OLD POINT FINANCIAL CORP
Form 10-K
March 15, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
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)	(IRS 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)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $5 par value	The NASDAQ Stock Market LLC
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 30, 2016 was $66,676,665 based on the closing sales price on the NASDAQ Capital Market of $19.18.

There were 4,975,417 shares of common stock outstanding as of March 10, 2017.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Company's Annual Meeting of Stockholders to be held on May 23, 2017, are incorporated by reference in Part III of this report.

OLD POINT FINANCIAL CORPORATION

FORM 10-K

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Part I
Item 1. Business

GENERAL

Old Point Financial Corporation (the Company) was incorporated under the laws of Virginia on February 16, 1984, for the purpose of acquiring all the outstanding common stock of The Old Point National Bank of Phoebus (the Bank), in connection with the reorganization of the Bank into a one-bank holding company structure. At the annual meeting of the stockholders on March 27, 1984, the proposed reorganization was approved by the requisite stockholder vote. At the effective date of the reorganization on October 1, 1984, the Bank merged into a newly formed national bank as a wholly-owned subsidiary of the Company, with each outstanding share of common stock of the Bank being converted into five shares of common stock of the Company.

The Company completed a spin-off of its trust department as of April 1, 1999. The organization is chartered as Old Point Trust & Financial Services, N.A. (Trust). Trust is a nationally chartered trust company. The purpose of the spin-off was to have a corporate structure more ready to compete in the field of wealth management. Trust is a wholly-owned subsidiary of the Company.

The Bank is a national banking association that was founded in 1922. As of the end of 2016, the Bank had 18 branch offices serving the Hampton Roads localities of Hampton, Newport News, Norfolk, Virginia Beach, Chesapeake, Williamsburg/James City County, York County and Isle of Wight County. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers.

The Company's primary activity is as a holding company for the common stock of the Bank and Trust. The principal business of the Company is conducted through its subsidiaries, which continue to conduct business in substantially the same manner as before the reorganization and spin-off.

As of December 31, 2016, the Company had assets of $903.0 million, loans of $603.9 million, deposits of $784.5 million, and stockholders' equity of $94.0 million. At year-end, the Company and its subsidiaries had a total of 286 employees, 20 of whom were part-time.

MARKET AREA AND COMPETITION

The Company's market area is located in Hampton Roads, situated in the southeastern corner of Virginia and boasting the world's largest natural deepwater harbor. The Hampton Roads Metropolitan Statistical Area (MSA) is the 37th most populous MSA in the United States according to the U.S. Census Bureau's 2010 census and the third largest deposit market in Virginia, after Richmond and the Washington Metropolitan area, according to the Federal Deposit Insurance Corporation (FDIC). Hampton Roads includes the cities of Chesapeake, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach and Williamsburg, and the counties of Isle of Wight, Gloucester, James City, Mathews, York and Surry. The market area is serviced by 63 banks, savings institutions and credit unions and, in addition, branches of virtually every major brokerage house serve the Company's market area.

The banking business in Virginia, and in the Company's primary service areas in the Hampton Roads MSA, is highly competitive and dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have over the Company is their ability to finance wide-ranging advertising campaigns, and by virtue of their greater total capitalization, to have substantially higher lending limits than the Company. Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution affect competition for deposits and loans. The Company competes by emphasizing customer service and technology, establishing long-term customer relationships

and building customer loyalty, and providing products and services to address the specific needs of the Company's customers. The Company targets individual and small-to-medium size business customers.

Concurrently, the Company continues to build a stronger presence in the business banking market, where greater opportunities for fee-based revenues and cross-selling exist. In 2009, the Company expanded its treasury services offerings by adding a Corporate Banking group and expanding its product offerings to match those offered by larger institutions. This expansion has continued throughout 2016 with an aim towards growth and relationship development. Through these business banking capabilities, the Company is able to service a highly lucrative market that offers the opportunities to identify new revenue streams and cross sell additional products.

Personal assets held by non-banks are difficult to track at a local level, so research relies on deposits reported by governmental agencies to measure market share. In 2016, the Company held tenth place with 2.41% market share of all Hampton Roads deposits, as compared to 2.62% market share in 2015. On the Peninsula, the Company retains first place in Hampton with 28.31% market share, but saw a decline in deposits from 2015 of $10.5 million. The Company saw deposit growth from 2015 for all other Peninsula markets, with an increase of $2.2 million in James City County, $2.8 million in Williamsburg, $6.0 million in Newport News, and $937 thousand in York County.

In Southside Hampton Roads, the Company increased deposit share in Virginia Beach by $6.7 million and in Norfolk by $5.6 million from 2015. However, in the Chesapeake and Isle of Wight County markets, deposits decreased from 2015 by $7.8 million and $647 thousand, respectively. Combined with heightened marketing efforts, the staff in the Company's newer locations continues to work diligently to increase the Company's name recognition in their respective regions of the Hampton Roads MSA.

The Company also faces competitive pressure from credit unions. The three largest credit unions headquartered in the Hampton Roads MSA are Chartway Federal Credit Union, Langley Federal Credit Union, and Newport News Shipbuilding Employees' Credit Union with deposits totaling approximately $1.9 billion, $1.8 billion and $1.2 billion respectively, all of which posted a positive growth rate for 2016.

AVAILABLE INFORMATION

The Company maintains a website on the Internet at 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-K or other SEC filings. The information available at the Company's Internet address is not part of this Form 10-K or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files 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.

REGULATION AND SUPERVISION

Set forth below is a brief description of some of the material laws and regulations that affect the Company. The description of these statutes and regulations is only a summary and is not a complete discussion or analysis. This discussion is qualified in its entirety by reference to the statutes and regulations summarized below. No assurance can be given that these statutes or regulations will not change in the future.

General. The Company continues to experience a period of rapidly changing regulations and an environment of constant regulatory reform. These regulatory changes have had and will continue to have a significant impact on how the Company conducts its business. The most significant of these laws is the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), adopted on July 21, 2010, to implement significant structural reforms to the financial services industry. The full extent of the Dodd-Frank Act and other potential regulatory reforms cannot yet be fully determined and will depend to a large extent on regulations that will be adopted in the future.

As a public company, the Company is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), which include, but are not limited to, the filing of annual, quarterly and other reports with the SEC. The Company is also required to comply with other laws and regulations of the SEC applicable to public companies.

The Company is also a bank holding company within the meaning of the Bank Holding Company Act of 1956 (the BHCA) and is registered as such with, and subject to the supervision of, the Board of Governors of the Federal Reserve System (the FRB). Generally, a bank holding company is required to obtain the approval of the FRB before acquiring direct or indirect ownership or control of more than five percent of the voting shares of a bank or engaging in an activity considered to be a non-banking activity, either directly or through a subsidiary. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates.

As a national bank, the Bank is subject to regulation, supervision and regular examination by the Office of the Comptroller of the Currency (the Comptroller). The prior approval of the Comptroller or other appropriate bank regulatory authority is required for a national bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the constituent organizations and the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the Community Reinvestment Act (the CRA) and fair housing initiatives, the data security and cybersecurity infrastructure of the constituent organizations and the combined organization, and the effectiveness of the subject organizations in combating money laundering activities. Each depositor's account with the Bank is insured by the FDIC to the maximum amount permitted by law. The Bank is also subject to certain regulations promulgated by the FRB and applicable provisions of Virginia law, insofar as they do not conflict with or are not preempted by federal banking law.

As a non-depository national banking association, Trust is subject to regulation, supervision and regular examination by the Comptroller. Trust's exercise of fiduciary powers must comply with Regulation 9 promulgated by the Comptroller and with Virginia law.

The regulations of the FRB, the Comptroller and the FDIC govern most aspects of the Company's business, including deposit reserve requirements, investments, loans, certain check clearing activities, issuance of securities, payment of dividends, branching, and numerous other matters. Further, the federal bank regulatory agencies have adopted guidelines and released interpretive materials that establish operational and managerial standards to promote the safe and sound operation of banks and bank holding companies. These standards relate to the institution's key operating functions, including but not limited to internal controls, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings, compensation of management, information systems, data security and cybersecurity, and risk management. As a consequence of the extensive regulation of commercial banking activities in the United States, the Company's business is particularly susceptible to changes in state and federal legislation and regulations, which may have the effect of increasing the cost of doing business, limiting permissible activities or increasing competition.

The Bank Holding Company Act. As a bank holding company, the Company is subject to the BHCA and regulation and supervision by the FRB. A bank holding company is required to obtain the approval of the FRB before making certain acquisitions or engaging in certain activities. Bank holding companies and their subsidiaries are also subject to restrictions on transactions with insiders and affiliates.

A bank holding company is required to obtain the approval of the FRB before it may acquire all or substantially all of the assets of any bank, and before it may acquire ownership or control of the voting shares of any bank if, after giving effect to the acquisition, the bank holding company would own or control more than 5 percent of the voting shares of such bank. The approval of the FRB is also required for the merger or consolidation of bank holding companies.

Pursuant to the BHCA, the FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or ownership constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

The Company is required to file periodic reports with the FRB and provide any additional information the FRB may require. The FRB also has the authority to examine the Company and its subsidiaries, as well as any arrangements between the Company and its subsidiaries, with the cost of any such examinations to be borne by the Company. Banking subsidiaries of bank holding companies are also subject to certain restrictions imposed by federal law in dealings with their holding companies and other affiliates.

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The Dodd-Frank Act. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including changes that will affect all bank holding companies and banks, including the Company and the Bank. Among other provisions, the Dodd-Frank Act:

- changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital. The Dodd-Frank Act also made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000;
- repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;
- created and centralized significant aspects of consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (CFPB), which is discussed in more detail below;
- imposed limits for debit card interchange fees for issuers that have assets greater than $10 billion, which also could affect the amount of interchange fees collected by financial institutions with less than $10 billion in assets;
- restricted the preemption of state law by federal law and disallowed subsidiaries and affiliates of national banks from availing themselves of such preemption;
- imposed comprehensive regulation of the over-the-counter derivatives market subject to significant rulemaking processes, to include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;
- required loan originators to retain 5 percent of any loan sold or securitized, unless it is a "qualified residential mortgage", subject to certain restrictions;
- prohibited banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (the Volcker Rule); and
- implemented corporate governance revisions that apply to all public companies, not just financial institutions.

