

OLD POINT FINANCIAL CORP  
Form 10-Q  
May 10, 2018  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934  
For the quarterly period ended March 31, 2018

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-12896

OLD POINT FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

VIRGINIA 54-1265373  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1 West Mellen Street, Hampton, Virginia 23663  
(Address of principal executive offices) (Zip Code)

(757) 728-1200  
(Registrant's telephone number, including area code)

Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

5,095,069 shares of common stock (\$5.00 par value) outstanding as of April 30, 2018

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OLD POINT FINANCIAL CORPORATION

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GLOSSARY OF DEFINED TERMS

ALLL	Allowance for Loan and Lease Losses
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bank	The Old Point National Bank of Phoebus
CET1	Common Equity Tier 1
Citizens Company	Citizens National Bank Old Point Financial Corporation
CRA	Community Reinvestment Act
ESPP	Employee Stock Purchase Plan
EVE	Economic Value of Equity
FASB	Financial Accounting Standards Board
FHLB	Federal Home Loan Bank
FOMC	Federal Open Market Committee
Federal Reserve	Board of Governors of the Federal Reserve System
FRB	Federal Reserve Bank
GAAP	Generally Accepted Accounting Principles
Incentive Stock Plan	Old Point Financial Corporation 2016 Incentive Stock Plan
IRS	Internal Revenue Service
OAEM	Other Assets Especially Mentioned
OCC	Office of the Comptroller of the Currency
OPM	Old Point Mortgage
OREO	Other Real Estate Owned
SEC	Securities and Exchange Commission
TDR	Troubled Debt Restructuring
Trust	Old Point Trust & Financial Services N.A.
VIE	Variable Interest Entities

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Balance Sheets

	March 31, 2018	December 31, 2017
	(dollars in thousands except per share data) (unaudited) *	
Assets		
Cash and due from banks	\$37,019	\$13,420
Interest-bearing due from banks	3,866	908
Federal funds sold	2,552	84
Cash and cash equivalents	43,437	14,412
Securities available-for-sale, at fair value	145,857	157,121
Restricted securities, at cost	4,023	3,846
Loans held for sale	715	779
Loans, net	723,144	729,092
Premises and equipment, net	36,754	37,197
Bank-owned life insurance	26,190	25,981
Goodwill	621	621
Other real estate owned, net	203	-
Other assets	12,829	12,777
Total assets	\$993,773	\$981,826
Liabilities & Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	\$231,345	\$225,716
Savings deposits	349,881	345,053
Time deposits	207,801	212,825
Total deposits	789,027	783,594
Federal funds purchased	-	10,000
Overnight repurchase agreements	36,141	20,693
Federal Home Loan Bank advances	70,000	67,500
Accrued expenses and other liabilities	3,607	3,651
Total liabilities	898,775	885,438
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$5 par value, 10,000,000 shares authorized; 5,020,784 and 5,019,703 shares outstanding (includes 2,245 shares of nonvested restricted stock)	25,093	25,087
Additional paid-in capital	17,298	17,270

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Retained earnings	55,344	54,738
Accumulated other comprehensive loss, net	(2,737 )	(707 )
Total stockholders' equity	94,998	96,388
Total liabilities and stockholders' equity	\$993,773	\$981,826

See Notes to Consolidated Financial Statements.

\* Derived from audited Consolidated Financial Statements

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Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Income

	Three Months Ended March 31,	
	2018	2017
	(unaudited, dollars in thousands except per share data)	
<b>Interest and Dividend Income:</b>		
Interest and fees on loans	\$7,895	\$6,780
Interest on due from banks	4	5
Interest on federal funds sold	2	3
<b>Interest on securities:</b>		
Taxable	494	496
Tax-exempt	344	427
Dividends and interest on all other securities	60	14
Total interest and dividend income	8,799	7,725
<b>Interest Expense:</b>		
Interest on savings deposits	104	64
Interest on time deposits	616	519
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	10	5
Interest on Federal Home Loan Bank advances	324	-
Total interest expense	1,054	588
Net interest income	7,745	7,137
Provision for loan losses	525	650
Net interest income, after provision for loan losses	7,220	6,487
<b>Noninterest Income:</b>		
Fiduciary and asset management fees	983	966
Service charges on deposit accounts	870	927
Other service charges, commissions and fees	1,067	1,016
Bank-owned life insurance income	209	198
Mortgage banking income	141	6
Gain on sale of available-for-sale securities, net	80	-
Other operating income	5	50
Total noninterest income	3,355	3,163
<b>Noninterest Expense:</b>		
Salaries and employee benefits	5,477	5,097
Occupancy and equipment	1,477	1,449
Data processing	516	414
FDIC insurance	191	96
Customer development	182	144
Professional services	488	373
Employee professional development	192	236
Loan related expenses	126	60
Other taxes	170	143
ATM and other losses	97	177



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Merger expenses	205	-
Other operating expenses	508	517
Total noninterest expense	9,629	8,706
Income before income taxes	946	944
Income tax expense	4	2
Net income	\$942	\$942
Basic earnings per share:		
Weighted average shares outstanding	5,020,075	4,977,267
Net income per share of common stock	\$0.19	\$0.19
Diluted earnings per share:		
Weighted average shares outstanding	5,020,146	4,991,864
Net income per share of common stock	\$0.19	\$0.19

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
 Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended March 31, 2018    2017 (unaudited, in thousands)	
Net income	\$942	\$942
Other comprehensive income (loss), net of tax		
Net unrealized gain (loss) on available-for-sale securities	(1,751)	428
Reclassification for (gain) loss included in net income	(63 )	-
Other comprehensive income (loss), net of tax	(1,814)	428
Comprehensive income (loss)	\$(872 )	\$1,370

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Changes in Stockholders' Equity

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
(unaudited, dollars in thousands except per share data)						
<b>THREE MONTHS ENDED MARCH 31, 2018</b>						
Balance at beginning of period	5,017,458	\$ 25,087	\$ 17,270	\$ 54,738	\$ (707 )	\$ 96,388
Net income	-	-	-	942	-	942
Other comprehensive loss, net of tax	-	-	-	-	(1,814 )	(1,814 )
Reclassification of the income tax effects of the Tax Cuts and Jobs Act from AOCI	-	-	-	139	(139 )	-
Reclassification of net unrealized gains on equity securities from AOCI per ASU 2016-01	-	-	-	77	(77 )	-
Employee Stock Purchase Plan share issuance	1,081	6	20	-	-	26
Stock-based compensation expense	-	-	8	-	-	8
Cash dividends (\$0.11 per share)	-	-	-	(552 )	-	(552 )
Balance at end of period	5,018,539	\$ 25,093	\$ 17,298	\$ 55,344	\$ (2,737 )	\$ 94,998
<b>THREE MONTHS ENDED MARCH 31, 2017</b>						
Balance at beginning of period	4,961,258	\$ 24,806	\$ 16,427	\$ 56,965	\$ (4,208 )	\$ 93,990
Net income	-	-	-	942	-	942
Other comprehensive income, net of tax	-	-	-	-	428	428
Exercise of stock options	18,006	90	271	-	-	361
Employee Stock Purchase Plan share issuance	773	4	17	-	-	21
Repurchase and retirement of common stock	(2,770 )	(14 )	(60 )	-	-	(74 )
Cash dividends (\$0.11 per share)	-	-	-	(547 )	-	(547 )
Balance at end of period	4,977,267	\$ 24,886	\$ 16,655	\$ 57,360	\$ (3,780 )	\$ 95,121

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries  
Consolidated Statements of Cash Flows

	Three Months Ended March 31, 2018      2017 (unaudited, dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$942	\$942
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	620	698
Provision for loan losses	525	650
Net gain on sale of available-for-sale securities	(80 )	-
Net amortization of securities	493	602
Loans originated and held for sale	(2,268 )	-
Proceeds from sale of loans held for sale	2,370	-
Gain on sale of loans held for sale	(38 )	-
Net loss on disposal of premises and equipment	11	-
Income from bank owned life insurance	(209 )	(198 )
Stock compensation expense	8	-
Decrease in other assets	633	365
Increase (decrease) in other liabilities	(45 )	365
Net cash provided by operating activities	2,962	3,424
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of available-for-sale securities	(1,467 )	(21,650)
Cash used in purchases of restricted securities, net	(177 )	(7 )
Proceeds from maturities and calls of available-for-sale securities	4,655	22,400
Proceeds from sales of available-for-sale securities	2,730	1,000
Paydowns on available-for-sale securities	2,437	2,464
Proceeds from sale of loans held for investment	8,746	-
Net increase in loans held for investment	(3,527 )	(30,800)
Purchases of premises and equipment	(189 )	(250 )
Net cash provided by (used in) investing activities	13,208	(26,843)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase in noninterest-bearing deposits	5,629	4,999
Increase in savings deposits	4,828	11,723
Decrease in time deposits	(5,024 )	(7,832 )
Increase in federal funds purchased and repurchase agreements, net	5,448	9,424
Increase in Federal Home Loan Bank advances	58,000	-
Repayment of Federal Home Loan Bank advances	(55,500)	-
Proceeds from exercise of stock options and ESPP issuance	26	382
Repurchase and retirement of common stock	-	(74 )
Cash dividends paid on common stock	(552 )	(547 )
Net cash provided by financing activities	12,855	18,075
Net increase (decrease) in cash and cash equivalents	29,025	(5,344 )
Cash and cash equivalents at beginning of period	14,412	25,854

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Cash and cash equivalents at end of period	\$43,437	\$20,510
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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash payments for:

Interest	\$1,050	\$595
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SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS

Unrealized gain (loss) on securities available-for-sale	\$(2,297)	\$648
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Loans transferred to other real estate owned	\$203	\$-
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See Notes to Consolidated Financial Statements.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

### Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (NASDAQ: OPOF) (the Company) and its subsidiaries have been prepared in accordance with U.S. GAAP for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at March 31, 2018 and December 31, 2017 and the statements of income, comprehensive income, changes in stockholders' equity and cash flows for the three months ended March 31, 2018 and 2017. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2017 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation, none of which were material in nature.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services N.A. (Trust). All significant intercompany balances and transactions have been eliminated in consolidation.

