to improve productivity and efficiency.
- Include a prudent amount of debt in our holding company capital structure to leverage a strong ROA into an even stronger ROE.

- *Achieve excellence in risk management*. We strive to achieve best quartile performance on credit quality metrics in the worst part of the business cycle and sustainable earnings growth over the long term. Risk taking is a fundamental part of banking. Top performing banks are very good at identifying, understanding, measuring, monitoring, managing, mitigating and getting paid for the risks the organization takes. We are committed to building and sustaining the culture, talent, tools, policies, processes and discipline needed to be a top performer in our risk management functions.

- *Be the place where exceptional people want to work.* We are committed to achieving great things and need teammates who share that commitment. We will sustain our fun, fulfilling and rewarding work environment built on trust and teamwork. We know that we will achieve our goals by fielding a team of champions, not by building our business around individual stars. We are a meritocracy where every individual knows he or she can make a difference every day, where their individual contributions are valued, where we invest in our teammates, and where we hold people accountable. We will invest in technology to leverage the talents of our associates and provide the flexibility to allow them to manage their work and life priorities effectively. We will offer benefits and resources intended to help our team members be fit to thrive on their journey through life. When we make difficult business decisions, we will do so with sensitivity to and understanding of the consequences of those decisions.

- *Make a lasting difference in our communities.* We will invest our work, wisdom and wealth to help our communities prepare young people for success in life, help families navigate the complex maze of modern life and support and honor the individuals who serve and protect us. We believe that we can be particularly effective in serving our many stakeholders by being a leader in education and workforce development initiatives in our community because success in these areas will help individuals and families provide for themselves and will provide businesses with the talented employees they need to grow and prosper.

We strongly believe that there is a continuing need for banks like Village with deep community roots and that a well-run community based bank can generate attractive returns for shareholders over the long term.

Market Area

The Company, the Bank, and the mortgage company are headquartered in Chesterfield County and primarily serve the Central Virginia region and the Richmond Metropolitan Statistical Area (the "Richmond MSA"). At the end of 2015, the Richmond MSA was the nation's 45th largest metro area. At the end of 2016, its population was 1,269,129 representing approximately 15% of the total population in the Commonwealth of Virginia with a median age of 38.2 years.

The unemployment rate for Richmond MSA was 4.1% in December 2016 compared to 4.1% for the Commonwealth of Virginia and 4.7% for the nation. At December 31, 2015 the unemployment rate for Richmond MSA was 4.1%, 4.2% for the Commonwealth of Virginia and 5.0% for the nation.

Banking Services

We currently conduct business from ten full-service branch banking offices, two offsite ATMs and two mortgage loan production offices in Central Virginia in the counties of Chesterfield, Hanover, Henrico and Powhatan. We also have a mortgage loan production office in Manassas, Virginia.

Deposit Services. Deposits are a major source of our funding. The Bank offers a full range of deposit services that are typically available in most banks and other financial institutions including checking accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer term certificates of deposit and Individual Retirement Accounts. These deposit accounts are offered at rates competitive with other institutions in our market area. We service our deposit clients in our full-service branches, at drive-up windows, at our ATMs, through our customer care team and through technology such as online banking, mobile banking applications and remote deposit capture for business clients. We have not applied for permission to establish a trust department and offer trust services. The Bank is not a member of the Federal Reserve System. Deposits are insured under the Federal Deposit Insurance Act to the limits provided thereunder.

Lending Services. We offer a full range of short-to-medium term commercial and personal loans. We also provide a wide range of real estate finance services. Our primary focus is on making loans in the Central Virginia market where we have branch banking offices. We also originate mortgage loans for sale in our Northern Virginia mortgage loan production office. We will periodically offer residential construction-to-permanent financing to clients of the mortgage company.

- *Commercial Business Lending*. We make secured and unsecured loans to small- and medium-sized businesses for purposes such as funding working capital needs (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. We also make loans under Small Business Administration and state sponsored business loan programs. In our underwriting, we evaluate the earnings and cash flows of the business, guarantor support and both the need for and the protection offered by the collateral for the loan.

- *Commercial Real Estate Acquisition, Development, Construction and Mortgage Lending*. We make loans to our clients for the purposes of acquiring, developing, constructing and owning commercial real estate. These properties may be owner-occupied or may be held for investment purposes and repaid from rental income or from the sale of the property.

- *Consumer Lending*. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. We also originate fixed and variable rate mortgage loans and real estate construction and acquisition loans. Residential loans originated by our mortgage company are usually sold in the secondary mortgage market.

- *Loan Participations*. We sell loan participations in the ordinary course of business when a loan originated by us exceeds our legal lending limit or we otherwise deem it prudent to share the risk with another lending institution. Additionally, we purchase loan participations from other banks, usually without recourse against that bank. We underwrite purchased loan participations in accordance with normal underwriting practices.

- *Loan Purchases.* We purchase Federal Rehabilitated Student Loan portfolios when approved by the Board of Directors. These loans are guaranteed by the U.S. Department of Education ("DOE") which covers approximately 98% of the principal and interest. These loans are serviced by a third party servicer that specializes in handling these types of loans.

  We also purchase the guaranteed portion of United State Department of Agriculture Loans ("USDA") which are guaranteed by the USDA for 100% of the principal and interest. The originating institution holds the unguaranteed portion of the loan and services the loan. These loans are typically purchased at a premium. In the event of a loan default or early prepayment the Bank may need to write off any unamortized premium.

Lending Limit. As of December 31, 2016, our legal lending limit for loans to one borrower was approximately $7,384,000. However, we generally limit credit to any one individual or entity to a maximum of $4,000,000.

Competition

We encounter strong competition from other local commercial banks, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions. A number of these competitors are well-established. Competition for loans is keen, and pricing is important. Most of our competitors have substantially greater resources and higher lending limits than ours and offer certain services, such as extensive and established branch networks and trust services, which we do not provide at the present time. Deposit competition also is strong, and we may have to pay higher interest rates to attract deposits. Nationwide banking institutions and their branches have increased competition in our markets, and federal legislation adopted in 1999 allows non-banking companies, such as insurance and investment firms, to establish or acquire banks. We believe that the Company can capitalize on recent merger activity to attract customers from the acquired institutions.

At June 30, 2016, the latest date such information is available from the FDIC, the Bank's deposit market share in Chesterfield County was 4.89%, 4.06% in Hanover County, 7.42% in Powhatan County, 0.38% in the Richmond MSA and 0.08% in Henrico County.

Regulation

We are subject to extensive regulation by certain federal and state agencies and receive periodic examinations by those regulatory authorities. As a consequence, our business is affected by state and federal legislation and regulations.

General. The discussion below is only a summary of the principal laws and regulations that comprise the regulatory framework applicable to us. The descriptions of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere herein, do not purport to be complete and are qualified in their entirety by reference to applicable laws and regulations. In recent years, regulatory compliance by financial institutions such as ours has placed a significant burden on us both in costs and employee time commitment.

Bank Holding Company. The Company is a bank holding company under the federal Bank Holding Company Act of 1956, as amended, and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve") and Virginia Bureau of Financial Institutions (the "BFI"). As a bank holding company, the Company is required to furnish to the Federal Reserve annual and quarterly reports of its operations and such additional information as the Federal Reserve may require. The Federal Reserve, FDIC and BFI also may conduct examinations of the Company and/or the Bank.

Bank Regulation. As a Virginia-chartered bank that is not a member of the Federal Reserve, the Bank is subject to regulation, supervision and examination by the BFI and the FDIC. Federal and state law also specify the activities in which the Bank may engage, the investments it may make and the aggregate amount of loans that may be granted to one borrower. Various consumer and compliance laws and regulations also affect the Bank's operations. Earnings are affected by general economic conditions, management policies and the legislative and governmental actions of various regulatory authorities, including those referred to above. The BFI and the FDIC conduct regular examinations, reviewing such matters as the overall safety and soundness of the institution, the adequacy of loan loss reserves, quality of loans and investments, management practices, compliance with laws, and other aspects of the Bank's operations. In addition to these regular examinations, the Bank must furnish the FDIC and BFI with periodic reports containing a full and accurate statement of its affairs. Supervision, regulation and examination of banks by these agencies are intended primarily for the protection of depositors rather than shareholders.

Prior Agreements with Regulators. In February 2012, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order with the FDIC and BFI (the "Supervisory Authorities"), and the Supervisory Authorities issued the related Consent Order effective February 3, 2012 (the "Consent Order"). In June 2012, the Company entered into a similar written agreement (the "Written

Agreement") with the Federal Reserve Bank of Richmond (the "Reserve Bank"). As a result of the steps the Company and the Bank took to, among other things, improve asset quality, increase capital, augment management and board oversight, and increase earnings, the Consent Order was terminated effective December 14, 2015. In place of the Consent Order, the Bank's Board of Directors made certain written assurances to the Supervisory Authorities in the form of a Memorandum of Understanding ("MOU") that became effective November 17, 2015. Due to further improvements by the Company and the Bank in asset quality and earnings, and the correction of a prior Regulation W violation, the MOU was terminated effective May 12, 2016, and the Written Agreement was terminated effective July 28, 2016. With the terminations of the MOU and the Written Agreement, neither the Company nor the Bank is under any formal or informal agreements with its regulators.

The following description summarizes some of the laws and regulations to which we are subject.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. In July 2010, the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was signed into law, incorporating numerous financial institution regulatory reforms. Certain of these reforms are yet to be implemented through regulations to be adopted by various federal banking and securities regulatory agencies. The following discussion describes the material elements of the regulatory framework that currently apply. The Dodd-Frank Act implements far-reaching reforms of major elements of the financial landscape, particularly for larger financial institutions. Many of its provisions do not directly impact community-based institutions like the Bank. For instance, provisions that regulate derivative transactions and limit derivatives trading activity of federally-insured institutions, enhance supervision of "systemically significant" institutions, impose new regulatory authority over hedge funds, limit proprietary trading by banks, and phase-out the eligibility of trust preferred securities for Tier 1 capital are among the provisions that do not directly impact the Bank either because of exemptions for institutions below a certain asset size or because of the nature of the Bank's operations. Provisions that do impact the Bank include the following:

- *FDIC Assessments*. The Dodd-Frank Act changes the assessment base for federal deposit insurance from the amount of insured deposits to average consolidated total assets less its average tangible equity. In addition, it increases the minimum size of the Deposit Insurance Fund ("DIF") and eliminates its ceiling, with the burden of the increase in the minimum size on institutions with more than $10 billion in assets.
- *Deposit Insurance.* The Dodd-Frank Act makes permanent the $250,000 limit for federal deposit insurance at all insured depository institutions.
- *Interest on Demand Deposits.* The Dodd-Frank Act provides that depository institutions may pay interest on demand deposits, including business transaction and other accounts.
- *Consumer Financial Protection Bureau.* The Dodd-Frank Act centralizes responsibility for consumer financial protection by creating the Consumer Financial Protection Bureau, responsible for implementing federal consumer protection laws, although banks below $10 billion in assets will continue to be examined and supervised for compliance with these laws by their federal bank regulator.
- *Mortgage Lending.* Additional requirements are imposed on mortgage lending, including minimum underwriting standards, prohibitions on certain yield-spread compensation to mortgage originators, special consumer protections for mortgage loans that do not meet certain provision qualifications, prohibitions and limitations on certain mortgage terms and various mandated disclosures to mortgage borrowers.
- *Holding Company Capital Levels.* Bank regulators are required to establish minimum capital levels for holding companies that are at least as stringent as those currently applicable to banks. In addition, all trust preferred securities issued after May 19, 2010 will be counted as Tier 2 capital, but the Company's currently outstanding trust preferred securities will continue to qualify as Tier 1 capital.
- *De Novo Interstate Branching.* National and state banks are permitted to establish de novo interstate branches outside of their home state, and bank holding companies and banks must be well-capitalized and well managed in order to acquire banks located outside their home state.

- *Transactions with Affiliates.* The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.
- *Transactions with Insiders.* Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution’s board of directors.
- *Corporate Governance.* The Dodd-Frank Act includes corporate governance revisions that apply to all public companies, not just financial institutions, including with regard to executive compensation and proxy access to shareholders.

The Company is continually evaluating the effects of the Dodd-Frank Act, together with implementing the regulations that have been proposed and adopted. The ultimate effects of the Dodd-Frank Act and the resulting rulemaking cannot be predicted at this time, but it has increased the Company’s operating and compliance costs in the short-term, and it could have a material adverse effect on the Company’s results of operation and financial condition.

Insurance of Accounts, Assessments and Regulation by the FDIC. Our deposits are insured by the FDIC up to the limits set forth under applicable law, currently $250,000. We are subject to the deposit insurance assessments of the DIF. The amount of the assessment is a function of the institution’s risk category, of which there are four, and its assessment base. An institution’s risk category is determined according to its supervisory ratings and capital levels and is used to determine the institution’s assessment rate. The assessment base is an institution’s average consolidated total assets less its average tangible equity.

The FDIC is authorized to prohibit any DIF-insured institution from engaging in any activity that the FDIC determines by regulation or order to pose a serious threat to the respective insurance fund. Also, the FDIC may initiate enforcement actions against banks, after first giving the institution’s primary regulatory authority an opportunity to take such action. The FDIC may terminate the deposit insurance of any depository institution if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed in writing by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If deposit insurance is terminated, the deposits at the institution at the time of termination, less subsequent withdrawals, shall continue to be insured for a period from six months to two years, as determined by the FDIC. We are aware of no existing circumstances that could result in termination of our deposit insurance.

Payment of Dividends. The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. Virtually all of the Company’s cash revenues will result from dividends paid to it by the Bank, which is subject to laws and regulations that limit the amount of dividends that it can pay. Under Virginia law, a bank may not declare a dividend in excess of its accumulated retained earnings without BFI approval. As of December 31, 2016, the Bank did not have any accumulated retained earnings. In addition, the Bank may not declare or pay any dividend if, after making the dividend, the Bank would be "undercapitalized," as defined in FDIC regulations.

The FDIC and the state have the general authority to limit the dividends paid by insured banks if the payment is deemed an unsafe and unsound practice. Both the FDIC and the state have indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsound and unsafe banking practice.

In addition, the Company is subject to certain regulatory requirements to maintain capital at or above regulatory minimums. These regulatory requirements regarding capital affect our dividend policies.

Regulators have indicated that holding companies should generally pay dividends only if the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, the Federal Reserve has issued guidelines that bank holding companies should inform and consult with the Federal Reserve in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the organization's capital structure.

Capital Adequacy. Both the Company and the Bank are required to comply with the capital adequacy standards established by the Federal Reserve, in the case of the Company, and the FDIC, in the case of the Bank. In June 2012, the federal bank regulatory agencies jointly issued proposed rules to revise the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to be consistent with the agreements reached by the Basel Committee on Banking Supervision in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" ("Basel III") and certain provisions of the Dodd-Frank Act. The proposed rules applied to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more, and top-tier savings and loan holding companies ("banking organizations"). On July 2, 2013, the federal bank regulatory agencies approved certain revisions to the proposed rules and finalized new capital requirements for banking organizations.

Among other things, the final rules establish a revised definition of regulatory capital, a new common equity Tier 1 minimum capital requirement ("CET1"), a higher minimum Tier 1 capital requirement, and a supplementary leverage ratio that incorporates a broader set of exposures in the denominator. The final rules also establish limits on a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a specified amount of CET1 capital in addition to the necessary amount to meet its minimum risk-based capital requirements.

Effective January 1, 2015, the final rules require the Company and the Bank to comply with the following new minimum capital ratios: (i) a new ratio of CET1 to risk-weighted assets of 4.5%; (ii) a ratio of Tier 1 capital to risk-weighted assets of 6.0% (iii) a ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of 8.0%; and (iv) a leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter). These are the initial capital requirements, which will be phased in over a four-year period that began on January 1, 2015. When fully phased in, Basel III will require the Company and the Bank to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%.

Basel III will also provide for a "countercyclical capital buffer," generally designed to absorb losses during periods of economic stress and to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. The buffer would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented (potentially resulting in total buffers of between 2.5% and 5%).

The Basel III capital framework is also expected to provide for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 are to be phased-in over a three-year period which began on January 1, 2016.

Additionally, the bank regulatory agencies' final rules revised the "prompt corrective action" regulations pursuant to Section 38 of the Federal Deposit Insurance Act of 1950 (the "FDI Act") by (i) introducing a CET1 capital ratio requirement at each level (other than critically undercapitalized), with the required ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum ratio for well-capitalized status being 8.0%; and (iii) eliminating the provision that provides that a bank with a composite supervisory rating of 1 may have a 3.0% Tier 1 leverage ratio and still be well-capitalized. These new thresholds were effective for the Bank as of January 1, 2015. The minimum total capital to risk-weighted assets ratio (10.0%) and minimum leverage ratio (5.0%) for well-capitalized status were unchanged by the final rules. As of December 31, 2016, the Bank met the new minimum ratios to be classified as a well capitalized financial institution.

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to banks in the three "undercapitalized" categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution and a lower capital category based on supervisory factors other than capital.

At December 31, 2016, the Bank's Tier 1 risk-based capital ratio was 14.28%, its total risk-based capital ratio was 15.33% and its leverage ratio was 10.47%. More information concerning our regulatory ratios at December 31, 2016 is included in Note 13 to the *Notes to Consolidated Financial Statements* included elsewhere in this Annual Report on Form 10-K.

Restrictions on Transactions with Affiliates. Both the Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- A bank's loans or extensions of credit, including purchases of assets subject to an agreement to repurchase, to affiliates;
- A bank's investment in affiliates;
- Assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- The amount of loans or extensions of credit to third parties collateralized by the securities or debt obligations of affiliates;
- Transactions involving the borrowing or lending of securities and any derivative transaction that results in credit exposure to an affiliate; and
- A bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid acquiring low-quality assets from its affiliates.

The Company and the Bank are also subject to the provisions of Section 23B of the Federal Reserve

Act which, among other things, prohibits an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

On September 30, 2010, the Company sold its headquarters building at the Watkins Centre to the Bank. This transaction allowed us to repay the outstanding mortgage loan on the building resulting in a reduction of our interest expense and improvement in earnings on a consolidated basis. The Federal Reserve Bank has determined that the sale of the headquarters building from the Company to the Bank was not permitted under Section 23A of the Federal Reserve Act as the amount of the transaction exceeded 10% of the Bank's capital stock and surplus. As a result, the Federal Reserve Bank directed the Company to take corrective action. The sale of the headquarters building at the Watkins Centre was finalized in the second quarter of 2016 resulting in a gain on sale of $504,000.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

The Dodd-Frank Act also provides that an insured depository institution may not purchase an asset from, or sell an asset to a bank insider (or their related interests) unless (1) the transaction is conducted on market terms between the parties, and (2) if the proposed transaction represents more than 10% of the capital stock and surplus of the insured institution, it has been approved in advance by a majority of the institution's non-interested directors.

Support of Subsidiary Institutions. Under the Dodd-Frank Act, and previously under Federal Reserve policy, we are required to act as a source of financial strength for our bank subsidiary, Village Bank, and to commit resources to support the Bank. This support can be required at times when it would not be in the best interest of our shareholders or creditors to provide it. In the unlikely event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of the Bank would be assumed by the bankruptcy trustee and entitled to a priority of payment. On December 31, 2012, the Company made a capital contribution of $1,500,000 to the Bank to improve its capital ratios. In addition, on December 4, 2013, the Company raised $1,684,075 through the sale of 67,907 shares of its common stock to its board of directors and executive management team at a price of $24.80 per share in a private placement. The total amount raised was contributed to the Bank as additional capital.

On March 27, 2015, the Company completed a rights offering to shareholders (the "Rights Offering") and concurrent standby offering to Kenneth R. Lehman (the "Standby Offering"), in which the Company issued an aggregate of 1,051,866 shares of common stock (the total number of shares offered) at $13.87 per share for aggregate gross proceeds of $14,589,381 (including the value of the Company's preferred stock exchanged by Mr. Lehman for shares of common stock of $4,618,813). In connection with the Rights Offering, 283,293 shares were issued to shareholders upon exercise of their basic subscription rights and 191,773 shares were issued to shareholders upon exercise of their oversubscription privileges (approximately 36.9% of the total number of shares requested pursuant to oversubscription privileges). In connection with the Standby Offering, Mr. Lehman purchased an aggregate of 576,800 shares of the Company's common stock, 333,007 of which were issued in exchange for 9,023 shares of the Company's preferred stock and 243,793 of which were purchased for cash. Also, as part of the Standby Offering, Mr. Lehman forgave $2,215,009 in accrued and unpaid dividends on the preferred stock. The Company made a capital contribution of $5,000,000 to the Bank from the cash proceeds of this offering.

Incentive Compensation Policies and Restrictions. In July 2010, the federal banking agencies issued guidance that applies to all banking organizations supervised by the agencies (thereby including both the Company and the Bank). Pursuant to the guidance, to be consistent with safety and soundness principles, a banking organization's incentive compensation arrangements should:

(1) provide employees with incentives that appropriately balance risk and reward; (2) be compatible with effective controls and risk management; and (3) be supported by strong corporate governance including active and effective oversight by the banking organization's board of directors. Monitoring methods and processes used by a banking organization should be commensurate with the size and complexity of the organization and its use of incentive compensation. At December 31, 2016, we had not been made aware of any instances of non-compliance with this guidance.

Emergency Economic Stabilization Act of 2008. In response to unprecedented market turmoil during the third quarter of 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was enacted on October 3, 2008. EESA authorized the U.S. Treasury to provide up to $700 billion to support the financial services industry. Pursuant to the EESA, the U.S. Treasury was initially authorized to use $350 billion for the Troubled Asset Relief Program ("TARP"), of which the U.S. Treasury allocated $250 billion to the TARP Capital Purchase Program (the "TARP Program").

On May 1, 2009, the Company issued preferred stock and a warrant to purchase its common stock to the U.S. Treasury pursuant to the TARP Program. The amount of capital raised in that transaction was $14.7 million. Pursuant to the terms of the preferred stock, dividends may not be paid on common stock unless dividends have been paid on the preferred stock. The preferred stock does not have voting rights other than the right to vote as a class on the issuance of any preferred stock ranking senior, any change in its terms or any merger, exchange or similar transaction that would adversely affect its rights. Holders of the preferred stock also have the right to elect two directors if dividends have not been paid for six periods.

In November 2013, the Company's preferred stock was sold by the U.S. Treasury as part of its efforts to manage and recover its investments under the TARP Program. While the sale of the preferred stock to new owners did not result in any proceeds to the Company (nor did it change the Company's capital position or accounting for these securities including accrual of dividends), it did eliminate certain restrictions put in place by the U.S. Treasury on TARP recipients.

In accordance with the Company's prior Written Agreement with the Reserve Bank, the Company had been deferring quarterly cash dividends on the preferred stock since May 2011. The Written Agreement was terminated by the Reserve Bank as of July 28, 2016. With the termination of the Written Agreement, the Company is not required to defer the quarterly cash dividends on the preferred stock. At December 31, 2016, the aggregate amount of the Company's total accrued but deferred dividend payments on the preferred stock was $2,815,000 and reflected as a reduction of retained earnings. This amount was accrued for and included in other liabilities on the Balance Sheet in the *Consolidated Financial Statements*.

Subsequent to December 31, 2016, the Company received approval from state and federal regulators allowing the Bank to pay a special dividend to the Company for the sole purpose of paying all accrued and unpaid dividends on the preferred stock through February 15, 2017, as well as to redeem 688 shares of the total 5,715 shares outstanding. The accrued and unpaid dividends paid on February 15, 2017 amounted to $2,911,000. The 688 shares were redeemed on February 24, 2017 at a redemption price of $1,000 per share plus accrued dividends from February 15, 2017 to the redemption date.

Privacy Legislation. Several laws, including the Right To Financial Privacy Act, and related regulations issued by the federal bank regulatory agencies, provide protections against the transfer and use of customer information by financial institutions. A financial institution must provide to its customers information regarding its policies and procedures with respect to the handling of customers' personal information. Each institution must conduct an internal risk assessment of its ability to protect customer information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated parties without prior notice and approval from the customer.

Bank Secrecy Act. The Bank Secrecy Act ("BSA"), which is intended to require financial institutions to develop policies, procedures and practices to prevent and deter money laundering, mandates that every bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA. The program must, at a minimum: (i) provide for a system of internal controls to assure ongoing compliance; (ii) provide for independent testing for compliance; (iii) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (iv) provide training for appropriate personnel. In addition, a bank is required to adopt a customer identification program as part of its BSA compliance program. Financial institutions are generally required to report cash transactions involving more than $10,000 to the U.S. Department of the Treasury. In addition, financial institutions are required to file suspicious activity reports for transactions that involve more than $5,000 and which the financial institution knows, suspects or has reason to suspect involves illegal funds, is designed to evade the requirements of the BSA or has no lawful purpose. The USA PATRIOT Act of 2001, enacted in response to the September 11, 2001 terrorist attacks, requires bank regulators to consider a financial institution's compliance with the BSA when reviewing applications from a financial institution. In May 2016, the regulations implementing the BSA were amended to explicitly include risk-based procedures for conducting ongoing customer due diligence, to include understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile. In addition, banks must identify and verify the identity of the beneficial owners of all legal entity customers (other than those that are excluded) at the time a new account is opened (other than accounts that are exempted). We must comply with these amendments and new requirements by May 11, 2018.

Reporting Terrorist Activities. The Office of Foreign Assets Control ("OFAC"), which is a division of the Department of the Treasury, is responsible for helping to insure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk OFAC areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software, which is updated each time a modification is made to the lists provided by OFAC and other agencies of Specially Designated Nationals and Blocked Persons.

Other Safety and Soundness Regulations. There are a number of obligations and restrictions imposed on depository institutions by federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance funds in the event the depository institution becomes in danger of default or is in default. The Federal banking agencies also have broad powers under current Federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized, as defined by the law. Federal regulatory authorities also have broad enforcement powers over us, including the power to impose fines and other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any such institution for the benefit of depositors and other creditors. At December 31, 2016, Village Bank met the ratio requirements to be classified as a well capitalized financial institution.

Loans-to-One Borrower. Under applicable laws and regulations the amount of loans and extensions of credit which may be extended by a bank to any one borrower, including related entities, generally may not exceed 15% of the sum of the capital, surplus, and loan loss reserve of the institution.

Community Reinvestment. The requirements of the Community Reinvestment Act ("CRA") are applicable to the Company. The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community credit needs currently are evaluated as part of the examination process pursuant to 12 assessment factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility.

Volcker Rule. On December 10, 2013, five U.S. financial regulators, including the FDIC, adopted final rules implementing the Volcker Rule. The final rules prohibit banking entities from (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds. The Volcker Rule is intended to provide greater clarity with respect to both the extent of those primary prohibitions and of the related exemptions and exclusions. The final rules were effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2016. The adoption of this guidance did not have a material effect on the Company's financial condition or results of operations.

Cybersecurity. In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. If the Company fails to observe the regulatory guidance, it could be subject to various regulatory sanctions, including financial penalties. To date, we have not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, but our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers.