Some of the rules that have been adopted or proposed to comply with Dodd-Frank Act mandates are discussed in more detail below.

Capital Requirements and Prompt Corrective Action. The FRB, the Comptroller and the FDIC have adopted risk-based capital adequacy guidelines for bank holding companies and banks pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) and the Basel III Capital Accords. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources" in Item 7 of this report on Form 10-K.

The federal banking agencies have broad powers to take prompt corrective action to resolve problems of insured depository institutions. Under the FDICIA, there are five capital categories applicable to bank holding companies and insured institutions, each with specific regulatory consequences. The extent of the agencies' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." These terms are defined under uniform regulations issued by each of the federal banking agencies. If the appropriate federal banking agency determines that an insured institution is in an unsafe or unsound condition, it may reclassify the institution to a lower capital category (other than critically undercapitalized) and require the submission of a plan to correct the unsafe or unsound condition.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject the Company and its subsidiaries to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits, and other restrictions on its business. In addition, an institution may not make a capital distribution, such as a dividend or other distribution that is in substance a distribution of capital to the owners of the institution if following such a distribution the institution would be undercapitalized. Thus, if the making of such dividend would cause the Bank to become undercapitalized, it could not pay a dividend to the Company.

Basel III Capital Framework. The federal bank regulatory agencies have adopted rules to implement the Basel III capital framework as outlined by the Basel Committee on Banking Supervision and standards for calculating risk-weighted assets and risk-based capital measurements (collectively, the Basel III Final Rules). For purposes of these capital rules, (i) common equity Tier 1 capital (CET1) consists principally of common stock (including surplus) and retained earnings; (ii) Tier 1 capital consists principally of CET1 plus non-cumulative preferred stock and related surplus, and certain grandfathered cumulative preferred stock and trust preferred securities; and (iii) Tier 2 capital consists principally of Tier 1 capital plus qualifying subordinated debt and preferred stock, and limited amounts of an institution's allowance for loan losses. Each regulatory capital classification is subject to certain adjustments and limitations, as implemented by the Basel III Final Rules. The Basel III Final Rules also establish risk weightings that are applied to many classes of assets held by community banks, including, importantly, applying higher risk weightings to certain commercial real estate loans.

The Basel III Final Rules were effective on January 1, 2015, and the Basel III Final Rules' capital conservation buffer (as described below) is being phased in beginning January 1, 2016 through 2019. When fully phased in, the Basel III Final Rules require banks to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

The Basel III Final Rules provide deductions from and adjustments to regulatory capital measures, and primarily to CET1, including deductions and adjustments that were not applied to reduce CET1 under historical regulatory capital rules. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities must be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. These deductions from and adjustments to regulatory capital are generally subject to a phase in period, which began in 2015 and will continue through 2018.

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

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC. The basic limit on FDIC deposit insurance coverage is $250,000 per depositor.

Under the Federal Deposit Insurance Act (FDIA), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations as an insured institution, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, subject to administrative and potential judicial hearing and review processes.

The DIF is funded by assessments on banks and other depository institutions calculated based on average consolidated total assets minus average tangible equity (defined as Tier 1 capital). As required by the Dodd-Frank Act, the FDIC has adopted a large-bank pricing assessment scheme, set a target "designated reserve ratio" (described in more detail

below) of 2 percent for the DIF, and established a lower assessment rate schedule when the reserve ratio reaches 1.15 percent and, in lieu of dividends, provides for a lower assessment rate schedule, when the reserve ratio reaches 2 percent and 2.5 percent.

An institution's assessment rate is based on a statistical analysis of financial ratios that estimates the likelihood of failure over a three year period, which considers the institution's weighted average CAMELS component rating, and is subject to further adjustments including related to levels of unsecured debt and brokered deposits (not applicable to banks with less than $10 billion in assets). At December 31, 2016, total base assessment rates institutions that have been insured for at least five years range from 1.5 to 40 basis points, with rates of 1.5 to 30 basis points applying to banks with less than $10 billion in assets.

The Dodd-Frank Act transferred to the FDIC increased discretion with regard to managing the required amount of reserves for the DIF, or the "designated reserve ratio." Among other changes, the Dodd-Frank Act (i) raised the minimum designated reserve ratio to 1.35 percent and removed the upper limit on the designated reserve ratio, (ii) requires that the designated reserve ratio reach 1.35 percent by September 2020, and (iii) requires the FDIC to offset the effect on institutions with total consolidated assets of less than $10 billion of raising the designated reserve ratio from 1.15 percent to 1.35 percent – which requirement was met through rules adopted by the FDIC during 2016. On June 30, 2016, the designated reserve ratio rose to 1.17 percent, which triggered three major changes to deposit insurance assessments for the third quarter of 2016: (i) the range of initial assessment rates for all institutions declined from 5 to 35 basis points to 3 to 30 basis points (which are included in the total base assessment rates in the above paragraph); (ii) surcharges equal to an annual rate of 4.5 basis points began for insured depository institutions with total consolidated assets of $10 billion or more; and (iii) the revised assessment method described above was implemented. The FDIA requires that the FDIC consider the appropriate level for the designated reserve ratio on at least an annual basis. The FDIC has adopted a DIF restoration plan to ensure that the fund reserve ratio reaches 1.35 percent by September 30, 2020, as required by the Dodd-Frank Act.

Incentive Compensation. The FRB, the Comptroller and the FDIC have issued regulatory guidance intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The FRB will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." The findings will be included in reports of examination, and deficiencies will be incorporated into the organization's supervisory ratings. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In addition, in 2016, the SEC and the federal banking agencies proposed rules that prohibit covered financial institutions (including bank holding companies and banks) from establishing or maintaining incentive-based compensation arrangements that encourage inappropriate risk taking by providing covered persons (consisting of senior executive officers and significant risk takers, as defined in the rules) with excessive compensation, fees or benefits that could lead to material financial loss to the financial institution. The proposed rules outline factors to be considered when analyzing whether compensation is excessive and whether an incentive-based compensation arrangement encourages inappropriate risks that could lead to material loss to the covered financial institution, and establishes minimum requirements that incentive-based compensation arrangements must meet to be considered to not encourage inappropriate risks and to appropriately balance risk and reward. The proposed rules also impose additional corporate governance requirements on the boards of directors of covered financial institutions and impose additional record-keeping requirements. The comment period for these proposed rules has closed and a final rule has not yet been published.

Community Reinvestment Act. The Company is subject to the requirements of 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 neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community credit needs are currently assessed based on specified factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility.

Confidentiality and Required Disclosures of Consumer Information. The Company is subject to various laws and regulations that address the privacy of nonpublic personal financial information of consumers. The Gramm-Leach-Bliley Act and certain regulations issued thereunder protect against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a

financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure. In 2016, the CFPB proposed rules that provide an exception to the requirement to deliver an annual privacy notice if a financial institution only provides nonpublic personal information to unaffiliated third parties under limited exceptions under the Gramm-Leach-Bliley Act and related regulations, and has not changed its policies and practices regarding disclosure of nonpublic personal financial information from those disclosed in the most recent privacy notice provided to the customer.

The Company is also subject to various laws and regulations that attempt to combat money laundering and terrorist financing. The Bank Secrecy Act requires all financial institutions to, among other things, create a system of controls designed to prevent money laundering and the financing of terrorism, and imposes recordkeeping and reporting requirements. The USA Patriot Act facilitates information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering, and requires financial institutions to establish anti-money laundering programs. The Office of Foreign Assets Control (OFAC), which is a division of the U.S. Department of the Treasury, is responsible for helping to ensure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name of an "enemy" of the United States on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account or place transferred funds into a blocked account, file a suspicious activity report with the Treasury and notify the FBI.

Consumer Laws and Regulations. The Company is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act and the Fair Housing Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions transact business with customers. The Company must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

The CFPB is the federal regulatory agency responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. The CFPB supervises and regulates providers of consumer financial products and services and has rulemaking authority in connection with numerous federal consumer financial protection laws (for example, but not limited to, the Truth in Lending Act and the Real Estate Settlement Procedures Act). As a smaller institution (i.e., with assets of $10 billion or less), most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the FRB and to the Bank and Trust by the Comptroller. However, the CFPB may include its own examiners in regulatory examinations by a smaller institution's prudential regulators and may require smaller institutions to comply with certain CFPB reporting requirements. In addition, regulatory positions taken by the CFPB and administrative and legal precedents established by CFPB enforcement activities, including in connection with supervision of larger bank holding companies and banks, could influence how the FRB and Comptroller apply consumer protection laws and regulations to financial institutions that are not directly supervised by the CFPB. The precise effect of the CFPB's consumer protection activities on the Company cannot be forecast.

Mortgage Banking Regulation. In connection with making mortgage loans, the Bank is subject to rules and regulations that, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers, in some cases, restrict certain loan features and fix maximum interest rates and fees, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level. The Bank's mortgage origination activities are subject to the Equal Credit Opportunity Act, Truth in Lending Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts, among other additional state and federal laws, regulations and rules.

The Bank's mortgage origination activities are also subject to Regulation Z, which implements the Truth in Lending Act. Certain provisions of Regulation Z require mortgage lenders to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Alternatively, a mortgage lender can originate "qualified mortgages", which are generally defined as mortgage loans without negative amortization, interest-only payments, balloon

payments, terms exceeding 30 years, and points and fees paid by a consumer equal to or less than 3% of the total loan amount. Higher-priced qualified mortgages (e.g., subprime loans) receive a rebuttable presumption of compliance with ability-to-repay rules, and other qualified mortgages (e.g., prime loans) are deemed to comply with the ability-to-repay rules. The Bank does not originate first mortgage loans at this time, and the first mortgages it purchases comply with Regulation Z's "qualified mortgage" rules. The Bank does originate second mortgages, or equity loans, and these loans do not conform to the qualified mortgage criteria but comply with applicable ability-to-repay rules.