### NATURE OF OPERATIONS

Old Point Financial Corporation is a holding company that conducts substantially all of its operations through two subsidiaries, the Bank and Trust. The Bank serves individual and commercial customers, the majority of which are in Hampton Roads, Virginia. As of March 31, 2018, the Bank had 18 branch offices. The Bank offers a full range of deposit and loan products to its retail and commercial customers, including mortgage loan products offered through its Old Point Mortgage (OPM) division. A full array of insurance products is also offered through Old Point Insurance, LLC in partnership with Morgan Marrow Company. Trust offers a full range of services for individuals and businesses. Products and services include retirement planning, estate planning, financial planning, estate and trust administration, retirement plan administration, tax services and investment management services.

### SUBSEQUENT EVENTS

In accordance with ASC 855-10, "Subsequent Events," the Company evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

On April 1, 2018, the Company completed its acquisition of Citizens National Bank (Citizens) for a purchase price of approximately \$7.1 million. Under the terms of the merger agreement, Citizens shareholders received 0.1041 shares of Company stock and \$2.19 in cash for each share of Citizens stock resulting in the issuance of 149,980 shares of Company stock. Systems integration is scheduled to be completed in late May 2018.

The Company's first quarter results do not include the financial results of Citizens because it was acquired after the close of the first quarter. As of March 31, 2018 Citizens had total assets of \$49.8 million, total loans of \$43.5 million,

and total deposits of \$43.8 million.

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## RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements. As the Company owns the majority of its buildings, management does not anticipate that the ASU will have a material impact.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements and has formed a committee to oversee the adoption of the new standard. The ALLL model currently in use by the Company already provides it with the ability to archive prior period information and contains loan balance and charge-off information beginning with September 30, 2011. The committee has reviewed the data included in each monthly archive file and has added fields to enhance its data analysis capabilities under the new standard.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU No. 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the



amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-03, "Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments provide targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, the amendments include clarifications related to: measurement elections, transition requirements, and adjustments associated with equity securities without readily determinable fair values; fair value measurement requirements for forward contracts and purchased options on equity securities; presentation requirements for hybrid financial liabilities for which the fair value option has been elected; and measurement requirements for liabilities denominated in a foreign currency for which the fair value option has been elected. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-03 to have a material impact on its consolidated financial statements.

## ACCOUNTING STANDARDS ADOPTED IN 2018

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU requires an entity to, among other things: (i) measure equity investments at fair value through net income, with certain exceptions; (ii) present in OCI 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 ASU provides an election to subsequently measure certain nonmarketable equity investments at cost less any impairment and adjusted for certain observable price changes. The ASU 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 adoption of ASU No. 2016-01 on January 1, 2018 did not have a material effect on the Company's Consolidated Financial Statements. The Company began measuring its equity investments at fair value through net income and reclassified \$77 thousand of AOCI to retained earnings in the first quarter of 2018, with no effect on total stockholders' equity. The Company also measured the fair value of its loan portfolio and time deposits at March 31, 2018 using an exit price notion (see Note 9. Fair Value Measurements).

In February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income (AOCI) to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending March 31, 2018. The reclassification decreased AOCI and increased retained earnings by \$139 thousand, with no effect on total stockholders' equity.

On January 1, 2018 the Company adopted ASU 2014-09 "Revenue from Contracts with Customers" and all subsequent amendments to the ASU (collectively, "ASC 606"). The majority of the Company's revenues are associated with financial instruments, including loans and securities, to which ASC 606 does not apply. ASC 606 is applicable to certain noninterest revenues including services charges on deposit accounts, interchange fees, merchant services income, trust and asset management income, and the sale of other real estate owned. However, the recognition of these revenue streams did not change upon adoption of ASC 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of ASC 606 are discussed below.

#### Fiduciary and Asset Management Fees

Fiduciary and asset management income is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the applicable fee schedule or contract terms. Payment is generally received immediately or in the following month. The Company does not earn performance-based incentives. Additional services such as tax return preparation services are transactional-based, and the performance obligation is generally satisfied, and related revenue recognized, as incurred. Payment is received shortly after services

are rendered.

#### Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

#### Other Service Charges, Commissions and Fees

Other service charges, commissions and fees are primarily comprised of debit card income, ATM fees, merchant services income, investment services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Investment services income relates to commissions earned on brokered trades of investment securities. Other service charges include revenue from processing wire transfers, safe deposit box rentals, cashier's checks, and other services. The Company's performance obligation for other service charges, commission and fees are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

#### Other Operating Income

Other operating income mainly consists of check sales to customers and fees charged for the early redemption of time deposits. Other operating income is largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment is generally received immediately.

## Note 2. Securities

Amortized costs and fair values of securities available-for-sale as of the dates indicated are as follows:

	Amortized Cost (in thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2018				
Obligations of U.S. Government agencies	\$9,440	\$ 25	\$ (128 )	\$9,337
Obligations of state and political subdivisions	59,924	150	(805 )	59,269
Mortgage-backed securities	73,699	-	(2,758 )	70,941
Money market investments	1,612	-	-	1,612
Corporate bonds and other securities	4,650	64	(16 )	4,698
Total	\$149,325	\$ 239	\$ (3,707 )	\$145,857
December 31, 2017				
Obligations of U.S. Government agencies	\$9,530	\$ 27	\$ (122 )	\$9,435
Obligations of state and political subdivisions	64,413	489	(137 )	64,765
Mortgage-backed securities	75,906	-	(1,610 )	74,296
Money market investments	1,194	-	-	1,194
Corporate bonds and other securities	7,049	195	(10 )	7,234
Other marketable equity securities	100	97	-	197
Total	\$158,192	\$ 808	\$ (1,879 )	\$157,121

The Company has a process in place to identify debt securities that could potentially have a credit or interest-rate related impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, and cash flow projections as indicators of credit issues. On a quarterly basis, management reviews all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. Management considers relevant facts and circumstances in evaluating whether a credit or interest-rate related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (a) the extent and length of time the fair value has been below cost; (b) the reasons for the decline in value; (c) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (d) for fixed maturity securities, the Company's intent to sell a security or whether it is more-likely-than-not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity, and for equity securities, the Company's ability and intent to hold the security for a period of time that allows for the recovery in value.

The Company has not recorded impairment charges through income on securities for the three months ended March 31, 2018 or the year ended December 31, 2017.

The following table summarizes gross realized gains and losses on the sale of investment securities during the periods indicated:

Three Months Ended March 31, 2018	2017
---	------

(in  
thousands)

Securities Available-for-sale

Realized gains on sales of securities	\$ 80	\$ -
Realized losses on sales of securities	-	-
Net realized gain (loss)	\$ 80	\$ -

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The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired as of March 31, 2018 and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of the dates indicated:

March 31, 2018

	Less Than Twelve Months Gross Unrealized Losses Value		More Than Twelve Months Gross Unrealized Losses Value		Total Gross Unrealized Losses Value	
March 31, 2018						
	(dollars in thousands)					
Securities Available-for-Sale						
Obligations of U.S. Government agencies	\$7	\$1,492	\$121	\$3,283	\$128	\$4,775
Obligations of state and political subdivisions	405	22,103	400	10,658	805	32,761
Mortgage-backed securities	136	6,810	2,622	64,131	2,758	70,941
Corporate bonds	5	1,095	11	789	16	1,884
Total securities available-for-sale	\$553	\$31,500	\$3,154	\$78,861	\$3,707	\$110,361

December 31, 2017

	Less Than Twelve Months Gross Unrealized Losses Value		More Than Twelve Months Gross Unrealized Losses Value		Total Gross Unrealized Losses Value	
December 31, 2017						
	(dollars in thousands)					
Securities Available-for-Sale						
Obligations of U.S. Government agencies	\$11	\$3,189	\$111	\$3,089	\$122	\$6,278
Obligations of state and political subdivisions	32	11,141	105	10,999	137	22,140
Mortgage-backed securities	67	9,742	1,543	64,554	1,610	74,296
Corporate bonds	2	1,098	8	792	10	1,890
Total securities available-for-sale	\$112	\$25,170	\$1,767	\$79,434	\$1,879	\$104,604

The number of investments at an unrealized loss position as of March 31, 2018 and December 31, 2017 were 100 and 77, respectively. Certain investments within the Company's portfolio had unrealized losses for more than twelve months at March 31, 2018 and December 31, 2017, as shown in the tables above. The unrealized losses were caused by increases in market interest rates. Because the Company does not intend to sell the investments and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at March 31, 2018 or December 31, 2017.

#### Restricted Securities

The restricted security category is comprised of stock in the Federal Home Loan Bank of Atlanta (FHLB) and the Federal Reserve Bank (FRB). These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and the securities lack a market. Therefore, FHLB and FRB stock is carried at cost and evaluated for impairment. When evaluating these stocks for impairment, their value is determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. Restricted stock is viewed as a long-term investment and management believes that the Company has the ability and the intent to hold this stock until its value is recovered.



## Note 3. Loans and the Allowance for Loan Losses

The following is a summary of the balances in each class of the Company's loan portfolio as of the dates indicated:

	March 31, 2018	December 31, 2017
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	\$ 102,428	\$ 101,021
Commercial	287,395	289,682
Construction	29,054	27,489
Second mortgages	18,721	17,918
Equity lines of credit	54,907	56,610
Total mortgage loans on real estate	492,505	492,720
Commercial and industrial loans	57,019	60,398
Consumer automobile loans	120,360	119,251
Other consumer loans	52,661	54,974
Other	10,330	11,197
Total loans, net of deferred fees (1)	732,875	738,540
Less: Allowance for loan losses	(9,731 )	(9,448 )
Loans, net of allowance and deferred fees and costs (1)	\$ 723,144	\$ 729,092

(1) Net deferred loan fees totaled \$906 thousand and \$916 thousand at March 31, 2018 and December 31, 2017, respectively.

Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled \$662 thousand and \$594 thousand at March 31, 2018 and December 31, 2017, respectively.

## CREDIT QUALITY INFORMATION

The Company uses internally-assigned risk grades to estimate the capability of borrowers to repay the contractual obligations of their loan agreements as scheduled or at all. The Company's internal risk grade system is based on experiences with similarly graded loans. Credit risk grades are updated at least quarterly as additional information becomes available, at which time management analyzes the resulting scores to track loan performance.

The Company's internally assigned risk grades are as follows:

Pass: Loans are of acceptable risk.

Other Assets Especially Mentioned (OAEM): Loans have potential weaknesses that deserve management's close attention.

Substandard: Loans reflect significant deficiencies due to several adverse trends of a financial, economic or managerial nature.

Doubtful: Loans have all the weaknesses inherent in a substandard loan with added characteristics that make collection or liquidation in full based on currently existing facts, conditions and values highly questionable or improbable.

Loss: Loans have been identified for charge-off because they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.