Future Legislation and Regulation. Congress may enact legislation from time to time that affects the regulation of the financial services industry, and state legislatures may enact legislation from time to time affecting the regulation of financial institutions chartered by or operating in those states. Federal and state regulatory agencies also periodically propose and adopt changes to their regulations or change the manner in which existing regulations are applied. The substance or impact of pending or future legislation or regulation, or the application thereof, cannot be predicted, although enactment of the proposed legislation could impact the regulatory structure under which we operate and may significantly increase costs, impede the efficiency of internal business processes, require an increase in regulatory capital, require modifications to business strategy, and limit the ability to pursue business opportunities in an efficient manner.

At this time, it is difficult to predict the legislative and regulatory changes that will result from the combination of a new President of the United States and the first year since 2010 in which both Houses of Congress and the White House have majority memberships from the same political party. In recent years, however, both the new President and senior members of the House of Representatives have advocated for significant reduction of financial services regulation, to include amendments to the Dodd-Frank Act and structural changes to the CFPB. The new administration and Congress also may cause broader economic changes due to changes in governing ideology and governing style. Future legislation, regulation, and government policy could affect the banking industry as a whole, including our business and results of operations, in ways that are difficult to predict.

Employees

As of December 31, 2016, the Company and its subsidiaries had a total of 171 full-time employees and 7 part-time employees. None of the Company's employees are covered by a collective bargaining agreement. The Company considers its relations with its employees to be good.

The Company has a Code of Ethics for directors, officers and all employees of the Company and its subsidiaries, and a Code of Ethics applicable to the Company's Chief Executive Officer, Chief Financial Officer and other principal financial officers. The Code addresses such topics as protection and proper use of Company assets, compliance with applicable laws and regulations, accuracy and preservation of records, accounting and financial reporting and conflicts of interest. A copy of the Code will be provided, without charge, to any shareholder upon written request to the Secretary of the Company, whose address is P.O. Box 330, 13319 Midlothian Turnpike, Midlothian, Virginia 23113.

Additional Information

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any reports, statements and other information we file at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operations of the Public Reference Room. Our SEC filings are also available on the SEC's Internet site (http://www.sec.gov).

The Company's common stock trades under the symbol "VBFC" on the Nasdaq Capital Market.

The Company's Internet address is www.villagebank.com. At that address, we make available, free of charge, the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act (see "Investor Relations" section of website), as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

In addition, we will provide, at no cost, paper or electronic copies of our reports and other filings made with the SEC (except for exhibits). Requests should be directed to C. Harril Whitehurst, Jr., Chief Financial Officer, Village Bank and Trust Financial Corp., PO Box 330, Midlothian, VA 23113.

The information on the websites listed above is not and should not be considered to be part of this annual report on Form 10-K and is not incorporated by reference in this document.

ITEM 1A. RISK FACTORS

Not applicable

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

ITEM 2. PROPERTIES

Our executive and administrative offices are owned by the Bank and are located at 13319 Midlothian Turnpike, Midlothian, Virginia 23113 in Chesterfield County. The current location also houses the principal office of the mortgage company.

In addition to its executive offices, the Bank owns seven full service branch buildings including the land on those buildings and leases an additional four full service branch buildings. Five of our branch offices are located in Chesterfield County, with three branch offices in Hanover County, two in Henrico County and one in Powhatan County. We are in the process of closing one branch in Chesterfield County and consolidating its operations in a nearby branch. This closure should be completed in the first quarter of 2017.

Our properties are maintained in good operating condition and are suitable and adequate for our operational needs.

ITEM 3. LEGAL PROCEEDINGS

As previously disclosed by the Company, in March 2013, the Special Inspector General for the Troubled Asset Relief Program notified the Company that it was conducting an investigation of the Company. SIGTARP issued seven subpoenas from March 2013 to November 2016 requesting that the Company produce certain documents and other information. The Company has been cooperating fully with SIGTARP in providing the requested materials. The Company cannot predict the duration or the outcome of this investigation, including the effect the investigation and the costs associated with the investigation could have on the Company's business, financial condition, or results of operations.

In the course of its operations, the Company may become a party to legal proceedings. There are no material pending legal proceedings to which the Company is a party or of which the property of the Company is subject.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

On August 8, 2014, we completed a reverse split of our common stock. All financial information and per share amounts are presented as if the reverse split was effective at the beginning of the earliest period presented.

Market Information

Shares of the Company's common stock trade on the Nasdaq Capital Market under the symbol "VBFC". The high and low prices of shares (adjusted for reverse stock split) of the Company's common stock for the periods indicated were as follows:

	High	Low
2015		
1st quarter	$ 25.99	$ 14.15
2nd quarter	22.40	17.30
3rd quarter	23.75	18.00
4th quarter	21.80	18.25
2016		
1st quarter	$ 20.36	$ 18.01
2nd quarter	23.50	18.91
3rd quarter	24.88	22.30
4th quarter	27.45	23.10

Dividends

The Company has not paid any dividends on its common stock. We intend to retain all of our earnings to finance the Company's operations and we do not anticipate paying cash dividends for the foreseeable future. Any decision made by the board of directors to declare dividends in the future will depend on the Company's future earnings, capital requirements, financial condition and other factors deemed relevant by the board. Banking regulations limit the amount of cash dividends that may be paid without prior approval of the Bank's regulatory agencies. Such dividends are limited to the Bank's accumulated retained earnings. The Federal Reserve has issued guidelines that bank holding companies should inform and consult with the Federal Reserve in advance of declaring or paying a dividend that exceeds earnings for the period (e.g. quarter) for which the dividend is being paid or that could result in a material adverse charge to the organization's capital structure.

The Company was previously prohibited by its Written Agreement with the Reserve Bank from paying dividends on capital stock, including the Series A preferred stock, or interest payments on the trust preferred capital notes without prior regulatory approval. The Written Agreement was terminated by the Reserve Bank as of July 28, 2016. With the termination of the Written Agreement, the Company is not required to defer the quarterly cash dividends on the Series A preferred stock. At December 31, 2016, the aggregate amount of the Company's total accrued but deferred dividend payments on the preferred stock was $2,815,000 and reflected as a reduction of retained earnings.

Subsequent to December 31, 2016, the Company received approval from state and federal regulators allowing the Bank to pay a special dividend to the Company for the sole purpose of paying all accrued and unpaid dividends on the preferred stock through February 15, 2017, as well as to redeem 688 shares of the total 5,715 shares outstanding. The accrued and unpaid dividends paid on February 15, 2017 amounted to $2,911,000. The 688 shares were redeemed on February 24, 2017 at a redemption price of $1,000 per share plus accrued dividends from February 15, 2017 to the redemption date.

Holders

At February 28, 2017, there were approximately 1,047 active holders of common stock; including registered holders and beneficial holders of shares through banks, brokers and other nominees.

For information concerning the Company's Equity Compensation Plans, see "Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters".

Purchases of Equity Securities

The Company did not repurchase any of its Common Stock during 2016.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company, consisting of the parent company and its wholly-owned subsidiary, the Bank. This discussion should be read in conjunction with the consolidated financial statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements

In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement, that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include statements regarding profitability, liquidity, allowance for loan losses, interest rate sensitivity, market risk, growth strategy and financial and other goals. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to:

- changes in assumptions underlying the establishment of allowances for loan losses, and other estimates;
- the risks of changes in interest rates on levels, composition and costs of deposits, loan demand, and the values and liquidity of loan collateral, securities, and interest sensitive assets and liabilities;
- the effects of future economic, business and market conditions;
- legislative and regulatory changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and other changes in banking, securities, and tax laws and regulations and their application by our regulators, and changes in scope and cost of FDIC insurance and other coverages;
- our inability to maintain our regulatory capital position;
- the Company's computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions despite security measures implemented by the Company;
- changes in market conditions, specifically declines in the residential and commercial real estate market, volatility and disruption of the capital and credit markets, soundness of other financial institutions we do business with;
- risks inherent in making loans such as repayment risks and fluctuating collateral values;
- changes in operations of Village Bank Mortgage Corporation as a result of the activity in the residential real estate market;
- exposure to repurchase loans sold to investors for which borrowers failed to provide full and accurate information on or related to their loan application or for which appraisals have not been acceptable or when the loan was not underwritten in accordance with the loan program specified by the loan investor;
- governmental monetary and fiscal policies;
- changes in accounting policies, rules and practices;
- reliance on our management team, including our ability to attract and retain key personnel;
- competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;
- demand, development and acceptance of new products and services;
- problems with technology utilized by us;

- changing trends in customer profiles and behavior; and
- other factors described from time to time in our reports filed with the SEC.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made. In addition, past results of operations are not necessarily indicative of future results.

General

The Company's primary source of earnings is net interest income, and its principal market risk exposure is interest rate risk. The Company is not able to predict market interest rate fluctuations and its asset/liability management strategy may not prevent interest rate changes from having a material adverse effect on the Company's results of operations and financial condition. Because the Company intentionally decreased assets for the three years prior to 2016 as it was resolving problem assets and attempting to improve capital ratios, as well as declines in yields on earning assets, net interest income declined from $13,018,000 in 2014 to $12,637,000 in 2015. With improved capital ratios and asset quality in 2016, the Company's asset strategy changed to one of growth, with interest earning assets increasing by $7,765,000. This increase in interest earning assets as well as an increase of 0.05% (5 basis points) on their yield, combined with a decline in interest bearing liabilities of $11,365,000 and a 0.05% (5 basis points) decline in their cost, increased net interest income to $13,380,000 in 2016.

Although we endeavor to minimize the credit risk inherent in the Company's loan portfolio, we must necessarily make various assumptions and judgments about the collectability of the loan portfolio based on our experience and evaluation of economic conditions. If such assumptions or judgments prove to be incorrect, the current allowance for loan losses may not be sufficient to cover loan losses and additions to the allowance may be necessary, which would have a negative impact on net income.

Results of Operations

The following presents management's discussion and analysis of the financial condition of the Company at December 31, 2016 and 2015, and results of operations for the Company for the years ended December 31, 2016, 2015 and 2014. This discussion should be read in conjunction with the Company's audited Financial Statements and the notes thereto appearing elsewhere in this Annual Report.

The following table sets forth selected financial ratios:

	2016	2015	2014
Performance Ratios			
Return on average assets[(1)]	3.15%	0.15%	(0.24)%
Return on average equity[(1)]	38.81%	2.30%	(5.43)%
Net interest margin[(2)]	3.53%	3.40%	3.46%
Efficiency[(3)]	90.34%	105.96%	104.48%
Loans to deposits	88.12%	84.27%	75.72%
Equity to assets	9.81%	7.23%	4.39%
Asset Quality Ratios			
ALLL to loans at year-end	1.00%	1.16%	2.00%
ALLL to loans at year-end excluding guaranteed student loans[(4)]	1.16%	1.41%	2.26%
ALLL to nonaccrual loans	140.41%	95.78%	76.62%
Nonperforming assets to total assets	1.20%	2.37%	4.63%
Nonperforming loans to total loans	1.58%	3.24%	7.01%
Net charge-offs to average loans	0.06%	0.06%	0.59%

(1) Return on Average Assets and Return on Average Equity for 2016 were positively impacted by the reversal in the third quarter of 2016 of an $11,997,000 valuation allowance previously recorded against the net deferred tax asset.
(2) Net interest margin is computed by dividing net interest income for the period by average interest earning assets.
(3) Efficiency ratio is computed by dividing noninterest expense by the sum of net interest income and noninterest income.
(4) Student loans are guaranteed by the Department of Education for approximately 98% of principal and interest and are evaluated separately for ALLL.

Such ratios are not measurements under accounting principles generally accepted in the United States (“GAAP”) and are not intended to be a substitute for our balance sheet or income statement prepared in accordance with GAAP.

Income Statement Analysis

Summary

We recorded net income of $13,513,000 and net income available to common shareholders of $12,776,000 or $8.99 in 2016 compared to income of $646,000 and net income available to common shareholders of $6,591,000 or $5.49 per fully diluted share in 2015 and a net loss of $1,037,000 and a net loss available to common shareholders of $2,473,000, or $(7.39) per fully diluted share, in 2014.

Net income and net income available to common shareholders for the year ended December 31, 2016 were positively impacted by the reversal in the third quarter of 2016 of an $11,997,000 valuation allowance previously recorded against the net deferred tax asset. Netting this reversal against income tax expense for 2016 of $825,000 resulted in an income tax benefit of $11,172,000 for the year ended December 31, 2016. Net income available to common shareholders for the year ended December 31, 2015 was positively impacted by the forgiveness of principal and dividends on preferred stock amounting to $6,619,000 associated with the rights offering to shareholders and concurrent standby offering completed in March 2015.

There were significant changes in income and expense items when comparing the 2016 and 2015 results and 2015 to 2014. These changes are listed in the following table (in thousands):

	2016 Compared to 2015	2015 Compared to 2014
Increase (decrease) in		
Net interest income	$ 743	$ (381)
(Recovery of) provision for loan losses	(2,000)	2,100
Gains on loan sales	354	1,627
Gain on sale of assets	504	-
Gain on sale of investments	156	216
Service charges and fees	(61)	275
Rental income	(523)	140
Other noninterest income	362	(89)
(Increase) decrease in		
Salaries and benefits	(449)	(161)
Commissions	(51)	(390)
Occupancy expense	260	(40)
Professional and outside services	(69)	(380)
Writedown of assets held for sale	2,429	(2,649)
Loss on branch consolidation	(252)	-
Expenses related to foreclosed real estate	(240)	1,091
FDIC premium	624	52
Other operating expenses	(78)	267
Other	(14)	5
	$ 1,695	$ 1,683

Net interest income

Net interest income, which represents the difference between interest earned on interest-earning assets and interest incurred on interest-bearing liabilities, is the Company's primary source of earnings. Net interest income can be affected by changes in market interest rates as well as the level and composition of assets, liabilities and shareholders' equity. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net yield on interest-earning assets ("net interest margin") is calculated by dividing tax equivalent net interest income by average interest-earning assets. Generally, the net interest margin will exceed the net interest spread because a portion of interest-earning assets are funded by various noninterest-bearing sources, principally noninterest-bearing deposits and shareholders' equity.

	Year Ended December 31,		
	2016	2015	Change
	(dollars in thousands)		
Average interest-earning assets	$ 379,163	$ 371,398	$ 7,765
Interest income	$ 15,989	$ 15,504	$ 485
Yield on interest-earning assets	4.22%	4.17%	0.05%
Average interest-bearing liabilities	$ 304,458	$ 315,823	$ (11,365)
Interest expense	$ 2,609	$ 2,867	$ (258)
Cost of interest-bearing liabilities	0.86%	0.91%	(0.05)%
Net interest income	$ 13,380	$ 12,637	$ 743
Net interest margin	3.53%	3.40%	0.13%

The increase in net interest income of $743,000 in 2016 was a result of positive movements in both interest income and interest expense. Interest income increased by $485,000 with interest income on loans increasing by $706,000 offset by a decrease in interest income on investments of $261,000. The increase in interest income on loans was attributable to an increase in average loans outstanding of $27,388,000. The decline in interest income on securities was due to a decline in average investment securities of $10,619,000 as we sold securities to reduce our exposure to interest rate changes. Interest expense declined by $258,000 primarily as a result of a decline in average interest bearing liabilities of $11,365,000.

	Year Ended December 31,		
	2015	2014	Change
	(dollars in thousands)		
Average interest-earning assets	$ 371,398	$ 376,003	$ (4,605)
Interest income	$ 15,504	$ 16,578	$ (1,074)
Yield on interest-earning assets	4.17%	4.41%	(0.24)%
Average interest-bearing liabilities	$ 315,823	$ 350,133	$ (34,310)
Interest expense	$ 2,867	$ 3,560	$ (693)
Cost of interest-bearing liabilities	0.91%	1.02%	(0.11)%
Net interest income	$ 12,637	$ 13,018	$ (381)
Net interest margin	3.40%	3.46%	(0.06)%

The decline in net interest income of $381,000 in 2015 was a result of declines in both interest income and interest expense. Interest income declined by $1,074,000 in 2015 primarily due to a decline of 0.24% (24 basis points) in the yield on average earning assets. While yields on all interest earning assets declined with the exception of federal funds sold, the primary driver was a decline in the yield on loans which declined by 0.61% (61 basis points) due to a competitive lending environment. Interest expense declined by $693,000 primarily as a result of a decline in average interest bearing liabilities of $34,310,000, with average interest bearing deposits declining by $27,436,000 and average Federal Home Loan Bank of Atlanta (“FHLB”) advances declining by $6,441,000.

The following table illustrates average balances of total interest-earning assets and total interest-bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted-average yields and rates (dollars in thousands). The average balances used in these tables and other statistical data were calculated using daily average balances. We have no tax exempt assets for the periods presented.

	Year Ended December 31, 2016			Year Ended December 31, 2015			Year Ended December 31, 2014		
	Average Balance	Interest Income/ Expense	Yield Rate	Average Balance	Interest Income/ Expense	Yield Rate	Average Balance	Interest Income/ Expense	Yield Rate
Loans									
Commercial	$ 29,989	$ 1,427	4.76%	$ 21,291	$ 1,096	5.15%	$ 23,991	$ 1,321	5.51%
Real estate - residential	82,592	4,397	5.32%	87,767	4,756	5.42%	94,482	5,275	5.58%
Real estate - commercial	128,346	6,108	4.76%	113,132	5,650	4.99%	115,541	6,350	5.50%
Real estate - construction	31,440	1,533	4.88%	30,828	1,609	5.22%	30,577	1,728	5.65%
Student loans	50,742	1,529	3.01%	42,610	1,204	2.83%	8,145	204	2.50%
Consumer	1,702	99	5.82%	1,795	72	4.01%	1,692	84	4.96%
Gross loans	324,811	15,093	4.65%	297,423	14,387	4.84%	274,428	14,962	5.45%
Investment securities	27,627	355	1.28%	38,246	616	1.61%	54,566	1,182	2.17%
Loans held for sale	12,520	470	3.75%	11,487	446	3.88%	8,204	347	4.23%
Federal funds and other	14,205	71	0.50%	24,242	55	0.22%	38,805	87	0.22%
Total interest earning assets	379,163	15,989	4.22%	371,398	15,504	4.17%	376,003	16,578	4.41%
Allowance for loan losses	(3,513)			(5,678)			(6,218)		
Cash and due from banks	13,860			9,765			12,376		
Premises and equipment, net	13,187			14,210			13,204		
Other assets	26,703			36,906			43,107		
Total assets	$ 429,400			$ 426,601			$ 438,472		
Interest bearing deposits									
Interest checking	42,783	77	0.18%	43,450	79	0.18%	42,311	78	0.18%
Money market	68,817	256	0.37%	67,796	251	0.37%	66,866	251	0.38%
Savings	20,119	36	0.18%	20,282	37	0.18%	20,555	37	0.18%
Certificates	158,203	1,998	1.26%	163,956	2,114	1.29%	193,188	2,640	1.37%
Total deposits	289,922	2,367	0.82%	295,484	2,481	0.84%	322,920	3,006	0.93%
Borrowings									
Long-tern debt - trust preferred securities	9,027	185	2.05%	9,922	213	2.15%	9,714	215	2.21%
FHLB advances	5,161	56	1.09%	9,027	170	1.88%	15,468	334	2.16%
Other borrowings	348	1	0.29%	1,390	3	0.22%	2,031	5	0.25%
Total interest bearing liabilities	304,458	2,609	0.86%	315,823	2,867	0.91%	350,133	3,560	1.02%
Noninterest bearing deposits	82,678			75,127			62,612		
Other liabilities	7,445			7,480			6,639		
Total liabilities	394,581			398,430			419,384		
Equity capital	34,819			28,171			19,088		
Total liabilities and capital	$ 429,400			$ 426,601			$ 438,472		
Net interest income before provision for loan losses		$ 13,380			$ 12,637			$ 13,018	
Interest spread - average yield on interest earning assets, less average rate on interest bearing liabilities			3.36%			3.27%			3.39%
Net interest margin (net interest income expressed as a percentage of average earning assets)			3.53%			3.40%			3.46%

Interest income and interest expense are affected by changes in both average interest rates and average volumes of interest-earning assets and interest-bearing liabilities. The following table analyzes changes in net interest income attributable to changes in the volume of interest-sensitive assets and liabilities compared to changes in interest rates. Nonaccrual loans are included in average loans outstanding. The changes in interest due to both rate and volume have been allocated to changes due to volume and changes due to rate in proportion to the relationship of the absolute dollar amounts of the changes in each (dollars in thousands).

	2016 vs. 2015 Increase (Decrease) Due to Changes in			2015 vs. 2014 Increase (Decrease) Due to Changes in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income						
Loans	$ 1,128	$ (398)	$ 730	$ 450	$ (926)	$ (476)
Investment securities	(151)	(110)	(261)	(305)	(261)	(566)
Fed funds sold and other	(8)	24	16	(32)	(1)	(33)
Total interest income	969	(484)	485	113	(1,188)	(1,075)
Interest expense						
Deposits						
Interest checking	(1)	(1)	(2)	2	(1)	1
Money market accounts	4	1	5	-	-	-
Savings accounts	-	(1)	(1)	-	-	-
Certificates of deposit	(73)	(43)	(116)	(383)	(143)	(526)
Total deposits	(70)	(44)	(114)	(381)	(144)	(525)
Borrowings						
Long-term debt	3	(31)	(28)	(0)	(2)	(2)
FHLB Advances	(57)	(57)	(114)	(125)	(39)	(164)
Other borrowings	(2)	-	(2)	(2)	-	(2)
Total interest expense	(126)	(132)	(258)	(508)	(185)	(693)
Net interest income	$ 1,095	$ (352)	$ 743	$ 621	$ (1,003)	$ (382)

Provision for (recovery of) loan losses

The amount of the loan loss provision (recovery) is determined by an evaluation of the level of loans outstanding, the level of non-performing loans, historical loan loss experience, delinquency trends, underlying collateral values, the amount of actual losses charged to the reserve in a given period and assessment of present and anticipated economic conditions.

The level of the allowance reflects changes in the size of the portfolio or in any of its components as well as management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The provision for (recovery of) loan losses by loan category is presented in the following schedule (in thousands):

	2016		2015		2014	
	Provision (Recovery)	Loans Outstanding	Provision (Recovery)	Loans Outstanding	Provision (Recovery)	Loans Outstanding
Construction and land development	$ 19	$ 33,862	$ 286	$ 31,150	$ (1,119)	$ 29,467
Commercial real estate	(730)	133,099	(866)	116,218	1,645	109,568
Consumer real estate	(146)	81,250	(1,143)	83,594	(159)	89,773
Commercial and industrial	44	39,390	(350)	20,086	(447)	22,165
Guaranteed student loans	149	47,398	13	53,989	217	33,562
Consumer	10	2,101	1	1,734	(37)	1,611
Unallocated	654	-	59	-	-	-
	$ -	$ 337,100	$ (2,000)	$ 306,771	$ 100	$ 286,146

For the year ended December 31, 2016, no provision for loan losses was necessary due to continued improvement in credit quality as well as declining historical loss experience used in its calculation. The recovery of loan losses recorded for the year ended December 31, 2015 was due primarily to credit quality improvements and an enhanced model for evaluating inherent losses in the Bank's loan portfolio. Improvements in credit quality are provided in the following schedule:

	December 31,		
	2016	2015	2014
Classified assets	$ 10,454	$ 15,375	$ 30,684
Nonaccrual loans	2,402	3,718	7,478
Foreclosed real estate	2,926	6,249	12,638

During the fourth quarter of 2015, we adopted a software solution for the analysis of the allowance for loan losses. While our methodology of evaluating the adequacy of the allowance for loan losses generally did not change, the software is more robust in that it:

- allows us to take a more measureable approach to our evaluation of qualitative factors such as economic conditions that may affect loss experience; and
- is widely used by community banks which provides peer data that can be used as a benchmark for comparison to our analysis.

In addition to the adoption of the software solution for our analysis, we reviewed the last twenty years of historical loss data for peer banks in Virginia to assist us in our evaluation of environmental factors and other conditions that could affect the loan portfolio and the overall adequacy of the allowance for loan losses.

The allowance for loan losses at each of the periods presented includes an amount that could not be identified to individual types of loans referred to as the unallocated portion of the allowance. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. We concluded that the unallocated portion of the allowance was acceptable given the level of classified assets and was within a reasonable range around the estimate of losses. The allowance for loan losses included an unallocated portion of approximately $713,000 and $59,000 at December 31, 2016 and 2015, respectively.

Discussion of the recovery of loan losses related to specific loan types are provided following:

- The recovery of loan losses totaling $1,119,000 for the construction and land development loan portfolio during 2014 was attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of the historical net recovery of 0.27% at December 31, 2014. Also contributing to the declines in the general component were declines of approximately $1,643,000 and $12,945,000 in the outstanding loan balance of this portfolio at December 31, 2014 and 2013, respectively.

- The recovery of loan losses totaling $730,000 and $866,000 for the commercial real estate portfolio at December 31, 2016 and 2015, respectively, was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 0.96% in 2014 to 0.57% in 2015 and to 0.20% in 2016. In addition, net charge-offs on this portfolio decreased from $1,220,000 in 2014 to $90,000 in 2015 and to a net recovery of $111,000 in 2016.

- The recovery of loan losses totaling $1,143,000 for the consumer real estate portfolio in 2015 was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 1.36% in 2014 to 0.24% in 2015 and to .0022% in 2016. In addition, net charge-offs on this portfolio decreased from $562,000 in 2014 to a recovery of $215,000 in 2015.

Noninterest income

Noninterest income includes service charges and fees on deposit accounts, fee income related to loan origination, gains and losses on sale of mortgage loans and securities held for sale, and rental income primarily on our previous headquarters building. Over the last three years the most significant noninterest income item has been gain on loan sales generated by the mortgage company, representing 59% in 2016, 60% in 2015, and 56% in 2014 of total noninterest income. Noninterest income amounted to $10,850,000 in 2016, $10,058,000 in 2015, and $7,889,000 in 2014.

	For the Year Ended December 31,		Change	
	2016	2015	$	%
	(dollars in thousands)			
Service charges and fees	$ 2,459	$ 2,520	$ (61)	(2.4)%
Gain on sale of loans	6,430	6,076	354	5.8%
Gain on sale of assets	504	-	504	100.0%
Gain on sale of investment securities	162	6	156	2600.0%
Rental income	582	1,105	(523)	(47.3)%
Other	713	351	362	103.1%
Total noninterest income	$ 10,850	$ 10,058	$ 792	7.9%

- The increase in gain on sale of loans is due to increased activity by our mortgage banking segment as the mortgage market was more favorable in the latter half of 2016. The gain on sale is recognized at the date of sale to the investor and mortgage loan sales increased from $208,479,000 in 2015 to $218,627,000 in 2016.
- The gain on sale of assets in 2016 relates to the sale of our previous headquarters building and was a onetime event.
- The gain on investment securities resulted from management's efforts to reduce interest rate risk in our investment portfolio by selling longer duration securities.
- The decline in rental income is a result of the sale of our previous headquarters building in June 2016 that generated rental income from nonrelated entities.
- The increase in other income is primarily due to a gain of $266,000 from a bank owned life insurance claim.