Volcker Rule. The Dodd-Frank Act prohibits bank holding companies and their subsidiary banks from engaging in proprietary trading except in limited circumstances, and places limits on ownership of equity investments in private equity and hedge funds (the Volcker Rule). The Company believes that its financial condition and its operations are not and will not be significantly impacted by the Volcker Rule or its implementing regulations. Smaller banks, with total consolidated assets of $10 billion or less, engaged in modest proprietary trading activities for their own accounts are subject to a simplified compliance program under the final rules. Several portions of the Volcker Rule remain subject to regulatory rulemaking and legislative activity, including to further delay effectiveness of some provisions of the Volcker Rule. The Company does not expect that any delays in the effectiveness of a portion of the Volcker Rule will significantly impact its financial condition.

Item 1A. Risk Factors

U.S. and international economic conditions and credit markets pose challenges for the Company and could adversely affect the results of operations, liquidity and financial condition. In recent years, economic growth and business activity in the Company's local markets as well as in the broader national and international economies, has been modest. In addition, uncertainty regarding oil prices, ongoing federal budget negotiations, the implementation of the employer mandate under the Patient Protection and Affordable Care Act, and the level of U.S. debt may present challenges to businesses and have a destabilizing effect on financial markets. Unfavorable or uncertain economic conditions generally could cause a decline in the value of the Company's securities portfolio, and could increase the regulatory scrutiny of financial institutions. Another deterioration of local economic conditions could again lead to declines in real estate values and home sales and increases in the financial stress on borrowers and unemployment rates, all of which could lead to increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral value. Such a deterioration of local economic conditions could cause the level of loan losses to exceed the level the Company has provided in its allowance for loan losses which, in turn, would reduce the Company's earnings.

Global credit market conditions could return to being disrupted and volatile. Although the Company remains well capitalized and has not suffered any liquidity issues, the cost and availability of funds may be adversely affected by illiquid credit markets. Any future turbulence in the U.S. and international markets and economy may adversely affect the Company's liquidity, financial condition and profitability.

The Company is subject to interest rate risk and variations in interest rates may negatively affect its financial performance. The Company's profitability depends in substantial part on its net interest margin, which is the difference between the rates received on loans and investments and the rates paid for deposits and other sources of funds. The net interest margin depends on many factors that are partly or completely outside of the Company's control, including competition; federal economic, monetary and fiscal policies; and economic conditions. Because of the differences in the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect the Company's net interest margin and, in turn, its profitability.

In December 2015, the FRB's Federal Open Market Committee (FOMC) raised the target range for the federal funds rate, which is the interest rate at which depository institutions lend reserve balances to other depository institutions overnight, to 0.25%-0.50%, which was the first change since the target range was lowered to 0%-0.25% in 2008. In December 2016, the FOMC again raised its target range by 25 basis points, to 0.50%-0.75%. At the time of this writing, the FOMC is expected to raise rates three times in 2017. Despite these projected increases, the FOMC's monetary policy remains accommodative, and the overall low interest rate environment is expected to continue in 2017. Continued low interest rates could put further pressure on the yields generated by the Company's loan portfolio and on the Company's net interest margin. At December 31, 2016, based on scheduled maturities only, the Company's balance sheet was liability sensitive at the one-year time frame and, as a result, its net interest margin will tend to

decrease in a rising interest rate environment and increase in a declining interest rate environment. However, when using decay rates to simulate maturities for non-maturing deposits, the Company's balance sheet as of December 31, 2016 is asset sensitive at the one-year time frame. When the Company is asset sensitive, the net interest margin should rise if rates rise and should fall if rates fall. For additional details, See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Sensitivity" in Item 7 of this report on Form 10-K.

In addition, any substantial and prolonged increase in market interest rates could reduce the Company's customers' desire to borrow money or adversely affect their ability to repay their outstanding loans by increasing their credit costs. Interest rate changes could also affect the fair value of the Company's financial assets and liabilities. Accordingly, changes in levels of market interest rates could materially and adversely affect the Company's net interest margin, asset quality, loan origination volume, business, financial condition, results of operations and cash flows.

System failures, interruptions, breaches of security, or the failure of a third-party provider to perform its obligations could adversely impact the Company's business operations and financial condition. Communications and information systems are essential to the conduct of the Company's businesses, as such systems are used to manage customer relationships, general ledger, deposits and loans. While the Company has established policies and procedures to prevent or limit the impact of systems failures, interruptions and security breaches, the Company's information, security, and other systems may stop operating properly or become disabled or damaged as a result of a number of factors, including events beyond the Company's control, such as sudden increases in customer transaction volume, electrical or telecommunications outages, natural disasters, and cyber-attacks. Information security risks have increased in recent years and hackers, activists and other external parties have become more technically sophisticated and well-resourced. These parties use a variety of methods to attempt to breach security systems and access the data of financial services institutions and their customers. The Company may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. In addition, any compromise of the security systems could deter customers from using the Bank's website and online banking service, both of which involve the transmission of confidential information. The security and authentication precautions imposed by the Company and the Bank may not protect the systems from compromises or breaches of security, which would adversely affect the Company's results of operations and financial condition.

In addition, the Company outsources certain data processing to certain third-party providers. Accordingly, the Company's operations are exposed to risk that these third-party providers will not perform in accordance with the contracted arrangements under service agreements. If the third-party providers encounter difficulties, or if the Company has difficulty in communicating with them, the Company's ability to adequately process and account for customer transactions could be affected, and the Company's business operations could be adversely impacted. Further, a breach of a third-party provider's technology may cause loss to the Company's customers. Replacing these third-party providers could also create significant delay and expense. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any systems failure, interruption or breach of security, or the failure of a third-party provider to perform its obligations, could expose the Company to risks of data loss or data misuse, could result in violations of applicable privacy and other laws, could damage the Company's reputation and result in a loss of customers and business, could subject it to additional regulatory scrutiny or could expose it to civil litigation, possible financial liability and costly response measures. Any of these occurrences could have a material adverse effect on the Company's financial condition and results of operations.

The Company's accounting estimates and risk management processes rely on analytical and forecasting models. Processes that management uses to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on the Company's earnings performance and liquidity, depend upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are accurate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation.

If the models that management uses for interest rate risk and asset-liability management are inadequate, the Company may incur increased or unexpected losses upon changes in market interest rates or other market measures and may be unable to maintain sufficient liquidity. If the models that management uses to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the Company could realize upon sale or settlement of such financial instruments. Any such failure in management's analytical or forecasting models could have a material adverse effect on the Company's business, financial condition and results of operations.

Weaknesses in the commercial real estate markets could negatively affect the Company's financial performance due to the Company's concentration in commercial real estate loans. At December 31, 2016, the Company had $308.5 million, or 51.09%, of total loans concentrated in commercial real estate, which includes, for purposes of this concentration, all construction loans, loans secured by multifamily residential properties, loans secured by farmland and loans secured by nonfarm, nonresidential properties. Commercial real estate loans expose the Company to a greater risk of loss than residential real estate and consumer loans. Commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Consequently, an adverse development with respect to one commercial real estate loan or credit relationship exposes the Company to a significantly greater risk of loss compared to an adverse development with respect to one residential real estate loan. Commercial real estate loans carry risks associated with the successful operation of a business if the properties are owner occupied. If the properties are non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts. Repayment of commercial real estate loans may, to a greater extent than residential real estate loans, be subject to adverse conditions in the real estate market or economy. Weak economic or market conditions may impair a borrower's business operations, slow the execution of new leases and lead to turnover in existing leases. The combination of these factors could result in deterioration in value of some of the Company's loans. The deterioration of one or more of the Company's significant commercial real estate loans could cause a significant increase in nonaccrual loans. An increase in nonaccrual loans could result in a loss of interest income from those loans, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial performance.

The Company's profitability depends significantly on local economic conditions and changes in the federal government's military or defense spending may negatively affect the local economy. The Company's success depends primarily on the general economic conditions of the markets in which the Company operates. Unlike larger financial institutions that are more geographically diversified, the Company provides banking and financial services to customers primarily in the Hampton Roads MSA. The local economic conditions in this area have a significant impact on the demand for loans, the ability of the borrowers to repay these loans and the value of the collateral securing these loans. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond the Company's control could impact these local economic conditions.

In addition, Hampton Roads is home to one of the largest military installations in the world and one of the largest concentrations of Department of Defense personnel in the United States. Some of the Company's customers may be particularly sensitive to the level of federal government spending on the military or on defense-related products. Federal spending is affected by numerous factors, including macroeconomic conditions, presidential administration priorities, and the ability of the federal government to enact relevant appropriations bills and other legislation. Any of these factors could result in future cuts to military or defense spending or increased uncertainty about federal spending, which could have a severe negative impact on individuals and businesses in the Company's primary service area. Any related increase in unemployment rates or reduction in business development activities in the Company's primary service area could lead to reductions in loan demand, increases in loan delinquencies, problem assets and foreclosures and reductions in loan collateral value, which could have a material adverse effect on the Company's operating results and financial condition.

The Company is subject to losses resulting from fraudulent and negligent acts on the part of loan applicants, correspondents or other third parties. The Company relies heavily upon information supplied by third parties, including the information contained in credit applications, employment and income documentation, property appraisals, title information, and equipment pricing and valuation, in deciding which loans to originate, as well as in establishing the terms of those loans. If any of the information upon which the Company relies during the loan approval process is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to asset funding, the value of the asset may be significantly lower than expected, the Company may fund a loan that it would not have otherwise funded or the Company may fund a loan on terms that it would not have otherwise

extended. Whether a misrepresentation is made by the applicant or by another third party, the Company generally bears the risk of loss associated with the misrepresentation. In addition, a loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentation are often difficult to locate, and it may be difficult to recover any monetary loss the Company may suffer.

Declines in loans outstanding could have a material adverse impact on the Company's operating results and financial condition. Growing and diversifying the loan portfolio is part of the Company's strategic initiative. If quality loan demand does not continue to increase and the Company's loan portfolio begins to decline, the Company expects that excess liquidity will be invested in marketable securities. Because loans typically yield higher returns than the Company's securities portfolio, a shift towards investments in the Company's asset mix would likely result in an overall reduction in net interest income and the net interest margin. The principal source of earnings for the Company is net interest income, and as discussed above, the Company's net interest margin is a major determinant of the Company's profitability. The effects of a reduction in net interest income and the net interest margin may be exacerbated by the intense competition for quality loans in the Company's primary service area and by rate reductions on loans currently held in the portfolio. As a result, a reduction in loans could have a material adverse effect on the Company's operating results and financial condition.