The following table presents credit quality exposures by internally assigned risk ratings as of the dates indicated:

Credit Quality Information

As of March 31, 2018

(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$ 100,314	\$ 450	\$ 1,664	\$ -	\$ 102,428
Commercial	259,935	13,770	13,690	-	287,395
Construction	28,259	73	722	-	29,054
Second mortgages	18,000	538	183	-	18,721
Equity lines of credit	54,597	-	310	-	54,907
Total mortgage loans on real estate	461,105	14,831	16,569	-	492,505
Commercial and industrial loans	54,598	1,833	588	-	57,019
Consumer automobile loans	119,930	-	430	-	120,360
Other consumer loans	52,446	-	215	-	52,661
Other	10,330	-	-	-	10,330
Total	\$ 698,409	\$ 16,664	\$ 17,802	\$ -	\$ 732,875

Credit Quality Information

As of December 31, 2017

(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	\$ 98,656	\$ -	\$ 2,365	\$ -	\$ 101,021
Commercial	264,275	10,526	14,881	-	289,682
Construction	26,694	74	721	-	27,489
Second mortgages	17,211	431	276	-	17,918
Equity lines of credit	56,318	-	292	-	56,610
Total mortgage loans on real estate	463,154	11,031	18,535	-	492,720
Commercial and industrial loans	58,091	1,469	838	-	60,398
Consumer automobile loans	119,211	-	40	-	119,251
Other consumer loans	54,926	-	48	-	54,974
Other	11,197	-	-	-	11,197
Total	\$ 706,579	\$ 12,500	\$ 19,461	\$ -	\$ 738,540

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## AGE ANALYSIS OF PAST DUE LOANS BY CLASS

All classes of loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Interest and fees continue to accrue on past due loans until the date the loan is placed in nonaccrual status, if applicable. The following table includes an aging analysis of the recorded investment in past due loans as of the dates indicated. Also included in the table below are loans that are 90 days or more past due as to interest and principal and still accruing interest, because they are well-secured and in the process of collection. Loans in nonaccrual status that are also past due are included in the aging categories in the table below.

## Age Analysis of Past Due Loans as of March 31, 2018

	30 - 59 Days Past Due (in thousands)	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans <sup>(1)</sup>	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:							
Residential 1-4 family	\$554	\$-	\$347	\$901	\$101,527	\$102,428	\$ -
Commercial	315	588	386	1,289	286,106	287,395	-
Construction	-	-	721	721	28,333	29,054	-
Second mortgages	53	-	45	98	18,623	18,721	45
Equity lines of credit	454	-	53	507	54,400	54,907	-
Total mortgage loans on real estate	1,376	588	1,552	3,516	488,989	492,505	45
Commercial loans	145	3	590	738	56,281	57,019	-
Consumer automobile loans	572	94	142	808	119,552	120,360	142
Other consumer loans	642	472	1,963	3,077	49,584	52,661	1,962
Other	51	9	16	76	10,254	10,330	17
Total	\$2,786	\$1,166	\$4,263	\$8,215	\$724,660	\$732,875	\$ 2,166

<sup>(1)</sup> For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the other consumer loans category includes student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$2.8 million at March 31, 2018.

## Age Analysis of Past Due Loans as of December 31, 2017

	30 - 59 Days Past Due (in thousands)	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans <sup>(1)</sup>	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:							
Residential 1-4 family	\$229	\$153	\$1,278	\$1,660	\$99,361	\$101,021	\$ 261
Commercial	194	771	1,753	2,718	286,964	289,682	-
Construction	-	-	721	721	26,768	27,489	-
Second mortgages	15	-	163	178	17,740	17,918	45
Equity lines of credit	75	19	53	147	56,463	56,610	-

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Total mortgage loans on real estate	513	943	3,968	5,424	487,296	492,720	306
Commercial loans	709	-	1,060	1,769	58,629	60,398	471
Consumer automobile loans	517	122	41	680	118,571	119,251	41
Other consumer loans	2,222	544	2,360	5,126	49,848	54,974	2,360
Other	84	9	4	97	11,100	11,197	4
Total	\$4,045	\$1,618	\$7,433	\$13,096	\$725,444	\$738,540	\$ 3,182

<sup>(1)</sup> For purposes of this table, Total Current Loans includes loans that are 1 - 29 days past due.

In the table above, the other consumer loans category includes student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. The past due principal portion of these guaranteed loans totaled \$4.2 million at December 31, 2017.

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Although the portion of the student loan portfolio that is 90 days or more past due would normally be considered impaired, the Company does not include these loans in its impairment analysis. Because the federal government has provided guarantees of repayment of these student loans in an amount ranging from 97% to 98% of the total principal and interest of the loans, management does not expect significant increases in past due student loans to have a material effect on the Company.

#### NONACCRUAL LOANS

The Company generally places commercial loans (including construction loans and commercial loans secured and not secured by real estate) in nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred or the loan reaches 90 days past due, unless the credit is well-secured and in the process of collection.

Under regulatory rules, consumer loans, which are loans to individuals for household, family and other personal expenditures, and consumer loans secured by real estate (including residential 1 - 4 family mortgages, second mortgages, and equity lines of credit) are not required to be placed in nonaccrual status. Although consumer loans and consumer loans secured by real estate are not required to be placed in nonaccrual status, the Company may elect to place these loans in nonaccrual status, if necessary to avoid a material overstatement of interest income. Generally, consumer loans secured by real estate are placed in nonaccrual status only when payments are 120 days past due.

Generally, consumer loans not secured by real estate are placed in nonaccrual status only when part of the principal has been charged off. If a charge-off has not occurred sooner for other reasons, a consumer loan not secured by real estate will generally be placed in nonaccrual status when payments are 120 days past due. These loans are charged off or written down to the net realizable value of the collateral when deemed uncollectible, when classified as a "loss," when repayment is unreasonably protracted, when bankruptcy has been initiated, or when the loan is 120 days or more past due unless the credit is well-secured and in the process of collection.

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash basis or cost recovery method, until it qualifies for return to accrual status or is charged off. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, or when the borrower has resumed paying the full amount of the scheduled contractual interest and principal payments for at least six months.

The following table presents loans in nonaccrual status by class of loan as of the dates indicated:

#### Nonaccrual Loans by Class

	March	
	31,	December
	2018	31, 2017
	(in thousands)	
Mortgage loans on real estate		
Residential 1-4 family	\$ 1,226	\$ 1,447
Commercial	10,924	9,468
Construction	722	721
Second mortgages	118	118
Equity lines of credit	311	292
Total mortgage loans on real estate	13,301	12,046
Commercial loans	830	836
Total	\$ 14,131	\$ 12,882

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The following table presents the interest income that the Company would have earned under the original terms of its nonaccrual loans and the actual interest recorded by the Company on nonaccrual loans for the periods presented:

	Three Months Ended March 31, 2018 2017 (in thousands)	
Interest income that would have been recorded under original loan terms	\$ 130	\$ 117
Actual interest income recorded for the period	80	87
Reduction in interest income on nonaccrual loans	\$50	\$30

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## TROUBLED DEBT RESTRUCTURINGS

The Company's loan portfolio includes certain loans that have been modified in a troubled debt restructuring (TDR), where economic concessions have been granted to borrowers who are experiencing financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reduction in the interest rate below current market rates for borrowers with similar risk profiles, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. The Company defines a TDR as nonperforming if the TDR is in nonaccrual status or is 90 days or more past due and still accruing interest at the report date.

When the Company modifies a loan, management evaluates any possible impairment as stated in the impaired loan section below.

The following tables present TDRs during the periods indicated, by class of loan. There were no troubled debt restructurings originated in the three months ended March 31, 2018.

## Troubled Debt Restructurings by Class

For the Three Months Ended March 31, 2017

	Number of Modifications (dollars in thousands)	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on March 31, 2017
Mortgage loans on real estate:				
Residential 1-4 family	1	\$ 142	\$ 142	\$ 142

The one loan restructured in the first three months ended March 31, 2017 was given below-market rates for debt with similar risk characteristics. At March 31, 2018 and December 31, 2017, the Company had no outstanding commitments to disburse additional funds on any TDR. At March 31, 2018 and December 31, 2017, the Company had \$204 thousand and \$77 thousand, respectively, in loans secured by residential 1 - 4 family real estate that were in the process of foreclosure.

In the first quarters of 2018 and 2017, there were no defaulting TDRs where the default occurred within twelve months of restructuring. The Company considers a TDR in default when any of the following occurs: the loan, as restructured, becomes 90 days or more past due; the loan is moved to nonaccrual status following the restructure; the loan is restructured again under terms that would qualify it as a TDR if it were not already so classified; or any portion of the loan is charged off.

All TDRs are factored into the determination of the allowance for loan losses and included in the impaired loan analysis, as discussed below.

## IMPAIRED LOANS

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts when due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming loans and loans modified in a TDR. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole or remaining source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, when foreclosure is probable, instead of the discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through a specific allocation in the allowance or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is in nonaccrual status, all payments are applied to principal under the cost-recovery method. For financial statement purposes, the recorded investment in the loan is the actual principal balance reduced by payments that would otherwise have been applied to interest. When reporting information on these loans to the applicable customers, the unpaid principal balance is reported as if payments were applied to principal and interest under the original terms of the loan agreements. Therefore, the unpaid principal balance reported to the customer would be higher than the recorded investment in the loan for financial statement purposes. When the ultimate collectability of the total principal of the impaired loan is not in doubt and the loan is in nonaccrual status, contractual interest is credited to interest income when received under the cash-basis method.

The following table includes the recorded investment and unpaid principal balances (a portion of which may have been charged off) for impaired loans with the associated allowance amount, if applicable, as of the dates presented. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized for the periods presented. The average balances are calculated based on daily average balances.