	For the Year Ended December 31, 2015	2014	Change $	%
	(dollars in thousands)			
Service charges and fees	$ 2,520	$ 2,245	$ 275	12.2%
Gain on sale of loans	6,076	4,449	1,627	36.6%
Gain on sale of investment securities	6	(210)	216	(102.9)%
Rental income	1,105	965	140	14.5%
Other	351	440	(89)	(20.2)%
Total noninterest income	$ 10,058	$ 7,889	$ 2,169	27.5%

- The increase in service charges and fees is due to increases from:
  - Commercial banking segment ($177,000) – more product offerings to our customers.
  - Mortgage banking segment ($98,000) – increased lending activity resulting from an improvement in the mortgage lending market.
- The gain on sale of loans is also due to improvement in the mortgage lending market. The gain on sale is recognized at the date of sale to the investor and mortgage loan sales increased from $162,983,000 in 2014 to $208,479,000 in 2015.
- The gain on sale of investment securities resulted from management's efforts to reduce interest rate risk in 2014 by selling longer duration securities.
- The increase in rental income was a result of moving the company's headquarters and leasing the vacated space to unrelated entities.

Noninterest expense

Noninterest expense includes all expenses of the Company with the exception of interest expense on deposits and borrowings, provision for loan losses and income taxes. Some of the primary components of noninterest expense are salaries and benefits, occupancy and equipment costs and expenses related to foreclosed real estate. Over the last three years, the most significant noninterest expense item has been salaries and benefits including commissions, representing 59%, 52%, and 54% of noninterest expense in 2016, 2015 and 2014, respectively. Noninterest expense increased from $21,844,000 in 2014 to $24,049,000 in 2015, and decreased to $21,889,000 in 2016.

	For the Year Ended December 31, 2016	2015	Change $	%
	(dollars in thousands)			
Salaries and benefits	$ 11,295	$ 10,846	$ 449	4.1%
Commissions	1,606	1,555	51	3.3%
Occupancy	1,470	1,730	(260)	(15.0)%
Equipment	762	765	(3)	(0.4)%
Write down of assets held for sale	220	2,649	(2,429)	(91.7)%
Cease use lease obligation	252	-	252	
Supplies	265	278	(13)	(4.7)%
Professional and outside services	2,999	2,930	69	2.4%
Advertising and marketing	355	325	30	9.2%
Foreclosed assets, net	393	153	240	156.9%
FDIC insurance premium	292	916	(624)	(68.1)%
Other operating expense	1,980	1,902	78	4.1%
Total noninterest income	$ 21,889	$ 24,049	$ (2,160)	(9.0)%

- The increase in salaries and benefits was due to staffing changes in key management positions.
- Occupancy declined due to the sale of our previous headquarters building in June 2016.
- Write down of assets held for sale decreased due to write downs in 2015 associated with the headquarters building. The building was sold in June 2016 for a gain of $504,000.
- Cease use lease obligation is due to recording a loss related to consolidating two branches.
- Costs associated with foreclosed assets increased due to gains on sale in 2015 as we disposed of these assets. We did not have similar gains in 2016.
- The decrease in the FDIC insurance premium was due to the improvement in the Bank's risk rating with the FDIC based on the removal of the Consent Order in December 2015.

	For the Year Ended December 31,		Change	
	2015	2014	$	%
	(dollars in thousands)			
Salaries and benefits	$ 10,846	$ 10,685	$ 161	1.5%
Commissions	1,555	1,165	390	33.5%
Occupancy	1,730	1,690	40	2.4%
Equipment	765	708	57	8.1%
Write down of assets held for sale	2,649	-	2,649	
Supplies	278	344	(66)	(19.2)%
Professional and outside services	2,930	2,550	380	14.9%
Advertising and marketing	325	321	4	1.2%
Foreclosed assets, net	153	1,244	(1,091)	(87.7)%
FDIC insurance premium	916	968	(52)	(5.4)%
Other operating expense	1,902	2,169	(267)	(12.3)%
Total noninterest income	$ 24,049	$ 21,844	$ 2,205	10.1%

- The increase in salaries and benefits was due primarily to an increase in stock based compensation.
- Commissions increased due to an increase in the activity of our mortgage banking segment.
- The write down of assets held for sale in 2015 related to our evaluation of the net realizable value of our previous headquarters building. This asset was sold in 2016 resulting in a gain of $504,000.
- The increase in professional and outside services is related to an increase in legal fees and servicing income from our student loan processors from additional student loan purchases in 2015.
- The decline in expenses related to foreclosed real estate was aided by gains of $862,000 offset by write downs of $690,000 on the sale of these properties. Additionally, write downs and expense declined by $434,000 as many of these properties were sold in 2015.

Income taxes

Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. The tax effects of these temporary differences are recognized currently in the deferred income tax provision or benefit. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the applicable enacted marginal tax rate.

The net deferred tax asset is included in other assets on the balance sheet. Accounting Standards Codification Topic 740, *Income Taxes*, requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. Management considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results. In making such judgments, significant weight is given to evidence that can be objectively verified. The deferred tax assets are analyzed quarterly for changes affecting realization.

In assessing the Company's ability to realize its net deferred tax asset, management considers whether it is more likely than not that some portion or all of the net deferred tax asset will or will not be realized. The Company's ultimate realization of the net deferred tax asset is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the nature and amount of historical and projected future taxable income, the scheduled reversal of deferred tax assets and liabilities, and available tax planning strategies in making this assessment. The amount of net deferred taxes recognized could be impacted by changes to any of these variables.

Each quarter, the Company weighs both the positive and negative information with respect to realization of the net deferred tax asset and analyzes its position as to whether or not a valuation allowance is required. At December 31, 2015, management concluded that the objective negative evidence represented by the Company's prior losses outweighed the more subjective positive evidence and, as a result, provided for a valuation allowance at December 31, 2015 of $11,997,000. Over the several quarters previous to September 30, 2016, the positive information was increasing while the negative information was decreasing. For the seven quarters prior to September 30, 2016, the Company demonstrated consistent earnings while its level of non-performing assets, which was the primary cause of the Company's losses, steadily decreased. Additionally, the Reserve Bank, the FDIC and the BFI terminated their formal agreements with the Company and the Bank, reducing regulatory risk.

Given the consistent earnings and improving asset quality, the Company's analysis concluded that, as of September 30, 2016, it was more likely than not that it would generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset. As such, the full valuation allowance of $11,997,000 was reversed to income tax expense at September 30, 2016. The Company's net deferred tax asset was $11,435,000 as of September 30, 2016. During the fourth quarter of 2016, the consistent earnings continued with earnings before income taxes of $700,000, and our asset quality continued to improve. As a result, we continue to believe that it is more likely than not that the Company will generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset as of December 31, 2016.

We recognized an income tax benefit of $11,172,000 for the year ended December 31, 2016 compared to not recognizing any income tax in 2015 and 2014 due to the valuation allowance on the net deferred tax asset. The income tax benefit in 2016 was due to the reversal of the valuation allowance previously recorded against the net deferred tax asset as of September 30, 2016, offset by tax on pretax earnings for 2016 of $825,000. Net operating losses available to offset future taxable income amounted to $21,974,000 at December 31, 2016 and begin expiring in 2028; $1,257,000 of such amount is subject to a limitation by Section 382 of the Internal Revenue Code of 1986, as amended, to $908,000 per year.

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded franchise tax expense of approximately $75,000 for the year ended December 31, 2016. Due to the Company's adjusted capital level we were not subject to franchise tax expense for the years ended December 31, 2015 and 2014.

During 2016, the Internal Revenue Service completed an examination of the Company's federal income tax return for the year ended December 31, 2013. No changes to the return were proposed.

Balance Sheet Analysis

Investment securities

At December 31, 2016 and 2015, all of our investment securities were classified as available for sale. Investment securities classified as available for sale may be sold in the future, prior to maturity. These securities are carried at fair value. Net aggregate unrealized gains or losses on these securities are included, net of taxes, as a component of shareholders' equity. Given the generally high credit quality of the portfolio, management expects to realize all of its investment upon market recovery or the maturity of such instruments, and thus believes that any impairment in value is interest rate related and therefore temporary. Available for sale securities included net unrealized losses of $275,000 and $665,000 at December 31, 2016 and 2015, respectively. As of December 31, 2016, management does not have the intent to sell any of the securities classified as available for sale and which have unrealized losses, and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost.

The Company sold approximately $22 million and $8 million of investment securities available for sale at a gain of $162,000 and $6,000 in 2016 and 2015, respectively. The sale of these securities, which had fixed interest rates, allowed the Company to decrease its exposure to the anticipated upward movement in interest rates that would result in unrealized losses being recognized in shareholders' equity. In November and December 2016, the Company purchased approximately $18 million in investment securities available for sale to invest liquidity in higher yielding assets. The securities purchased have durations of less than five years to minimize exposure to upward movement in interest rates and, in some cases, have returning cash flows that can be reinvested should interest rates rise.

The following table presents the composition of our investment portfolio at the dates indicated (in thousands).

	Par Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Average Yield
December 31, 2016						
US Government Agencies						
One to five years	$ 29,400	$ 29,607	$ -	$ (213)	$ 29,394	1.25%
More than ten years	2,862	2,868	-	(16)	2,852	1.08%
	32,262	32,475	-	(229)	32,246	1.24%
Mortgage-backed securities						
One to five years	3,457	3,524	-	(33)	3,491	1.78%
More than ten years	8,253	8,170	1	(14)	8,157	2.16%
	11,710	11,694	1	(47)	11,648	2.05%
Total investment securities	$ 43,972	$ 44,169	$ 1	$ (276)	$ 43,894	1.45%
December 31, 2015						
US Government Agencies						
One to five years	$ 11,000	$ 11,270	$ -	$ (157)	$ 11,113	0.91%
Five to ten years	18,500	19,697	-	(403)	19,294	2.32%
More than ten years	3,312	3,319	-	(13)	3,306	0.85%
	32,812	34,286	-	(573)	33,713	1.51%
Mortgage-backed securities						
One to five years	1,794	1,841	-	(28)	1,813	1.30%
More than ten years	1,149	1,202	1	(15)	1,188	1.34%
	2,943	3,043	1	(43)	3,001	1.35%
Municipals						
More than ten years	1,130	1,255	-	(50)	1,205	3.72%
	1,130	1,255	-	(50)	1,205	3.72%
Total investment securities	$ 36,885	$ 38,584	$ 1	$ (666)	$ 37,919	1.57%

Loans

One of management's objectives is to improve the quality of the loan portfolio. The Company seeks to achieve this objective by maintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness of and the designation of lending limits for each borrower. The portfolio strategies include seeking industry, loan type and loan size diversification in order to minimize credit concentration risk. Management also focuses on originating loans in markets with which the Company is familiar. Additionally, as a significant amount of the loan losses we have experienced in the past is attributable to construction and land development loans, our strategy has shifted from reducing this type of lending to closely manage the quality and concentration in these loan types.

Approximately 74% of all loans are secured by mortgages on real property located principally in the Commonwealth of Virginia. We are much less reliant on real estate secured lending than was the case in 2012 when 90% of our loan portfolio consisted of this type of lending. Approximately 14% of the loan portfolio consists of rehabilitated student loans purchased by the Bank in 2016, 2015 and 2014 (see discussion following). Commercial and industrial loans represented $39 million, or 11%, of the portfolio at December 31, 2016. Loans in this category are typically made to individuals, small and medium-sized businesses and range between $250,000 and $2.5 million. Based on underwriting standards, these loans may be secured in whole or in part by collateral such as liquid assets, accounts receivable, equipment, inventory, and real property. The collateral securing any loan may depend on the type of loan and may vary in value based on market conditions. The remainder of our loan portfolio is in consumer loans which represent less than 1% of the total.

The Bank purchased one portfolio of rehabilitated student loans guaranteed by the DOE totaling approximately $7 million on July 16, 2016. The Bank had previously purchased two portfolios totaling approximately $23 million in 2015 and two portfolios totaling approximately $33 million in 2014. The guarantee covers approximately 98% of principal and accrued interest. The loans are serviced by a third-party servicer that specializes in handling the special needs of the DOE student loan programs. The Bank used excess liquidity to purchase the loans.

The following tables present the composition of our loan portfolio at the dates indicated and maturities of selected loans at December 31, 2016 (in thousands).

	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013	December 31, 2012
Construction and land development					
Residential	$ 6,770	$ 5,202	$ 4,315	$ 2,931	$ 2,845
Commercial	27,092	25,948	25,152	28,179	41,210
Total construction and land development	33,862	31,150	29,467	31,110	44,055
Commercial real estate					
Owner occupied	66,021	69,256	58,804	73,585	92,773
Non-owner occupied	57,944	38,037	38,892	43,868	54,551
Multifamily	8,824	8,537	11,438	11,560	7,979
Farmland	310	388	434	1,463	2,581
Total commercial real estate	133,099	116,218	109,568	130,476	157,884
Consumer real estate					
Home equity lines	20,691	20,333	20,082	21,246	25,521
Secured by 1-4 family residential					
First deeds of trust	54,791	56,776	61,837	66,872	80,788
Second deeds of trust	5,768	6,485	7,854	8,675	9,517
Total consumer real estate	81,250	83,594	89,773	96,793	115,826
Commercial and industrial loans					
(except those secured by real estate)	39,390	20,086	22,165	26,254	34,384
Guaranteed student loans	47,398	53,989	33,562	-	-
Consumer and other	2,101	1,734	1,611	1,930	2,761
Total Loans	337,100	306,771	286,146	286,563	354,910
Deferred loan cost, net	660	670	722	683	788
Less: Allowance for loan losses	(3,373)	(3,562)	(5,729)	(7,239)	(10,808)
Total loans, net	$ 334,387	$ 303,879	$ 281,139	$ 280,007	$ 344,890

	Within 1 Year	Fixed Rate 1 to 5 Years	Fixed Rate After 5 Years	Fixed Rate Total	Variable Rate 1 to 5 Years	Variable Rate After 5 Years	Variable Rate Total	Total Maturities
Construction and land development								
Residential	$ 6,770	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,770
Commercial	20,805	6,071	-	6,071	162	54	216	27,092
Total construction and land development	27,575	6,071	-	6,071	162	54	216	33,862
Commercial real estate								
Owner occupied	10,579	19,519	25,091	44,610	10,053	779	10,832	66,021
Non-owner occupied	13,202	23,932	9,970	33,902	10,840		10,840	57,944
Multifamily	190	2,715	1,683	4,398	4,236		4,236	8,824
Farmland	29	181	-	181	100	-	100	310
Total commercial real estate	24,000	46,347	36,744	83,091	25,229	779	26,008	133,099
Consumer real estate								
Home equity lines	16,692	-	3,994	3,994	5	-	5	20,691
Secured by 1-4 family residential								
First deeds of trust	21,722	16,532	4,551	21,083	11,986	-	11,986	54,791
Second deeds of trust	1,277	1,330	589	1,919	2,572	-	2,572	5,768
Total consumer real estate	39,691	17,862	9,134	26,996	14,563	-	14,563	81,250
Commercial and industrial loans								
(except those secured by real estate)	19,659	11,736	7,460	19,196	535	-	535	39,390
Guaranteed student loans	-	-	-	-	47,398	-	47,398	47,398
Consumer and other	573	1,435	93	1,528	-	-	-	2,101
	$111,498	$83,451	$53,431	$136,882	$87,887	$ 833	$ 88,720	$337,100

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

- Risk rated 1 to 4 loans are considered of sufficient quality to preclude an adverse rating. These assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral;
- Risk rated 5 loans are defined as having potential weaknesses that deserve management's close attention;
- Risk rated 6 loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any; and
- Risk rated 7 loans have all the weaknesses inherent in substandard loans, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loans are considered impaired when, based on current information and events it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Allowance for loan losses

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. We maintain policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with GAAP; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system.

The allowance reflects management's best estimate of probable losses within the existing loan portfolio and of the risk inherent in various components of the loan portfolio, including loans identified as impaired as required by FASB Codification Topic 310: *Receivables*. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment.

Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon historical net charge-off rates, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the financial statements.

The allowance for loan losses was $3,373,000, $3,562,000 and $5,729,000 at December 31, 2016, 2015 and 2014, respectively. The ratio of the allowance for loan losses to gross loans was 1.00% at December 31, 2016, 1.16% at December 31, 2015, and 2.00% December 31, 2014. However, excluding the student loan portfolio which is guaranteed by the DOE for 98% of principal and interest, the ratio was 1.16%, 1.36% and 2.26% at December 31, 2016, 2015 and 2014, respectively. The allowance for loan losses as a percentage of net loans decreased in 2016 to 1.00% primarily as a result of the improvement in historical charge-off rates for the periods evaluated that are used to estimate the expected loss inherent in different groups of loans. The allowance for loan losses as a percentage of net loans decreased in 2015 to 1.16% primarily as a result of the recovery of loan losses of $2,000,000 while portfolio loans of $252,782,000, excluding student loans, remained consistent with the prior year amount of $252,584,000. We believe the amount of the allowance for loan losses at December 31, 2016 is adequate to absorb the losses that can reasonably be anticipated from the loan portfolio at that date.

The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated (dollars in thousands).

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Beginning balance	$ 3,562	$ 5,729	$ 7,239	$ 10,808	$ 16,071
(Recovery of), provision for loan losses	-	(2,000)	100	1,173	9,095
Charge-offs					
Construction and land development					
Residential				-	(797)
Commercial	(10)	(252)	(100)	(279)	(5,645)
Commercial real estate					
Owner occupied	(66)	(127)	(631)	(454)	(961)
Non-owner occupied	(1)	-	(518)	(619)	(431)
Multifamily				-	(10)
Farmland	-	-	(96)	(896)	-
Consumer real estate					
Home equity lines	(53)	(62)	(476)	(266)	(884)
Secured by 1-4 family residential					
First deed of trust	(140)	(103)	(277)	(1,953)	(3,220)
Second deed of trust	(25)	(55)	(86)	(367)	(663)
Commercial and industrial					
(except those secured by real estate)	(15)	(162)	(172)	(760)	(1,880)
Guaranteed student loans	(221)		-	-	-
Consumer and other	(13)	(55)	(25)	(64)	(408)
	(544)	(816)	(2,381)	(5,658)	(14,899)
Recoveries					
Construction and land development					
Residential	1	2	2	102	45
Commercial	10	49	44	424	14
Commercial real estate					
Owner occupied	-	33	-	43	200
Non-owner occupied	53	4	25	20	-
Farmland	125	-	-	-	-
Consumer real estate					
Home equity lines	3	5	15	9	13
Secured by 1-4 family residential					
First deed of trust	25	380	72	94	86
Second deed of trust	29	50	190	38	21
Commercial and industrial					
(except those secured by real estate)	100	100	401	177	155
Guranteed student loans					
Consumer and other	9	26	22	9	7
	355	649	771	916	541
Net charge-offs	(189)	(167)	(1,610)	(4,742)	(14,358)
Ending balance	$ 3,373	$ 3,562	$ 5,729	$ 7,239	$ 10,808
Loans outstanding at end of period[(1)]	$ 337,760	$ 307,441	$ 286,868	$ 287,246	$ 355,698
Ratio of allowance for loan losses as a percent of loans outstanding at end of period	1.00%	1.16%	2.00%	2.52%	3.04%
Average loans outstanding for the period[(1)]	$ 297,423	$ 297,423	$ 274,429	$ 315,642	$ 394,680
Ratio of net charge-offs to average loans outstanding for the period	0.06%	0.06%	0.59%	1.50%	3.64%

(1) Loans are net of unearned income.

Charge-offs decreased from $816,000 in 2015 to $544,000 in 2016, which represents the lowest level of charge-offs for the last five years. This reflects an improvement in credit quality that mirrors the overall improvement in the local economy.

We have allocated the allowance for loan losses according to the amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within each of the categories of loans. The allocation of the allowance as shown in the table below should not be interpreted as an indication that losses in future years will occur in the same proportions or that the allocation indicates future loss trends. Furthermore, the portion allocated to each loan category is not the total amount available for future losses that might occur within such categories since the total allowance is a general allowance applicable to the entire portfolio (dollars in thousands).

	December 31, 2016		December 31, 2015		December 31, 2014		December 31, 2013		December 31, 2012	
	Total	%	Total	%	Total	%	Total	%	Total	%
Construction and land development										
Residential	$ 41	1.22%	$ 30	0.8%	$ 34	0.6%	$ 135	1.9%	$ 495	4.6%
Commercial	300	8.89%	291	8.2%	202	3.5%	1,274	17.5%	4,612	42.6%
Commercial real estate										
Owner occupied	611	18.11%	1,167	32.8%	1,837	32.1%	1,200	16.6%	1,359	12.6%
Non-owner occupied	406	12.04%	460	12.9%	607	10.6%	670	9.3%	817	7.6%
Multifamily	56	1.66%	51	1.4%	77	1.3%	19	0.3%	23	0.2%
Farmland	3	0.09%	17	0.5%	130	2.3%	337	4.7%	-	0.0%
Consumer real estate										
Home equity lines	271	8.03%	448	12.6%	469	8.2%	424	5.9%	658	6.1%
Secured by 1-4 family residential										
First deed of trust	447	13.25%	602	16.9%	1,345	23.5%	1,992	27.5%	1,358	12.6%
Second deed of trust	136	4.03%	111	3.1%	275	4.8%	394	5.4%	223	2.1%
Commercial and industrial										
(except those secured by real estate)	223	6.61%	94	2.6%	506	8.8%	724	9.9%	1,162	10.7%
Guranteed student loans	158	4.68%	230	6.5%	217	3.8%	-	0.0%	-	0.0%
Consumer and other	8	0.24%	2	0.1%	30	0.5%	70	1.0%	101	0.9%
Unallocated	713	21.15%	59	1.6%	-	0.0%	-	0.0%	-	0.0%
Total	$ 3,373	100.0%	$ 3,562	100.0%	$ 5,729	100.0%	$ 7,239	100.0%	$ 10,808	100.0%

Asset quality

The following table summarizes asset quality information at the dates indicated (dollars in thousands).

	December 31,				
	2016	2015	2014	2013	2012
Nonaccrual loans	$ 2,402	$ 3,718	$ 7,478	$ 18,647	$ 25,605
Foreclosed properties	2,926	6,249	12,638	16,742	20,204
Total nonperforming assets	$ 5,328	$ 9,967	$ 20,116	$ 35,389	$ 45,809
Restructured loans (not included in nonaccrual loans above)	$ 10,154	$ 14,260	$ 24,812	$ 28,236	$ 30,167
Loans past due 90 days and still accruing *(1)*	$ 8,174	$ 8,590	$ 719	$ 60	$ 115
Nonperforming assets to loans *(2)*	1.58%	3.25%	7.03%	12.35%	12.91%
Nonperforming assets to total assets	1.2%	2.4%	4.6%	8.0%	9.0%
Allowance for loan losses to nonaccrual loans	140.4%	95.8%	76.6%	38.8%	42.2%

(1) All loans 90 days past due and still accruing at December 31, 2016 and 2015 are rehabilitated student loans which have a 98% guarantee by the DOE.
(2) Loans are net of unearned income and deferred cost.

The following table presents an analysis of the changes in nonperforming assets for 2016 (in thousands).

	Nonaccrual Loans	OREO	Total
Balance December 31, 2015	$ 3,718	$ 6,249	$ 9,967
Additions	1,812	277	2,089
Loans placed back on accrual	(2,198)	-	(2,198)
Transfers to OREO	(296)	296	-
Repayments	(506)	-	(506)
Charge-offs	(128)	(231)	(359)
Sales	-	(3,665)	(3,665)
	-	-	-
Balance December 31, 2016	$ 2,402	$ 2,926	$ 5,328

Nonperforming restructured loans are included in nonaccrual loans. Until a nonperforming restructured loan has performed in accordance with its restructured terms for a minimum of six months, it will remain on nonaccrual status.

Interest is accrued on outstanding loan principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as non-accrual when the Company considers collection of expected principal and interest doubtful. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that concern over our ability to collect principal and interest is not significant. When loans are placed in non-accrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received. Interest accruals are resumed on such loans only when in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest.

Of the total nonaccrual loans of $2,402,000 at December 31, 2016 that were considered impaired, 8 loans totaling $660,000 had specific allowances for loan losses totaling $97,000. This compares to $3,718,000 in nonaccrual loans at December 31, 2015 of which 12 loans totaling $2,112,000 had specific allowances for loan losses of $370,000.

Cumulative interest income that would have been recorded had nonaccrual loans been performing would have been $119,000, $146,000 and $224,000 for 2016, 2015 and 2014, respectively. Student loans totaling $8,174,000 and $8,590,000 at December 31, 2016 and 2015, respectively, were past due 90 days or more and interest was still being accrued as principal and interest on such loans have a 98% guarantee by the DOE. The 2% not covered by the DOE guarantee is provided for in the allowance for loan losses.

Other real estate owned consists of assets acquired through or in lieu of foreclosure. $1,983,000 of the $2,926,000 other real estate owned at December 31, 2016, or 68%, relates to loans previously classified as construction loans.

Deposits

The following table gives the composition of our deposits at the dates indicated (dollars in thousands).

	December 31, 2016		December 31, 2015		December 31, 2014	
	Amount	%	Amount	%	Amount	%
Demand accounts	$ 92,574	24.2%	$ 78,282	21.5%	$ 77,496	20.5%
Interest checking accounts	44,390	11.6%	44,256	12.1%	42,924	11.3%
Money market accounts	71,290	18.6%	64,841	17.8%	64,987	17.2%
Savings accounts	26,598	6.9%	19,403	5.3%	20,643	5.4%
Time deposits of $100,000 and over	74,279	19.4%	72,745	19.9%	75,559	19.9%
Other time deposits	74,146	19.3%	85,321	23.4%	97,251	25.7%
Total	$ 383,277	100.0%	$ 364,848	100.0%	$ 378,860	100.0%

Total deposits increased by 5.1% in 2016 and decreased by, 3.6% and 3.0% in 2015 and 2014, respectively. Checking and savings accounts increased by $21,621,000 or 15%, money market accounts increased by $6,449,000 or 10% and time deposits decreased by $9,641,000 or 6% in 2016. The decline in deposits in 2015 and 2014 was a result of repricing maturing time deposits at rates below market for noncore depositors. In reducing deposits, we targeted higher cost deposits to reduce our overall cost of funds. Higher cost time deposits declined as a percentage of total deposits from 45.6% at December 31, 2014 to 43.3% at December 31, 2015 and to 38.7% at December 31, 2016.

The variety of deposit accounts offered by the Company has allowed us to be competitive in obtaining funds and has allowed us to respond with flexibility to, although not to eliminate, the threat of disintermediation (the flow of funds away from depository institutions such as banking institutions into direct investment vehicles such as government and corporate securities). Our ability to attract and retain deposits, and our cost of funds, has been, and will continue to be, significantly affected by money market conditions.

The following table is a schedule of average balances and average rates paid for each deposit category for the periods presented (dollars in thousands).