The Company's substantial dependence on dividends from its subsidiaries may prevent it from paying dividends to its stockholders and adversely affect its business, results of operations or financial condition. The Company is a separate legal entity from its subsidiaries and does not have significant operations or revenues of its own. The Company substantially depends on dividends from its subsidiaries to pay dividends to stockholders and to pay its operating expenses. The availability of dividends from the subsidiaries is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Company and other factors, that the Comptroller could assert that payment of dividends by the subsidiaries is an unsafe or unsound practice. In the event the subsidiaries are unable to pay dividends to the Company, the Company may not be able to pay dividends on the Company's common stock, service debt or pay operating expenses. Consequently, the inability to receive dividends from the subsidiaries could adversely affect the Company's financial condition, results of operations, cash flows and limit stockholders' return, if any, to capital appreciation.

The small-to-medium size businesses the Company targets may have fewer financial resources to weather a downturn in the economy, which could materially harm operating results. The Company targets individual and small-to-medium size business customers. Small-to-medium size businesses frequently have smaller market shares than their competitors, may be more vulnerable to economic downturns, often need substantial additional capital to expand and compete and may experience significant volatility in operating results. Any one or more of these factors may impair a borrower's ability to repay a loan. In addition, the success of a small-to-medium size business often depends on the management talents and efforts of one person or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns and other events that negatively impact businesses in the Company's primary service area could have a proportionately greater impact on small-to-medium-size businesses and accordingly could cause the Company to incur substantial credit losses that could negatively affect its results of operations and financial condition.

The ownership of foreclosed property exposes the Company to significant costs, some of which are uncertain. When the Company has to foreclose upon real property held as collateral, the Company is exposed to the risks inherent in the ownership of real estate. The amount that the Company may realize after a loan default is dependent upon factors outside of the Company's control, including environmental cleanup liability, especially with regard to non-residential real estate, neighborhood values, real estate tax rates, operating or maintenance expenses of the foreclosed properties, and supply of and demand for properties. Significant costs associated with the ownership of real estate may exceed the income earned from such real estate, and the Company may have to advance funds to protect its investment or dispose of the real estate at a loss. These factors may materially and adversely affect the Company's business, financial condition, cash flows and result of operations.

The Company and its subsidiaries are subject to extensive regulation which could adversely affect them. The Company is subject to extensive regulation by federal, state and local governmental authorities and is subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of operations, including those referenced above. Regulations adopted by these agencies, which are generally intended to protect depositors and customers rather than to benefit stockholders, govern a comprehensive range of matters including, without limitation, ownership and control of the Company's shares, acquisition of other companies and businesses, permissible activities that the Company and its subsidiaries may engage in, maintenance of adequate capital levels and other aspects of operations. These regulations could limit the Company's growth by restricting certain of its activities. The laws, rules and regulations applicable to the Company are subject to regular modification and change. Regulatory changes could subject the Company to more demanding regulatory compliance requirements which could affect the Company in unpredictable and adverse ways. Such changes could subject the Company to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or damage to the Company's reputation, which could have a material adverse effect on the Company's business, financial condition and results of operations. Legislation and regulatory initiatives containing wide-ranging proposals for altering the structure, regulation and competitive relationship of financial institutions are introduced regularly. The Company cannot predict in what form or whether a proposed statute or regulation will be adopted or the extent to which such adoption may affect its business.

Market risk affects the earnings of Trust. The fee structure of Trust is generally based upon the market value of accounts under administration. Most of these accounts are invested in equities of publicly traded companies and debt obligations of both government agencies and publicly traded companies. As such, fluctuations in the equity and debt markets in general have had a direct impact upon the earnings of Trust.

Compliance with the CFPB regulations aimed at the mortgage banking industry may require substantial changes to mortgage lending systems and processes that may adversely affect income from the Company's residential mortgage activities. The CFPB has finalized a number of significant rules that impact nearly every aspect of the lifecycle of a residential real estate loan. Among other things, the rules adopted by the CFPB require mortgage lenders either to make a reasonable and good faith determination, based on verified and documented information, that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms, or to originate "qualified mortgages." In June 2015, the CFPB issued rules that combined disclosures previously established by the Truth in Lending Act and the Real Estate Settlement Procedures Act into a single disclosure referred to as the TILA-RESPA Integrated Disclosure, or TRID. TRID applies to most closed-end mortgage loans and overhauls the manner in which mortgage loan origination disclosures are made.

Although the Company does not originate or sell first mortgage loans at this time, it may elect to do so in the future, and TRID does apply to the mortgages it purchases. TRID also applies to second mortgages originated by the Company (but not to equity lines of credit). During 2015, the Company made significant changes to its residential real estate business, including investments in technology and employee training. These CFPB rules, in addition to other previously-issued and to-be-issued CFPB regulations, could materially affect the Company's ability to originate and sell residential real estate loans or limit the terms on which the Company may offer products, which could adversely affect the Company's financial condition and results of operations.

The Basel III Final Rules require higher levels of capital and liquidity, which could adversely affect the Company's net income and return on equity. The capital adequacy and liquidity guidelines applicable to the Company and the Bank under the Basel III Final Rules began to be phased in beginning in 2015. The Basel III Final Rules, when fully phased in, will require the Company and the Bank to maintain substantially more capital as a result of higher minimum capital levels and more demanding regulatory capital risk-weightings and calculations. The changes to the standardized calculations of risk-weighted assets are complex and may create enormous compliance burdens for the

Company and the Bank. The Basel III Final Rules will require the Company and the Bank to substantially change the manner in which they collect and report information to calculate risk-weighted assets, and may increase dramatically risk-weighted assets as a result of applying higher risk weightings to many types of loans and securities. As a result, the Company and the Bank may be forced to limit originations of certain types of commercial and mortgage loans, thereby reducing the amount of credit available to borrowers and limiting opportunities to earn interest income from the loan portfolio, which may have a detrimental impact on the Company's net income.

If the Company were to require additional capital as a result of the Basel III Final Rules, it could be required to access the capital markets on short notice and in relatively weak economic conditions, which could result in raising capital that significantly dilutes existing stockholders. Additionally, the Company may be forced to limit banking operations and activities, and growth of loan portfolios and interest income, to focus on retention of earnings to improve capital levels. Higher capital levels may also lower the Company's return on equity.

The Company is dependent on key personnel and the loss of one or more of those key personnel could harm its business. The banking business in Virginia, and in the Company's primary service area in the Hampton Roads MSA, is highly competitive and dominated by a relatively small number of large banks. Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of and experience in the Virginia community banking industry. The Company's success depends to a significant degree upon its ability to attract and retain qualified management, loan origination, administrative, marketing and technical personnel and upon the continued contributions of and customer relationships developed by management and personnel. In particular, the Company's success is highly dependent upon the capabilities of its senior executive management. The Company believes that its management team, comprised of individuals who have worked in the banking industry for many years, is integral to implementing the Company's business plan. The Company has not entered into employment agreements with any of its executive management employees, and the loss of the services of one or more of them could harm the Company's business.

The allowance for loan losses may not be adequate to cover actual losses. A significant source of risk arises from the possibility that losses could be sustained because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans and leases. There is no precise method to predict loan losses. Like all financial institutions, the Company maintains an allowance for loan losses to provide for loan defaults and non-performance. Accounting measurements related to impairment and the allowance for loan losses require significant estimates that are subject to uncertainty and changes relating to new information and changing circumstances. The allowance for loan losses may not be adequate to cover actual loan losses. In addition, future provisions for loan losses could materially and adversely affect, and have in recent years materially and adversely affected, the Company's operating results.

The allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolutions, changes in the size and composition of the loan portfolio and industry information. Also included in management's estimates for loan losses are considerations with respect to the impact of economic events, the outcome of which are uncertain. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and judgment. The amount of future losses is susceptible to changes in economic and other conditions, including changes in interest rates, that may be beyond the Company's control and these future losses may exceed current estimates. If management's assumptions prove to be incorrect or if the Company experiences significant loan losses in future periods, the current level of the allowance for loan losses may not be adequate to cover actual loan losses and adjustments may be necessary. In addition, federal regulatory agencies, as an integral part of their examination process, review the Company's loans and allowance for loan losses and may require an increase in the allowance for loan losses or recognition of additional loan charge-offs, based on judgments different from those of management. While management believes that the Company's allowance is adequate to cover current losses, the Company cannot assure investors that it will not need to increase the allowance or that regulators will not require the allowance to be increased. Either of these occurrences could materially and adversely affect earnings and profitability.

The Company may be adversely affected by changes in government monetary policy. As a bank holding company, the Company's business is affected by the monetary policies established by the FRB, which regulates the national money supply in order to mitigate recessionary and inflationary pressures. In setting its policy, the FRB may utilize techniques such as the following:

- Engaging in open market transactions in U.S. Government securities;
- Setting the discount rate on member bank borrowings; and
- Determining reserve requirements.

These techniques determine, to a significant extent, the Company's cost of funds for lending and investing. These techniques, all of which are outside the Company's control, may have an adverse effect on deposit levels, net interest

margin, loan demand or the Company's business and operations.

The Company's future success depends on its ability to compete effectively in the highly competitive financial services industry. The Company faces substantial competition in all phases of its operations from a variety of different competitors. Growth and success depends on the Company's ability to compete effectively in this highly competitive financial services environment. Many competitors offer products and services that are not offered by the Company, and many have substantially greater resources, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively and may have larger lending limits that would allow them to serve the credit needs of larger customers. In addition, financial technology start-ups are emerging in key areas of banking. Some of the financial services organizations with which the Company competes are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured national banks, and may have broader geographic services areas and lower cost structures. As a result, these non-bank competitors have certain advantages over the Company in accessing funding and in providing various services. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Failure to compete effectively to attract new and retain current customers in the Company's markets could cause it to lose market share, slow its growth rate and may have an adverse effect on its financial condition and results of operations.