## Impaired Loans by Class

	As of March 31, 2018				For the three months ended March 31, 2018	
	Unpaid Principal Balance	Recorded Investment Without Allowance	Recorded Investment With Allowance	Associated Allowance	Average Recorded Investment	Interest Recognized
Mortgage loans on real estate:						
Residential 1-4 family	\$2,059	\$1,944	\$ 94	\$ 49	\$2,042	\$ 16
Commercial	16,290	14,245	436	164	15,596	93
Construction	813	722	91	17	814	1
Second mortgages	469	315	134	14	471	4
Equity lines of credit	312	53	258	29	312	-
Total mortgage loans on real estate	\$19,943	\$17,279	\$ 1,013	\$ 273	\$19,235	\$ 114
Commercial loans	1,109	830	-	-	836	-
Other consumer loans	170	-	168	68	169	4
Total	\$21,222	\$18,109	\$ 1,181	\$ 341	\$20,240	\$ 118

## Impaired Loans by Class

As of December 31, 2017

For the Year Ended

December 31, 2017

	Recorded Investment			Associated Allowance	Average Recorded Investment	Interest Recognized
	Unpaid Principal Balance	Without Allowance	With Allowance			
Mortgage loans on real estate:						
Residential 1-4 family	\$2,873	\$2,499	\$ 316	\$ 52	\$2,525	\$ 90
Commercial	15,262	11,622	1,644	1	13,541	579
Construction	814	721	92	18	406	23
Second mortgages	473	318	135	14	464	20
Equity lines of credit	293	53	239	10	261	-
Total mortgage loans on real estate	\$19,715	\$15,213	\$ 2,426	\$ 95	\$17,197	\$ 712
Commercial loans	1,115	836	-	-	1,388	30
Other consumer loans	-	-	-	-	41	-
Total	\$20,830	\$16,049	\$ 2,426	\$ 95	\$18,626	\$ 742

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## MONITORING OF LOANS AND EFFECT OF MONITORING FOR THE ALLOWANCE FOR LOAN LOSSES

Loan officers are responsible for continual portfolio analysis and prompt identification and reporting of problem loans, which includes assigning a risk grade to each applicable loan at its origination and revising such grade as the situation dictates. Loan officers maintain frequent contact with borrowers, which should enable the loan officer to identify potential problems before other personnel. In addition, meetings with loan officers and upper management are held to discuss problem loans and review risk grades. Nonetheless, in order to avoid over-reliance upon loan officers for problem loan identification, the Company's loan review system provides for review of loans and risk grades by individuals who are independent of the loan approval process. Risk grades and historical loss rates (determined by migration analysis) by risk grades are used as a component of the calculation of the allowance for loan losses.

## ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and probable losses inherent in the loan portfolio. The Company segments the loan portfolio into categories as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report). Loans are segmented into the following pools: commercial, real estate-construction, real estate-mortgage, consumer and other loans. The Company also sub-segments the real estate-mortgage segment into four classes: residential 1-4 family, commercial real estate, second mortgages and equity lines of credit.

The Company uses an internally developed risk evaluation model in the estimation of the credit risk process. The model and assumptions used to determine the allowance are independently validated and reviewed to ensure that the theoretical foundation, assumptions, data integrity, computational processes and reporting practices are appropriate and properly documented.

Each portfolio segment has risk characteristics as follows:

**Commercial:** Commercial loans carry risks associated with the successful operation of a business or project, in addition to other risks associated with the ownership of a business. The repayment of these loans may be dependent upon the profitability and cash flows of the business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.

**Real estate-construction:** Construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may at any point in time be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be the loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.

**Real estate-mortgage:** Residential mortgage loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Commercial real estate loans carry risks associated with the successful operation of a business if owner occupied. If non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts.

**Consumer loans:** Consumer loans carry risks associated with the continued credit-worthiness of the borrowers and the value of the collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

**Other loans:** Other loans are loans to mortgage companies, loans for purchasing or carrying securities, and loans to insurance, investment and finance companies. These loans carry risks associated with the successful operation of a business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time, depend on interest rates or fluctuate in active trading markets.

Each segment of the portfolio is pooled by risk grade or by days past due. Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on

days past due, while all other loans, including loans to consumers that are secured by real estate, are segmented by risk grades. A historical loss percentage is then calculated by migration analysis and applied to each pool. The migration analysis applied to all pools is able to track the risk grading and historical performance of individual loans throughout a number of periods set by management, which provides management with information regarding trends (or migrations) in a particular loan segment. At March 31, 2018 and December 31, 2017 management used eight twelve-quarter migration periods.

Management also provides an allocated component of the allowance for loans that are specifically identified that may be impaired, and are individually analyzed for impairment. An allocated allowance is established when the present value of expected future cash flows from the impaired loan (or the collateral value or observable market price of the impaired loan) is lower than the carrying value of that loan.

Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. These additional qualitative factors include: economic conditions, trends in growth, loan concentrations, changes in certain loans, changes in underwriting, changes in management and changes in the legal and regulatory environment.

#### ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$9.7 million adequate to cover probable loan losses inherent in the loan portfolio at March 31, 2018.

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The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans for the periods presented. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

## ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS

(in thousands)

For the Three Months Ended	Real Estate -					Total
	Commercial	Construction	Mortgage (1)	Consumer (2)	Other	
March 31, 2018						
Allowance for Loan Losses:						
Balance at the beginning of period	\$ 1,889	\$ 541	\$ 5,217	\$ 1,644	\$ 157	\$ 9,448
Charge-offs	(78 )	-	(125 )	(125 )	(79 )	(407 )
Recoveries	18	-	71	52	24	165
Provision for loan losses	190	(131 )	310	90	66	525
Ending balance	\$ 2,019	\$ 410	\$ 5,473	\$ 1,661	\$ 168	\$ 9,731
Ending balance individually evaluated for impairment	\$ -	\$ 17	\$ 256	\$ 68	\$ -	\$ 341
Ending balance collectively evaluated for impairment	2,019	393	5,217	1,593	168	9,390
Ending balance	\$ 2,019	\$ 410	\$ 5,473	\$ 1,661	\$ 168	\$ 9,731
Loan Balances:						
Ending balance individually evaluated for impairment	\$ 830	\$ 813	\$ 17,479	\$ 168	\$ -	\$ 19,290
Ending balance collectively evaluated for impairment	56,189	28,241	445,972	172,853	10,330	713,585
Ending balance	\$ 57,019	\$ 29,054	\$ 463,451	\$ 173,021	\$ 10,330	\$ 732,875

For the Year Ended	Real Estate -					Total
	Commercial	Construction	Mortgage (1)	Consumer	Other	
December 31, 2017						
Allowance for Loan Losses:						
Balance at the beginning of period	\$ 1,493	\$ 846	\$ 5,267	\$ 455	\$ 184	\$ 8,245
Charge-offs	(807 )	-	(1,934 )	(279 )	(267 )	(3,287 )
Recoveries	37	104	45	56	88	330
Provision for loan losses	1,166	(409 )	1,839	1,412	152	4,160
Ending balance	\$ 1,889	\$ 541	\$ 5,217	\$ 1,644	\$ 157	\$ 9,448
Ending balance individually evaluated for impairment	\$ -	\$ 18	\$ 77	\$ -	\$ -	\$ 95
Ending balance collectively evaluated for impairment	1,889	523	5,140	1,644	157	9,353
Ending balance	\$ 1,889	\$ 541	\$ 5,217	\$ 1,644	\$ 157	\$ 9,448
Loan Balances:						
Ending balance individually evaluated for impairment	\$ 836	\$ 813	\$ 16,826	\$ 0	\$ -	\$ 18,475
Ending balance collectively evaluated for impairment	59,562	26,676	448,405	174,225	11,197	720,065
Ending balance	\$ 60,398	\$ 27,489	\$ 465,231	\$ 174,225	\$ 11,197	\$ 738,540

(1) The real estate-mortgage segment includes residential 1 – 4 family, commercial real estate, second mortgages and equity lines of credit.

(2) The consumer segment includes consumer automobile loans.

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## Note 4. Low-Income Housing Tax Credits

The Company was invested in four separate housing equity funds at both March 31, 2018 and December 31, 2017. The general purpose of these funds is to encourage and assist participants in investing in low-income residential rental properties located in the Commonwealth of Virginia; develop and implement strategies to maintain projects as low-income housing; deliver Federal Low Income Housing Credits to investors; allocate tax losses and other possible tax benefits to investors; and preserve and protect project assets.

The investments in these funds were recorded as other assets on the consolidated balance sheets and were \$3.6 million and \$3.5 million at March 31, 2018 and December 31, 2017, respectively. The expected terms of these investments and the related tax benefits run through 2033. Total projected tax credits to be received for 2018 are \$442 thousand, which is based on the most recent quarterly estimates received from the funds. Additional capital calls expected for the funds totaled \$1.1 million at both March 31, 2018 and December 31, 2017 and are recorded in accrued expenses and other liabilities on the corresponding consolidated balance sheet. There were no impairments losses related to these investments at March 31, 2018 and 2017.

	Three Months Ended March 31,		Affected Line Item on
	2018	2017	Consolidated Statement of Income
	(in thousands)		
Tax credits and other tax benefits			
Amortization of operating losses	\$ 80	\$ 80	ATM and other losses
Tax benefit of operating losses*	\$ 17	\$ 27	Income tax expense
Tax credits	124	95	Income tax expense
Total tax benefits	\$ 141	\$ 122	

\* Computed using a 21% tax rate for the first three months of 2018 and a 34% tax rate for the first three months of 2017

## Note 5. Borrowings

The Company classifies all borrowings that will mature within a year from the date on which the Company enters into them as short-term borrowings. Short-term borrowings sources consist of federal funds purchased, overnight repurchase agreements (which are secured transactions with customers that generally mature within one to four days), and advances from the FHLB.

The Company maintains federal funds lines with several correspondent banks to address short-term borrowing needs. At March 31, 2018 and December 31, 2017 the remaining credit available from these lines totaled \$55.0 million and \$45.0 million, respectively. The Company has a collateral dependent line of credit with the FHLB with remaining credit availability of \$223.0 million and \$217.0 as of March 31, 2018 and December 31, 2017, respectively.

The following table presents total short-term borrowings as of the dates indicated:

	March		December	
	31,		31,	2017
	2018			
	(in thousands)			
Federal funds purchased	\$-		\$	10,000
Overnight repurchase agreements	36,141		20,693	
FHLB advances	50,000		47,500	
Total short-term borrowings	\$86,141		\$	78,193
Maximum month-end outstanding balance	\$99,898		\$	79,819
Average outstanding balance during the period	\$88,686		\$	53,165
Average interest rate (year-to-date)	1.14	%	0.72	%
Average interest rate at end of period	0.99	%	1.27	%

The Company had long-term FHLB advances totaling \$20.0 million outstanding at March 31, 2018 and December 31, 2017 with \$10.0 million scheduled to mature on February 28, 2019 and \$10.0 million scheduled to mature on November 15, 2019. The interest rates on these advances range from 1.54% to 1.90%.