	Year Ended December 31,					
	2016		2015		2014	
	Amount	Rate	Amount	Rate	Amount	Rate
Noninterest-bearing demand accounts	$ 82,678		$ 75,127		$ 62,612	
Interest-bearing deposits						
Interest checking accounts	42,783	0.18%	43,450	0.18%	42,311	0.18%
Money market accounts	68,817	0.37%	67,796	0.37%	66,866	0.38%
Savings accounts	20,119	0.18%	20,282	0.18%	20,555	0.18%
Time deposits of $100,000 and over	77,248	1.37%	72,989	1.41%	105,829	1.20%
Other time deposits	80,955	1.16%	90,967	1.19%	87,359	1.56%
Total interest-bearing deposits	289,922	0.82%	295,484	0.84%	322,920	0.93%
Total average deposits	$ 372,600		$ 370,611		$ 385,532	

With short-term interest rates remaining at historic lows throughout the last few years, we were able to significantly reduce the interest rates paid on deposits, particularly on longer term certificates of deposit, as higher rate certificates of deposit matured in 2016, 2015 and 2014.

The following table is a schedule of maturities for time deposits of $100,000 or more at December 31, 2016 (in thousands).

Due within three months	$	7,507
Due after three months through six months		8,684
Due after six months through twelve months		16,236
Over twelve months		41,852
	$	74,279

The Dodd-Frank Act permanently raises the current standard maximum deposit insurance amount to $250,000. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

Borrowings

We utilize borrowings to supplement deposits to address funding or liability duration needs.

As a member of the Federal Home Loan Bank of Atlanta, the Bank is required to own capital stock in the FHLB and is authorized to apply for borrowings from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. Borrowings from the FHLB were $2,400,000 and $6,000,000 at December 31, 2016 and 2015, respectively. The FHLB advances are secured by the pledge of loans. Available borrowings at December 31, 2016 were approximately $27,000,000 based on currently pledged collateral; however, with additional pledges, the Company could be granted up to 25% of assets in advances.

Federal funds purchased represent unsecured and secured borrowings from other banks and generally mature daily. We did not have any purchased federal funds at December 31, 2016 or 2015.

Other borrowings decreased by $427,000, from $508,000 at December 31, 2015 to $81,000 at December 31, 2016. These borrowings represent business checking sweep accounts that bear interest and are secured by pledged securities.

Off-balance sheet arrangements

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contractual amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Unless noted otherwise, the Company does not require collateral or other security to support financial instruments with credit risk.

At December 31, 2016, the Company had outstanding the following approximate off-balance-sheet financial instruments whose contract amounts represent credit risk (in thousands):

	Contract Amount 2016	Contract Amount 2015
Undisbursed credit lines	$ 55,315	$ 46,656
Commitments to extend or originate credit	16,467	9,132
Standby letters of credit	4,397	1,484
Total commitments to extend credit	$ 76,179	$ 57,272

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Capital resources

Shareholders' equity at December 31, 2016 was $43,614,000, compared to $30,359,000 at December 31, 2015 and $19,058,000 at December 31, 2014. The $13,254,000 increase in shareholders' equity in 2016 is primarily due to net income for the year of $13,513,000, which includes the reversal of the $11,977,000 valuation allowance previously recorded against the net deferred tax asset, offset by dividends on preferred stock of $737,000.

The $11,301,000 increase in shareholders' equity in 2015 is primarily due to the Rights Offering to shareholders and concurrent Standby Offering completed in March 2015. Net cash proceeds from the offering amounted to $8,717,000. In addition, as part of the Standby Offering, $2,215,000 in accrued and unpaid dividends on our preferred stock was forgiven. Shareholders' equity was also increased by $646,000 from net income for the year and decreased by dividends on preferred stock of $674,000.

On May 1, 2009, the Company received a $14,738,000 investment by the United States Department of the Treasury under the TARP Program. The TARP Program is a voluntary program designed to provide capital for healthy banks to improve the flow of funds from banks to their customers. Under the TARP Program, the Company issued to the Treasury $14,738,000 of preferred stock and warrants to purchase 31,190 shares of the Company's common stock at a purchase price of $70.88 per share. The preferred stock issued by the Company under the TARP Program carried a 5% dividend until May 1, 2014, and now carries a 9% dividend. In November 2013, the Company participated in a successful auction of the Company's preferred stock securities by the U.S. Treasury that resulted in the purchase of the securities by private and institutional investors. The U.S. Treasury continues to own the warrants. This freed the Company from some constraints and costs that were in place while the U.S. Treasury held the securities.

During the first quarter of 2005, the Company issued $5.2 million in Trust Preferred Capital Notes to increase its regulatory capital and to help fund its expected growth in 2005. During the third quarter of 2007, the Company issued $3.6 million in Trust Preferred Capital Notes to partially fund the construction of an 80,000 square foot headquarters building at the Watkins Centre completed in July 2008. The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. See Note 15 of the *Notes to Consolidated Financial Statements* for a more detailed discussion of the Trust Preferred Capital Notes.

The Company was previously prohibited by its Written Agreement with the Reserve Bank from paying dividends on capital stock, including the Series A preferred stock, or interest payments on the trust preferred capital notes without prior regulatory approval. The Written Agreement was terminated by the Reserve Bank as of July 28, 2016. With the termination of the Written Agreement, the Company is not required to defer the quarterly cash dividends on the Series A preferred stock. At December 31, 2016, the aggregate amount of the Company's total accrued but deferred dividend payments on the preferred stock was $2,815,000 and reflected as a reduction of retained earnings. This amount was accrued for and included in other liabilities on the Balance Sheet in the *Consolidated Financial Statements*.

Subsequent to December 31, 2016, the Company received approval from state and federal regulators allowing the Bank to pay a special dividend to the Company for the sole purpose of paying all accrued and unpaid dividends on the preferred stock through February 15, 2017, as well as to redeem 688 shares of the total 5,715 shares outstanding. The accrued and unpaid dividends paid on February 15, 2017 amounted to $2,911,000. The 688 shares were redeemed on February 24, 2017 at a redemption price of $1,000 per share plus accrued dividends from February 15, 2017 to the redemption date.

The Company received notification on February 26, 2016 from the Reserve Bank approving the payment of all accrued and deferred interest payments on trust preferred securities bringing the Company current as of March 2016.

On December 4, 2013 the Company issued 67,907 new shares of common stock through a private placement to directors and executive officers. The sale raised $1,684,075 in new capital for the Company. The $24.80 sale price for the common shares was the stock's book value at September 30, 2013, which represented a 30% premium over the closing price of the stock on December 3, 2013.

On August 6, 2014, the Company filed Articles of Amendment to its Articles of Incorporation with the Virginia State Corporation Commission to effect a 1-for-16 reverse stock split of its outstanding common stock. The Articles of Amendment became effective on August 8, 2014. As a result of the reverse split, every sixteen shares of the Company's issued and outstanding common stock were consolidated into one issued and outstanding share of common stock.

On March 27, 2015, the Company completed a Rights Offering to shareholders and concurrent Standby Offering to Kenneth R. Lehman, in which the Company issued an aggregate of 1,051,866 shares of common stock (the total number of shares offered) at $13.87 per share for aggregate gross proceeds of $14,589,381 (including the value of the Company's common stock of $4,618,813 exchanged for shares of preferred stock by Mr. Lehman). In connection with the Rights Offering, 283,293 shares were issued to shareholders upon exercise of their basic subscription rights and 191,773 shares were issued to shareholders upon exercise of their oversubscription privileges (approximately 36.9% of the total number of shares requested pursuant to oversubscription privileges). In connection with the Standby Offering, Mr. Lehman purchased an aggregate of 576,800 shares of the Company's common stock, 333,007 of which were issued in exchange for 9,023 shares of the Company's preferred stock and 243,793 of which were purchased for cash. Also, as part of the Standby Offering, Mr. Lehman forgave $2,215,009 in accrued and unpaid dividends on the preferred stock.

On December 22, 2015, the Bank received notification from the FDIC and the BFI that the Consent Order under which the Bank had been operating since February 3, 2012 was terminated effective December 14, 2015. The Consent Order was terminated as a result of the steps the Company and the Bank took to, among other things, improve asset quality, increase capital, augment management and board oversight, and increase earnings. In place of the Consent Order, the Bank's board of directors made certain written assurances to the FDIC and BFI in the MOU concerning asset quality, earnings, regulatory violations, minimum capital levels, asset growth, restrictions on paying dividends and a requirement to furnish progress reports to the FDIC and BFI. Due to further improvements by the Company and the Bank in asset quality and earnings, and the correction of a prior Regulation W violation, the MOU was terminated effective May 12, 2016, and the Written Agreement was terminated effective July 28, 2016. With the terminations of the MOU and the Written Agreement, neither the Company nor the Bank is under any formal or informal agreements with its regulators.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy Statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. The Bank continues to be subject to various capital requirements administered by banking agencies.

The following table presents the composition of regulatory capital and the capital ratios for the Bank at the dates indicated (dollars in thousands).

	December 31, 2016	December 31, 2015	December 31, 2014
Tier 1 capital			
Total bank equity capital	$ 50,231	$ 38,665	$ 30,158
Net unrealized loss on available-for-sale securities	181	439	644
Defined benefit postretirement plan	60	69	77
Dissallowed deferred tax asset	(4,619)	-	-
Disallowed intangible assets	(1)	(40)	(198)
Total Tier 1 capital	45,852	39,133	30,681
Tier 2 capital			
Allowance for loan losses	3,373	3,562	3,572
Total Tier 2 capital	3,373	3,562	3,572
Total risk-based capital	49,225	42,695	34,253
Risk-weighted assets	$ 321,166	$ 304,611	$ 283,581
Average assets	$ 438,069	$ 419,398	$ 427,113
Capital ratios			
Leverage ratio (Tier 1 capital to average assets)	10.47%	9.33%	7.18%
Common equity tier 1 capital ratio (CET 1)	14.28%	12.85%	N/A
Tier 1 capital to risk-weighted assets	14.28%	12.85%	10.82%
Total capital to risk-weighted assets	15.33%	14.02%	12.08%
Equity to total assets	11.29%	9.25%	7.02%

Under new capital guidelines discussed more fully following, the Bank must identify high volatility commercial real estate ("HVCRE") loans, which are defined as a credit facility that, prior to conversion to permanent financing, finances or has financed the acquisition, development, or construction of real property, unless the facility finances (1) one to four family residential properties; (2) certain community development projects; (3) the purchase or development of agricultural land; (4) commercial real estate projects that meet the criteria in the rule, including criteria regarding the loan-to-value ratio and capital contributions to the project. Under the new guidelines, HVCRE loans are risk weighted at 150% for capital ratios purposes, rather than 100% as with other loans.

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The Bank met the ratio requirements to be categorized as a "well capitalized" institution as of December 31, 2016, 2015 and 2014. However, due to the minimum capital ratios required by the prior Consent Order, the Bank was considered adequately capitalized in 2014. The MOU required the Bank to maintain a leverage ratio of at least 8% and a total capital to risk-weighted assets ratio of at least 12%. Primarily as a result of the Company's Rights Offering and Standby Offering completed on March 27, 2015, the Bank's leverage ratio increased to 9.33% and the total capital to risk weighted assets ratio increased to 14.02% at December 31, 2015, exceeding the ratios required by the MOU. With the termination of the Consent Order and MOU, the Bank is considered well-capitalized at December 31, 2016.

When capital falls below the "well capitalized" requirement, consequences can include: new branch approval could be withheld; more frequent examinations by the FDIC; brokered deposits cannot be renewed without a waiver from the FDIC; and other potential limitations as described in FDIC Rules and Regulations Sections 337.6 and 303, and FDI Act Section 29. In addition, the FDIC insurance assessment increases when an institution falls below the “well capitalized” classification.

Liquidity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

At December 31, 2016 and 2015, our liquid assets, consisting of cash, cash equivalents and investment securities available for sale, totaled $55,690,000 and $55,181,000, or 12.5% and 13.1% of total assets, respectively. Investment securities traditionally provide a secondary source of liquidity since they can be converted into cash in a timely manner. However, one security of approximately $1,050,000 is pledged against internal sweeps. Therefore, the related borrowings would need to be repaid prior to the securities being sold in order for these securities to be converted to cash.

Our holdings of liquid assets plus the ability to maintain and expand our deposit base and borrowing capabilities serve as our principal sources of liquidity. We plan to meet our future cash needs through the liquidation of temporary investments, the generation of deposits, and from additional borrowings. In addition, we will receive cash upon the maturity and sale of loans and the maturity of investment securities. We maintain two federal funds lines of credit with correspondent banks totaling $15 million for which there were no borrowings against the lines at December 31, 2016.

We are also a member of the FHLB, from which applications for borrowings can be made. The FHLB requires that securities, qualifying mortgage loans, and stock of the FHLB owned by the Bank be pledged to secure any advances from the FHLB. The unused borrowing capacity currently available from the FHLB at December 31, 2016 was $24.7 million, based on the Bank's qualifying collateral available to secure any future borrowings. However, we are able to pledge additional collateral to the FHLB in order to increase our available borrowing capacity up to 25% of assets. Liquidity provides us with the ability to meet normal deposit withdrawals, while also providing for the credit needs of customers. We are committed to maintaining liquidity at a level sufficient to protect depositors, provide for reasonable growth, and fully comply with all regulatory requirements.

At December 31, 2016, we had commitments to originate $76,179,000 of loans. Fixed commitments to incur capital expenditures were approximately $275,000 at December 31, 2016. Certificates of deposit scheduled to mature or reprice in the 12-month period ending December 31, 2016 total $66,472,000. We believe that a significant portion of such deposits will remain with us. We further believe that deposit growth, loan repayments and other sources of funds will be adequate to meet our foreseeable short-term and long-term liquidity needs.

Interest Rate Sensitivity

An important element of asset/liability management is the monitoring of our sensitivity to interest rate movements. In order to measure the effects of interest rates on our net interest income, management takes into consideration the expected cash flows from the securities and loan portfolios and the expected magnitude of the repricing of specific asset and liability categories. We evaluate interest sensitivity risk and then formulate guidelines to manage this risk based on management’s outlook regarding the economy, forecasted interest rate movements and other business factors. Our goal is to maximize and stabilize the net interest margin by limiting exposure to interest rate changes.

Contractual principal repayments of loans do not necessarily reflect the actual term of our loan portfolio. The average lives of mortgage loans are substantially less than their contractual terms because of loan prepayments and because of enforcement of due-on-sale clauses, which gives us the right to declare a loan immediately due and payable in the event, among other things, the borrower sells the real property subject to the mortgage and the loan is not repaid. In addition, certain borrowers increase their equity in the security property by making payments in excess of those required under the terms of the mortgage.

The sale of fixed rate loans is intended to protect us from precipitous changes in the general level of interest rates. The valuation of adjustable rate mortgage loans is not as directly dependent on the level of interest rates as is the value of fixed rate loans. As with other investments, we regularly monitor the appropriateness of the level of adjustable rate mortgage loans in our portfolio and may decide from time to time to sell such loans and reinvest the proceeds in other adjustable rate investments.

Critical Accounting Policies and Estimates

General

The accounting and reporting policies of the Company and the Bank are in accordance with GAAP and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities, and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and/or results of operations.

The more critical accounting and reporting policies include the Company's accounting for the allowance for loan losses, real estate acquired in settlement of loans, and income taxes. The Company's accounting policies are fundamental to understanding the Company's consolidated financial position and consolidated results of operations. Accordingly, the Company's significant accounting policies are discussed in detail in Note 1 of the *Notes to Consolidated Financial Statements*.

The following is a summary of the Company's critical accounting policies that are highly dependent on estimates, assumptions, and judgments.

Allowance for loan losses

We monitor and maintain an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. We maintain policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with GAAP; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system.

The allowance reflects management's best estimate of probable losses within the existing loan portfolio and of the risk inherent in various components of the loan portfolio, including loans identified as impaired as required by FASB Codification Topic 310: *Receivables*. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment.

Loans are grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon historical net charge-off rates, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans and leases, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the financial statements.

During the fourth quarter of 2015, we adopted a software solution for the analysis of the allowance for loan losses. While our methodology of evaluating the adequacy of the allowance for loan losses generally did not change, the software is more robust in that it:

- allows us to take a more measureable approach to our evaluation of qualitative factors such as economic conditions that may affect loss experience; and
- is widely used by community banks which provides peer data that can be used as a benchmark for comparison to our analysis.

In addition to the adoption of the software solution for our analysis, we reviewed the last twenty years of historical loss data for peer banks in Virginia to assist us in our evaluation of environmental factors and other conditions that could affect the loan portfolio and the overall adequacy of the allowance for loan losses.

Troubled debt restructurings

A loan is accounted for as a troubled debt restructuring if we, for economic or legal reasons, grant a concession to a borrower considered to be experiencing financial difficulties that we would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan, or a modification of terms such as a reduction of the stated interest rate or balance of the loan, a reduction of accrued interest, an extension of the maturity date or renewal of the loan at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings can be in either accrual or nonaccrual status. Nonaccrual troubled debt restructurings are included in nonperforming loans. Accruing troubled debt restructurings are generally excluded from nonperforming loans as it is considered probable that all contractual principal and interest due under the restructured terms will be collected. Troubled debt restructurings generally remain categorized as nonperforming loans and leases until a six-month payment history has been maintained.

In accordance with current accounting guidance, loans modified as troubled debt restructurings are, by definition, considered to be impaired loans. Impairment for these loans is measured on a loan-by-loan basis similar to other impaired loans as described above under ***Allowance for loan losses***. Certain loans modified as troubled debt restructurings may have been previously measured for impairment under a general allowance methodology (i.e., pooling), thus at the time the loan is modified as a troubled debt restructuring the allowance will be impacted by the difference between the results of these two measurement methodologies. Loans modified as troubled debt restructurings that subsequently default are factored into the determination of the allowance in the same manner as other defaulted loans.

Real estate acquired in settlement of loans

Real estate acquired in settlement of loans represents properties acquired through foreclosure or physical possession. Write-downs to fair value of foreclosed assets less estimate costs to sell at the time of transfer are charged to allowance for loan losses. Subsequent to foreclosure, the Company periodically evaluates the value of foreclosed assets held for sale and records an impairment charge for any subsequent declines in fair value less selling costs. If fair value declines subsequent to foreclosure a valuation allowance is recorded through expense. Operating costs after acquisition are expensed as incurred. The valuation allowance was $612,000 and $1,748,000 at December 31, 2016 and 2015, respectively. Fair value is based on an assessment of information available at the end of a reporting period and depends upon a number of factors, including historical experience, economic conditions, and issues specific to individual properties. The evaluation of these factors involves subjective estimates and judgments that may change.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance may be established. Management considers the determination of this valuation allowance to be a critical accounting policy due to the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amounts of taxes recoverable through loss carry backs decline, or if management projects lower levels of future taxable income. Management determined that as of December 31, 2015, the objective negative evidence represented by the Company's recent losses outweighed the more subjective positive evidence and, as a result, recognized a valuation allowance for all of the net deferred tax asset that is dependent on future earnings of the Company of approximately $11,807,000.

Given consistent earnings and improving asset quality, the Company's analysis concluded that, as of September 30, 2016, it was more likely than not that it would generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset. As such, the full valuation allowance of $11,997,000 was released at September 30, 2016. The Company's net deferred tax asset was $11,435,000 as of September 30, 2016. During the fourth quarter of 2016, the consistent earnings continued with earnings before income taxes of $700,000, and our asset quality continued to improve. As a result, we continue to believe that it is more likely than not that the Company will generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset as of December 31, 2016.

During 2016, the Internal Revenue Service completed an examination of the Company's federal income tax return for the year ended December 31, 2013. No changes to the return were proposed.

New accounting standards

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606). The amendments in this ASU modify the guidance companies use to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets, unless those contracts are within the scope of other standards. The ASU requires that entities apply a specific method to recognize revenue reflecting the consideration expected from customers in exchange for the transfer of goods and services. The guidance also requires new qualitative and quantitative disclosures, including information about contract balances and performance obligations. Entities are also required to disclose significant judgments and changes in judgments for determining the satisfaction of performance obligations.

In August 2015, the FASB issued ASU 2014-09 changing the effective date for ASU 2014-09 to annual reporting periods beginning after December 15, 2017 from December 15, 2016. The Company's primary source of revenue is interest income from loans and their fees. As these items are outside the scope of the guidance, this income is not expected to be impacted by implementation of ASU 2014-09. The Company is still reviewing other sources of income such as secondary market lending fees and other deposit account fees to evaluate the impact of ASU 2014-09. The Company continues to evaluate the impact that ASU 2014-09 will have on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes". ASU 2015-17 eliminates the guidance in Topic 740, "Income Taxes", that required an entity to separate deferred tax liabilities and assets of the same tax jurisdiction or a tax filing group, as well as any related valuation allowance, be offset and presented as a single noncurrent amount in a classified balance sheet. The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance in this ASU is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted as of the beginning of any interim or annual reporting period. The Company does not expect this ASU to have a significant impact on its financial condition or results of operations.

In January 2016, the FASB issued ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in Other Comprehensive Income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The Update provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Update also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is only permitted for the provision related to instrument-specific credit risk. The Company is currently assessing the impact of ASU 2016-01 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)". This ASU requires lessees to recognize assets and liabilities arising from most operating leases on the statement of financial position. ASU 2016-02 will be effective for the Company for the fiscal years beginning after December 15, 2018 with early adoption permitted. The Company has determined that the provisions of ASU-2016-02 may result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase liabilities, however, the Company does not expect this to have a material impact on the Company's financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU No. 2016-09 "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." This ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted; however if the Company elects to early adopt, then all amendments must be adopted in the same period. The Company has concluded the adoption of ASU No. 2016-09 will hot have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This ASU amends guidance on reporting credit losses for assets held at amortized cost basis and available-for-sale debt securities by eliminating the probable initial recognition threshold (incurred loss methodology) and requiring entities to reflect its current estimate of all expected credit losses. The amendments in the ASU are effective beginning after December 15, 2019 and for interim periods within that year. Early adoption is permitted beginning after December 15, 2018. Entities will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings in the first period effective. While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company’s Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems.

In August 2016, The FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Payments (a consensus of Merging Issues Task Force).” This ASU attempts to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The purpose of this update is to reduce existing diversity in practice in eight areas addressed by the update. The amendment will be effective for the Company for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Company has concluded the adoption of ASU No. 2016-15 will not have a material impact on its consolidated financial statements.

Amendment to Village Bank Supplemental Executive Retirement Plan

On July 9, 2016, the Bank amended its supplemental executive retirement plan to provide that the participants’ benefits will vest upon a change of control of the Bank. The plan previously provided that a participant’s benefits would vest upon a change of control only if the participant experienced a qualifying termination of employment within 12 months after the change of control.

Impact of inflation and changing prices

The Company’s financial statements included herein have been prepared in accordance with GAAP, which require the Company to measure financial position and operating results primarily in terms of historical dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs. In management’s opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and related footnotes of the Company are presented following.

Report of Independent Registered Public Accounting Firm

Board of Directors
Village Bank and Trust Financial Corp.
Midlothian, Virginia

We have audited the accompanying consolidated balance sheets of Village Bank and Trust Financial Corp. and Subsidiary as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Village Bank and Trust Financial Corp. and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Richmond, Virginia
March 31, 2017

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Balance Sheets
December 31, 2016 and 2015

(in thousands, except share data)

	2016	2015
Assets		
Cash and due from banks	$ 10,848	$ 17,076
Federal funds sold	948	186
Total cash and cash equivalents	11,796	17,262
Investment securities available for sale	43,894	37,919
Loans held for sale	14,784	14,373
Loans		
Outstandings	337,100	306,771
Allowance for loan losses	(3,373)	(3,562)
Deferred fees and costs, net	660	670
Total loans, net	334,387	303,879
Other real estate owned, net of valuation allowance	2,926	6,249
Assets held for sale	841	12,631
Premises and equipment, net	12,758	13,671
Bank owned life insurance	7,093	7,130
Accrued interest receivable	2,274	2,060
Other assets	14,049	4,767
	$ 444,802	$ 419,941
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest bearing demand	$ 92,574	$ 78,282
Interest bearing	290,703	286,566
Total deposits	383,277	364,848
Federal Home Loan Bank advances	2,400	6,000
Long-term debt - trust preferred securities	8,764	8,764
Other borrowings	81	508
Accrued interest payable	70	1,346
Other liabilities	6,596	8,116
Total liabilities	401,188	389,582
Shareholders' equity		
Preferred stock, $4 par value, $1,000 liquidation preference, 1,000,000 shares authorized; 5,715 shares issued and outstanding at December 31, 2016 and December 31, 2015	23	23
Common stock, $4 par value - 10,000,000 shares authorized; 1,428,261 shares issued and outstanding at December 31, 2016 1,417,775 shares issued and outstanding at December 31, 2015	5,629	5,562
Additional paid-in capital	58,643	58,497
Accumulated deficit	(21,172)	(33,948)
Common stock warrant	732	732
Stock in directors rabbi trust	(1,034)	(1,034)
Directors deferred fees obligation	1,034	1,034
Accumulated other comprehensive loss	(241)	(507)
Total shareholders' equity	43,614	30,359
	$ 444,802	$ 419,941

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Operations
Years Ended December 31, 2016, 2015 and 2014

(in thousands, except per share data)

	2016	2015	2014
Interest income			
Loans	$ 15,563	$ 14,833	$ 15,309
Investment securities	355	616	1,182
Federal funds sold	71	55	87
Total interest income	15,989	15,504	16,578
Interest expense			
Deposits	2,367	2,481	3,006
Borrowed funds	242	386	554
Total interest expense	2,609	2,867	3,560
Net interest income	13,380	12,637	13,018
Provision for (recovery of) loan losses	-	(2,000)	100
Net interest income after provision for (recovery of) loan losses	13,380	14,637	12,918
Noninterest income			
Service charges and fees	2,459	2,520	2,245
Gain on sale of loans	6,430	6,076	4,449
Gain on sale of asset held for sale	504	-	-
Gain (loss) on sale of investment securities	162	6	(210)
Rental income	582	1,105	965
Other	713	351	440
Total noninterest income	10,850	10,058	7,889
Noninterest expense			
Salaries and benefits	11,295	10,846	10,685
Commissions	1,606	1,555	1,165
Occupancy	1,470	1,730	1,690
Equipment	762	765	708
Write down of assets held for sale	220	2,649	-
Cease use lease obligation	252	-	-
Supplies	265	278	344
Professional and outside services	2,999	2,930	2,550
Advertising and marketing	355	325	321
Foreclosed assets, net	393	153	1,244
FDIC insurance premium	292	916	968
Other operating expense	1,980	1,902	2,169
Total noninterest expense	21,889	24,049	21,844
			-
Income (loss) before income tax benefit	2,341	646	(1,037)
Income tax benefit	(11,172)	-	-
Net income (loss)	13,513	646	(1,037)
Preferred stock dividends and amortization of discount	(737)	(674)	(1,436)
Preferred stock principal forgiveness	-	4,404	-
Preferred stock dividend forgiveness	-	2,215	-
Net income (loss) available to common shareholders	$ 12,776	$ 6,591	$ (2,473)
Earnings (loss) per share, basic	$ 8.99	$ 5.65	$ (7.39)
Earnings (loss) per share, diluted	$ 8.99	$ 5.49	$ (7.39)

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016, 2015 and 2014

(in thousands)

	2016	2015	2014
Net income (loss)	$ 13,513	$ 646	$ (1,037)
Other comprehensive income			
Unrealized holding gains arising during the period	552	317	4,499
Tax effect	188	108	1,529
Net change in unrealized holding gains on securities available for sale, net of tax	364	209	2,970
Reclassification adjustment			
Reclassification adjustment for (gains) losses realized in net income (loss)	(162)	(6)	210
Tax effect	(55)	(2)	72
Reclassification for (gains) losses included in net income (loss), net of tax	(107)	(4)	138
Minimum pension adjustment	14	14	14
Tax effect	5	5	5
Minimum pension adjustment, net of tax	9	9	9
Total other comprehensive income	266	214	3,117
Total comprehensive income	$ 13,779	$ 860	$ 2,080

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2016, 2015 and 2014

(in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Warrant	Discount on Preferred Stock	Stock in Directors Rabbi Trust	Directors Deferred Fees Obligation	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2013	$ 59	$ 21,353	$ 38,054	$ (38,066)	$ 732	$ (50)	$ (878)	$ 878	$ (3,838)	$ 18,244
Amortization of preferred stock									-	-
discount	-	-	-	(50)	-	50	-	-		-
Preferred stock dividend	-	-	-	(1,386)	-	-	-	-	-	(1,386)
Reverse stock split	-	(20,019)	20,019							
Issuance of common stock	-	5	(16)	-	-	-	-	-	-	(11)
Stock based compensation	-	-	131	-	-	-	-	-	-	131
Minimum pension adjustment										
(net of income taxes of $5)	-	-	-	-	-	-	-	-	9	9
Net loss	-	-	-	(1,037)	-	-	-	-	-	(1,037)
Change in unrealized gain on										
investment securities available-for-sale,										
net of reclassification and tax effect	-	-	-	-	-	-	-	-	3,108	3,108
Balance, December 31, 2014	59	1,339	58,188	(40,539)	732	-	(878)	878	(721)	19,058
Preferred stock dividend	-	-	-	(674)	-	-			-	(674)
Restricted stock issuance	-	16	(95)	-	-	-	(156)	156	-	(79)
Issuance of common stock, net of offering										
expense of $1,200	-	2,875	5,842	-	-	-	-	-	-	8,717
Preferred stock exchanged for common stock	(18)	1,332	(1,314)	-	-		-	-	-	-
Preferred stock principal forgiveness	(18)	-	(4,386)	4,404	-	-	-	-	-	-
Preferred stock dividend forgiveness	-	-	-	2,215	-	-	-	-	-	2,215
Stock based compensation	-	-	262	-	-	-			-	262
Minimum pension adjustment										-
(net of income taxes of $5)	-	-	-	-	-	-			9	9
Net income	-	-	-	646	-	-			-	646
Change in unrealized gain on										
investment securities available-for-sale,										
net of reclassification and tax effect	-	-	-	-	-	-	-	-	205	205
Balance, December 31, 2015	23	5,562	58,497	(33,948)	732	-	(1,034)	1,034	(507)	30,359
Preferred stock dividend	-	-	-	(737)	-	-				(737)
Restricted stock issuance		67	(67)	-	-		-	-		-
Stock based compensation	-	-	213	-	-	-	-	-	-	213
Minimum pension adjustment										-
(net of income taxes of $5)	-	-	-	-	-	-	-	-	9	9
Net income	-	-	-	13,513	-	-	-	-	-	13,513
Change in unrealized gain on										
investment securities available-for-sale,										
net of reclassification and tax effect	-	-	-	-	-	-	-	-	257	257
Balance, December 31, 2016	$ 23	$ 5,629	$ 58,643	$ (21,172)	$ 732	$ -	$ (1,034)	$ 1,034	$ (241)	$ 43,614

See accompanying notes to consolidated financial statements.