The Company may not be able to compete effectively without the appropriate use of current technology. The use of technology in the financial services market, including the banking industry, evolves frequently. The Company may be unable to attract and maintain banking relationships with certain customers if it does not offer appropriate technology-driven products and services. In addition to better serving customers, the effective use of technology may increase efficiency and reduce costs. The Company may not be able to effectively implement new technology-driven products or services or be successful in marketing these products and services to its customers. As a result, the Company's ability to compete effectively may be impaired, which could lead to a material adverse effect on the Company's financial condition and results of operations.

Negative public opinion could damage the Company's reputation and adversely impact the Company's business, financial condition and results of operation. Reputation risk, or the risk to the Company's business, financial condition and results of operation from negative public opinion, is inherent in the financial services industry. Negative public opinion can result from actual or alleged conduct in any number of activities, including lending or foreclosure practices, regulatory compliance, corporate governance and sharing or inadequately protecting customer information, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion could adversely affect the Company's ability to keep and attract customers and employees, could expose it to litigation and regulatory action, and could adversely affect its access to the capital markets. Damage to the Company's reputation could adversely affect deposits and loans and otherwise negatively affect the Company's business, financial condition and results of operation.

Deposit insurance premiums could increase in the future, which may adversely affect future financial performance. The FDIC insures deposits at FDIC insured financial institutions, including the Bank. The FDIC charges insured financial institutions premiums to maintain the DIF at a certain level. Economic conditions from 2008 to 2011 increased the rate of bank failures and expectations for further bank failures, requiring the FDIC to make payments for insured deposits from the DIF. Although the DIF has since been replenished, a similar economic downturn in the future could require measures similar to those implemented during the last financial crisis, such as special assessments or required prepayments of insurance premiums. If the FDIC takes action to replenish the DIF, or if the Bank's asset size increases, the Bank's FDIC insurance premiums could increase, which could have an adverse effect on the Company's results of operations.

The Company may need to raise additional capital in the future and such capital may not be available when needed or at all. The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs, particularly if its asset quality or earnings were to deteriorate significantly. Economic conditions and the loss of confidence in financial institutions may increase the

Company's cost of funding and limit access to certain customary sources of capital, including inter-bank borrowings, repurchase agreements and borrowings from the Federal Reserve Bank's discount window. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of the Company's control, and the Company's financial performance.

The Company cannot assure that such capital will be available on acceptable terms or at all. Any occurrence that may limit the Company's access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of the Bank or counterparties participating in the capital markets, or a downgrade of the parent company or the Bank's ratings, may adversely affect the Company's capital costs and its ability to raise capital and, in turn, its liquidity. Moreover, if the Company needs to raise capital in the future, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on the Company's liquidity, business, financial condition and results of operations.

The Company and its subsidiaries are subject to operational risk, which could adversely affect business, financial condition and results of operation. The Company and its subsidiaries, like all businesses, are subject to operational risk, including the risk of loss resulting from human error, fraud or unauthorized transactions due to inadequate or failed internal processes and systems, and external events that are wholly or partially beyond the Company's control (including, for example, sudden increases in customer transaction volume, electrical or telecommunications outages, natural disasters, and cyber-attacks). Operational risk also encompasses compliance (legal) risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices or ethical standards. The Company and its subsidiaries have established a system of internal controls to address these risks, but there are inherent limitations to such risk management strategies as there may exist, or develop in the future, risks that are not anticipated, identified or monitored. Any losses resulting from operational risk could take the form of explicit charges, increased operational costs, litigation costs, harm to reputation or forgone opportunities, loss of customer business, or the unauthorized release, misuse, loss or destruction of proprietary information, any and all of which could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's directors and executive officers own a significant portion of the Company's common stock and can exert significant influence over its business and corporate affairs. The Company's directors and executive officers, as a group, beneficially owned 29.90% of the Company's common stock as of June 30, 2016. Consequently, if they vote their shares in concert, they can significantly influence the outcome of matters submitted to the Company's stockholders for approval, including the election of directors. The interests of the Company's directors and executive officers may conflict with the interests of other holders of the Company's common stock, and the Company's directors and executive officers may take actions affecting the Company with which other holders of the Company's common stock disagree.

Future sales of the Company's common stock by stockholders or the perception that those sales could occur may cause the common stock price to decline. Although the Company's common stock is listed for trading on the NASDAQ stock market, the trading volume in the common stock may be lower than that of other larger financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the potential for lower relative trading volume in the common stock, significant sales of the common stock in the public market, or the perception that those sales may occur, could cause the trading price of the Company's common stock to decline or to be lower than it otherwise might be in the absence of these sales or perceptions.

Future issuances of the Company's common stock could adversely affect the market price of the common stock and could be dilutive. The Company may issue additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, shares of the Company's common stock. Issuances of a substantial number of shares of common stock, or the expectation that such issuances might occur, could materially adversely affect the market price of the common stock and could be dilutive to stockholders. Any decision the Company makes to issue common stock in the future will depend on market conditions and other factors, and the Company cannot predict or estimate the amount, timing, or nature of possible future issuances of common stock.

Accordingly, holders of the Company's common stock bear the risk that future issuances of securities will reduce the market price of the common stock and dilute their stock holdings in the Company.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2016, the Company owned its main office, which includes a branch, located in Hampton, Virginia; the corporate headquarters, which includes a branch; six office buildings; and 12 branches. All of these are owned directly and free of any encumbrances. One of the office buildings is currently listed for sale and held in other real estate owned.

The land at the Fort Monroe branch is leased by the Company under an agreement that expires in June 2017. Two of the remaining three branches are leased from unrelated parties. The Crown Center branch is leased from Crown Center Associates, LLC, which is indirectly owned by Michael Glasser, a member of the Company's Board of Directors. These three branch leases have renewal options that expire anywhere within one to eight years from December 31, 2016.

For more information concerning the commitments under current leasing agreements, see Note 6 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Item 3. Legal Proceedings

Neither the Company nor any of its subsidiaries is a party to any material pending legal proceedings before any court, administrative agency, or other tribunal.

Item 4. Mine Safety Disclosures

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name (Age) And Present Position	Served in Current Position Since	Principal Occupation During Past Five Years
Robert F. Shuford, Sr. (79) Chairman, President & Chief Executive Officer Old Point Financial Corporation	1965	Chairman of the Board, President & Chief Executive Officer of the Company Chairman of the Board of the Bank
Robert F. Shuford, Jr. (52) Executive Vice President/Bank Old Point Financial Corporation	2015	Executive Vice President/Bank of the Company since 2015; Chief Operating Officer & Senior Vice President/Operations of the Company from 2003 to 2015 President & Chief Executive Officer of the Bank since 2015; Senior Executive Vice President & Chief Operating Officer of the Bank from 2012 to 2015; Executive Vice President & Chief Operating Officer of the Bank from 2003 to 2012
Laurie D. Grabow (59) Chief Financial Officer & Senior Vice President/Finance Old Point Financial Corporation	1999	Chief Financial Officer & Senior Vice President/Finance of the Company Chief Financial Officer & Executive Vice President of the Bank
Eugene M. Jordan, II (62) Secretary to the Board & Executive Vice President/Trust Old Point Financial Corporation	2003	Secretary to the Board & Executive Vice President/Trust of the Company since 2015; Executive Vice President/ Trust of the Company from 2003 to 2015 President and Chief Executive Officer of Trust since 2003
Joseph R. Witt (56) Chief Business Development Officer & Senior Vice President Old Point Financial Corporation	2008	Chief Business Development Officer & Senior Vice President of the Company since 2015; Chief Administrative Officer & Senior Vice President/Administration of the Company from 2012 to 2015; Senior Vice President/ Corporate Banking/Human Resources of the Company from 2010 to 2012; Senior Vice President/Corporate Banking of the Company from 2008 to 2010 Senior Executive Vice President & Chief Business Development Officer of the Bank since 2015; Senior Executive Vice President & Chief Administrative Officer of the Bank from 2012 to 2015; Executive Vice President/ Corporate Banking & Human Resources Director of the Bank from 2010 to 2012

Donald S. Buckless (52)		
Chief Lending Officer & Senior Vice President Old Point Financial Corporation	2016	Chief Lending Officer & Senior Vice President of the Company since 2016 Chief Lending Officer & Executive Vice President of the Bank since 2016; Chief Lending Officer & Senior Vice President of the Bank from 2015 to 2016; Senior Vice President/Commercial Lending Officer of the Bank from May 2012 to 2015; Senior Vice President of SunTrust from December 2000 to May 2012

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of the Company is quoted on the NASDAQ Capital Market under the symbol "OPOF". The approximate number of stockholders of record as of March 10, 2017 was 1,184. On that date, the closing price of the Company's common stock on the NASDAQ Capital Market was $28.32. The range of high and low sale prices and dividends paid per share of the Company's common stock for each quarter during 2016 and 2015 is presented in Item 7 of this report on Form 10-K under "Capital Resources" and is incorporated herein by reference. Additional information related to restrictions on funds available for dividend declaration can be found in Note 17 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

On January 12, 2010, the Company authorized a program to repurchase during any given calendar year up to an aggregate of 5 percent of the shares of the Company's common stock outstanding as of January 1 of that calendar year. The Company did not repurchase any shares of the Company's common stock under this plan during 2016. There is currently no stated expiration date for this program.

Pursuant to the Company's stock option plans, participants may exercise stock options by surrendering shares of the Company's common stock that the participants already own. Shares surrendered by participants of these plans are repurchased at current market value pursuant to the terms of the applicable stock options. No such repurchases occurred during 2016.

Item 6. Selected Financial Data

The following table summarizes the Company's performance for the past five years.