## Note 6. Commitments and Contingencies

## CREDIT-RELATED FINANCIAL INSTRUMENTS

The Company is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making such commitments as it does for on-balance-sheet instruments.

The following financial instruments whose contract amounts represent credit risk were outstanding at March 31, 2018 and December 31, 2017:

	March 31, 2018	December 31, 2017
	(in thousands)	
Commitments to extend credit:		
Home equity lines of credit	\$61,946	\$56,486
Commercial real estate, construction and development loans committed but not funded	16,636	19,526
Other lines of credit (principally commercial)	71,172	68,101
Total	\$149,754	\$144,113
Letters of credit	\$3,744	\$3,331

## Note 7. Share-Based Compensation

The Company has adopted an employee stock purchase plan and offers share-based compensation through its equity compensation plan. Share-based compensation arrangements may include stock options, restricted and unrestricted stock awards, restricted stock units, performance units and stock appreciation rights. Accounting standards require all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period. The Company accounts for forfeitures during the vesting period as they occur.

The 2016 Incentive Stock Plan (the Incentive Stock Plan) permits the issuance of up to 300,000 shares of common stock for awards to key employees and non-employee directors of the Company and its subsidiaries in the form of stock options, restricted stock, restricted stock units, stock appreciation rights, stock awards and performance units. The Company did not award any equity compensation under the Incentive Stock Plan during the three months ended March 31, 2018.

Restricted stock activity for the three months ended March 31, 2018 is summarized below:

	Shares	Weighted Average Grant Date Fair Value
Nonvested, January 1, 2018	2,245	\$ 33.60
Issued	-	-
Vested	-	-
Forfeited	-	-
Nonvested, March 31, 2018	2,245	\$ 33.60

The weighted average period over which nonvested awards are expected to be recognized is 1.50 years.

No restricted stock was granted during the three months ended March 31, 2018 or 2017.

The remaining unrecognized compensation expense for non-vested restricted stock shares totaled \$50 thousand as of March 31, 2018.

Stock-based compensation expense was \$8 thousand for the three months ended March 31, 2018. There was no stock compensation expense for the three months ended March 31, 2017.

Under the Company's Employee Stock Purchase Plan (ESPP), substantially all employees of the Company and its subsidiaries can authorize a specific payroll deduction from their base compensation for the periodic purchase of the Company's common stock. Shares of stock are issued quarterly at a discount to the market price of the Company's stock on the day of purchase, which can range from 0-15% and was set at 5% for 2017 and for the first three months of 2018.

1,081 shares were purchased under the ESPP during the three months ended March 31, 2018. At March 31, 2018, the Company had 244,372 remaining shares reserved for issuance under this plan.



## Note 8. Stockholders' Equity and Earnings per Share

## STOCKHOLDERS' EQUITY – Accumulated Other Comprehensive Loss

The following table presents information on amounts reclassified out of accumulated other comprehensive loss, by category, during the periods indicated:

	Three Months Ended March 31, 2018	2017	Affected Line Item on Consolidated Statement of Income
Available-for-sale securities	(in thousands)		
Realized gains on sales of securities	\$ 80	\$ -	Gain on sale of available-for-sale securities, net
Tax effect	17	\$ -	Income tax expense
	\$ 63	\$ -	

The following table presents the changes in accumulated other comprehensive loss, by category, net of tax, for the periods indicated:

	Unrealized Gains (Losses) on Available-for-Sale Securities (in thousands)	Defined Benefit Plans	Accumulated Other Comprehensive Loss
Three Months Ended March 31, 2018			
Balance at beginning of period	\$ (707 )	\$ -	\$ (707 )
Net other comprehensive loss	(1,814)	-	(1,814 )
Reclassification of the income tax effects of the Tax Cuts and Jobs Act from AOCI	(139 )	-	(139 )
Reclassification of net unrealized gains on equity securities from AOCI per ASU 2016-01	(77 )	-	(77 )
Balance at end of period	\$ (2,737)	\$ -	\$ (2,737 )
Three Months Ended March 31, 2017			
Balance at beginning of period	\$ (1,739)	\$ (2,469)	\$ (4,208 )
Net other comprehensive income	428	-	428
Balance at end of period	\$ (1,311)	\$ (2,469)	\$ (3,780 )

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The following table presents the change in each component of accumulated other comprehensive loss on a pre-tax and after-tax basis for the periods indicated.

	Three Months Ended March 31, 2018		
	Pretax	Tax	Net-of-Tax
	(in thousands)		
Unrealized losses on available-for-sale securities:			
Unrealized holding losses arising during the period	\$(2,217)	\$(466)	\$(1,751 )
Reclassification adjustment for gains recognized in income	(80 )	(17 )	(63 )
Total change in accumulated other comprehensive loss, net	\$(2,297)	\$(483)	\$(1,814 )

	Three Months Ended March 31, 2017		
	Pretax	Tax	Net-of-Tax
	(in thousands)		
Unrealized gains on available-for-sale securities:			
Unrealized holding gains arising during the period	\$648	\$220	\$ 428
Reclassification adjustment for gains recognized in income	-	-	-
Total change in accumulated other comprehensive loss, net	\$648	\$220	\$ 428

## EARNINGS PER COMMON SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options.

The following is a reconciliation of the denominators of the basic and diluted EPS computations for the three months ended March 31, 2018 and 2017:

	Net Income Available to Common Shareholders (Numerator) (in thousands except per share data)	Weighted Average Common Shares (Denominator)	Per Share Amount
Three Months Ended March 31, 2018			
Net income, basic	\$942	5,020	\$ 0.19
Potentially dilutive common shares - stock options	-	-	-
Potentially dilutive common shares - employee stock purchase program	-	-	-
Diluted	\$942	5,020	\$ 0.19
Three Months Ended March 31, 2017			
Net income, basic	\$942	4,977	\$ 0.19
Potentially dilutive common shares - stock options	-	15	-
Potentially dilutive common shares - employee stock purchase program	-	-	-
Diluted	\$942	4,992	\$ 0.19

The Company had no antidilutive shares in the first three months of 2018 or 2017. Non-vested restricted common shares, which carry all rights and privileges of a common share with respect to the stock, including the right to vote, were included in the basic and diluted per common share calculations.

## Note 9. Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurements and Disclosures" topics of FASB ASU 2010-06, FASB ASU 2011-04, and FASB ASU 2016-01, the fair value of a financial instrument is the price that would be received in the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value can be a reasonable point within a range that is most representative of fair value under current market conditions.

In estimating the fair value of assets and liabilities, the Company relies mainly on two models. The first model, used by the Company's bond accounting service provider, determines the fair value of securities. Securities are priced based on an evaluation of observable market data, including benchmark yield curves, reported trades, broker/dealer quotes, and issuer spreads. Pricing is also impacted by credit information about the issuer, perceived market movements, and current news events impacting the individual sectors. For assets other than securities and for all liabilities, fair value is determined using the Company's asset/liability modeling software. The software uses current yields, anticipated yield changes, and estimated duration of assets and liabilities to calculate fair value.

In accordance with ASC 820, "Fair Value Measurements and Disclosures," the Company groups its financial assets and financial liabilities generally measured at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

An instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

### ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

Debt securities with readily determinable fair values that are classified as "available-for-sale" are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's available-for-sale securities are considered to be Level 2 securities.

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The following table presents the balances of certain assets measured at fair value on a recurring basis as of the dates indicated:

	Balance	Fair Value Measurements at March 31, 2018 Using		
		Quoted Prices in Active Markets for Significant Identifiable Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Available-for-sale securities				
Obligations of U.S. Government agencies	\$9,337	\$-	\$9,337	\$ -
Obligations of state and political subdivisions	59,269	-	59,269	-
Mortgage-backed securities	70,941	-	70,941	-
Money market investments	1,612	-	1,612	-
Corporate bonds	4,698	-	4,698	-
Total available-for-sale securities	\$145,857	\$-	\$145,857	\$ -

	Balance	Fair Value Measurements at December 31, 2017 Using		
		Quoted Prices in Active Markets for Significant Identifiable Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Available-for-sale securities				
Obligations of U.S. Government agencies	\$9,435	\$-	\$9,435	\$ -
Obligations of state and political subdivisions	64,765	-	64,765	-
Mortgage-backed securities	74,296	-	74,296	-
Money market investments	1,194	-	1,194	-
Corporate bonds	7,234	-	7,234	-
Other marketable equity securities	197	-	197	-
Total available-for-sale securities	\$157,121	\$-	\$157,121	\$ -

ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

Under certain circumstances, adjustments are made to the fair value for assets and liabilities although they are not measured at fair value on an ongoing basis.

Impaired loans

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts when due from the borrower in accordance with the contractual terms of the loan agreement. The measurement of fair value and loss associated with impaired loans can be based on the observable market price of the loan, the fair value of the collateral securing the loan, or the present value of the loan's expected future cash flows, discounted at the loan's effective interest rate. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable, with the vast majority of the collateral in real estate.

The value of real estate collateral is determined utilizing an income, market, or cost valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company. In the case of loans with lower balances, the Company may obtain a real estate evaluation instead of an appraisal. Evaluations utilize many of the same techniques as appraisals, and are typically performed by independent appraisers. Once received, appraisals and evaluations are reviewed by trained staff independent of the lending function to verify consistency and reasonability. Appraisals and evaluations are based on significant unobservable inputs, including but not limited to: adjustments made to comparable properties, judgments about the condition of the subject property, the availability and suitability of comparable properties, capitalization rates, projected income of the subject or comparable properties, vacancy rates, projected depreciation rates, and the state of the local and regional economy. The Company may also elect to make additional reductions in the collateral value based on management's best judgment, which represents another source of unobservable inputs. Because of the subjective nature of collateral valuation, impaired loans are considered Level 3.

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Impaired loans may be secured by collateral other than real estate. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). If a loan is not collateral-dependent, its impairment may be measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate. Because the loan is discounted at its effective rate of interest, rather than at a market rate, the loan is not considered to be held at fair value and is not included in the tables below. Collateral-dependent impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as part of the provision for loan losses on the Consolidated Statements of Income.

#### Other Real Estate Owned (OREO)

Loans are transferred to OREO when the collateral securing them is foreclosed on. The measurement of gain or loss associated with OREOs is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. If there is a contract for the sale of a property, and management reasonably believes the transaction will be consummated in accordance with the terms of the contract, fair value is based on the sale price in that contract (Level 1). If management has recent information about the sale of identical properties, such as when selling multiple condominium units on the same property, the remaining units would be valued based on the observed market data (Level 2). Lacking either a contract or such recent data, management would obtain an appraisal or evaluation of the value of the collateral as discussed above under Impaired Loans (Level 3). After the asset has been booked, a new appraisal or evaluation is obtained when management has reason to believe the fair value of the property may have changed and no later than two years after the last appraisal or evaluation was received. Any fair value adjustments to OREOs below the original book value are recorded in the period incurred and expensed against current earnings.