Village Bank and Trust Financial Corp. and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Cash Flows from Operating Activities			
Net income	$ 13,513	$ 646	$ (1,037)
Adjustments to reconcile net income to net			
cash provided by (used in) operating activities:			
Depreciation and amortization	765	843	681
Deferred income taxes	813	277	(401)
Valuation allowance (recovery) on net deferred tax asset	(11,997)	(277)	334
Provision for (recovery of) loan losses	-	(2,000)	100
Write-down of other real estate owned	624	690	1,642
Valuation allowance other real estate owned	(393)	(35)	(720)
Write-down of assets held for sale	220	2,649	-
(Gain) loss on securities sold	(162)	(6)	210
Gain on loans sold	(6,430)	(6,076)	(4,449)
Gain on sale of assets held for sale	(504)	-	-
(Gian) loss on sale and disposal of premises and equipment	2	12	(3)
Gain on sale of other real estate owned	(15)	(862)	(142)
Stock compensation expense	213	262	131
Proceeds from sale of mortgage loans	218,627	208,479	162,983
Origination of mortgage loans for sale	(212,608)	(206,862)	(160,077)
Amortization of premiums and accretion of discounts on securities, net	142	287	396
Decrease (increase) in interest receivable	(214)	(688)	114
Increase in bank owned life insurance	(185)	(183)	(182)
Income recognized from death benefit on bank owned life insurance	(226)	-	-
Decrease (increase) in other assets	2,660	(190)	(138)
Increase (decrease) in interest payable	(1,276)	179	74
Increase (decrease) in other liabilities	(2,257)	505	2,736
Net cash provided by (used in) operating activities	1,312	(2,350)	2,252
Cash Flows from Investing Activities			
Purchases of available for sale securities	(27,822)	(6,748)	-
Proceeds from the sale or calls of available for sale securities	22,257	8,401	22,310
Proceeds from the sale of assets held for sale	7,338	-	-
Net increase in loans	(26,169)	(21,181)	(8,860)
Proceeds from bank owned life insurance death benefit	448	-	-
Proceeds from sale of other real estate owned	3,680	7,037	10,952
Purchases of premises and equipment	(912)	(1,080)	(2,587)
Proceeds from sale of premises and equipment	-	-	17
Net cash provided by (used in) investing activities	(21,180)	(13,571)	21,832
Cash Flows from Financing Activities			
Issuance of common stock	-	(79)	(11)
Net proceeds from sale of common stock, net of expenses of $990	-	8,965	-
Net increase (decrease) in deposits	18,429	(14,012)	(11,768)
Net decrease in Federal Home Loan Bank Advances	(3,600)	(8,000)	(4,000)
Net increase (decrease) in other borrowings	(427)	(2,794)	589
Net cash provided by (used in) financing activities	14,402	(15,920)	(15,190)
Net increase (decrease) in cash and cash equivalents	(5,466)	(31,841)	8,894
Cash and cash equivalents, beginning of period	17,262	49,103	40,209
Cash and cash equivalents, end of period	$ 11,796	$ 17,262	$ 49,103
Supplemental Disclosure of Cash Flow Information			
Cash payments for interest	$ 3,233	$ 2,688	$ 3,486
Supplemental Schedule of Non Cash Activities			
Real estate owned assets acquired in settlement of loans	$ 268	$ 461	$ 7,628
Assets moved to held for sale	$ -	$ 831	$ -
Accrual of additions on held for sale	$ -	$ 547	$ -
Bank financed sale of asset held for sale	$ 4,912	$ -	$ -
Dividends on preferred stock accrued	$ 737	$ 674	$ 1,386
Non-Cash conversion of preferred shares	$ -	$ 4,619	$ -
Forgiveness of principal and accrued dividends	$ -	$ 6,619	$ -

See accompanying notes to consolidated financial statements.

Note 1. Summary of Significant Accounting Policies

The accounting and reporting policies of Village Bank and Trust Financial Corp. and subsidiary (the "Company") conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practice within the banking industry. The following is a description of the more significant of those policies:

Business

The Company is the holding company of Village Bank (the "Bank"). The Bank opened to the public on December 13, 1999 as a traditional community bank offering deposit and loan services to individuals and businesses in the Richmond, Virginia metropolitan area. Village Bank Mortgage Corporation ("Village Mortgage") is a full service mortgage banking company wholly-owned by the Bank.

The Bank is subject to regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. As a consequence of the extensive regulation of commercial banking activities, the Bank's business is susceptible to being affected by state and federal legislation and regulations.

The majority of the Company's real estate loans are collateralized by properties in markets in the Richmond, Virginia metropolitan area. Accordingly, the ultimate collectability of those loans collateralized by real estate is particularly susceptible to changes in market conditions in the Richmond area.

Basis of presentation and consolidation

The consolidated financial statements include the accounts of the Company, the Bank and Village Mortgage. All material intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the balance sheets dates and revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan losses and its related provision, and the estimate of the fair value of assets held for sale.

Investment securities

At the time of purchase, debt securities are classified into the following categories: held to maturity, available for sale or trading. Debt securities that the Company has both the positive intent and ability to hold to maturity are classified as held to maturity. Held to maturity securities are stated at amortized cost adjusted for amortization of premiums and accretion of discounts on purchase using a method that approximates the effective interest method. Investments classified as trading or available for sale are stated at fair value. Changes in fair value of trading investments are included in current earnings while changes in fair value of available for sale investments are excluded from current earnings and reported, net of taxes, as a separate component of other comprehensive income. Presently, the Company does not maintain a portfolio of trading securities or held to maturity.

The fair value of investment securities held to maturity and available for sale is estimated based on quoted prices for similar assets determined by bid quotations received from independent pricing services. Declines in the fair value of securities below their amortized cost that are other than temporary are reflected in earnings or other comprehensive income, as appropriate. For those debt securities whose fair value is less than their amortized cost basis, we consider our intent to sell the security, whether it is more likely than not that we will be required to sell the security before recovery and if we do not expect to recover the entire amortized cost basis of the security. In analyzing an issuer's financial condition, we may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition.

Interest income is recognized when earned. Realized gains and losses for securities classified as available-for-sale and held-to-maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Loans held for sale

The Company, through the Bank's mortgage banking subsidiary, Village Bank Mortgage, originates residential mortgage loans for sale in the secondary market. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value on an aggregate basis as determined by outstanding commitments from investors. Upon entering into a commitment to originate a loan, the Company locks in the loan and rate with an investor and commits to deliver the loan if settlement occurs on a best efforts basis, thus limiting interest rate risk. Certain additional risks exist that the investor fails to meet its purchase obligation; however, based on historical performance and the size and nature of the investors the Company does not expect them to fail to meet their obligation. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Residential mortgage loans held for sale are sold to the permanent investor with the mortgage servicing rights released. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. Gains on the sale of loans totaling approximately $6,430,000, $6,076,000 and $4,449,000 were realized during the years ended December 31, 2016, 2015 and 2014, respectively.

Once a residential mortgage loan is sold to a permanent investor, the Company has no further involvement or retained interest in the loan. There are limited circumstances in which the permanent investor can contractually require the Company to repurchase the loan. The Company makes no provision for any such recourse related to loans sold as history has shown repurchase of loans under these circumstances has been remote.

The Company, through Village Mortgage, enters into commitments to originate residential mortgage loans in which the interest rate on the loan is determined prior to funding, termed rate lock commitments. Such rate lock commitments on mortgage loans to be sold in the secondary market are considered to be derivatives. The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 30 to 45 days. The Company protects itself from changes in interest rates during this period by requiring a firm purchase agreement from a permanent investor before a loan can be closed. As a result, the Company is not exposed to losses nor will it realize gains or losses related to its rate lock commitments due to changes in interest rates.

The fair value of rate lock commitments and best efforts contracts is not readily ascertainable with precision because rate lock commitments and best efforts contracts are not actively traded in stand-alone markets. The Company determines the fair value of rate lock commitments and best efforts contracts by measuring the change in the value of the underlying asset while taking into consideration the probability that the rate lock commitments will close. Due to high correlation between rate lock commitments and best efforts contracts, no significant gains or losses have occurred on the rate lock commitments.

At December 31, 2016, Village Mortgage had rate lock commitments to originate mortgage loans aggregating approximately $16,467,000 and loans held for sale of approximately $14,784,000. Village Mortgage has entered into corresponding commitments with third party investors to sell loans of approximately $31,251,000. Under the best efforts contractual relationship with these investors, Village Mortgage is obligated to sell the loans, and the investor is obligated to purchase the loans, only if the loans close. No other obligation exists. As a result of these best efforts contractual relationships with these investors Village Mortgage is not exposed to losses, nor will it realize gains, related to its rate lock commitments due to changes in interest rates.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank and put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets. Our transfers of financial assets are limited to commercial loan participations sold, which were insignificant for 2016, 2015 and 2014, and the sale of residential mortgage loans in the secondary market; the extent of which are disclosed in the Consolidated Statements of Cash Flows.

Loans

Loans are stated at the principal amount outstanding, net of unearned income. Loan origination fees and certain direct loan origination costs are deferred and amortized to interest income over the life of the loan as an adjustment to the loan's yield over the term of the loan.

Interest is accrued on outstanding principal balances, unless the Company considers collection to be doubtful. Commercial and unsecured consumer loans are designated as non-accrual when payment is delinquent 90 days or at the point which the Company considers collection doubtful, if earlier. Mortgage loans and most other types of consumer loans past due 90 days or more may remain on accrual status if management determines that such amounts are collectible. When loans are placed in non-accrual status, previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received as long as the remaining recorded investment in the loan is deemed fully collectible. Loans may be placed back on accrual status when, in the opinion of management, the circumstances warrant such action such as a history of timely payments subsequent to being placed on nonaccrual status, additional collateral is obtained or the borrowers cash flows improve.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The total contractual amount of standby letters of credit, whose contract amount represent credit risk was approximately $4,397,000 at December 31, 2016 and approximately $1,484,000 at December 31, 2015.

Allowance for loan losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans while taking into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions which may affect a borrower's ability to repay, overall portfolio quality, and review of specific potential losses. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general and specific components. The general component covers non-classified loans and is based on historical loss experience and risk characteristics (i.e. trends in delinquencies and other non-performing loans, changes in economic conditions on both a local and national level, and changes in the categories of loans comprising the loan portfolio) adjusted for qualitative factors. The specific component relates to loans that we have concluded, based on the value of collateral, guarantees and any other pertinent factors, have known losses. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Troubled debt restructurings

A loan or lease is accounted for as a troubled debt restructuring if we, for economic or legal reasons related to the borrower's financial condition, grant a significant concession to the borrower that we would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan or lease, or a modification of terms such as a reduction of the stated interest rate or balance of the loan or lease, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk, or some combination of these concessions. Troubled debt restructurings generally remain categorized as nonperforming loans and leases until a six-month payment history has been maintained.

In accordance with current accounting guidance, loans modified as troubled debt restructurings are, by definition, considered to be impaired loans. Impairment for these loans is measured on a loan-by-loan basis similar to other impaired loans as described above under ***Allowance for loan losses***. Certain loans modified as troubled debt restructurings may have been previously measured for impairment under a general allowance methodology (i.e., pooling), thus at the time the loan is modified as a troubled debt restructuring the allowance will be impacted by the difference between the results of these two measurement methodologies. Loans modified as troubled debt restructurings that subsequently default are factored into the determination of the allowance in the same manner as other defaulted loans.

Real estate acquired in settlement of loans

Real estate acquired through or in lieu of foreclosure is initially recorded at estimated fair value less estimated selling costs. Subsequent to the date of acquisition, it is carried at the lower of cost or fair value, adjusted for net selling costs. If fair value declines subsequent to foreclosure a valuation allowance is recorded through expense. Operating costs after acquisition are expensed as incurred. The valuation allowance was $612,000 and $1,748,000 at December 31, 2016 and 2015, respectively. Costs relating to the development and improvement of such property are capitalized when appropriate, whereas those costs relating to holding the property are expensed.

Assets held for sale

Assets held for sale at December 31, 2016 included a branch building we previously closed. Assets held for sale at December 31, 2015 are the Company's previous headquarters building at the Watkins Centre and a branch building we previously closed. They were transferred from premises and equipment to assets held for sale at cost less accumulated depreciation at the date of transfer, December 31, 2013 and June 29, 2015 respectively, which were lower than their respective fair values, adjusted for net selling costs, at that date. The Company periodically evaluates the value of assets held for sale and records an impairment charge for any subsequent declines in fair value less selling costs.

Premises and equipment

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation of buildings and improvements is computed using the straight-line method over the estimated useful lives of the assets of 39 years. Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 7 years. Amortization of premises (leasehold improvements) is computed using the straight-line method over the term of the lease or estimated lives of the improvements, whichever is shorter.

Income taxes

Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The primary temporary differences are the allowance for loan losses and depreciation and amortization. The effect on recorded deferred income taxes of a change in tax laws or rates is recognized in income in the period that includes the enactment date. To the extent that available evidence about the future raises doubt about the realization of a deferred income tax asset, a valuation allowance is established. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest and penalties associated with unrecognized tax benefits are classified as taxes other than income in the statement of income. The Company has no uncertain tax positions.

Consolidated statements of cash flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, due from banks (including cash items in process of collection), interest-bearing deposits with banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods. Cash flows from loans originated by the Bank for investment and deposits are reported net. The Company did not pay income taxes in 2016, 2015 and 2014.

Comprehensive income

Comprehensive income is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. Total comprehensive income consists of net income (loss) and other comprehensive income. The Company's other comprehensive income and accumulated other comprehensive income are comprised of unrealized gains and losses on investment securities available for sale and amortization of the unfunded pension liability. At December 31, 2016 and 2015 the accumulated other comprehensive income was comprised of unrealized losses on securities available for sale of $181,000 and $439,000 and unfunded pension liability of $60,000 and $68,000 net of tax, respectively.

Earnings per common share

Basic earnings (loss) per common share represent net income available to common shareholders, which represents net income (loss) less dividends paid or payable to preferred stock shareholders, divided by the weighted-average number of common shares outstanding during the period. For diluted earnings per common share, net income available to common shareholders is divided by the weighted average number of common shares issued and outstanding for each period plus amounts representing the dilutive effect of stock options, restricted stock, and warrants, as well as any adjustment to income that would result from the assumed issuance. The effects of stock options, restricted stock, and warrants are excluded from the computation of diluted earnings per common share in periods in which the effect would be antidilutive. Stock options, restricted stock, and warrants are antidilutive if the underlying average market price of the stock that can be purchased for the period is less than the exercise price of the option or warrant. Potential common shares that may be issued by the Company relate solely to outstanding stock options, restricted stock, and warrants and are determined using the treasury stock method.

Stock incentive plan

On May 26, 2015, the Company's shareholders approved the adoption of the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (the "2015 Plan") authorizing the issuance of up to 60,000 shares of common stock. The 2015 Plan was adopted to replace the Company's 2006 stock incentive plan and any new awards will be made pursuant to the 2015 Plan. The prior awards made under the 2006 plan were unchanged by the adoption of the 2015 Plan and continue to be governed by the terms of the 2006 plan. See Note 14 for more information on the stock incentive plan.

Fair values of financial instruments

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are independent, knowledgeable, able to transact and willing to transact. See Note 17 for the methods and assumptions the Bank uses in estimating fair values of financial instruments.

Insurance of Accounts, Assessments and Regulation by the FDIC. Our deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to the limits set forth under applicable law, currently $250,000. We are subject to the deposit insurance assessments of the DIF. The amount of the assessment is a function of the institution's risk category, of which there are four, and its assessment base. An institution's risk category is determined according to its supervisory ratings and capital levels and is used to determine the institution's assessment rate. The assessment base is an institution's average consolidated total assets less its average tangible equity.

The FDIC is authorized to prohibit any DIF-insured institution from engaging in any activity that the FDIC determines by regulation or order to pose a serious threat to the respective insurance fund. Also, the FDIC may initiate enforcement actions against banks, after first giving the institution's primary regulatory authority an opportunity to take such action. The FDIC may terminate the deposit insurance of any depository institution if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed in writing by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If deposit insurance is terminated, the deposits at the institution at the time of termination, less subsequent withdrawals, shall continue to be insured for a period from six months to two years, as determined by the FDIC. We are aware of no existing circumstances that could result in termination of our deposit insurance.

Segments

In previous reports, the Company concluded that it had one operating and reportable segment, "Community Banking". This conclusion was based on the fact that the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities supports the others. The Company has re-assessed its segment reporting and decided to report two segments:

traditional commercial banking and mortgage banking, as management has changed the information it reviews to make decisions. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income

	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Year Ended December 31, 2016				
Revenues				
Interest income	$ 15,636	$ 470	$ (117)	$ 15,989
Gain on sale of loans	-	6,430	-	6,430
Other revenues	3,868	742	(190)	4,420
Total revenues	19,504	7,642	(307)	26,839
Expenses				
Interest expense	2,609	117	(117)	2,609
Salaries and benefits	7,702	3,593	-	11,295
Commissions	-	1,606	-	1,606
Other expenses	8,088	1,090	(190)	8,988
Total operating expenses	18,399	6,406	(307)	24,498
Income before income taxes	$ 1,105	$ 1,236	$ -	$ 2,341
Total assets	$ 448,373	$ 10,026	$ (13,597)	$ 444,802

	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Year Ended December 31, 2015				
Revenues				
Interest income	$ 15,165	$ 446	$ (107)	$ 15,504
Gain on sale of loans	-	6,076	-	6,076
Other revenues	3,473	749	(240)	3,982
Total revenues	18,638	7,271	(347)	25,562
Expenses				
Interest expense	2,877	107	(117)	2,867
Salaries and benefits	7,346	3,500	-	10,846
Commissions	-	1,555	-	1,555
Other expenses	8,787	1,091	(230)	9,648
Total operating expenses	19,010	6,253	(347)	24,916
Income (loss) before income taxes	$ (372)	$ 1,018	$ -	$ 646
Total assets	$ 426,038	$ 8,806	$ (14,903)	$ 419,941

Year Ended December 31, 2014	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Revenues				
Interest income	$ 16,287	$ 347	$ (56)	$ 16,578
Gain on sale of loans	-	4,449	-	4,449
Other revenues	3,078	706	(344)	3,440
Total revenues	19,365	5,502	(400)	24,467
Expenses				
Interest expense	3,561	55	(56)	3,560
Salaries and benefits	7,454	3,231	-	10,685
Commissions	-	1,165	-	1,165
Other expenses	9,237	1,201	(344)	10,094
Total operating expenses	20,252	5,652	(400)	25,504
Income (loss) before income taxes	$ (887)	$ (150)	$ -	$ (1,037)
Total assets	$ 435,046	$ 8,081	$ (9,123)	$ 434,004

New accounting pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" (Topic 606). The amendments in this ASU modify the guidance companies use to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets, unless those contracts are within the scope of other standards. The ASU requires that entities apply a specific method to recognize revenue reflecting the consideration expected from customers in exchange for the transfer of goods and services. The guidance also requires new qualitative and quantitative disclosures, including information about contract balances and performance obligations. Entities are also required to disclose significant judgments and changes in judgments for determining the satisfaction of performance obligations.

In August 2015, the FASB issued ASU 2014-09 changing the effective date for ASU 2014-09 to annual reporting periods beginning after December 15, 2017 from December 15, 2016. The Company's primary source of revenue is interest income from loans and their fees. As these items are outside the scope of the guidance, this income is not expected to be impacted by implementation of ASU 2014-09. The Company is still reviewing other sources of income such as secondary market lending fees and other deposit account fees to evaluate the impact of ASU 2014-09. The Company continues to evaluate the impact that ASU 2014-09 will have on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes". ASU 2015-17 eliminates the guidance in Topic 740, "Income Taxes", that required an entity to separate deferred tax liabilities and assets of the same tax jurisdiction or a tax filing group, as well as any related valuation allowance, be offset and presented as a single noncurrent amount in a classified balance sheet. The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance in this ASU is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted as of the beginning of any interim or annual reporting period. The Company does not expect this ASU to have a significant impact on its financial condition or results of operations.

In January 2016, the FASB issued ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU requires an entity to: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in Other Comprehensive Income the changes in instrument-specific credit risk for financial liabilities measured using the fair value option; (iii) present financial assets and financial liabilities by measurement category and form of financial asset; (iv) calculate the fair value of financial instruments for disclosure purposes based on an exit price and; (v) assess a valuation allowance on deferred tax assets related to unrealized losses of AFS debt securities in combination with other deferred tax assets. The Update provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The Update also requires a qualitative impairment assessment of such equity investments and amends certain fair value disclosure requirements. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is only permitted for the provision related to instrument-specific credit risk. The Company is currently assessing the impact of ASU 2016-01 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”. This ASU requires lessees to recognize assets and liabilities arising from most operating leases on the statement of financial position. ASU 2016-02 will be effective for the Company for the fiscal years beginning after December 15, 2018 with early adoption permitted. The Company has determined that the provisions of ASU-2016-02 may result in an increase in assets to recognize the present value of the lease obligations with a corresponding increase liabilities, however, the Company does not expect this to have a material impact on the Company’s financial position, results of operations or cash flows.

In March 2016, the FASB issued ASU No. 2016-09 “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” This ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted; however if the Company elects to early adopt, then all amendments must be adopted in the same period. The Company has concluded the adoption of ASU No. 2016-09 will hot have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” This ASU amends guidance on reporting credit losses for assets held at amortized cost basis and available-for-sale debt securities by eliminating the probable initial recognition threshold (incurred loss methodology) and requiring entities to reflect its current estimate of all expected credit losses. The amendments in the ASU are effective beginning after December 15, 2019 and for interim periods within that year. Early adoption is permitted beginning after December 15, 2018. Entities will apply the amendments in this ASU through a cumulative-effect adjustment to retained earnings in the first period effective. While the Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company’s Consolidated Financial Statements, it has taken steps to prepare for the implementation when it becomes effective, such as forming an internal task force, gathering pertinent data, consulting with outside professionals, and evaluating its current IT systems.

In August 2016, The FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Payments (a consensus of Merging Issues Task Force).” This ASU attempts to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The purpose of this update is to reduce existing diversity in practice in eight areas addressed by the update. The amendment will be effective for the Company for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Company has concluded the adoption of ASU No. 2016-15 will not have a material impact on its consolidated financial statements.

Note 2. Investment securities available for sale

The amortized cost and estimated fair value of investment securities available for sale as of December 31, 2016 and 2015 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2016				
U.S. Government agencies	$ 32,475	$ -	$ (229)	$ 32,246
Mortgage-backed securities	11,694	1	(47)	11,648
	$ 44,169	$ 1	$ (276)	$ 43,894
December 31, 2015				
U.S. Government agencies	$ 34,286	$ -	$ (573)	$ 33,713
Mortgage-backed securities	3,043	1	(43)	3,001
Municipals	1,255	-	(50)	1,205
	$ 38,584	$ 1	$ (666)	$ 37,919

Investment securities with book values of approximately $1,050,000 and $5,968,000 at December 31, 2016 and 2015, respectively, were pledged to secure deposit repurchase agreements.

Gross realized gains and losses pertaining to available for sale securities are detailed as follows for the years ending December 31, 2016, 2015 and 2014 (in thousands):

	2016	2015	2014
Gross realized gains	$ 162	$ 13	$ 218
Gross realized losses	-	(7)	(428)
	$ 162	$ 6	$ (210)

The Company sold approximately $22 million, $8 million and $22 million of investment securities available for sale at a gain of $162,000 and $6,000 in 2016 and 2015, respectively and a loss of $210,000 in 2014. The sale of these securities, which had fixed interest rates, allowed the Company to decrease its exposure to the anticipated upward movement in interest rates that would result in unrealized losses being recognized in shareholders' equity. In 2014, approximately $15 million of the proceeds from the sale of these securities were used to purchase rehabilitated student loans that have variable interest rates that will increase as interest rates in general increase.