SELECTED FINANCIAL HIGHLIGHTS

Years ended December 31,	2016	2015	2014	2013	2012
(dollars in thousands except per share data)					
RESULTS OF OPERATIONS					
Interest income	$29,826	$30,295	$30,289	$29,823	$32,580
Interest expense	2,574	3,632	3,849	4,680	5,774
Net interest income	27,252	26,663	26,440	25,143	26,806
Provision for loan losses	1,930	1,025	600	1,300	2,400
Net interest income after provision for loan losses	25,322	25,638	25,840	23,843	24,406
Net gains (losses) on available-for-sale securities	522	76	2	(26)	2,313
Noninterest income	12,944	13,060	12,642	12,799	12,646
Noninterest expenses	34,831	35,086	34,172	33,105	34,183
Income before income taxes	3,957	3,688	4,312	3,511	5,182
Income tax expense	160	54	196	348	995
Net income	$3,797	$3,634	$4,116	$3,163	$4,187
FINANCIAL CONDITION					
Total assets	$902,966	$896,787	$876,280	$864,288	$907,499
Total deposits	$784,502	$746,471	$716,654	$725,405	$753,816
Total loans	$603,882	$568,475	$535,994	$500,699	$471,133
Stockholders' equity	$93,990	$93,176	$88,497	$80,761	$89,300
Average assets	$886,058	$884,386	$869,965	$881,378	$869,436
Average equity	$95,280	$90,433	$85,550	$84,695	$87,912
PERTINENT RATIOS					
Return on average assets	0.43 %	0.41 %	0.47 %	0.36 %	0.48 %
Return on average equity	3.99 %	4.02 %	4.81 %	3.73 %	4.76 %
Dividends paid as a percent of net income	52.23 %	46.40 %	31.32 %	34.49 %	23.67 %
Average equity as a percent of average assets	10.75 %	10.23 %	9.83 %	9.61 %	10.11 %
PER SHARE DATA					
Basic earnings per share	$0.77	$0.73	$0.83	$0.64	$0.84
Diluted earnings per share	$0.77	$0.73	$0.83	$0.64	$0.84
Cash dividends declared	$0.40	$0.34	$0.26	$0.22	$0.20
Book value	$18.94	$18.79	$17.85	$16.29	$18.01
GROWTH RATES					
Year-end assets	0.69 %	2.34 %	1.39 %	-4.76 %	6.83 %
Year-end deposits	5.09 %	4.16 %	-1.21 %	-3.77 %	9.11 %
Year-end loans	6.23 %	6.06 %	7.05 %	6.28 %	-9.45 %

Year-end equity	0.87	%	5.29	%	9.58	%	-9.56	%	4.00	%
Average assets	0.19	%	1.66	%	-1.29	%	1.37	%	1.83	%
Average equity	5.36	%	5.71	%	1.01	%	-3.66	%	5.51	%
Net income	4.49	%	-11.71	%	30.13	%	-24.46	%	27.26	%
Cash dividends declared	17.65	%	30.77	%	18.18	%	10.00	%	0.00	%
Book value	0.80	%	5.27	%	9.58	%	-9.55	%	4.04	%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is intended to assist readers in understanding and evaluating the financial condition, changes in financial condition and the results of operations of the Company, consisting of the parent company (the Parent) and its wholly-owned subsidiaries, the Bank and Trust. This discussion should be read in conjunction with the Consolidated Financial Statements and other financial information contained elsewhere in this report.

Caution About Forward-Looking Statements
In addition to historical information, this report may contain forward-looking statements. For this purpose, any statement that is not a statement of historical fact may be deemed to be a forward-looking statement. These forward-looking statements may include, but are not limited to, statements regarding profitability, including the focus on reducing time deposits; the net interest margin; strategies for managing the net interest margin and the expected impact of such efforts; levels and sources of liquidity; the loan portfolio and expected trends in the quality of the loan portfolio; the allowance and provision for loan losses; the effect of a sustained increase in nonperforming assets; the securities portfolio; monetary policy actions of the Federal Open Market Committee; changes in interest rates; interest rate sensitivity; asset quality; levels of net loan charge-offs and nonperforming assets; sales of OREO properties; levels of interest expense; levels and components of noninterest income and noninterest expense; lease expense; income taxes; expected impact of efforts to restructure the balance sheet; expected yields on the loan and securities portfolios; expected rates on interest-bearing liabilities; expected timing of and expense in connection with the anticipated termination of the pension plan; expected timing of and effect of the purchase of the outstanding interest in Old Point Mortgage, LLC; market risk; business and growth strategies; investment strategy; and financial and other goals. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "intends" or other words of similar meaning. These statements can also be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements.

There are many factors that could have a material adverse effect on the operations and future prospects of the Company including, but not limited to, changes in interest rates and yields; general economic and general business conditions, including unemployment levels; uncertainty over future federal spending or the budget priorities of the new presidential administration, particularly in connection with the Department of Defense, on the Company's service area; effects of the transfer of the securities portfolio from held-to-maturity securities to available-for-sale securities; 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 adequacy of the Company's credit quality review processes; the level of nonperforming assets and related charge-offs and recoveries; turnover times experienced by the mortgage companies to which the Company has extended warehouse lines of credit; the performance of the Company's re-opened dealer lending program; the federal government's guarantee of repayment of student loans purchased by the Company; the ability of the Company to diversify its sources of noninterest income; new incentive structure for securities brokerage activities; the local real estate market; volatility and disruption in national and international financial markets; government intervention in the U.S. financial system; application of the Basel III capital standards to the Company and its subsidiaries; FDIC premiums and/or assessments; demand for loan and other banking products and financial services in the Company's primary service area; levels of noninterest income and expense; deposit flows; competition; the use of inaccurate assumptions in management's modeling systems; technology; 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; adequacy of the allowance for loan losses; and changes in accounting principles, policies and guidelines. The Company could also be adversely affected by monetary and fiscal policies of the U.S. Government, as well as any regulations or programs implemented pursuant to the Dodd-Frank Act or other legislation and policies of the Comptroller, U.S. Treasury and the Federal Reserve Board.

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

Executive Overview

Description of Operations

Headquartered in Hampton, Virginia, the Company is the parent company of Trust and the Bank. Trust is a wealth management services provider. The Bank offers a complete line of consumer, mortgage and business banking services, including loan, deposit, and cash management services to individual and commercial customers. The Bank is an independent community bank and has 18 branches throughout the Hampton Roads localities of Chesapeake, Hampton, Isle of Wight County, Newport News, Norfolk, Virginia Beach, Williamsburg/James City County and York County.

Management Initiatives in 2016
Management's two main 2016 initiatives were to grow the loan portfolio and reduce the Company's noninterest expense. Management believes substantial progress was made with respect to both initiatives. The loan portfolio grew by $34.9 million when comparing net loans on December 31, 2015 to December 31, 2016, while noninterest expense was $255 thousand lower in 2016 than in 2015. Noninterest expense declined despite a $391 thousand prepayment penalty for the early payoff of the Company's single most expensive source of funding. This early payoff is discussed in more detail below.

Primary Financial Data for 2016
In 2016, the Company's net income increased $163 thousand to $3.8 million, as compared to net income of $3.6 million in 2015, or an increase of 4.49%. The increase in net income was due to higher net interest income, higher noninterest income, and lower noninterest expense. Net interest income increased mainly due to reduced interest expense on Federal Home Loan Bank advances, while the increase in noninterest income was primarily the result of gains on sales of available-for-sale securities. Decreases in salaries and employee benefits and losses on other real estate owned, partially offset by increases in legal and audit expenses, were the main drivers of the decline in noninterest expense.

Assets as of December 31, 2016 were $903.0 million, an increase of $6.2 million or 0.69% compared to assets as of December 31, 2015. During 2016, the Company continued the loan growth seen in prior years, funding this growth mainly from increases in low-cost deposits and cash flows from the securities portfolio. Net loans grew $34.9 million, or 6.22%, over the year, while low-cost deposits increased $36.6 million, or 6.83%, and securities declined $14.8 million, or 6.92%. In years prior to 2013, the Company experienced a lack of quality loan demand in its market area and invested excess funds in securities that could be readily liquidated as the Company waited for loan demand to recover. This recovery began in the second half of 2013 and continued through 2016.

Critical Accounting Estimates
The accounting and reporting policies of the Company are in accordance with U.S. generally accepted accounting principles (GAAP) and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's consolidated financial position and/or results of operations. The accounting policy that required management's most difficult, subjective or complex judgments is the Company's allowance for loan losses, which is described below.

Allowance for Loan Losses
The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on three basic principles of accounting which require: (i) that losses be accrued when they are probable of occurring and estimable, (ii) that losses be accrued based on the differences between the loan balances and the value of collateral, present value of expected future cash flows (discounted at the loan's effective interest rate) or values that are observable in the secondary market and (iii) that adequate documentation exist to support the allowance for loan losses estimate.

The Company's allowance for loan losses is the accumulation of various components that are calculated based on independent methodologies. Management's estimate is based on certain observable, historical data and other factors that management believes are most reflective of the underlying credit losses being estimated. This evaluation includes 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 bank regulatory examinations. These factors, as well as identified impaired loans, historical losses and current economic and business conditions, are used in developing estimated loss factors used in the calculations.

Authoritative accounting literature requires that the impairment of loans that have been separately identified for evaluation be measured based on the present value of expected future cash flows (discounted at the loan's effective interest rate) or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment is to be based on the net realizable value of the collateral. Authoritative accounting literature, as amended, also requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

For loans not individually evaluated for impairment, the loan portfolio is segmented into pools, based on the loan classifications as defined by Schedule RC-C of the Federal Financial Institutions Examination Council Consolidated Reports of Condition and Income Form 041 (Call Report) and collectively evaluated for impairment. Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1-29 days past due), 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of December 31, 2016 and December 31, 2015, the Company had no loans in these categories.

Specific reserves are determined on a loan-by-loan basis based on management's evaluation of the Company's exposure for each credit, given the current payment status of the loan and the net market value of any underlying collateral.

While management uses the best information available to establish the allowance for loan losses, future adjustment to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations or if required by regulators, based upon information available to them at the time of their examinations. Such adjustments to original estimates, as necessary, are made in the period in which these factors and other relevant considerations indicate that loss levels may vary from previous estimates.

During the third quarter of 2016, the Company changed its method for calculating the allowance for loan and lease losses. This change is discussed in detail in Note 4 of the Notes to the Consolidated Financial Statements included in this annual report on Form 10-K.

Impairment of Securities

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) the Company intends to sell the security or (ii) it is more-likely-than-not that the Company will be required to sell the security before recovery of its amortized cost basis. If, however, the Company does not intend to sell the security and it is not more-likely-than-not that the Company will be required to sell the security before recovery, management must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on the Company's ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in net income. Management regularly reviews each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, management's best estimate of the present value of cash flows expected to be collected from debt securities, management's intention with regard to holding the security to maturity and the likelihood that the Company would be required to sell the security before recovery.