#### Loans Held For Sale

Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). Gains and losses on the sale of loans are recorded within the mortgage segment and are reported on a separate line item on the Company's Consolidated Statements of Income.

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The following table presents the assets carried on the consolidated balance sheets for which a nonrecurring change in fair value has been recorded. Assets are shown by class of loan and by level in the fair value hierarchy, as of the dates indicated. Certain impaired loans are valued by the present value of the loan's expected future cash flows, discounted at the loan's effective interest rate rather than at a market rate. These loans are not carried on the consolidated balance sheets at fair value and, as such, are not included in the table below.

	Carrying Value at March 31, 2018 Using			
	Quoted Prices in Active Markets for Significant Identifiable Assets		Other Observable Inputs (Level 2)	
	Fair Value (Level 1) (in thousands)	Other Observable Inputs (Level 2)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans				
Mortgage loans on real estate:				
Residential 1-4 family	\$45	\$-	\$-	\$ 45
Commercial	272	-	-	272
Construction	74	-	-	74
Equity lines of credit	229	-	-	229
Total mortgage loans on real estate	\$620	\$-	\$-	\$ 620
Consumer loans	100	-	-	100
Total	\$720	\$-	\$-	\$ 720
Loans				
Loans held for sale	\$715	\$-	\$ 715	\$ -
Other real estate owned				
Commercial real estate	\$203	\$-	\$-	\$ 203

	Carrying Value at December 31, 2017 Using			
	Quoted Prices in Active Markets for Significant Identifiable Assets		Other Observable Inputs (Level 2)	
	Fair Value (Level 1) (in thousands)	Other Observable Inputs (Level 2)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans				

Mortgage loans on real estate:

Residential 1-4 family	\$264	\$-	\$ -	\$ 264
Construction	74	-	-	74
Equity lines of credit	229	-	-	229
Total	\$567	\$-	\$ -	\$ 567

Loans

Loans held for sale	\$779	\$-	\$ 779	\$ -
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The following table displays quantitative information about Level 3 Fair Value Measurements as of the dates indicated:

## Quantitative Information About Level 3 Fair Value Measurements

	Fair Value at March 31, 2018 (dollars in thousands)	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
Impaired loans					
Residential 1-4 family real estate	\$ 45	Market comparables	Selling costs	7.25	%
			Liquidation discount	4.00	%
Commercial real estate	\$ 272	Market comparables	Selling costs	7.78	%
			Liquidation discount	4.70	%
Construction	\$ 74	Market comparables	Selling costs	7.25	%
			Liquidation discount	4.00	%
Equity lines of credit	\$ 229	Market comparables	Selling costs	6.70	%
			Liquidation discount	3.70	%
Consumer	\$ 100	Market comparables	Selling costs	0.00	%
			Liquidation discount	0.00	%
Other real estate owned					
Commercial real estate	\$ 203	Market comparables	Selling costs	7.25	%
			Liquidation discount	10.00	%

## Quantitative Information About Level 3 Fair Value Measurements

	Fair Value at December 31, 2017 (dollars in thousands)	Valuation Techniques	Unobservable Input	Range (Weighted Average)	
Impaired loans					
Residential 1-4 family real estate	\$ 264	Market comparables	Selling costs	7.25	%
			Liquidation discount	0.00% - 4.00% (2.91	%)
Construction	\$ 74	Market comparables	Selling costs	7.25	%
			Liquidation discount	4.00	%
Equity lines of credit	\$ 229	Market comparables	Selling costs	7.25	%
			Liquidation discount	4.00	%

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The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments as of the dates indicated are as follows:

	Carrying Value	Fair Value Measurements at March 31, 2018 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Cash and cash equivalents	\$43,437	\$43,437	\$ -	\$ -
Securities available-for-sale	145,857	-	145,857	-
Restricted securities	4,023	-	4,023	-
Loans held for sale	715	-	715	-
Loans, net of allowances for loan losses *	723,144	-	-	705,413
Bank-owned life insurance	26,190	-	26,190	-
Accrued interest receivable	2,787	-	2,787	-
<b>Liabilities</b>				
Deposits	\$789,027	\$-	\$ 790,246	\$ -
Overnight repurchase agreements	36,141	-	36,141	-
Federal Home Loan Bank advances	70,000	-	69,716	-
Accrued interest payable	364	-	364	-

	Carrying Value	Fair Value Measurements at December 31, 2017 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
Cash and cash equivalents	\$14,412	\$14,412	\$ -	\$ -
Securities available-for-sale	157,121	-	157,121	-
Restricted securities	3,846	-	3,846	-
Loans held for sale	779	-	779	-
Loans, net of allowances for loan losses *	729,092	-	-	722,464
Bank-owned life insurance	25,981	-	25,981	-

Accrued interest receivable	3,254	-	3,254	-
<b>Liabilities</b>				
Deposits	\$783,594	\$-	\$ 782,539	\$ -
Federal funds purchased	10,000	-	10,000	-
Overnight repurchase agreements	20,693	-	20,693	-
Federal Home Loan Bank advances	67,500	-	67,329	-
Accrued interest payable	360	-	360	-

\* In accordance with the adoption of ASU 2016-01, the fair values of loans held for investment and time deposits as of March 31, 2018 were measured using an exit price notion. The fair values of loans held for investment and time deposits as of December 31, 2017 were measured using an entry price notion.

## Note 10. Segment Reporting

The Company operates in a decentralized fashion in three principal business segments: The Old Point National Bank of Phoebus (the Bank), Old Point Trust & Financial Services, N. A. (Trust), and the Company as a separate segment (for purposes of this Note, the Parent). Revenues from the Bank's operations consist primarily of interest earned on loans and investment securities and service charges on deposit accounts. Trust's operating revenues consist principally of income from fiduciary activities. The Parent's revenues are mainly fees and dividends received from the Bank and Trust companies. The Company has no other segments.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technologies and marketing strategies.

Information about reportable segments, and reconciliation of such information to the consolidated financial statements as of and for the three months ended March 31, 2018 and 2017 follows:

	Three Months Ended March 31, 2018				
	Bank	Trust	Parent	Eliminations	Consolidated
	(in thousands)				
<b>Revenues</b>					
Interest and dividend income	\$8,778	\$21	\$1,288	\$ (1,288)	) \$ 8,799
Income from fiduciary activities	-	983	-	-	983
Other income	2,127	260	50	(65)	) 2,372
Total operating income	10,905	1,264	1,338	(1,353)	) 12,154
<b>Expenses</b>					
Interest expense	1,054	-	-	-	1,054
Provision for loan losses	525	-	-	-	525
Salaries and employee benefits	4,625	745	107	-	5,477
Other expenses	3,639	264	314	(65)	) 4,152
Total operating expenses	9,843	1,009	421	(65)	) 11,208
Income before taxes	1,062	255	917	(1,288)	) 946
Income tax expense (benefit)	(25)	) 54	(25)	) -	4
Net income	\$1,087	\$201	\$942	\$ (1,288)	) \$ 942
Capital expenditures	\$189	\$-	\$-	\$ -	\$ 189
Total assets	\$987,507	\$6,098	\$94,998	\$ (94,830)	) \$ 993,773
<b>Three Months Ended March 31, 2017</b>					
	Bank	Trust	Parent	Eliminations	Consolidated
	(in thousands)				
<b>Revenues</b>					
Interest and dividend income	\$7,708	\$17	\$1,041	\$ (1,041)	) \$ 7,725
Income from fiduciary activities	-	966	-	-	966
Other income	1,955	257	50	(65)	) 2,197
Total operating income	9,663	1,240	1,091	(1,106)	) 10,888

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Expenses					
Interest expense	588	-	-	-	588
Provision for loan losses	650	-	-	-	650
Salaries and employee benefits	4,255	727	115	-	5,097
Other expenses	3,325	264	85	(65 )	3,609
Total operating expenses	8,818	991	200	(65 )	9,944
Income before taxes	845	249	891	(1,041 )	944
Income tax expense (benefit)	(32 )	85	(51 )	-	2
Net income	\$877	\$164	\$942	\$ (1,041 )	\$ 942
Capital expenditures	\$250	\$-	\$-	\$ -	\$ 250
Total assets	\$917,101	\$5,880	\$95,127	\$ (95,332 )	\$ 922,776

The accounting policies of the segments are the same as those described in the summary of significant accounting policies reported in the Company's 2017 annual report on Form 10-K. The Company evaluates performance based on profit or loss from operations before income taxes, not including nonrecurring gains or losses.

Both the Parent and the Trust companies maintain deposit accounts with the Bank, on terms substantially similar to those available to other customers. These transactions are eliminated to reach consolidated totals.

The Company operates in one geographical area and does not have a single external customer from which it derives 10 percent or more of its revenues.

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

Management's discussion and analysis is presented to aid the reader in understanding and evaluating the financial condition and results of operations of Old Point Financial Corporation and its subsidiaries (collectively, the Company). This discussion and analysis should be read with the consolidated financial statements, the notes to the financial statements, and the other financial data included in this report, as well as the Company's Annual Report on Form 10-K and management's discussion and analysis for the year ended December 31, 2017. Highlighted in the discussion are material changes from prior reporting periods and any identifiable trends affecting the Company. Results of operations for the three months ended March 31, 2018 and 2017 are not necessarily indicative of results that may be attained for any other period. Amounts are rounded for presentation purposes while some of the percentages presented are computed based on unrounded amounts.

Caution About Forward-Looking Statements

In addition to historical information, certain statements in this report which use language such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" and similar expressions, may identify 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 are based on the beliefs of the Company's management, as well as estimates and assumptions made by, and information currently available to, management. These statements are inherently uncertain, and there can be no assurance that the underlying estimates, assumptions or beliefs will prove to be accurate. Actual results could differ materially from historical results or those anticipated by such statements. Forward-looking statements in this report include, without limitation: statements regarding the Acquisition of Citizens; future financial performance and profitability; future impacts of the Tax Cuts and Jobs Act on the Company's operations; performance of the investment and loan portfolios, including performance of the consumer auto loan portfolio and the purchased student loan portfolio and expected trends in the quality of the loan portfolio; the effects of diversifying the loan portfolio; strategic business and growth initiatives; management's efforts to reposition the balance sheet; deposit growth; levels and sources of liquidity; the securities portfolio; use of proceeds from the sale of securities; future levels of charge-offs or net recoveries; the impact of increases in NPAs on future earnings; write-downs and expected sales of other real estate owned; income taxes; monetary policy actions of the Federal Open Market Committee; and changes in interest rates.