Investment securities available for sale that have an unrealized loss position at December 31, 2016 and December 31, 2015 are detailed below (in thousands):

	Securities in a loss position for less than 12 Months		Securities in a loss position for more than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016						
US Government Agencies	$ 27,291	$ (213)	$ 2,852	$ (16)	$30,143	$ (229)
Mortgage-backed securities	9,450	(47)	-	-	9,450	(47)
	$ 36,741	$ (260)	$ 2,852	$ (16)	$39,593	$ (276)
December 31, 2015						
US Government Agencies	$ 18,598	$ (329)	$15,115	$ (244)	$33,713	$ (573)
Municipals	707	(14)	497	(36)	1,204	(50)
Mortgage-backed securities	2,899	(43)	-	-	2,899	(43)
	$ 22,204	$ (386)	$15,612	$ (280)	$37,816	$ (666)

All of the unrealized losses are attributable to increases in interest rates and not to credit deterioration. Currently, the Company believes that it is probable that the Company will be able to collect all amounts due according to the contractual terms of the investments. Because the decline in market value is attributable to changes in interest rates and not to credit quality, and because it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other than temporarily impaired at December 31, 2016.

The amortized cost and estimated fair value of investment securities available for sale as of December 31, 2016, by contractual maturity, are as follows (in thousands):

	Amortized Cost	Estimated Fair Value
One to five years	$ 33,131	$ 32,885
More than ten years	11,038	11,009
Total	$ 44,169	$ 43,894

Note 3. Loans

Loans classified by type as of December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Construction and land development		
Residential	$ 6,770	$ 5,202
Commercial	27,092	25,948
	33,862	31,150
Commercial real estate		
Owner occupied	66,021	69,256
Non-owner occupied	57,944	38,037
Multifamily	8,824	8,537
Farmland	310	388
	133,099	116,218
Consumer real estate		
Home equity lines	20,691	20,333
Secured by 1-4 family residential,		
First deed of trust	54,791	56,776
Second deed of trust	5,768	6,485
	81,250	83,594
Commercial and industrial loans (except those secured by real estate)	39,390	20,086
Guaranteed student loans	47,398	53,989
Consumer and other	2,101	1,734
Total loans	337,100	306,771
Deferred loan cost, net	660	670
Less: allowance for loan losses	(3,373)	(3,562)
	$ 334,387	$ 303,879

The Bank purchased portfolios of rehabilitated student loans guaranteed by the Department of Education (“DOE”). The guarantee covers approximately 98% of principal and accrued interest. The loans are serviced by a third-party servicer that specializes in handling the special needs of the DOE student loan programs.

Loans pledged as collateral with the Federal Home Loan Bank of Atlanta (“FHLB”) as part of their lending arrangements with the Company totaled $27,073,000 and $7,891,000 as of December 31, 2016 and 2015, respectively.

The following is a summary of loans directly or indirectly with executive officers or directors of the Company for the years ended December 31, 2016 and 2015 (in thousands):

	2016	2015
Beginning balance	$ 8,073	$ 8,258
Additions	2,703	5,504
Reductions	(3,065)	(5,689)
Ending balance	$ 7,711	$ 8,073

Executive officers and directors also had unused credit lines totaling $3,219,000 and $1,375,000 at

December 31, 2016 and 2015, respectively. All loans and credit lines to executive officers and directors were made in the ordinary course of business at the Company's normal credit terms, including interest rate and collateralization prevailing at the time for comparable transactions with other persons.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due as long as the remaining recorded investment in the loan is deemed fully collectible. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all principal and interest amounts contractually due are brought to current and future payments are reasonably assured.

Year-end nonaccrual loans segregated by type as of December 31, 2016 and 2015 were as follows (in thousands):

	2016	2015
Construction and land development		
Commercial	$ 102	$ 52
	102	52
Commercial real estate		
Owner occupied	225	1,078
	225	1,078
Consumer real estate		
Home equity lines	163	154
Secured by 1-4 family residential,		
First deed of trust	1,404	1,498
Second deed of trust	72	421
	1,639	2,073
Commercial and industrial loans (except those secured by real estate)	430	508
Consumer and other	6	7
Total loans	$ 2,402	$ 3,718

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

- Risk rated 1 to 4 loans are considered of sufficient quality to preclude an adverse rating. These assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral;
- Risk rated 5 loans are defined as having potential weaknesses that deserve management's close attention;
- Risk rated 6 loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any; and
- Risk rated 7 loans have all the weaknesses inherent in substandard loans, with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following tables provide information on the risk rating of loans at the dates indicated (in thousands):

	Risk Rated 1-4	Risk Rated 5	Risk Rated 6	Risk Rated 7	Total Loans
December 31, 2016					
Construction and land development					
Residential	$ 6,770	$ -	$ -	$ -	$ 6,770
Commercial	25,342	1,648	102	-	27,092
	32,112	1,648	102	-	33,862
Commercial real estate					
Owner occupied	58,788	3,565	3,668	-	66,021
Non-owner occupied	57,944	-	-	-	57,944
Multifamily	8,634	190	-	-	8,824
Farmland	310	-	-	-	310
	125,676	3,755	3,668	-	133,099
Consumer real estate					
Home equity lines	19,501	487	703	-	20,691
Secured by 1-4 family residential					
First deed of trust	49,648	2,847	2,296	-	54,791
Second deed of trust	5,399	125	244	-	5,768
	74,548	3,459	3,243	-	81,250
Commercial and industrial loans					
(except those secured by real estate)	39,390			-	39,390
Guaranteed student loans	46,009	739	650	-	47,398
Consumer and other	2,043	52	6	-	2,101
Total loans	$ 319,778	$ 9,653	$ 7,669	$ -	$ 337,100

	Risk Rated 1-4	Risk Rated 5	Risk Rated 6	Risk Rated 7	Total Loans
December 31, 2015					
Construction and land development					
Residential	$ 5,202	$ -	$ -	$ -	$ 5,202
Commercial	24,053	572	1,323		25,948
	29,255	572	1,323	-	31,150
Commercial real estate					
Owner occupied	64,261	2,850	2,145	-	69,256
Non-owner occupied	35,887	2,055	95	-	38,037
Multifamily	8,337	200	-	-	8,537
Farmland	388	-	-	-	388
	108,873	5,105	2,240	-	116,218
Consumer real estate					
Home equity lines	18,539	435	1,359	-	20,333
Secured by 1-4 family residential					
First deed of trust	51,200	2,710	2,866	-	56,776
Second deed of trust	5,751	128	606	-	6,485
	75,490	3,273	4,831	-	83,594
Commercial and industrial loans					
(except those secured by real estate)	18,873	373	840		20,086
Guaranteed student loans	53,989	-	-	-	53,989
Consumer and other	1,649	62	23	-	1,734
Total loans	$ 288,129	$ 9,385	$ 9,257	$ -	$ 306,771

The following tables present the aging of the recorded investment in past due loans as of the dates indicated (in thousands):

December 31, 2016	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Construction and land development							
Residential	$ -	$ -	$ -	$ -	$ 6,770	$ 6,770	$ -
Commercial	-	-	-	-	27,092	27,092	-
	-	-	-	-	33,862	33,862	-
Commercial real estate							
Owner occupied	-	-	-	-	66,021	66,021	-
Non-owner occupied	-	-	-	-	57,944	57,944	-
Multifamily	190	-	-	190	8,634	8,824	-
Farmland	-	-	-	-	310	310	-
	190	-	-	190	132,909	133,099	-
Consumer real estate							
Home equity lines	-	-	-	-	20,691	20,691	-
Secured by 1-4 family residential							
First deed of trust	414	63	-	477	54,314	54,791	-
Second deed of trust	128	-	-	128	5,640	5,768	-
	542	63	-	605	80,645	81,250	-
Commercial and industrial loans							
(except those secured by real estate)	15	62	-	77	39,313	39,390	-
Guaranteed student loans	2,743	1,923	8,174	12,840	34,558	47,398	8,174
Consumer and other	11	-	-	11	2,090	2,101	-
Total loans	$ 3,501	$ 2,048	$ 8,174	$ 13,723	$ 323,377	$ 337,100	$ 8,174

December 31, 2015	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Construction and land development							
Residential	$ -	$ -	$ -	$ -	$ 5,202	$ 5,202	$ -
Commercial	-	-	-	-	25,948	25,948	-
	-	-	-	-	31,150	31,150	-
Commercial real estate							
Owner occupied	327	-	-	327	68,929	69,256	-
Non-owner occupied	-	110	-	110	37,927	38,037	-
Multifamily	-	-	-	-	8,537	8,537	-
Farmland	-	-	-	-	388	388	-
	327	110	-	437	115,781	116,218	-
Consumer real estate							
Home equity lines	-	-	-	-	20,333	20,333	-
Secured by 1-4 family residential							
First deed of trust	163	292	-	455	56,321	56,776	-
Second deed of trust	94	-	-	94	6,391	6,485	-
	257	292	-	549	83,045	83,594	-
Commercial and industrial loans							
(except those secured by real estate)	-	-	-	-	20,086	20,086	-
Guaranteed student loans	7,816	1,252	8,590	17,658	36,331	53,989	8,590
Consumer and other	10	-	-	10	1,724	1,734	-
Total loans	$ 8,410	$ 1,654	$ 8,590	$ 18,654	$ 288,117	$ 306,771	$ 8,590

Loans greater than 90 days past due are student loans that are guaranteed by the DOE which covers approximately 98% of the principal and interest. Accordingly, these loans will not be placed on nonaccrual status.

Loans are considered impaired when, based on current information and events it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible. Impaired loans are set forth in the following table as of the dates indicated (in thousands):

	December 31, 2016		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded			
Construction and land development			
Commercial	$ 102	$ 169	$ -
Commercial real estate			
Owner occupied	1,487	1,487	
Non-owner occupied	2,236	2,236	-
	3,723	3,723	-
Consumer real estate			
Home equity lines	703	703	-
Secured by 1-4 family residential			
First deed of trust	3,514	3,518	-
Second deed of trust	619	865	-
	4,836	5,086	-
Commercial and industrial loans			
(except those secured by real estate)	538	768	-
	9,199	9,746	-
With an allowance recorded			
Construction and land development			
Commercial	479	479	9
Commercial real estate			
Owner occupied	4,117	4,132	86
Non-Owner occupied	-	-	-
	4,117	4,132	86
Consumer real estate			
Secured by 1-4 family residential			
First deed of trust	1,550	1,550	144
Second deed of trust	90	90	90
	1,640	1,640	234
Commercial and industrial loans			
(except those secured by real estate)	6	122	6
	6,242	6,373	335
Total			
Construction and land development			
Commercial	581	648	9
	581	648	9
Commercial real estate			
Owner occupied	5,604	5,619	86
Non-owner occupied	2,236	2,236	-
	7,840	7,855	86
Consumer real estate			
Home equity lines	703	703	-
Secured by 1-4 family residential,			
First deed of trust	5,064	5,068	144
Second deed of trust	709	955	90
	6,476	6,726	234
Commercial and industrial loans			
(except those secured by real estate)	544	890	6
	$ 15,441	$ 16,119	$ 335

	December 31, 2015		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded			
Construction and land development			
Commercial	$ 123	$ 190	$ -
Commercial real estate			
Owner occupied	1,066	1,066	
Non-owner occupied	2,418	2,418	-
	3,484	3,484	-
Consumer real estate			
Home equity lines	1,238	1,247	-
Secured by 1-4 family residential			
First deed of trust	3,984	3,988	-
Second deed of trust	962	1,232	-
	6,184	6,467	-
Commercial and industrial loans			
(except those secured by real estate)	690	920	-
	10,481	11,061	-
With an allowance recorded			
Construction and land development			
Commercial	1,699	1,699	2
Commercial real estate			
Owner occupied	5,719	5,734	383
Non-Owner occupied	449	449	26
	6,168	6,183	409
Consumer real estate			
Secured by 1-4 family residential			
First deed of trust	1,775	1,775	324
Second deed of trust	250	250	98
	2,025	2,025	422
Commercial and industrial loans			
(except those secured by real estate)	136	238	18
	10,028	10,145	851
Total			
Construction and land development			
Commercial	1,822	1,889	2
	1,822	1,889	2
Commercial real estate			
Owner occupied	6,785	6,800	383
Non-owner occupied	2,867	2,867	26
	9,652	9,667	409
Consumer real estate			
Home equity lines	1,238	1,247	-
Secured by 1-4 family residential,			
First deed of trust	5,759	5,763	324
Second deed of trust	1,212	1,482	98
	8,209	8,492	422
Commercial and industrial loans			
(except those secured by real estate)	826	1,158	18
	$ 20,509	$ 21,206	$ 851

The following is a summary of average recorded investment in impaired loans with and without valuation allowance and interest income recognized on those loans for periods indicated (in thousands):

	December 31,			
	2016		2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Construction and land development				
Residential	$ -	$ -	$ 61	$ -
Commercial	87	40	1,769	95
	87	40	1,830	95
Commercial real estate				
Owner occupied	1,040	29	1,349	69
Non-owner occupied	2,501	106	4,435	121
Multifamily	-	-	-	-
Farmland	-	-	-	-
	3,541	135	5,784	190
Consumer real estate				
Home equity lines	1,030	10	890	51
Secured by 1-4 family residential				
First deed of trust	4,019	145	5,374	233
Second deed of trust	753	43	1,121	47
	5,802	198	7,385	331
Commercial and industrial loans				
(except those secured by real estate)	421	31	344	44
Consumer and other	-	-	9	1
	9,851	404	15,352	661
With an allowance recorded				
Construction and land development				
Commercial	1,118	25	844	23
Commercial real estate				
Owner occupied	4,511	162	6,088	226
Non-Owner occupied	46	12	369	24
	4,557	174	6,457	250
Consumer real estate				
Home equity lines	-	-	22	-
Secured by 1-4 family residential				
First deed of trust	1,624	9	1,434	26
Second deed of trust	131	4	277	15
	1,755	13	1,733	41
Commercial and industrial loans				
(except those secured by real estate)	66	-	317	5
	7,496	212	9,351	319
Total				
Construction and land development				
Residential	-	-	61	-
Commercial	1,206	65	2,613	118
	1,206	65	2,674	118
Commercial real estate				
Owner occupied	5,551	191	7,437	295
Non-owner occupied	2,547	118	4,804	145
Multifamily	-	-	-	-
Farmland	-	-	-	-
	8,098	309	12,241	440
Consumer real estate				
Home equity lines	1,030	10	912	51
Secured by 1-4 family residential,				
First deed of trust	5,643	154	6,808	259
Second deed of trust	884	47	1,398	62
	7,557	211	9,118	372
Commercial and industrial loans				
(except those secured by real estate)	487	31	661	49
Consumer and other	-	-	9	1
	$ 17,348	$ 616	$ 24,703	$ 980

As of December 31, 2016, 2015 and 2014, the Company had impaired loans of $2,402,000, $3,718,000 and $7,478,000, respectively, which were on nonaccrual status. These loans had valuation allowances of $97,000, $370,000 and $1,087,000 as of December 31, 2016, 2015 and 2014, respectively. Cumulative interest income that would have been recorded had nonaccrual loans been performing would have been $119,000, $146,000 and $224,000 for 2016, 2015 and 2014, respectively.

Included in impaired loans are loans classified as troubled debt restructurings ("TDRs"). A modification of a loan's terms constitutes a TDR if the creditor grants a concession to the borrower for economic or legal reasons related to the borrowers financial difficulties that it would not otherwise consider. For loans classified as impaired TDRs, the Company further evaluates the loans as performing or nonaccrual. To restore a nonaccrual loan that has been formally restructured in a TDR to accrual status, we perform a current, well documented credit analysis supporting a return to accrual status based on the borrower's financial condition and prospects for repayment under the revised terms. Otherwise, the TDR must remain in nonaccrual status. The analysis considers the borrower's sustained historical repayment performance for a reasonable period to the return-to-accrual date, but may take into account payments made for a reasonable period prior to the restructuring if the payments are consistent with the modified terms. A sustained period of repayment performance generally would be a minimum of six months and would involve payments in the form of cash or cash equivalents.

An accruing loan that is modified in a TDR can remain in accrual status if, based on a current well-documented credit analysis, collection of principal and interest in accordance with the modified terms is reasonably assured, and the borrower has demonstrated sustained historical repayment performance for a reasonable period before modification. The following is a summary of performing and nonaccrual TDRs and the related specific valuation allowance by portfolio segment as of December 31, 2016 (dollars in thousands).

	Total	Performing	Nonaccrual	Specific Valuation Allowance
December 31, 2016				
Construction and land development				
Commercial	$ 479	$ 479	$ -	$ 9
	479	479	-	9
Commercial real estate				
Owner occupied	4,342	4,117	225	86
Non-owner occupied	2,236	2,236	-	-
Multifamily	-	-	-	-
	6,578	6,353	225	86
Consumer real estate				
Home equity lines	-	-	-	-
Secured by 1-4 family residential				
First deeds of trust	3,853	3,012	841	139
Second deeds of trust	547	547	-	-
	4,400	3,559	841	139
Commercial and industrial loans				
(except those secured by real estate)	397	-	397	-
Consumer and other	-	-	-	-
	$ 11,854	$ 10,391	$ 1,463	$ 234
Number of loans	55	36	16	3

	Total	Performing	Nonaccrual	Specific Valuation Allowance
December 31, 2015				
Construction and land development				
Residential	$ -	$ -	$ -	$ -
Commercial	1,699	1,699	-	2
	1,699	1,699	-	2
Commercial real estate				
Owner occupied	5,730	5,458	272	184
Non-owner occupied	2,866	2,866	-	26
Multifamily	-	-	-	-
	8,596	8,324	272	210
Consumer real estate				
Home equity lines	87	-	87	-
Secured by 1-4 family residential				
First deeds of trust	4,283	3,544	739	236
Second deeds of trust	693	693	-	1
	5,063	4,237	826	237
Commercial and industrial loans				
(except those secured by real estate)	127	-	127	18
Consumer and other	-	-	-	-
	$ 15,485	$ 14,260	$ 1,225	$ 467
Number of loans	66	51	15	13

The following table provides information about TDRs identified during the indicated periods (dollars in thousands).

	December 31, 2016			December 31, 2015		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Consumer real estate						
Home equity lines	-	$ -	$ -	1	$ 87	$ 87
Secured by 1-4 family residential						
First deed of trust	1	234	234	-	-	-
	1	234	234	1	87	87
Commercial and industrial loans						
(except those secured by real estate)	3	352	352			
	4	$ 586	$ 586	1	$ 87	$ 87

The following table provides information about defaults on TDRs for the indicated periods (dollars in thousands).

	December 31, 2016		December 31, 2015	
	Number of Loans	Recorded Balance	Number of Loans	Recorded Balance
Commercial real estate				
Owner occupied	1	$ 225	1	$ 156
	1	225	1	156
Consumer real estate				
Secured by 1-4 family residential				
First deed of trust	13	1,134	11	889
Second deed of trust	2	83	2	94
	15	1,217	13	983
Commercial and industrial (except those secured by real estate)	-	-	1	127
	16	$ 1,442	15	$ 1,266

Note 4. Allowance for loan losses

Activity in the allowance for loan losses was as follows for the periods indicated (in thousands):

	Beginning Balance	Provision for (Recovery of) Loan Losses	Charge-offs	Recoveries	Ending Balance
Year Ended December 31, 2016					
Construction and land development					
Residential	$ 30	$ 10	$ -	$ 1	$ 41
Commercial	291	9	(10)	10	300
	321	19	(10)	11	341
Commercial real estate					
Owner occupied	1,167	(490)	(66)	-	611
Non-owner occupied	460	(106)	(1)	53	406
Multifamily	51	5	-	-	56
Farmland	17	(139)	-	125	3
	1,695	(730)	(67)	178	1,076
Consumer real estate					
Home equity lines	448	(127)	(53)	3	271
Secured by 1-4 family residential					
First deed of trust	602	(40)	(140)	25	447
Second deed of trust	111	21	(25)	29	136
	1,161	(146)	(218)	57	854
Commercial and industrial loans (except those secured by real estate)	94	44	(15)	100	223
Student loans	230	149	(221)	-	158
Consumer and other	2	10	(13)	9	8
Unallocated	59	654	-	-	713
	$ 3,562	$ -	$ (544)	$ 355	$ 3,373
Year Ended December 31, 2015					
Construction and land development					
Residential	$ 34	$ (6)	$ -	$ 2	$ 30
Commercial	202	292	(252)	49	291
	236	286	(252)	51	321
Commercial real estate					
Owner occupied	1,837	(576)	(127)	33	1,167
Non-owner occupied	607	(151)	-	4	460
Multifamily	77	(26)	-	-	51
Farmland	130	(113)	-	-	17
	2,651	(866)	(127)	37	1,695
Consumer real estate					
Home equity lines	469	36	(62)	5	448
Secured by 1-4 family residential					
First deed of trust	1,345	(1,020)	(103)	380	602
Second deed of trust	275	(159)	(55)	50	111
	2,089	(1,143)	(220)	435	1,161
Commercial and industrial loans (except those secured by real estate)	506	(350)	(162)	100	94
Student loans	217	13	-	-	230
Consumer and other	30	1	(55)	26	2
Unallocated	-	59	-	-	59
	$ 5,729	$ (2,000)	$ (816)	$ 649	$ 3,562

	Beginning Balance	Provision for (Recovery of) Loan Losses	Charge-offs	Recoveries	Ending Balance
Year Ended December 31, 2014					
Construction and land development					
Residential	$ 135	$ (103)	$ -	$ 2	$ 34
Commercial	1,274	(1,016)	(100)	44	202
	1,409	(1,119)	(100)	46	236
Commercial real estate					
Owner occupied	1,200	1,268	(631)	-	1,837
Non-owner occupied	670	430	(518)	25	607
Multifamily	19	58	-	-	77
Farmland	337	(111)	(96)	-	130
	2,226	1,645	(1,245)	25	2,651
Consumer real estate					
Home equity lines	424	506	(476)	15	469
Secured by 1-4 family residential					
First deed of trust	1,992	(442)	(277)	72	1,345
Second deed of trust	394	(223)	(86)	190	275
	2,810	(159)	(839)	277	2,089
Commercial and industrial loans (except those secured by real estate)	724	(447)	(172)	401	506
Student loans	-	217	-	-	217
Consumer and other	70	(37)	(25)	22	30
	$ 7,239	$ 100	$ (2,381)	$ 771	$ 5,729

Overall the recovery of loan losses recorded for the year ended December 31, 2015 was due primarily to credit quality improvements and an enhanced model for evaluating inherent losses in the Bank's loan portfolio. Improvements in credit quality are provided in the following schedule:

	December 31, 2016	December 31, 2015	December 31, 2014
Classified assets	$ 10,454	$ 15,375	$ 30,684
Nonaccrual loans	2,402	3,718	7,478
Foreclosed real estate	2,926	6,249	12,638

During the fourth quarter of 2015, we adopted a software solution for the analysis of the allowance for loan losses. While our methodology of evaluating the adequacy of the allowance for loan losses generally did not change, the software is more robust in that it:

- allows us to take a more measureable approach to our evaluation of qualitative factors such as economic conditions that may affect loss experience; and
- is widely used by community banks which provides peer data that can be used as a benchmark for comparison to our analysis.

In addition to the adoption of the software solution for our analysis, we reviewed the last twenty years of historical loss data for peer banks in Virginia to assist us in our evaluation of environmental factors and other conditions that could affect the loan portfolio and the overall adequacy of the allowance for loan losses.

The allowance for loan losses at each of the periods presented includes an amount that could not be identified to individual types of loans referred to as the unallocated portion of the allowance. We recognize the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. We concluded that the unallocated portion of the allowance was acceptable given the level of classified assets and was within a reasonable range around the estimate of losses. The allowance for loan losses included an unallocated portion of approximately $713,000 and $59,000 at December 31, 2016 and 2015, respectively.

Discussion of the recovery of loan losses related to specific loan types are provided following:

- The recovery of loan losses totaling $1,119,000 for the construction and land development loan portfolio during 2014 was attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of the historical net recovery of 0.27% at December 31, 2014. Also contributing to the declines in the general component were declines of approximately $1,643,000 and $12,945,000 in the outstanding loan balance of this portfolio at December 31, 2014 and 2013, respectively.

- The recovery of loan losses totaling $730,000 and $866,000 for the commercial real estate portfolio at December 31, 2016 and 2015, respectively, was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 0.96% in 2014 to 0.57% in 2015 and to 0.20% in 2016. In addition, net charge-offs on this portfolio decreased from $1,220,000 in 2014 to $90,000 in 2015 and to a net recovery of $111,000 in 2016.

- The recovery of loan losses totaling $1,143,000 for the consumer real estate portfolio in 2015 was also attributable to changes in our assessment of the general component of the allowance for loan losses as it related to this portfolio. The general component allocated to this portfolio declined primarily as a result of declines in the historical loss experience from 1.36% in 2014 to 0.24% in 2015 and to .0022% in 2016. In addition, net charge-offs on this portfolio decreased from $562,000 in 2014 to a recovery of $215,000 in 2015.