Other Real Estate Owned (OREO)

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and management's ability and intention with regard to continued ownership of the properties. The Company may incur additional write-downs of foreclosed assets to fair value less costs to sell if

valuations indicate a further deterioration in market conditions.

Retirement Plan

The Company maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of mutual funds invested in marketable equity securities and corporate and government fixed income securities, are valued using market quotations. The Company's actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions may include the discount rate, the interest crediting rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated may affect pension assets, liabilities or expense.

Income Taxes

The Company recognizes expense for federal income and state bank franchise taxes payable as well as deferred federal income taxes for estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the Consolidated Financial Statements. Income and franchise tax returns are subject to audit by the Internal Revenue Service (IRS) and state taxing authorities. Income and franchise tax expense for current and prior periods is subject to adjustment based on the outcome of such audits. The Company believes it has adequately provided for all taxes payable.

Earnings Summary

Net income was $3.8 million ($0.77 per diluted share) in 2016 compared to $3.6 million ($0.73 per diluted share) in 2015. The increase in net income was due to higher net interest income, higher noninterest income, and lower noninterest expense. Net interest income increased mainly due to reduced interest expense on Federal Home Loan Bank advances, while the increase in noninterest income was primarily the result of gains on sales of available-for-sale securities. Decreases in salaries and employee benefits and losses on other real estate owned, partially offset by increases in legal and audit expenses, were the main drivers of the decline in noninterest expense.

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 $28.2 million in 2016, an increase of $518 thousand from 2015 and an increase of $777 thousand from 2014. The net interest margin was 3.66% in 2016 as compared to 3.56% in 2015 and 3.57% in 2014, primarily as a result of lower interest expense.

When comparing 2016 to 2015, the following changes occurred. Tax equivalent interest income decreased $540 thousand, or 1.73%. Average earning assets decreased $7.3 million, or 0.94%. Total average loans increased $21.7 million, or 3.85%, and average investment securities decreased $31.3 million, or 15.47%, as continued loan demand allowed the Company to shift its assets from securities to loans. The Company's portfolio of mortgage-backed securities generates cash flows on a monthly basis, which are typically re-invested into loans.

In 2016, the Company began holding more of its excess liquidity in a noninterest-bearing account at a correspondent bank, as evidenced by the $10.3 million increase in average cash and due from banks. Although this account does not earn interest, the Company receives an earnings credit based on balances held in the account. The earnings credit rate is higher than the interest rate earned on accounts at other correspondent banks. For further discussion of this earnings credit, see the Noninterest Expense section below.

Interest income was also impacted by continued declines in average loan yields, from 4.63% in 2015 to 4.52% in 2016. Management expects that the Company's loan yields will continue to decline, due to intense competition for quality loans and rate reductions on loans currently held in the portfolio. The Federal Open Market Committee (FOMC) raised the target range for the federal funds rate in December of both 2015 and 2016. Management currently expects the FOMC to raise rates three times in 2017, possibly beginning in March 2017. Despite these projected increases, management expects the FOMC's monetary policy to remain accommodative and the overall low interest rate environment to continue in 2017. Accordingly, management expects continued pressure on loan yields and the net interest margin and plans to continue to manage the mix of the Company's liabilities to increase low cost funds and reduce high cost funds when possible.

As part of its strategy to reduce interest expense, the Company prepaid a $25.0 million Federal Home Loan Bank (FHLB) advance. This advance, which would have matured in June of 2016, was instead paid off in February of 2016. In past years, the prepayment penalty on this advance made an early payoff prohibitively expensive, but in the first

quarter of 2016, volatility in the markets simultaneously reduced the prepayment penalty on the advance and increased the value of the Company's securities portfolio. As a result, the Company was able to sell for a gain certain securities that management expected to perform poorly in a rising rate environment. The liquidity from these sales was used to prepay the FHLB advance. The prepayment penalty on the advance was $391 thousand, compared to $456 thousand in interest expense that would have been paid if the advance had been allowed to mature in June.

Average interest-bearing liabilities decreased $24.2 million, or 4.08%, partially due to the prepayment of the FHLB advance and partially due to decreases in interest-bearing deposits. As discussed above, management has focused on adjusting the composition of its interest-bearing liabilities, specifically by allowing high-cost time deposits to reduce. Management expects that the reduction of the Company's interest expense will slow or stop in 2017, as the majority of higher-cost time deposits have repriced to current, lower market rates and management anticipates increases in market rates in 2017. To mitigate the expected increase in market rates, management will continue to focus on the mix of deposits by actively targeting new noninterest-bearing deposits.

Overall, interest expense decreased $1.1 million, or 29.13% in 2016 as compared to 2015, and the cost of interest-bearing liabilities decreased 16 basis points.

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

TABLE I
AVERAGE BALANCE SHEETS, NET INTEREST INCOME* AND RATES*

Years ended December 31,	2016			2015			2014		
	Average Balance	Interest Income/ Expense	Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate**	Average Balance	Interest Income/ Expense	Yield/ Rate**
	(dollars in thousands)								
ASSETS									
Loans*	$585,206	$26,451	4.52 %	$563,534	$26,106	4.63 %	$517,183	$24,959	4.83 %
Investment securities:									
Taxable	104,549	1,802	1.72 %	130,541	2,510	1.92 %	164,755	3,562	2.16 %
Tax-exempt*	66,509	2,326	3.50 %	71,831	2,520	3.51 %	74,112	2,580	3.48 %
Total investment securities	171,058	4,128	2.41 %	202,372	5,030	2.49 %	238,867	6,142	2.57 %
Interest-bearing due from banks	9,226	48	0.52 %	5,848	15	0.26 %	5,356	13	0.24 %
Federal funds sold	1,667	6	0.36 %	1,860	2	0.11 %	3,515	5	0.14 %
Other investments	1,562	113	7.23 %	2,373	133	5.60 %	2,944	125	4.25 %
Total earning assets	768,719	30,746	4.00 %	775,987	31,286	4.03 %	767,865	31,244	4.07 %
Allowance for loan losses	(7,895)			(7,404)			(7,062)		
	760,824			768,583			760,803		
Cash and due from banks	42,111			31,858			25,700		
Bank premises and equipment, net	40,480			41,988			42,277		
Other assets	42,643			41,957			41,185		
Total assets	$886,058			$884,386			$869,965		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Time and savings deposits:									
Interest-bearing transaction accounts	$20,045	$9	0.04 %	$11,219	$4	0.04 %	$11,537	$5	0.04 %
Money market deposit accounts	221,339	179	0.08 %	228,627	186	0.08 %	213,918	179	0.08 %
Savings accounts	78,305	39	0.05 %	74,436	37	0.05 %	73,576	46	0.06 %
Time deposits, $100,000 or more	110,963	1,170	1.05 %	113,945	1,111	0.98 %	108,630	1,038	0.96 %

Other time deposits	99,376	946	0.95 %	107,142	1,033	0.96 %	128,383	1,316	1.03 %
Total time and savings deposits	530,028	2,343	0.44 %	535,369	2,371	0.44 %	536,044	2,584	0.48 %
Federal funds purchased, repurchase agreements and other borrowings	25,348	25	0.10 %	30,777	30	0.10 %	32,848	32	0.10 %
Federal Home Loan Bank advances	14,016	206	1.47 %	27,466	1,231	4.48 %	28,507	1,233	4.33 %
Total interest-bearing liabilities	569,392	2,574	0.45 %	593,612	3,632	0.61 %	597,399	3,849	0.64 %
Demand deposits	214,876			194,677			184,555		
Other liabilities	6,510			5,664			2,461		
Total liabilities	790,778			793,953			784,415		
Stockholders' equity	95,280			90,433			85,550		
Total liabilities and stockholders' equity	$886,058			$884,386			$869,965		
Net interest margin		$28,172	3.66 %		$27,654	3.56 %		$27,395	3.57 %

* Computed on a fully tax-equivalent basis using a 34% rate.

The following table summarizes changes in net interest income attributable to changes in the volume of interest-bearing assets and liabilities and changes in interest rates.

TABLE II
VOLUME AND RATE ANALYSIS*

	2016 vs. 2015 Increase (Decrease) Due to Changes in:			2015 vs. 2014 Increase (Decrease) Due to Changes in:			2014 vs. 2013 Increase (Decrease) Due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total	Volume	Rate	Total
	(in thousands)								
EARNING ASSETS									
Loans	$1,004	$ (659)	$345	$2,237	$ (1,090)	$1,147	$2,319	$ (1,129)	$1,190
Investment securities:									
Taxable	(500)	(208)	(708)	(740)	(312)	(1,052)	(1,289)	304	(985)
Tax-exempt	(187)	(7)	(194)	(79)	19	(60)	673	(135)	538
Total investment securities	(687)	(215)	(902)	(819)	(293)	(1,112)	(616)	169	(447)
Federal funds sold	0	4	4	(2)	(1)	(3)	1	3	4
Other investments **	46	(33)	13	(1)	11	10	(153)	99	(54)
Total earning assets	363	(903)	(540)	1,415	(1,373)	42	1,551	(858)	693
INTEREST-BEARING LIABILITIES									
Interest-bearing transaction accounts	5	0	5	0	(1)	(1)	0	(1)	(1)
Money market deposit accounts	(7)	0	(7)	12	(5)	7	16	(71)	(55)
Savings accounts	2	0	2	1	(10)	(9)	11	(27)	(16)
Time deposits, $100,000 or more	(29)	88	59	51	22	73	(199)	(199)	(398)
Other time deposits	(75)	(12)	(87)	(218)	(65)	(283)	(308)	(59)	(367)
Total time and savings deposits	(104)	76	(28)	(154)	(59)	(213)	(480)	(357)	(837)
Federal funds purchased, repurchase agreements and other borrowings	(5)	0	(5)	(2)	0	(2)	2	(5)	(3)
Federal Home Loan Bank advances	(603)	(422)	(1,025)	(45)	43	(2)	172	(163)	9
Total interest-bearing liabilities	(712)	(346)	(1,058)	(201)	(16)	(217)	(306)	(525)	(831)
Change in net interest income	$1,075	$ (557)	$518	$1,616	$ (1,357)	$259	$1,857	$ (333)	$1,524

* Computed on a fully tax-equivalent basis using a 34% rate.
** Other investments include interest-bearing balances due from banks.