Factors that could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to: the possibility that any of the anticipated benefits of the Acquisition of Citizens will not be realized or will not be realized within the expected time period; Citizens may not be integrated into the Company successfully or such integration may be more difficult, time-consuming, or costly than expected; expected revenue synergies and cost savings from the Acquisition may not be fully realized or realized within the expected timeframe; revenues following the Acquisition may be lower than expected; customer and employee relationships and business operations may be disrupted by the Acquisition. Other factors that could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in: interest rates and yields; general economic and business conditions, including unemployment levels; demand for loan products; the performance of the Company's dealer lending program; the legislative/regulatory climate; monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board and any changes associated with the current administration; the quality or composition of the loan or securities portfolios; changes in the volume and mix of interest-earning assets and interest-bearing liabilities; the effects of management's investment strategy and strategy to manage the net interest margin; the U.S. government's guarantee of repayment of student loans purchased by the Company; the level of net charge-offs on loans; deposit flows; competition; demand for financial services in the Company's market area; implementation of new technologies; the Company's ability to develop and maintain secure and reliable electronic systems; any interruption or breach of security in the Company's information systems or those of the Company's third party vendors or other service providers; reliance on third parties for key services; the use of inaccurate assumptions in management's modeling systems; technological risks and developments and cyber-attacks and events; the real estate market; accounting principles, policies and guidelines; and other factors detailed in the Company's publicly filed documents, including its Annual Report on Form 10-K for the year ended



December 31, 2017. 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, which speak only as of date of the report.

These risks and uncertainties, in addition to the risks and uncertainties identified in the Company's 2017 annual report on Form 10-K, 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. We undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances arising after the date on which the statement was made, except as otherwise required by law.

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#### Available Information

The Company maintains a website on the Internet at [www.oldpoint.com](http://www.oldpoint.com). The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). This reference to the Company's Internet address shall not, under any circumstances, be deemed to incorporate the information available at such Internet address into this Form 10-Q or other SEC filings. The information available on the Company's Internet website is not part of this Form 10-Q or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files with or furnishes to the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company's SEC filings can also be obtained on the SEC's website on the Internet at [www.sec.gov](http://www.sec.gov).

#### About Old Point Financial Corporation

The Company is the parent company of The Old Point National Bank of Phoebus (the Bank) and Old Point Trust & Financial Services, N. A. (Trust). The Bank is a locally managed community bank serving the Hampton Roads localities of Chesapeake, Hampton, Isle of Wight County, Newport News, Norfolk, Virginia Beach, Williamsburg/James City County and York County. The Bank currently has 18 branch offices. Trust is a wealth management services provider.

On April 1, 2018, the Company completed its acquisition of Citizens National Bank (Citizens). Under the terms of the merger agreement, Citizens shareholders received 0.1041 shares of Old Point stock and \$2.19 in cash for each share of Citizens stock. Systems integration is scheduled to be completed in late May 2018.

#### Critical Accounting Policies and Estimates

As of March 31, 2018, there have been no significant changes with regard to the critical accounting policies and estimates disclosed in the Company's 2017 annual report on Form 10-K. The accounting policy that required management's most difficult, subjective or complex judgments continues to be the Company's allowance for loan losses. The Company's policies for calculating the allowance for loan losses are discussed in this Item 2 and in Note 3 of the Notes to the Consolidated Financial Statements included in this quarterly report on Form 10-Q, and are discussed in further detail in the Company's 2017 annual report on Form 10-K.

#### Earnings Summary

Net income for the first three months of 2018 was \$942 thousand, or \$0.19 per diluted share, compared to net income of \$942 thousand, or \$0.19 per diluted share, for the first three months of 2017.

Highlights of the quarter are as follow:

Net interest income for the first quarter of 2018 was \$7.7 million, an increase of \$608 thousand, or 8.5%, compared to the same period in 2017. This increase was primarily due to a higher level of earning assets, driven by year-over-year growth in the loan portfolio. Higher net interest income and noninterest income was offset by higher noninterest expense.

Provisions for loan losses in the first quarter of 2018 were \$525 thousand, which represents a decline of \$125 thousand, or 19.2%, from the first quarter of 2017.

Annualized net charge-offs as a percentage of average loans improved to 0.13% for the quarter from 0.24% for the first quarter of 2017.

Noninterest income for the quarter totaled \$3.4 million, an increase of \$192 thousand, or 6.1%, from the same period a year ago.

Total assets increased to \$993.8 million at March 31, 2018, an increase of \$71.0 million, or 7.7%, from March 31, 2017.

### Net Interest Income

The principal source of earnings for the Company is net interest income. Net interest income is the difference between interest and fees generated by earning assets and interest expense paid to fund them. Changes in the volume and mix of interest-earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income. The net interest margin is calculated by dividing tax-equivalent net interest income by average earning assets. Net interest income, on a fully tax-equivalent basis, was \$7.9 million in the first quarter of 2018, an increase of \$464 thousand, or 6.3%, from the first quarter of 2017. The increase was the result of an increase in tax-equivalent interest income of \$930 thousand, or 11.7%, partially offset by an increase in interest expense of \$466 thousand, or 79.3%.

The Company experienced continued declines in loan yield with the average yield on loans held for investment decreasing to 4.24% in the first quarter of 2018 from 4.42% in the first quarter of 2017. A significant component of this decrease was the increase in outstanding consumer automobile loans. Consumer automobile loans increased \$87.6 million, or 267.8%, from the first quarter of 2017, and the average yield on the portfolio was approximately 3.40% at March 31, 2018. Largely mitigating the reduction in loan yield was a sustained shift in the composition of earning assets from investments to loans. Average loans held for investment increased 20.8% while total investment securities decreased 15.2% from the first quarter of 2017 to the first quarter of 2018. As a consequence of this shift, there was only a modest contraction in the average tax-equivalent earning asset yield to 3.94% for the first quarter of 2018 from 3.98% for the first quarter of 2017. The lower corporate income tax rate resulting from the Tax Cuts and Jobs Act contributed to the decline in tax-equivalent earning asset yield, as the tax-equivalent benefit from tax-exempt interest income from municipal securities was diminished. Applying the new 21% effective income tax rate rather than the former 34% rate resulted in a diminution in the average tax-equivalent earning asset yield of 5 basis points.

The average rate on interest-bearing liabilities for the quarter ended March 31, 2018 was 0.63%, an increase of 22 basis points from the same period in 2017. The increase in funding costs is attributable to higher rates paid on time deposits and money market accounts as well as higher borrowing costs. Also contributing to the increase was an increased reliance on borrowings due to growth in loan balances exceeding that of deposit balances.

The net interest margin for the first quarter of 2018 was 3.48%, down from 3.69% in the same period of 2017. The margin decline was the result of a lower average earning asset yield and higher average rate on interest-bearing liabilities. The effect on the tax-equivalent adjustment resulting from the Tax Cuts and Jobs act discussed earlier is responsible for 4 basis points of the margin contraction.

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The following table shows an analysis of average earning assets, interest-bearing liabilities and rates and yields for the periods indicated. Nonaccrual loans are included in loans outstanding.

AVERAGE BALANCE SHEETS, NET INTEREST INCOME\* AND RATES\*

	For the quarter ended March 31,					
	2018			2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate**
	(dollars in thousands)					
<b>ASSETS</b>						
Loans held for investment*	\$744,620	\$7,901	4.24 %	\$616,357	\$6,811	4.42 %
Loans held for sale	756	9	4.76 %	-	-	-
Investment securities:						
Taxable	94,387	494	2.09 %	107,141	496	1.85 %
Tax-exempt*	57,929	436	3.01 %	72,441	647	3.57 %
Total investment securities	152,316	930	2.44 %	179,582	1,143	2.55 %
Interest-bearing due from banks	1,150	4	1.39 %	2,108	5	0.95 %
Federal funds sold	455	2	1.76 %	1,598	3	0.75 %
Other investments	4,415	60	5.44 %	970	14	5.77 %
Total earning assets	903,712	\$8,906	3.94 %	800,615	\$7,976	3.98 %
Allowance for loan losses	(9,842 )			(8,392 )		
Other nonearning assets	93,388			108,220		
Total assets	\$987,258			\$900,443		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Time and savings deposits:						
Interest-bearing transaction accounts	\$27,597	\$3	0.04 %	\$28,226	\$2	0.03 %
Money market deposit accounts	231,035	91	0.16 %	236,060	52	0.09 %
Savings accounts	85,505	10	0.05 %	79,997	10	0.05 %
Time deposits	211,641	616	1.16 %	207,138	519	1.00 %
Total time and savings deposits	555,778	720	0.52 %	551,421	583	0.42 %
Federal funds purchased, repurchase agreements and other borrowings	28,353	10	0.14 %	20,632	5	0.10 %
Federal Home Loan Bank advances	80,333	324	1.61 %	-	-	0.00 %
Total interest-bearing liabilities	664,464	1,054	0.63 %	572,053	588	0.41 %
Demand deposits	223,056			228,062		
Other liabilities	3,452			5,846		
Stockholders' equity	96,286			94,482		
Total liabilities and stockholders' equity	\$987,258			\$900,443		
Net interest margin		\$7,852	3.48 %		\$7,388	3.69 %

\*Computed on a fully tax-equivalent basis using a 21% rate for 2018 and a 34% rate for 2017

\*\*Annualized

#### Provision for Loan Losses

The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management's evaluation of the portfolio. This expense is based on management's estimate of probable credit losses inherent in the loan portfolio. Management's evaluation included credit quality trends, collateral values, discounted cash flow analysis, loan volumes, geographic, borrower and industry concentrations, the findings of internal credit quality assessments and results from external regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, were used in developing estimated loss factors for determining the allowance for loan losses. Based on its analysis of the adequacy of the allowance for loan losses, management concluded that the provision was appropriate.

The provision for loan losses was \$525 thousand in the first three months of 2018, compared to \$650 thousand in the first three months of 2017.