Loans were evaluated for impairment as follows for the periods indicated (in thousands):

	Recorded Investment in Loans					
	Allowance			Loans		
	Ending Balance	Individually	Collectively	Ending Balance	Individually	Collectively
Year Ended December 31, 2016						
Construction and land development						
Residential	$ 41	$ -	$ 41	$ 6,770	$ -	$ 6,770
Commercial	300	9	291	27,092	581	26,511
	341	9	332	33,862	581	33,281
Commercial real estate						
Owner occupied	611	86	525	66,021	5,604	60,417
Non-owner occupied	406	-	406	57,944	2,236	55,708
Multifamily	56	-	56	8,824	-	8,824
Farmland	3	-	3	310	-	310
	1,076	86	990	133,099	7,840	125,259
Consumer real estate						
Home equity lines	271	-	271	20,691	703	19,988
Secured by 1-4 family residential						
First deed of trust	447	144	303	54,791	5,064	49,727
Second deed of trust	136	90	46	5,768	709	5,059
	854	234	620	81,250	6,476	74,774
Commercial and industrial loans						
(except those secured by real estate)	223	6	217	39,390	544	38,846
Student loans	158	-	158	47,398	-	47,398
Consumer and other	721	-	721	2,101	-	2,101
	$ 3,373	$ 335	$ 3,038	$ 337,100	$ 15,441	$ 321,659
Year Ended December 31, 2015						
Construction and land development						
Residential	$ 30	$ -	$ 30	$ 5,202	$ -	$ 5,202
Commercial	291	2	289	25,948	1,822	24,126
	321	2	319	31,150	1,822	29,328
Commercial real estate						
Owner occupied	1,167	383	784	69,256	6,785	62,471
Non-owner occupied	460	26	434	38,037	2,867	35,170
Multifamily	51	-	51	8,537	-	8,537
Farmland	17	-	17	388	-	388
	1,695	409	1,286	116,218	9,652	106,566
Consumer real estate						
Home equity lines	448	-	448	20,333	1,238	19,095
Secured by 1-4 family residential						
First deed of trust	602	324	278	56,776	5,759	51,017
Second deed of trust	111	98	13	6,485	1,212	5,273
	1,161	422	739	83,594	8,209	75,385
Commercial and industrial loans						
(except those secured by real estate)	94	18	76	20,086	826	19,260
Student loans	230	-	230	53,989	-	53,989
Consumer and other	61	-	61	1,734	-	1,734
	$ 3,562	$ 851	$ 2,711	$ 306,771	$ 20,509	$ 286,262
Year Ended December 31, 2014						
Construction and land development						
Residential	$ 34	$ -	$ 34	$ 4,315	$ 164	$ 4,151
Commercial	202	26	176	25,152	3,968	21,184
	236	26	210	29,467	4,132	25,335
Commercial real estate						
Owner occupied	1,837	905	932	58,804	8,311	50,493
Non-owner occupied	607	-	607	38,892	6,593	32,299
Multifamily	77	-	77	11,438	2,322	9,116
Farmland	130	-	130	434	21	413
	2,651	905	1,746	109,568	17,247	92,321
Consumer real estate						
Home equity lines	469	-	469	20,082	800	19,282
Secured by 1-4 family residential						
First deed of trust	1,345	200	1,145	61,837	7,900	53,937
Second deed of trust	275	142	133	7,854	1,360	6,494
	2,089	342	1,747	89,773	10,060	79,713
Commercial and industrial loans						
(except those secured by real estate)	506	239	267	22,165	818	21,347
Student loans	217	-	217	33,562	-	33,562
Consumer and other	30	-	30	1,611	23	1,588
	$ 5,729	$ 1,512	$ 4,217	$ 286,146	$ 32,280	$ 253,866

Note 5. Premises and equipment

The following is a summary of premises and equipment as of December 31, 2016 and 2015 (in thousands):

	2016	2015
Land	$ 4,352	$ 4,858
Buildings and improvements	9,087	9,216
Furniture, fixtures and equipment	7,613	7,437
Total premises and equipment	21,052	21,511
Less: Accumulated depreciation and amortization	(8,294)	(7,840)
Premises and equipment, net	$ 12,758	$ 13,671

Depreciation and amortization of premises and equipment for 2016, 2015 and 2014 amounted to $765,000, $843,000 and $681,000, respectively.

Note 6. Investment in bank owned life insurance

The Bank is owner and designated beneficiary on life insurance policies in the aggregate face amount of $13,728,000 covering certain of its directors and executive officers. The earnings from these policies are used to offset expenses related to retirement plans. The cash surrender value of these policies at December 31, 2016 and 2015 was approximately $7,093,000 and $7,130,000, respectively.

Note 7. Deposits

Deposits as of December 31, 2016 and 2015 were as follows (in thousands):

	2016	2015
Demand accounts	$ 92,574	$ 78,282
Interest checking accounts	44,390	44,256
Money market accounts	71,290	64,841
Savings accounts	26,598	19,403
Time deposits of $250,000 and over	13,372	9,717
Other time deposits	135,053	148,349
Total	$ 383,277	$ 364,848

The following are the scheduled maturities of time deposits as of December 31, 2016 (in thousands):

Year Ending December 31,	Less Than $250,000	Greater than or Equal to $250,000	Total
2017	$ 62,380	$ 4,092	$ 66,472
2018	25,956	2,552	28,508
2019	15,552	2,791	18,343
2020	9,808	576	10,384
2021	21,357	3,361	24,718
	$ 135,053	$ 13,372	$ 148,425

Deposits held at the Company by related parties, which include officers, directors, greater than 5% shareholders and companies in which directors of the board have a significant ownership interest, approximated $5,709,000 and $6,240,000 at December 31, 2016 and 2015, respectively.

Note 8. Borrowings

The Company uses both short-term and long-term borrowings to supplement deposits when they are available at a lower overall cost to the Company or they can be invested at a positive rate of return.

As a member of the Federal Home Loan Bank of Atlanta, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances from the FHLB. The Company held $512,000 in FHLB stock at December 31, 2016 and $685,000 at December 31, 2015 which is held at cost and included in other assets. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses to which the advances may be put, as well as on the size of the advances and repayment provisions. The FHLB borrowings are secured by the pledge of commercial and 1-4 family residential loans. The Company had FHLB advances of approximately $2,400,000 at December 31, 2016 maturing through 2018. At December 31, 2015, approximately $6,000,000 of advances was outstanding.

The Company had advances from the FHLB for the periods indicated that consisted of the following (in thousands):

Year Ended December 31, 2016

Type	Maturity Date	Interest Rate	Advance Amount
Fixed Rate	06/01/2017	1.06%	$ 800
Fixed Rate	12/01/2017	1.27%	800
Fixed Rate	06/01/2018	1.48%	800
			$ 2,400

Year Ended December 31, 2015

Type	Maturity Date	Interest Rate	Advance Amount
Fixed Rate	02/25/2016	2.65%	$ 1,000
Fixed Rate	04/11/2016	2.71%	1,000
Fixed Rate	06/01/2016	0.56%	800
Fixed Rate	12/01/2016	0.81%	800
Fixed Rate	06/01/2017	1.06%	800
Fixed Rate	12/01/2017	1.27%	800
Fixed Rate	06/01/2018	1.48%	800
			$ 6,000

The Company uses federal funds purchased and repurchase agreements for short-term borrowing needs. Securities sold under agreements to repurchase are classified as borrowings and generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities. The carrying value of these repurchase agreements was $81,000 and $508,000 at December 31, 2016 and 2015, respectively.

Information related to borrowings as of December 31, 2016 and 2015 is as follows (dollars in thousands):

	Year Ended December 31,		
	2016	2015	2014
Maximum outstanding during the year			
FHLB advances	$ 12,200	$ 14,000	$ 18,000
Balance outstanding at end of year			
FHLB advances	2,400	6,000	14,000
Average amount outstanding during the year			
FHLB advances	5,161	9,027	15,468
Average interest rate during the year			
FHLB advances	1.09%	1.88%	2.16%
Average interest rate at end of year			
FHLB advances	1.46%	1.58%	2.07%

Note 9. Income taxes

The following summarizes the tax effects of temporary differences which comprise net deferred tax assets and liabilities at December 31, 2016 and 2015 (in thousands):

	2016	2015
Deferred tax assets		
Net operating loss carryforward	$ 7,471	$ 8,475
Capital loss carryforward	14	69
State net operating loss carryfoward	50	11
Allowance for loan losses	1,147	1,211
Unrealized loss on available-for-sale securities	93	226
Interest on nonaccrual loans	41	50
Expenses and writedowns related to foreclosed property	883	991
Stock compensation	253	140
Employee benefits	1,079	1,015
Pension expense	31	35
Depreciation	144	-
Lease Obligation	74	-
Other, net	71	38
Goodwill	23	39
Total deferred tax assets	11,374	12,300
Deferred tax liabilities		
Depreciation	-	43
Amortization of intangibles	1	34
Total deferred tax liabilities	1	77
Net deferred tax asset prior to valuation allowance	11,373	12,223
Less Unrealized gain on available-for-sale securities	-	(226)
Net deferred tax asset subject to valuation allowance	-	11,997
Less valuation allowance	-	11,997
Net deferred tax asset	$ 11,373	$ 226

The net deferred tax asset is included in other assets on the consolidated balance sheet. Accounting Standards Codification Topic 740, *Income Taxes*, requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. Management considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results. In making such judgments, significant weight is given to evidence that can be objectively verified. The deferred tax assets are analyzed quarterly for changes affecting realization.

There was an $11,172,000 income tax benefit recorded for the year ended December 31, 2016 compared to no tax expense for the year ended December 31 2015. The income tax benefit in 2016 was primarily due to the reversal of an $11,997,000 valuation allowance previously recorded against the net deferred tax asset. This valuation allowance was first recorded in the fourth quarter of 2011 due to the uncertainty of whether or not the Company would be able to realize the asset.

In assessing the Company's ability to realize its net deferred tax asset, management considers whether it is more likely than not that some portion or all of the net deferred tax asset will or will not be realized. The Company's ultimate realization of the net deferred tax asset is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. Management considers the nature and amount of historical and projected future taxable income, the scheduled reversal of deferred tax assets and liabilities, and available tax planning strategies in making this assessment. The amount of net deferred taxes recognized could be impacted by changes to any of these variables.

Each quarter, the Company weighs both the positive and negative information with respect to realization of the net deferred tax asset and analyzes its position as to whether or not a valuation allowance is required. Over the past several quarters, the positive information has been increasing while the negative information has been decreasing. Over the last seven quarters, the Company has demonstrated consistent earnings while its level of non-performing assets, which was the primary cause of the Company's losses, has steadily decreased. Additionally, the Federal Reserve Bank of Richmond (the "Reserve Bank"), the FDIC and the Virginia Bureau of Financial Institutions have terminated their formal agreements with the Company and the Bank, reducing regulatory risk.

Given the consistent earnings and improving asset quality, the Company's analysis concluded that, it is more likely than not that the Company will generate sufficient taxable income within the applicable carry-forward periods to realize its net deferred tax asset. As such, the full valuation allowance of $11,997,000 was released.

The net operating losses available to offset future taxable income amounted to $21,974,000 at December 31, 2016 and begin expiring in 2028; $1,257,000 of such amount is subject to a limitation by Section 382 of the Internal Revenue Code of 1986, as amended, to $908,000 per year.

The income tax expense (benefit) charged to operations for the years ended December 31, 2016, 2015 and 2014 consists of the following (in thousands):

	2016	2015	2014
Current tax expense (benefit)	$ 12	$ -	$ 67
Deferred tax expense (benefit)	813	277	(401)
Valuation allowance	(11,997)	(277)	334
Provision (benefit) for income taxes	$ (11,172)	$ -	$ -

A reconciliation of income taxes computed at the federal statutory income tax rate to total income taxes is as follows for the years ended December 31, 2016, 2015 and 2014 (in thousands):

	2016	2015	2014
Net income (loss) before income taxes	$ 2,341	$ 646	$ (1,037)
Computed "expected" tax expense (benefit)	$ 796	$ 220	$ (352)
Valuation allowance change	(11,997)	(277)	334
State taxes, net of fed	(39)	-	44
Cash surrender value of life insurance	(63)	(62)	(62)
Other	131	119	36
Provision (benefit) for income taxes	$ (11,172)	$ -	$ -

Commercial banking organizations conducting business in Virginia are not subject to Virginia income taxes. Instead, they are subject to a franchise tax based on bank capital. The Company recorded franchise tax expense of approximately $75,000 for the year ended December 31, 2016. Due to the Company's adjusted capital level, we were not subject to franchise tax expense for the years ended December 31, 2015 and 2014.

Note 10. Earnings (loss) per share

The following table presents the basic and diluted earnings per share computations (in thousands except per share data):

	2016	2015	2014
Numerator			
Net income (loss) - basic and diluted	$ 13,513	$ 646	$ (1,037)
Preferred stock dividend and accretion	(737)	(674)	(1,436)
Preferred stock principal forgiveness	-	4,404	-
Preferred stock dividend forgiveness	-	2,215	-
Net income (loss) available to common shareholders	$ 12,776	$ 6,591	$ (2,473)
Denominator			
Weighted average shares outstanding - basic	1,421	1,166	334
Dilutive effect of common stock options and restricted stock awards	-	35	-
Weighted average shares outstanding - diluted	1,421	1,201	334
Earnings (loss) per share - basic	$ 8.99	$ 5.65	$ (7.39)
Earnings (loss) per share - diluted	$ 8.99	$ 5.49	$ (7.39)

Outstanding options and warrants to purchase common stock were considered in the computation of diluted earnings per share for the periods presented. Stock options for 6,830 shares of common stock were not included in computing diluted earnings per share in 2014, because their effects were anti-dilutive. Restricted stock awards for 14,642 shares of common stock were not included in computing diluted earnings per share in 2014 because their effects were also anti-dilutive (see Notes 13 and 14).

Note 11. Lease commitments

Certain premises and equipment are leased under various operating leases. Total rent expense charged to operations was $387,000, $422,000 and $439,000 in 2016, 2015 and 2014, respectively. At December 31, 2016, the minimum total rental commitment under such non-cancelable operating leases was as follows (in thousands):

2017	$	405
2018		283
2019		213
2020		208
2021		64
	$	1,173

Note 12. Commitments and contingencies

Off-balance-sheet risk – The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the financial statements. The contract amounts of these instruments reflect the extent of involvement that the Company has in particular classes of instruments.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit, and to potential credit loss associated with letters of credit issued, is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for loans and other such on-balance sheet instruments.

At December 31, 2016 and 2015, the Company had outstanding the following approximate off-balance-sheet financial instruments whose contract amounts represent credit risk (in thousands):

	Contract Amount 2016	Contract Amount 2015
Undisbursed credit lines	$ 55,315	$ 46,656
Commitments to extend or originate credit	16,467	9,132
Standby letters of credit	4,397	1,484
Total commitments to extend credit	$ 76,179	$ 57,272

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Historically, many commitments expire without being drawn upon; therefore, the total commitment amounts shown in the above table are not necessarily indicative of future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the customer. Collateral held varies but may include personal or income-producing commercial real estate, accounts receivable, inventory and equipment.

Concentrations of credit risk – Generally, the Company's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Company's market area. Although the Company is building a diversified loan portfolio, a substantial portion of its clients' ability to honor contracts is reliant upon the economic stability of the Richmond, Virginia area, including the real estate markets in the area. The concentrations of credit by type of loan are set forth in Note 3. The distribution of commitments to extend credit approximates the distribution of loans outstanding.

Prior Agreements with Regulators – In February 2012, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order with the FDIC and the Virginia Bureau of Financial Institutions (the

“Supervisory Authorities”), and the Supervisory Authorities issued the related Consent Order effective February 3, 2012 (the “Consent Order”). In June 2012, the Company entered into a similar written agreement (the “Written Agreement”) with the Reserve Bank. As a result of the steps the Company and the Bank took to, among other things, improve asset quality, increase capital, augment management and board oversight, and increase earnings, the Consent Order was terminated effective December 14, 2015. In place of the Consent Order, the Bank’s Board of Directors made certain written assurances to the Supervisory Authorities in the form of a Memorandum of Understanding (“MOU”) that became effective November 17, 2015. Due to further improvements by the Company and the Bank in asset quality and earnings, and the correction of a prior Regulation W violation, the MOU was terminated effective May 12, 2016, and the Written Agreement was terminated effective July 28, 2016. With the terminations of the MOU and the Written Agreement, neither the Company nor the Bank is under any formal or informal agreements with its regulators.

IRS Examination – During 2016, the Internal Revenue Service completed an examination of the Company’s federal income tax return for the year ended December 31, 2013. No changes to the return were proposed.

Note 13. Shareholders’ equity and regulatory matters

On May 1, 2009, as part of the Capital Purchase Program (the “TARP Program”) established by the U.S. Department of the Treasury (the “Treasury”) under the Emergency Economic Stabilization Act of 2008, the Company entered into a Letter Agreement and Securities Purchase Agreement—Standard Terms (collectively, the “Purchase Agreement”) with the Treasury, pursuant to which the Company sold (i) 14,738 shares of the Company’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value $4.00 per share, having a liquidation preference of $1,000 per share (the “preferred stock”) and (ii) a warrant (the “Warrant”) to purchase 499,029 shares of the Company’s common stock at an initial exercise price of $4.43 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of $14,738,000 in cash. The fair value of the preferred stock was estimated using discounted cash flow methodology at an assumed market equivalent rate of 13%, with 20 quarterly payments over a five year period, and was determined to be $10,208,000. The fair value of the Warrant was estimated using the Black-Scholes option pricing model, with assumptions of 25% volatility, a risk-free rate of 2.03%, a yield of 6.162% and an estimated life of 5 years, and was determined to be $534,000. The aggregate fair value for both the preferred stock and Warrant was determined to be $10,742,000 with 95% of the aggregate attributable to the preferred stock and 5% attributable to the Warrant. Therefore, the $14,738,000 issuance was allocated with $14,006,000 being assigned to the preferred stock and $732,000 being allocated to the Warrant. The difference between the $14,738,000 face value of the preferred stock and the amount allocated of $14,006,000 to the preferred stock was accreted as a discount on the preferred stock using the effective interest rate method over five years.

The preferred stock qualifies as Tier 1 capital and accrued cumulative dividends at a rate of 5% until May 1, 2014 and now accrues at a 9% rate, unless the shares are redeemed by the Company. The preferred stock is generally non-voting, other than on certain matters that could adversely affect the preferred stock.

The Warrant was immediately exercisable. The Warrant provides for the adjustment of the exercise price and the number of shares of common stock issuable upon exercise pursuant to customary anti-dilution provisions, such as upon stock splits or distributions of securities or other assets to holders of common stock, and upon certain issuances of common stock at or below a specified price relative to the then-current market price of common stock. The Warrant expires ten years from the issuance date. Pursuant to the Purchase Agreement, the Treasury had agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrant.

In November 2013, the Company participated in a successful auction of the Company’s preferred stock by the Treasury that resulted in the purchase of the preferred stock by private and institutional investors.

In accordance with the Company's prior Written Agreement with the Reserve Bank, the Company had been deferring quarterly cash dividends on the preferred stock since May 2011. The Written Agreement was terminated by the Reserve Bank as of July 28, 2016. With the termination of the Written Agreement, the Company is not required to defer the quarterly cash dividends on the preferred stock. At December 31, 2016, the aggregate amount of the Company's total accrued but deferred dividend payments on the preferred stock was $2,815,000 and reflected as a reduction of retained earnings.

Subsequent to December 31, 2016, the Company received approval from state and federal regulators allowing the Bank to pay a special dividend to the Company for the sole purpose of paying all accrued and unpaid dividends on the preferred stock through February 15, 2017, as well as to redeem 688 shares of the total 5,715 shares outstanding. The accrued and unpaid dividends paid on February 15, 2017 amounted to $2,911,000. The 688 shares were redeemed on February 24, 2017 at a redemption price of $1,000 per share plus accrued dividends from February 15, 2017 to the redemption date.

On December 4, 2013, the Company issued 67,907 new shares of common stock through a private placement to directors and executive officers. The sale raised $1,684,075 in new capital for the Company. The $24.80 sale price for the common shares was the stock's book value at September 30, 2013, which represented a 30% premium over the closing price of the stock on December 3, 2013.

On August 6, 2014, the Company filed Articles of Amendment to its Articles of Incorporation with the Virginia State Corporation Commission to effect a reverse stock split of its outstanding common stock which became effective on August 8, 2014. As a result of the reverse split, every sixteen shares of the Company's issued and outstanding common stock were consolidated into one issued and outstanding share of common stock.

On March 27, 2015, the Company completed a rights offering to shareholders (the "Rights Offering") and concurrent standby offering to Kenneth R. Lehman (the "Standby Offering"), in which the Company issued an aggregate of 1,051,866 shares of common stock (the total number of shares offered) at $13.87 per share for aggregate gross proceeds of $14,589,381 (including the value of the Company's common stock of $4,618,813 exchanged for shares of preferred stock by Mr. Lehman). In connection with the Rights Offering, 283,293 shares were issued to shareholders upon exercise of their basic subscription rights and 191,773 shares were issued to shareholders upon exercise of their oversubscription privileges (approximately 36.9% of the total number of shares requested pursuant to oversubscription privileges). In connection with the Standby Offering, Mr. Lehman purchased an aggregate of 576,800 shares of the Company's common stock, 333,007 of which were issued in exchange for 9,023 shares of the Company's preferred stock and 243,793 of which were purchased for cash. Also, as part of the Standby Offering, Mr. Lehman forgave $2,215,009 in accrued and unpaid dividends on the preferred stock.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under the capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures are established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 Capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 Capital to average assets (the Leverage ratio).

Federal regulatory agencies are required by law to adopt regulations defining five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The Bank met the ratio criteria to be categorized as a "well capitalized" institution as of December 31, 2016, 2015 and 2014. However, due to the minimum capital ratios required by the prior Consent Order, the Bank was considered adequately capitalized in 2014. The MOU required the Bank to maintain a leverage ratio of at least 8% and a total capital to risk-weighted assets ratio of at least 12%. Primarily as a result of the Company's Rights Offering and Standby Offering completed on March 27, 2015, the Bank's leverage ratio increased to 9.33% and the total capital to risk-weighted assets ratio was 14.02%, exceeding the ratios required by the MOU. At December 31, 2016, the Bank's Tier 1 risk-based capital ratio was 14.28%, its total risk-based capital ratio was 15.33% and its leverage ratio was 10.47%. When capital falls below the "well capitalized" requirement, consequences can include: new branch approval could be withheld, more frequent examinations by the FDIC; brokered deposits cannot be renewed without a waiver from the FDIC; and other potential limitation as described in FDIC Rules and Regulations sections 337.6 and 303, and Federal Deposit Insurance Act section 29. In addition, the FDIC insurance assessment increases when an institution falls below the "well capitalized" classification.

In July 2013, the Board of Governors of the Federal Reserve System and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (commonly known as Basel III). Under the final rules, which began for the Company and the Bank on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements will increase for both the quantity and quality of capital held by the Company and the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which when fully phased-in, effectively results in a minimum CET1 ratio of 7.0%. Basel III raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital ratio of 8.5% when fully phased-in), effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased-in), and requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance-sheet exposures. Management expects that the capital ratios for the Company and the Bank under Basel III will continue to exceed the well capitalized minimum capital requirements.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy Statement issued February 2015, and is no longer obligated to report consolidated regulatory capital. The Bank continues to be subject to various capital requirements administered by banking agencies. The capital amounts and ratios at December 31, 2016 and 2015 for the Bank are presented in the table below (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016						
Total capital (to risk-weighted assets)						
Village Bank	$ 49,225	15.33%	$ 25,693	8.00%	$ 42,117	10.00%
Tier 1 capital (to risk-weighted assets)						
Village Bank	45,852	14.28%	12,847	4.00%	19,270	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Village Bank	45,852	10.47%	17,523	4.00%	21,903	5.00%
Common equity tier 1 (to risk-weighted assets)						
VillageBank	45,852	14.28%	14,452	4.50%	20,876	6.50%
December 31, 2015						
Total capital (to risk-weighted assets)						
Village Bank	$ 42,695	14.02%	$ 24,369	8.00%	$ 30,461	10.00%
Tier 1 capital (to risk-weighted assets)						
Village Bank	39,133	12.85%	12,184	4.00%	18,277	6.00%
Leverage ratio (Tier 1 capital to average assets)						
Village Bank	39,133	9.33%	16,776	4.00%	20,970	5.00%
Common equity tier 1 (to risk-weighted assets)						
VillageBank	39,133	12.85%	13,707	4.50%	15,231	6.50%

Note 14. Stock incentive plan

In accordance with accounting standards, the Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions). That cost is recognized over the period during which an employee is required to provide service in exchange for the award rather than disclosed in the financial statements.

The following table summarizes options outstanding under the stock incentive plan at the indicated dates:

	2016				2015			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	2,929	$ 24.47	$ 12.71		6,830	$ 92.34	$ 57.97	
Granted	-	-	-		-	-	-	
Forfeited	(592)	25.48	12.53		(3,901)	168.79	95.85	
Exercised	-	-	-		-	-	-	
Options outstanding, end of period	2,337	$ 24.21	$ 12.76	$ -	2,929	$ 24.47	$ 12.71	$ -
Options exercisable, end of period	2,337				1,730			

Year Ended December 31,

	2014			
	Options	Weighted Average Exercise Price	Fair Value Per Share	Intrinsic Value
Options outstanding, beginning of period	6,210	$ 99.03	$ 64.96	
Granted	884	25.28	15.52	
Forfeited	(264)	25.28	80.33	
Exercised	-	-	-	
Options outstanding, end of period	6,830	$ 92.34	$ 57.97	$ -
Options exercisable, end of period	5,318			

The following table summarizes information about stock options outstanding at December 31, 2016:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Options	Weighted Average Remaining Years of Contractual Life	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
$16.00-$25.76	2,337	6.06	$ 24.21	2,337	$ 24.21
	2,337	6.06	24.21	2,337	24.21

During the second quarter of 2016, we granted certain officers 4,000 performance based shares of common stock with a weighted average fair market value of $20.00 at the date of grant. These restricted stock awards vest over two years. During the third quarter of 2016, we granted certain officers 6,250 restricted shares of common stock with a weighted average fair market value of $22.50

at the date of grant. These restricted stock awards have a three-year graded vesting. During the third quarter of 2015, we granted certain officers 40,675 restricted shares of common stock with a weighted average fair market value of $19.72 at the date of grant. Prior to vesting, these shares are subject to forfeiture to us without consideration upon termination of employment under certain circumstances. The total number of shares underlying non-vested restricted stock was 39,080 and 47,893 at December 31, 2016 and 2015, respectively.

The fair value of the stock is calculated under the same methodology as stock options and the expense is recognized over the vesting period. Unamortized stock-based compensation related to non-vested share based compensation arrangements granted under the Incentive Plan as of December 31, 2016 and 2015 was $697,000 and $514,000, respectively. The time based unamortized compensation of $374,000 is expected to be recognized over a weighted average period of 1.79 years. During 2016 there were forfeitures of 3,399 shares of restricted stock awards. There were no forfeitures of restricted stock awards in 2015 and 2014.

A summary of changes in the Company's nonvested restricted stock awards for the year follows:

	Shares	Weighted-Average Grant-Date Fair-Value	Aggregate Intrinsic Value
December 31, 2015	47,893	$ 20.82	$1,278,733
Granted	10,850	21.88	289,695
Vested	(16,264)	20.85	(434,257)
Forfeited	(3,399)	(21.53)	(90,727)
December 31, 2016	39,080	$ 21.04	$1,043,444

Stock-based compensation expense was $213,000, $262,000, and $131,000 for the years ended December 31, 2016, 2015, and 2014, respectively.

Note 15. Trust preferred securities

During the first quarter of 2005, Southern Community Financial Capital Trust I, a wholly-owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On February 24, 2005, $5.2 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have a LIBOR-indexed floating rate of interest (three-month LIBOR plus 2.15%) which adjusts, and is payable, quarterly. The interest rate was 3.13% and 2.69% at December 31, 2016 and 2015, respectively. The securities were redeemable at par beginning on March 15, 2010 and each quarter after such date until the securities mature on March 15, 2035. No amounts have been redeemed at December 31, 2016 and there are no plans to do so. The principal asset of the Trust is $5.2 million of the Company's junior subordinated debt securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

During the third quarter of 2007, Village Financial Statutory Trust II, a wholly–owned subsidiary of the Company, was formed for the purpose of issuing redeemable securities. On September 20, 2007, $3.6 million of Trust Preferred Capital Notes were issued through a pooled underwriting. The securities have LIBOR-indexed floating rate of interest (three-month LIBOR plus 1.4%) which adjusts and is also payable quarterly. The interest rate at December 31, 2016 was 2.38%. The securities may be redeemed at par at any time commencing in December 2012 until the securities mature in 2037. No amounts have been redeemed at December 31, 2016 and there are no plans to do so. The principal asset of the Trust is $3.6 million of the Company's junior subordinated securities with like maturities and like interest rates to the Trust Preferred Capital Notes.

The Trust Preferred Capital Notes may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred Capital Notes not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of the Company with respect to the issuance of the Trust Preferred Capital Notes constitute a full and unconditional guarantee by the Company of the Trust's obligations with respect to the Trust Preferred Capital Notes. Subject to certain exceptions and limitations, the Company may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related Trust Preferred Capital Notes and require a deferral of common dividends. The Company is current on these interest payments.

Note 16. Retirement plans

401K Plan: The Bank provides a qualified 401K plan to all eligible employees which is administered through the Virginia Bankers Association Benefits Corporation. Employees are eligible to participate in the plan after three months of employment. Eligible employees may, subject to statutory limitations, contribute a portion of their salary to the plan through payroll deduction. Due to the recent economic conditions the Bank ceased its matching program in 2009 however beginning January 2013 the Bank reinstituted the 401K match. The Bank provided a matching contribution of $.50 for every $1.00 the participant contributes up to the first 4% of their salary. Participants are fully vested in their own contributions and vest equally over three years of service in the Bank's matching contributions. Total contributions to the plan for the years ended December 31, 2016, 2015 and 2014 were $164,000, $159,000 and $150,000, respectively.

Amendment to Village Bank Supplemental Executive Retirement Plan

On July 9, 2016, the Bank amended its supplemental executive retirement plan to provide that the participants' benefits will vest upon a change of control of the Bank. The plan previously provided that a participant's benefits would vest upon a change of control only if the participant experienced a qualifying termination of employment within 12 months after the change of control.

Supplemental Executive Retirement Plan: The Bank established the Village Bank Supplemental Executive Retirement Plan (the "SERP") on January 1, 2005 to provide supplemental retirement income to certain executive officers as designated by the Personnel Committee, later replaced by the Compensation Committee, and approved by the board of directors. While we are subject to the regulatory agreements, the respective regulatory agencies also review and approve new participants or changes in benefits under the SERP. The SERP is an unfunded employee pension plan under the provisions of ERISA. An eligible employee, once designated by the Committee and approved by the board of directors in writing to participate in the SERP, becomes a participant in the SERP 60 days following such approval (unless an earlier participation date is approved). There are currently five executive officers who participate in the SERP. The retirement benefit to be received by a participant is determined by the Committee and approved by the board of directors and is payable in equal monthly installments over the period specified in the SERP for each respective participant, commencing on the first day of the month following a participant's retirement or termination of employment, provided the participant has been employed by the Bank for a minimum of 10 years. The Compensation Committee, in its sole discretion, may choose to treat a participant who has experienced a termination of employment on or after attaining age 65 but prior to completing his service requirement as having completed his service requirement. At December 31, 2016 and 2015, the Bank's liability under the SERP was $2,064,000 and $1,972,000, respectively, and expense for the years ended December 31, 2016, 2015 and 2014 was $168,000, $201,000 and $257,000, respectively. The increase in cash surrender value of the BOLI related to the participants was $183,000 and $182,000 for the years ended December 31, 2015 and 2014, respectively, while the cash surrender value decreased in 2016 by $37,000. The cash surrender value decreased in 2016 due to proceeds from bank owned life insurance claim of $266,000.

Directors' Deferral Plan: The Bank established the Village Bank Outside Directors Deferral Plan (the "Directors Deferral Plan") on January 1, 2005 under which non-employee directors of Village Bank have the opportunity to defer receipt of all or a portion of certain compensation until retirement or departure from the board of directors. Deferral of compensation under the Directors Deferral Plan is voluntary by non-employee directors and to participate in the plan a director must file a deferral election as provided in the plan. A director shall become an active participant with respect to a plan year (as defined in the plan) only if he is expected to have compensation during the plan year and he timely files a deferral election. A separate account is established for each participant in the plan and each account shall, in addition to compensation deferred at the election of the participant, be credited with interest on the balance of the account, the rate of such interest to be established by the board of directors in its sole discretion at the beginning of each plan year. For those directors electing to purchase stock, the obligation will only be settled by delivery of the fixed number of shares they purchased. At December 31, 2016 and 2015, the Bank's liability under the Directors Deferral Plan was $166,000 and $82,000, respectively, and expense for the years ended December 31, 2016, 2015 and 2014 was $89,000, $87,000 and $123,000, respectively. In the first quarter of 2015 and the fourth quarter of 2013 certain directors elected to purchase common stock with funds from their deferred compensation accounts causing the December 31, 2015 and December 31, 2103 liability to be lower than the December 31, 2014 liability. A rabbi trust was established to hold the shares. At December 31, 2016 and 2015, the trust held 48,055 shares of Company common stock totaling $1,034,382.

Note 17. Fair Value

Effective January 1, 2008, the Company adopted the provisions of FASB Codification Topic 820: *Fair Value Measurements* which defines fair value, establishes a framework for measuring fair value under U.S GAAP, and expands disclosures about fair value measurements.

FASB Codification Topic 820: *Fair Value Measurements and Disclosures* establishes a hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair values hierarchy is as follows:

- *Level 1 Inputs*— Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

- *Level 2 Inputs* — Significant other 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.

- *Level 3 Inputs* - Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods to determine the fair value of each type of financial instrument:

Securities: Fair values for securities available-for-sale are obtained from an independent pricing service. The prices are not adjusted. The independent pricing service uses industry-standard models to price U.S. Government agency obligations and mortgage backed securities that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace (Levels 1 and 2).

Impaired loans: The fair values of impaired loans are measured for impairment using the fair value of the collateral for collateral-dependent loans on a nonrecurring basis. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or when economic or other circumstances dictate a need to obtain an updated appraisal of the property, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Operations.

Real estate owned: Real estate owned assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, real estate owned assets are carried at fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Assets held for sale: assets held for sale were transferred from premises and equipment at cost less accumulated depreciation at the date of transfer. The Company periodically evaluates the value of assets held for sale and records an impairment charge for any subsequent declines in fair value less selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the assets held for sale as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the asset held for sale as nonrecurring Level 3.

Assets measured at fair value under Topic 820 on a recurring and non-recurring basis are summarized below (in thousands):

		Fair Value Measurement at December 31, 2016 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets - Recurring				
US Government Agencies	$ 32,246	2,103	30,143	-
Mortgage-backed securities	11,648	9,450	2,198	-
Financial Assets - Non-Recurring				
Impaired loans	15,441	-	14,467	974
Assets held for sale	841	-	-	841
Real estate owned	2,926	-	2,926	-

	Fair Value Measurement at December 31, 2015 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets - Recurring				
US Government Agencies	$ 33,713	3,307	30,406	-
Mortgage-backed securities	3,001	-	3,001	-
Municipals	1,205	-	1,205	-
			-	
Financial Assets - Non-Recurring				
Impaired loans	20,509	-	18,862	1,647
Assets held for sale	12,631		-	12,631
Real estate owned	6,249	-	6,190	59

The following table presents qualitative information about Level 3 fair value measurements for financial instruments for the years ended December 31, 2016 and 2015 (dollars in thousands):

	December 31, 2016			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
	(In thousands)			
Impaired loans - real estate secured	$ 517	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (10%)
Impaired loans - non-real estate secured	$ 457	Appraisal (1) or Discounted Cash Flow	Selling costs	10%
			Discount for lack of marketability or practical life	0%-50% (20%)
Real estate owned	$ -	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (15%)
Assets held for sale	$ 841	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (15%)

	December 31, 2015			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
	(In thousands)			
Impaired loans - real estate secured	$ 1,042	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (10%)
Impaired loans - non-real estate secured	$ 605	Appraisal (1) or Discounted Cash Flow	Selling costs	10%
			Discount for lack of marketability or practical life	0%-50% (20%)
Real estate owned	$ 59	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (15%)
Assets held for sale	$ 12,631	Appraisal (1) or Internal Valuation (2)	Selling costs	6%-10% (7%)
			Discount for lack of marketability and age of appraisal	6%-30% (15%)

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally included various level 3 inputs which are not identifiable.

(2) Internal valuations may be conducted to determine Fair Value for assets with nominal carrying balances.

The following table presents the changes in the Level 3 fair value category for the years ended December 31, 2016 and 2015 (in thousands):

	Impaired Loans	Real Estate Owned	Assets Held for Sale	Total Assets
Balance at December 31, 2014	$ 2,263	$ 1,337	$ 11,743	$ 15,343
Total realized and unrealized gains (losses)				
Included in earnings	-	142	-	142
Included in other comprehensive income	-	-	-	-
Net transfers in and/or out of Level 3	(616)	(1,420)	888	(1,148)
Balance at December 31, 2015	$ 1,647	$ 59	$ 12,631	$ 14,337
Total realized and unrealized gains (losses)				
Included in earnings	-	15	-	15
Included in other comprehensive income	-	-	-	-
Net transfers in and/or out of Level 3	(673)	(74)	(11,790)	(12,537)
Balance at December 31, 2016	$ 974	$ -	$ 841	$ 1,815

In general, fair value of securities is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon market prices determined by an outside, independent entity that primarily uses as inputs, observable market-based parameters. Fair value of loans held for sale is based upon internally developed models that primarily use as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Company's creditworthiness, among other things, as well as unobservable parameters.

Any such valuation adjustments are applied consistently over time. The Company valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's monthly and or quarter valuation process.

Cash and cash equivalents – The carrying amount of cash and cash equivalents approximates fair value.

Investment securities – The fair value of investment securities held-to-maturity and available-for-sale is estimated based on quoted prices for similar assets or liabilities determined by bid quotations received from independent pricing services. The carrying amount of other investments approximates fair value.

Loans – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. For all other loans, fair values are calculated by discounting the contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loans, or by using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Assets held for sale – The carrying value of assets held for sale is based on fair value less selling costs. Fair values for assets held for sale are estimated based on appraised values of the asset or management's estimation of the value of the assets.

Deposits – The fair value of deposits with no stated maturity, such as demand, interest checking and money market, and savings accounts, is equal to the amount payable on demand at year-end. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowings – The fair value of borrowings is based on the discounted value of contractual cash flows using the rates currently offered for borrowings of similar remaining maturities.

Accrued interest – The carrying amounts of accrued interest receivable and payable approximate fair value.

	Level in Fair Value Hierarchy	December 31, 2016 Carrying Value	December 31, 2016 Estimated Fair Value	December 31, 2015 Carrying Value	December 31, 2015 Estimated Fair Value
			(In thousands)		
Financial assets					
Cash	Level 1	$ 10,848	$ 10,848	$ 17,076	$ 17,076
Cash equivalents	Level 2	948	948	186	186
Investment securities available for sale	Level 1	11,553	11,553	3,307	3,307
Investment securities available for sale	Level 2	32,341	32,341	34,612	34,612
Federal Home Loan Bank stock	Level 2	512	512	685	685
Loans held for sale	Level 2	14,784	14,784	14,373	14,373
Loans	Level 2	321,659	310,337	286,262	274,230
Impaired loans	Level 2	14,467	14,467	18,862	18,862
Impaired loans	Level 3	974	974	1,647	1,647
Assets held for sale	Level 3	841	841	12,631	12,631
Other real estate owned	Level 2	2,926	2,926	6,190	6,190
Other real estate owned	Level 3	-	-	59	59
Bank owned life insurance	Level 3	7,093	7,093	7,130	7,130
Accrued interest receivable	Level 2	2,274	2,274	2,060	2,060
Financial liabilities					
Deposits	Level 2	383,277	383,985	364,848	365,294
FHLB borrowings	Level 2	2,400	2,402	6,000	6,004
Trust preferred securities	Level 2	8,764	8,565	8,764	8,984
Other borrowings	Level 2	81	81	508	508
Accrued interest payable	Level 2	70	70	1,346	1,346

Note 18. Segment Reporting

In previous reports, the Company concluded that it had one operating and reportable segment, “Community Banking”. This conclusion was based on the fact that the Company’s activities are interrelated, and each activity is dependent and assessed based on how each of the activities supports the others. The Company has re-assessed its segment reporting and decided to report two segments: traditional commercial banking and mortgage banking, as management has changed the information it reviews to make decisions. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the commercial banking segment’s cost of funds. Additionally, the mortgage banking segment leases premises from the commercial banking segment. These transactions are eliminated in the consolidation process.

The following table presents segment information as of and for the years ended December 31, 2016, 2015 and 2014. (in thousands):

Year Ended December 31, 2016	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Revenues				
Interest income	$ 15,636	$ 470	$ (117)	$ 15,989
Gain on sale of loans	-	6,430	-	6,430
Other revenues	3,868	742	(190)	4,420
Total revenues	19,504	7,642	(307)	26,839
Expenses				
Interest expense	2,609	117	(117)	2,609
Salaries and benefits	7,702	3,593	-	11,295
Commissions	-	1,606	-	1,606
Other expenses	8,088	1,090	(190)	8,988
Total operating expenses	18,399	6,406	(307)	24,498
Income before income taxes	$ 1,105	$ 1,236	$ -	$ 2,341
Total assets	$ 448,373	$ 10,026	$ (13,597)	$ 444,802

Year Ended December 31, 2015	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Revenues				
Interest income	$ 15,165	$ 446	$ (107)	$ 15,504
Gain on sale of loans	-	6,076	-	6,076
Other revenues	3,473	749	(240)	3,982
Total revenues	18,638	7,271	(347)	25,562
Expenses				
Interest expense	2,877	107	(117)	2,867
Salaries and benefits	7,346	3,500	-	10,846
Commissions	-	1,555	-	1,555
Other expenses	8,787	1,091	(230)	9,648
Total operating expenses	19,010	6,253	(347)	24,916
Income (loss) before income taxes	$ (372)	$ 1,018	$ -	$ 646
Total assets	$ 426,038	$ 8,806	$ (14,903)	$ 419,941

Year Ended December 31, 2014	Commercial Banking	Mortgage Banking	Eliminations	Consolidated Totals
Revenues				
Interest income	$ 16,287	$ 347	$ (56)	$ 16,578
Gain on sale of loans	-	4,449	-	4,449
Other revenues	3,078	706	(344)	3,440
Total revenues	19,365	5,502	(400)	24,467
Expenses				
Interest expense	3,561	55	(56)	3,560
Salaries and benefits	7,454	3,231	-	10,685
Commissions	-	1,165	-	1,165
Other expenses	9,237	1,201	(344)	10,094
Total operating expenses	20,252	5,652	(400)	25,504
Income (loss) before income taxes	$ (887)	$ (150)	$ -	$ (1,037)
Total assets	$ 435,046	$ 8,081	$ (9,123)	$ 434,004

Note 19. Parent corporation only financial statements

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Balance Sheet
(in thousands)

	December 31, 2016	December 31, 2015
Assets		
Cash and due from banks	$ 1,770	$ 3,494
Investment in subsidiaries	50,230	38,665
Investment in special purpose subsidiary	264	264
Prepaid expenses and other assets	2,935	45
	$ 55,199	$ 42,468
Liabilities and Shareholders' Equity		
Liabilities		
Balance due to nonbank subsidiaries	$ 8,764	$ 8,764
Other liabilities	2,821	3,345
Total liabilities	11,585	12,109
Shareholders' equity		
Preferred stock	23	23
Common stock	5,629	5,562
Additional paid-in capital	58,643	58,497
Warrant surplus	732	732
Accumulated deficit	(21,172)	(33,948)
Stock in directors rabbi trust	(1,034)	(1,034)
Directors deferred fees obligation	1,034	1,034
Accumulated other comprehensive loss	(241)	(507)
Total stockholders' equity	43,614	30,359
	$ 55,199	$ 42,468

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Statements of Operations and Comprehensive Income (Loss)
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Interest income			
Village Bank money market	$ 8	$ 10	$ 1
Interest expense			
Interest on trust preferred securities	185	213	215
Total interest expense	185	213	215
Net interest expense	(177)	(203)	(214)
Noninterest expense			
Write down of assets held for sale	-	1,759	-
Supplies	48	48	54
Professional and outside services	199	412	53
Other	33	52	52
Total noninterest expense	280	2,271	159
Net loss before undistributed income (loss) of subsidiary	(457)	(2,474)	(373)
Undistributed income (loss) of subsidiary	11,087	3,120	(664)
Net income (loss) before income tax expense (benefit)	10,630	646	(1,037)
Income tax expense (benefit)	(2,883)	-	-
Net income (loss)	$ 13,513	$ 646	$ (1,037)
Total comprehensive income	$ 13,779	$ 860	$ 2,080

Village Bank and Trust Financial Corp.
(Parent Corporation Only)
Condensed Statements of Cash Flows
Years Ended December 31, 2016, 2015 and 2014
(in thousands)

	2016	2015	2014
Cash Flows from Operating Activities			
Net income (loss)	$ 13,513	$ 646	$ (1,037)
Adjustments to reconcile net income (loss) to net cash used in operating activities			
Writedown on assets held for sale	-	1,759	-
Undistributed (income) loss of subsidiary	(11,087)	(3,120)	664
(Increase) decrease in other assets	(2,890)	258	(239)
Increase (decrease) in other liabilities	(1,260)	(19)	247
Net cash used in operating activities	(1,724)	(476)	(365)
Cash Flows from Investing Activities			
Investment in subsidiary	-	(5,000)	-
Net cash used in investing activities	-	(5,000)	-
Cash Flows from Financing Activities			
Proceeds from issuance of common stock	-	(79)	(11)
Net proceeds from sale of common stock, net of expenses of $990	-	8,965	-
Net cash provided by (used in) financing activities	-	8,886	(11)
Net increase (decrease) in cash	(1,724)	3,410	(376)
Cash, beginning of year	3,494	84	460
Cash, end of year	$ 1,770	$ 3,494	$ 84

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that as of December 31, 2016, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and regulations and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Company's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Company or its subsidiaries to disclose material information otherwise required to be set forth in the Company's periodic reports.

Management's Report on Internal Control over Financial Reporting. Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance to the Company's management and board of directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework (2013)*. Based on our assessment, we believe that, as of December 31, 2016, the Company's internal control over financial reporting was effective based on those criteria.

*Changes in Internal Control Over Financial Reporting***.** There has been no change in the Company's internal control over financial reporting during the fourth quarter of the fiscal year ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required to be disclosed in this Item 10 is contained in the Company's Proxy Statement for the 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required to be disclosed in this Item 11 is contained in the Company's Proxy Statement for the 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required to be disclosed in this Item 12 is contained in the Company's Proxy Statement for the 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required to be disclosed in this Item 13 is contained in the Company's Proxy Statement for the 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required to be disclosed in this Item 14 is contained in the Company's Proxy Statement for the 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements
The following consolidated financial statements and reports are included in Part II, Item 8, of this report on Form 10K.

Report of Independent Registered Public Accounting Firm (BDO USA, LLP)
Consolidated Balance Sheets – December 31, 2016 and 2015
Consolidated Statements of Operations – Years Ended December 31, 2016, 2015 and 2014
Consolidated Statements of Shareholders' Equity – Years Ended December 31, 2016, 2015 and 2014
Consolidated Statements of Comprehensive Income – Years Ended December 31, 2016, 2015 and 2014
Consolidated Statements of Cash Flows – Years Ended December 31, 2016, 2015 and 2014
Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules
All schedules are omitted since they are not required, are not applicable, or the required information is shown in the consolidated financial statements or notes thereto.

(a)(3) Exhibits
The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

Exhibit Number	Description
3.1	Articles of Incorporation of Village Bank and Trust Financial Corp., as amended (incorporated herein by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q for the period ended September 30, 2014, filed with the SEC on October 31, 2014).
3.2	Amended and Restated Bylaws of Village Bank and Trust Financial Corp. (incorporated herein by reference to Exhibit 3.2 of the Current Report on Form 8-K, filed with the SEC on March 27, 2015).
4.1	Specimen of Certificate for Village Bank and Trust Financial Corp. common stock (incorporated by reference to Exhibit 4.1 of the Form S-1 Registration Statement filed with the Securities and Exchange Commission on November 12, 2014 (SEC File No. 333-200147)).
4.2	Form of Certificate for Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).
4.3	Warrant to Purchase Shares of Common Stock, dated May 1, 2009 (incorporated by reference to Exhibit 4.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).
10.1	Employment Agreement, dated August 8, 2013, by and between Village Bank and Trust Financial Corp. and William G. Foster (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on August 19, 2013).*

10.2	Employment Agreement, dated January 6, 2017, by and between Village Bank and Trust Financial Corp. and C. Harril Whitehurst, Jr. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on January 9, 2017).*
10.3	Employment Agreement, dated April 5, 2016, by and between Village Bank and James E. Hendricks, Jr. (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 8, 2016).*
10.4	Employment Agreement, dated April 5, 2016, by and between Village Bank and Max C. Morehead, Jr. (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on April 8, 2016).*
10.5	Employment Agreement, dated January 24, 2017, by and between Village Bank Mortgage Corporation and George Karousos.*
10.6	Incentive Plan, as amended June 18, 2014 (incorporated by reference to Exhibit 99.1 of the Form S-8 Registration Statement filed with the Securities and Exchange Commission on June 18, 2014 (SEC File No. 333-196893)).*
10.7	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.5 of the Annual Report on Form 10-KSB for the year ended December 31, 2004).*
10.8	Form of Non-Employee Director Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.6 of the Annual Report on Form 10-KSB for the year ended December 31, 2004).*
10.9	Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (incorporated herein by reference to Exhibit 99.0 of the Registration Statement on Form S-8 filed with the Securities and Exchange Commission on July 1, 2015 (SEC File No. 333-205407)).*
10.10	Form of Performance-Based Restricted Stock Unit Award Agreement under the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 8, 2015).*
10.11	Form of Time-Based Restricted Stock Award Agreement under the Village Bank and Trust Financial Corp. 2015 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 8, 2015).*
10.12	Outside Directors Deferral Plan, dated January 1, 2005 (incorporated by reference to Exhibit 10.9 of the Annual Report on Form 10-K for the year ended December 31, 2010).*
10.13	Supplemental Executive Retirement Plan, dated January 1, 2005 (incorporated by reference to Exhibit 10.10 of the Annual Report on Form 10-K for the year ended December 31, 2010).*
10.14	Standby Purchase Agreement, dated November 11, 2014, between Village Bank and Trust Financial Corp. and Kenneth R. Lehman (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on November 12, 2014).

10.15	Letter Agreement, dated as of May 1, 2009, by and between Village Bank and Trust Financial Corp. and the United States Department of the Treasury (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).
10.16	Side Letter Agreement, dated as of May 1, 2009, by and between Village Bank and Trust Financial Corp. and the United States Department of the Treasury (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).
10.17	Form of Senior Executive Officer Waiver (incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).*
10.18	Form of Senior Executive Officer Consent Letter (incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on May 6, 2009).*
10.19	Stipulation and Consent to the Issuance of a Consent Order (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 9, 2012).
10.20	Consent Order (incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on February 9, 2012).
10.21	Written Agreement by and between Village Bank and Trust Financial Corp. and the Federal Reserve Bank of Richmond (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed with the Securities and Exchange Commission on July 2, 2012).
21	Subsidiaries of Village Bank and Trust Financial Corp.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Section 302 Certification by Chief Executive Officer.
31.2	Section 302 Certification by Chief Financial Officer.
32	Section 906 Certification.
101	The following materials from the Village Bank and Trust Financial Corp. Annual Report on Form 10-K for the year ended December 31, 2016 formatted in eXtensible Business Reporting (XBRL) (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Shareholders' Equity, (v) Consolidated Statements of Cash Flows, and (vi) Notes to Condensed Consolidated Financial Statements.

* Management contracts and compensatory plans and arrangements.

ITEM 16. FORM 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

VILLAGE BANK AND TRUST FINANCIAL CORP.

Date: March 31, 2017

By /s/ William G. Foster, Jr.
William G. Foster, Jr.
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ William G. Foster Jr._ William G. Foster, Jr.	President, Chief Executive Officer and Director (Principal Executive Officer)	March 31, 2017
/s/ C. Harril Whitehurst, Jr._ C. Harril Whitehurst, Jr.	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2017
/s/ R.T. Avery, III R.T. Avery, III	Director	March 31, 2017
/s/ Craig D. Bell_ Craig D. Bell	Director and Chairman of the Board	March 31, 2017
/s/ William B. Chandler_ William B. Chandler	Director	March 31, 2017
/s/ O. Woodland Hogg, Jr._ O. Woodland Hogg, Jr.	Director	March 31, 2017
/s/ Michael A. Katzen Michael A. Katzen	Director	March 31, 2017
/s/ Charles E. Walton_ Charles E. Walton	Director	March 31, 2017

Signature	Title	Date
/s/ John T. Wash, Sr._ John T. Wash, Sr.	Director	March 31, 2017
/s/ George R. Whittemore George R. Whittemore	Director	March 31, 2017
/s/ Thomas W. Winfree Thomas W. Winfree	Director	March 31, 2017
/s/ Michael L. Toalson_ Michael L. Toalson	Director	March 31, 2017
/s/ Kenneth Lehman Kenneth R. Lehman	Director	March 31, 2017

Exhibit 21

Subsidiaries of Village Bank and Trust Financial Corp.

Name of Subsidiary	State of Organization
Village Bank	Virginia
Village Bank Mortgage Corporation (wholly-owned subsidiary of Village Bank)	Virginia
Village Insurance Agency, Inc. (wholly-owned subsidiary of Village Bank)	Virginia
Village Financial Services Corporation (wholly-owned subsidiary of Village Bank)	Virginia
Southern Community Financial Capital Trust I	Virginia
Village Financial Statutory Trust II	Virginia

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

Board of Directors
Village Bank and Trust Financial Corp.
Midlothian, Virginia

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-3 and S-8 (Nos. 333-159594, 333-192408, 333-196893, and 333-205407) of Village Bank and Trust Financial Corp. of our report dated March 31, 2017, relating to the consolidated financial statements, which appear in this Annual Report on Form 10-K for the year ended December 31, 2016.

/s/ BDO USA, LLP

Richmond, Virginia
March 31, 2017

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, William G. Foster, Jr., certify that:

1. I have reviewed this Annual Report on Form 10-K of Village Bank and Trust Financial Corp. for the year ended December 31, 2016;

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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-a5(f)) for the registrant and have:

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

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

   (c) Evaluated the effectiveness of the 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 and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: March 31, 2017

By: /s/ William G. Foster, Jr.
William G. Foster, Jr.
President and
Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, C. Harril Whitehurst, Jr., certify that:

1. I have reviewed this Annual Report on Form 10-K of Village Bank and Trust Financial Corp. for the year ended December 31, 2016;

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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-a5(f)) for the registrant and have:

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

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

   (c) Evaluated the effectiveness of the 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 and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: March 31, 2017

By: /s/ C. Harril Whitehurst, Jr.
C. Harril Whitehurst, Jr.
Executive Vice President and
Chief Financial Officer

Exhibit 32

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

In connection with the Annual Report of Village Bank and Trust Financial Corp. (the "Company") on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on their knowledge and belief:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

/s/ William G. Foster, Jr. William G. Foster, Jr. President and Chief Executive Officer	March 31, 2017 Date
/s/ C. Harril Whitehurst, Jr. C. Harril Whitehurst, Jr. Executive Vice President and Chief Financial Officer	March 31, 2017 Date

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