The decline in the provision for loan losses in the three months ended March 31, 2018 as compared to the same period in 2017 was largely due to slower net loan growth. The strong loan growth experienced over recent quarters moderated during the first quarter in part due to accelerated payoffs. Also, the Company sold an \$8.8 million pool of consumer automobile loans during the first quarter of 2018 at approximately book value as part of a strategy to maintain a balanced loan portfolio.

Net loans charged off as a percent of average loans on an annualized basis were 0.13% for the first three months of 2018 compared to 0.24% in the first three months of 2017. The state of the local economy can have a significant impact on the level of loan charge-offs. If the economy begins to contract, nonperforming assets could increase as a result of declines in real estate values and home sales or increases in unemployment rates and financial stress on borrowers. Increased nonperforming assets would increase charge-offs and reduce earnings due to larger contributions to the loan loss provision. If current economic conditions remain stable and net loan charge-offs are consistent with management's forecast, management expects that the loan loss provision will be lower in 2018 than in 2017.

#### Noninterest Income

Noninterest income totaled \$3.4 million for the three months ended March 31, 2018, an increase of \$192 thousand, or 6.1% from the same period in 2017. The increase in noninterest income relative to the year ago period was largely due to higher mortgage banking income and securities gains.

Mortgage banking income was \$141 thousand in the first quarter of 2018 compared to \$6 thousand in the first quarter of 2017. The increase is the result of the acquisition in the second quarter of 2017 of the outstanding interest in Old Point Mortgage, which is now included in the Company's consolidated financial statements. Net securities gains were \$80 thousand in the first quarter of 2018 compared to no gains in the same period of 2017.

Other service charges, commissions and fees also increased appreciably relative to the year ago period. These totaled \$1.1 million for the first quarter of 2018, an increase of \$51 thousand, or 5.0%, from the first quarter of 2017. The improvement was principally driven by higher merchant processing and debit card income.

### Noninterest Expense

Total noninterest expense of \$9.6 million increased \$923 thousand or 10.60%, when comparing the three months ended March 31, 2018 to the same period in 2017. Higher salaries and employee benefits and merger-related expenses were responsible for the majority of the increase. Salaries and employee benefits increased \$380 thousand, or 7.5%, when compared to the same period of 2017. This increase was largely due to higher personnel costs resulting from the addition of staff in connection with the Old Point Mortgage acquisition completed in April 2017. The Company incurred \$205 thousand in merger costs associated with the Citizens acquisition during the first quarter of 2018; there were no merger costs in the same period of 2017.

Other notable changes in noninterest expense when comparing the first quarters of 2018 and 2017 include:

Professional services (increased \$115 thousand or 30.8%): There were significant increases in processing fees due to growth in the automobile dealer loan portfolio. Servicing fees related to the student loan portfolio were also elevated due to nonrecurring charges associated with a change in the third party that services these loans.

Data processing (increased \$102 thousand or 24.6%): The increase was driven by higher debit card and online banking fees associated with higher volumes.

FDIC insurance (increased \$95 thousand or 99.0%): The assessment rate applied by the FDIC increased due to several factors including declines in the Bank's leverage ratio and net income. Growth in Bank assets also contributed to the insurance premium increase.

The Company's effective federal income tax rates for the three months ended March 31, 2018 and 2017 were 0.42% and 0.21%, respectively. These rates were minimized by the relative level of income that is exempt from federal income tax including that from bank-owned life insurance and tax-exempt municipal securities. The tax liability was also reduced by tax credits associated with the Company's investments in housing equity funds (see Note 4.

Low-Income Housing Tax Credits).

### Balance Sheet Review

Unless otherwise noted, all comparisons in this section are between balances at December 31, 2017 and March 31, 2018.

Total assets as of March 31, 2018 were \$993.8 million, an increase of \$11.9 million or 1.2%. Net loans held for investment declined \$5.9 million, or 0.8%. The strong net loan growth experienced over recent quarters moderated during the first quarter of 2018 in part due to accelerated payoffs. Also, the Company sold an \$8.8 million pool of consumer automobile loans during the quarter at approximately book value as part of a strategy to maintain a balanced loan portfolio.

Cash and cash equivalents increased \$29.0 million from sales, calls, and maturities of investment securities as well as the aforementioned sale of consumer automobile loans. Securities available-for-sale declined \$11.1 million, or 7.0%.

Total deposits increased \$5.4 million, or 0.7%, to \$789.0 million at March 31, 2018. Noninterest-bearing deposits increased \$5.6 million, or 2.5%, and savings deposits increased \$4.8 million, or 1.4%. Partially offsetting this growth was a decline in time deposits of \$5.0 million, or 2.4%. There were no federal funds purchased outstanding at March 31, 2018 compared to \$10.0 million at December 31, 2017. Overnight repurchase agreements increased \$15.4 million, or 74.7%, and FHLB advances increased \$2.5 million, or 3.7%.

Average assets for the first three months of 2018 were \$987.3 million compared to \$900.4 million for the first three months of 2017, an increase of 9.6%. Comparing the first three months of 2018 to the first three months of 2017, average growth in loans held for investment of \$128.3 million was funded by increases in average FHLB advances (\$80.3 million) and average deposits (\$4.4 million) and declines in average investment securities (\$27.3 million) and average cash and other nonearning assets (\$14.8 million).

The Company's holdings of "Alt-A" type mortgage loans such as adjustable rate and nontraditional type loans were inconsequential, amounting to less than 1.0% of the Company's loan portfolio as of March 31, 2018.

The Company does not have a formal program for subprime lending. The Company is required by law to comply with the requirements of the Community Reinvestment Act (the CRA), which imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low- and moderate-income borrowers. In order to comply with the CRA and meet the credit needs of its local communities, the Company finds it necessary to make certain loans with subprime characteristics.

For the purposes of this discussion, a "subprime loan" is defined as a loan to a borrower having a credit score of 660 or below. The majority of the Company's subprime loans are to customers in the Company's local market area. The following table details the Company's loans with subprime characteristics that were secured by 1-4 family first mortgages, 1-4 family open-end loans (i.e., equity lines of credit) and 1-4 family junior lien loans (e.g., second mortgages) for which the Company has recorded a credit score in its system.

Loans Secured by 1 - 4 Family  
First Mortgages,  
1 - 4 Family Open-end and 1 - 4  
Family Junior Liens  
As of March 31, 2018  
(dollars in thousands)

	<u>Amount</u>	<u>Percent</u>
Subprime	\$21,808	12.84 %
Non-subprime	148,052	87.16 %
	\$169,860	100.00 %

Total loans \$732,875

Percentage of Real  
Estate-Secured Subprime  
Loans to Total Loans 2.98 %

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In addition to the subprime loans secured by real estate discussed above, as of March 31, 2018, the Company had an additional \$16.8 million in subprime consumer loans that were not government guaranteed, were unsecured, or were secured by collateral other than real estate. Together with the subprime loans secured by real estate, the Company's total subprime loans as of March 31, 2018 were \$38.6 million, amounting to 5.27% of the Company's total loans at March 31, 2018.

Additionally, the Company has no investments secured by "Alt-A" type mortgage loans such as adjustable rate and nontraditional type mortgages or subprime loans.

#### Liquidity

Liquidity is the ability of the Company to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, investments in securities and loans maturing within one year. The Company's internal sources of such liquidity are deposits, loan and investment repayments and securities available-for-sale. As of March 31, 2018, the Bank's unpledged, available-for-sale securities totaled \$67.9 million. The Company's primary external source of liquidity is advances from the FHLB.

A major source of the Company's liquidity is its large, stable deposit base. In addition, secondary liquidity sources are available through the use of borrowed funds if the need should arise, including secured advances from the FHLB. As of the end of the first quarter of 2018, the Company had \$77.3 million in FHLB borrowing availability based on loans and securities currently available for pledging, less advances currently outstanding. The Company believes that the availability at the FHLB is sufficient to meet future cash-flow needs. The Company also has available short-term, unsecured borrowed funds in the form of federal funds lines of credit with correspondent banks. As of the end of the first quarter of 2018, the Company had \$55.0 million available in federal funds lines to address any short-term borrowing needs.

As disclosed in the Company's consolidated statements of cash flows, net cash provided by operating activities was \$3.0 million, net cash provided by investing activities was \$13.2 million and net cash provided by financing activities was \$12.9 million for the three months ended March 31, 2018. Combined, this contributed to a \$29.0 million increase in cash and cash equivalents for the three months ended March 31, 2018.

Management is not aware of any market or institutional trends, events or uncertainties that are expected to have a material effect on the liquidity, capital resources or operations of the Company. Nor is management aware of any current recommendations by regulatory authorities that would have a material effect on liquidity, capital resources or operations.

Based on the Company's management of liquid assets, the availability of borrowed funds, and the Company's ability to generate liquidity through liability funding, management believes that the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and to meet its customers' future borrowing needs.

Notwithstanding the foregoing, the Company's ability to maintain sufficient liquidity may be affected by numerous factors, including economic conditions nationally and in the Company's markets. Depending on its liquidity levels, its capital position, conditions in the capital markets and other factors, the Company may from time to time consider the issuance of debt, equity, other securities or other possible capital markets transactions, the proceeds of which could provide additional liquidity for the Company's operations.

#### Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, restructured loans that are accruing interest and not performing according to their modified terms, and OREO. See Note 3 of the Notes to the Consolidated Financial Statements included in this quarterly report on Form 10-Q for an explanation of



the loan categories. OREO consists of real estate from a foreclosure on loan collateral.

The majority of the loans past due 90 days or more and accruing interest are student loans with principal and interest amounts that are 97 - 98% guaranteed by the federal government. When a loan changes from "past due 90 days or more and accruing interest" status to "nonaccrual" status, the loan is reviewed for impairment. In most cases, if the loan is considered impaired, then the difference between the value of the collateral and the principal amount outstanding on the loan is charged off. If the Company is waiting on an appraisal to determine the collateral's value or is in negotiations with the borrower or other parties that may affect the value of the collateral, management allocates funds to the allowance for loan losses to cover the anticipated deficiency, based on information available to management at that time.

In the case of TDRs, the restructuring may be to modify to an unsecured loan (e.g., a short sale) that the borrower can afford to repay. In these circumstances, the entire balance of the loan would be specifically allocated for, unless the present value of expected future cash flows was more than the current balance on the loan. It would not be charged off if the loan documentation supports the borrower's ability to repay the modified loan.

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The following table presents information on nonperforming assets, as of the dates indicated:

NONPERFORMING ASSETS

	March	December	
	31,	31,	Increase
	2018	2017	(Decrease)
	(in thousands)		
Nonaccrual loans			