Interest Sensitivity

An important element of earnings performance and the maintenance of sufficient liquidity is proper management of the interest sensitivity gap. The interest sensitivity gap is the difference between interest-sensitive assets and interest-sensitive liabilities in a specific time interval. This gap can be managed by repricing assets or liabilities, which are variable rate instruments, by replacing an asset or liability at maturity or by adjusting the interest rate during the life of the asset or liability. Matching the amounts of assets and liabilities maturing in the same time interval helps to hedge interest rate risk and to minimize the impact of rising or falling interest rates on net interest income.

The Company determines the overall magnitude of interest sensitivity risk and then formulates policies governing asset generation and pricing, funding sources and pricing, and off-balance sheet commitments. These decisions are based on management's expectations regarding future interest rate movements, the state of the national and regional economy, and other financial and business risk factors. The Company uses computer simulations to measure the effect of various interest rate scenarios on net interest income. This modeling reflects interest rate changes and the related impact on net interest income and net income over specified time horizons.

Based on scheduled maturities only, the Company was liability sensitive at the one-year timeframe as of December 31, 2016. It should be noted, however, that non-maturing, interest-bearing deposit liabilities, which consist of interest checking, money market and savings accounts, are less interest sensitive than other market driven deposits. On December 31, 2016 non-maturing, interest-bearing deposit liabilities totaled $344.5 million, or 61.97%, of total interest-bearing deposits. In a rising rate environment, changes in these deposit rates have historically lagged behind the changes in earning asset rates, thus mitigating the impact from the liability sensitive position indicated by the static gap analysis. Income simulation analysis allows the Company to reflect the expected differences in re-pricing behavior among various assets and liabilities to more reliably measure the potential effects on income from changes in the interest rate environment. Utilizing this income simulation methodology, the model reveals that the Company is asset sensitive at the one-year timeframe as of December 31, 2016.

When the Company is liability sensitive, net interest income should improve if interest rates fall since liabilities will reprice faster than assets (depending on the optionality or prepayment speeds of the assets). Conversely, if interest rates rise, net interest income should decline. When the Company is asset sensitive, net interest income should improve if interest rates rise and fall if rates fall.

The Company's interest rate sensitivity position is illustrated in the following table. The carrying amounts of assets and liabilities are presented in the periods they are expected to reprice or mature.

TABLE III
INTEREST SENSITIVITY ANALYSIS

As of December 31, 2016	Within 3 Months	4-12 Months	1-5 Years	Over 5 Years	Total
	(in thousands)				
USES OF FUNDS					
Interest-bearing due from banks	$1,667	$0	$0	$0	$1,667
Federal funds sold	2,302	0	0	0	2,302
Taxable investments	30,401	8,018	9,904	79,024	127,347
Tax-exempt investments	301	0	12,618	59,099	72,018
Total federal funds sold and investment securities	34,671	8,018	22,522	138,123	203,334
Loans					
Commercial	$15,649	$5,185	$21,197	$12,403	$54,434
Consumer	19,056	167	10,602	29,082	58,907
Real estate	70,065	41,310	239,918	120,231	471,524
Other	10,329	0	582	8,106	19,017
Total loans	115,099	46,662	272,299	169,822	603,882
Total earning assets	$149,770	$54,680	$294,821	$307,945	$807,216
SOURCES OF FUNDS					
Interest-bearing transaction accounts	$30,165	$0	$0	$0	$30,165
Money market deposit accounts	234,799	0	0	0	234,799
Savings accounts	79,488	0	0	0	79,488
Time deposits $100,000 or more	15,439	40,332	59,263	0	115,034
Other time deposits	14,893	29,262	52,220	0	96,375
Federal funds purchased and other borrowings	0	0	0	0	0
Overnight repurchase agreements	18,704	0	0	0	18,704
Term repurchase agreements	0	0	0	0	0
FHLB advances	0	0	0	0	0
Total interest bearing liabilities	$393,488	$69,594	$111,483	$0	$574,565

Rate sensitivity GAP	$(243,718)	$(14,914)	$183,338	$307,945	$232,651
Cumulative GAP	$(243,718)	$(258,632)	$(75,294)	$232,651	

The most likely scenario represents the rate environment as management forecasts it to occur. Management uses a "static" test to measure the effects of changes in interest rates on net interest income. This test assumes that management takes no steps to adjust the balance sheet to respond to the shock by repricing assets/liabilities, as discussed in the first paragraph of this section.

Under the rate environment forecasted by management, rate shocks in 50 to 100 basis point increments are applied to estimate the impact on the Company's net interest income. The table below shows the estimated impact of changes in interest rates on net interest income as of December 31, 2016, assuming gradual and parallel changes in interest rates, and consistent levels of assets and liabilities. Net interest income for the following twelve months is projected to increase when interest rates are higher than current rates. Due to the current low interest rate environment, no measurement was considered necessary for a further decline in interest rates.

Estimated Changes in Net Interest Income
As of December 31, 2016

Changes in Net Interest Income				
Changes in Interest Rates	Amount (in thousands)		Percent	
Up 4.00%	$	499	1.78	%
Up 3.00%	$	380	1.35	%
Up 2.00%	$	248	0.88	%
Up 1.00%	$	117	0.42	%
No change	$	0	0.00	%

Management cannot predict future interest rates or their exact effect on net interest income. Computations of future effects of hypothetical interest rate changes are based on numerous assumptions and should not be relied upon as indicative of actual results. Certain limitations are inherent in such computations. Assets and liabilities may react differently than projected to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag changes in market interest rates. Interest rate shifts may not be parallel.

Changes in interest rates can cause substantial changes in the amount of prepayments of loans and mortgage-backed securities, which may in turn affect the Company's interest rate sensitivity position. Additionally, credit risk may rise if an interest rate increase adversely affects the ability of borrowers to service their debt.

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 to 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 loan loss provision. 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 $1.9 million for the year ended December 31, 2016 as compared to $1.0 million for 2015. A portion of the increase is due to loan growth during 2016, which required the Company to set aside additional funds. The provision was also impacted by higher levels of charge offs in 2016 than in 2015. Charged-off loans totaled $1.8 million in 2016, compared to $897 thousand in 2015. Recoveries amounted to $347 thousand in 2016 and $535 thousand in 2015. The Company's net loans charged off to year-end loans were 0.24% in 2016 as compared to 0.06% in 2015.

Net loan charge-offs for 2016 were higher than in 2015 primarily due to a charge-off in the second quarter of 2016, on a single borrowing relationship whose condition deteriorated rapidly. None of the loans in this relationship had been more than sixty days past due until the second quarter of 2016, when the Company became aware of the potential impairment on these loans. Working through the assessment and collection process, the Company charged off a total

of $876 thousand on this borrowing relationship in 2016.

Management believes that net loan charge-offs in subsequent years will be lower than what was experienced in 2016, as no similarly large charge off is expected in 2017. The state of the local economy also significantly impacts 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 2017 than in 2016.

Noninterest Income
Unless otherwise noted, all comparisons in this section are between the twelve months ended December 31, 2016 and the twelve months ended December 31, 2015.

Noninterest income increased $330 thousand or 2.51% for the year ended December 31, 2016 as compared to the year ended December 31, 2015. Noninterest income in 2016 was positively impacted by sales of securities during the year, sales that are congruent with management's current strategy for the Company's investment portfolio. These investment portfolio sales resulted in a net gain of $509 thousand in the first quarter of 2016. In the second quarter, sharp declines in market interest rates provided the Company with the opportunity to sell certain under-performing securities for a gain, which allowed the Company to fund loan growth and reduce the portfolio's susceptibility to interest rate risk. Smaller gains were recognized in the third quarter of 2016.

In addition to these gains, two other categories of noninterest income increased: service charges on deposit accounts (up $31 thousand or 0.77%) and other operating income (up $144 thousand or 31.79%). Service charges on deposit accounts increased primarily due to deposit growth and new product offerings introduced in the third quarter of 2015. The increases from these changes were partially offset by continued declines in overdraft fee income. Regulatory changes in recent years have curtailed this income source for most banks, including the Company, and while management expects to see continued overall improvements in service charges on deposit accounts, overdraft fee income is expected to remain flat or decline in 2017.

The increase in other operating income was due to an additional $154 thousand in income from Old Point Mortgage LLC (Old Point Mortgage), a joint venture between the Bank and Tidewater Mortgage Services. Old Point Mortgage has been working to improve its efficiencies and re-define its incentive structure for its sales staff. Management believes that the success of these efforts is evident in the increased income seen in 2016, compared to 2015.

In addition to the increase in income from Old Point Mortgage, other operating income was also impacted by foreclosed property income and income from early withdrawal penalties on time deposits. Foreclosed property income decreased due to the sale of foreclosed properties. As the Bank no longer holds any tenant-occupied foreclosed properties, management does not expect to have any foreclosed property income in 2017. Income from early withdrawal penalties increased due to a change in the Bank's fee structure for early withdrawals. With this change, management hopes to better control its interest expense when rates rise.

The remaining categories of noninterest income decreased, with the largest decrease in other service charges, commissions and fees (down $144 thousand or 3.53%). Within this category, declines in securities brokerage income and ATM interchange fees were only partially offset by increases in merchant processing fee income. In 2017, management has instituted a new incentive structure and anticipates an increase in securities brokerage income. The 2016 trends for ATM interchange fees and merchant processing fee income are expected to continue in 2017.

Income from bank-owned life insurance was down $90 thousand or 10.17% as lower market rates reduced yields on the underlying assets. Management does not expect a similar decline in 2017 and expects 2017 income to match or be slightly above income for 2016.

Income from fiduciary activities decreased $57 thousand or 1.58%. This category is heavily impacted by the market value of assets under management. Fluctuations in the stock market during the first half of 2016 reduced income by $116 thousand when compared to the first half of 2015. As markets stabilized in the third and fourth quarters of 2016, income from fiduciary activities began to increase again, offsetting some of the declines from the first half of the year. Income from fiduciary activities was up $58 thousand for the second half of 2016 when compared to the second half of 2015. This category is difficult to project, due to the unpredictable nature of its primary source. However, management does expect that, in general, income from fiduciary activities will continue to trend upward in future

years as a result of business development efforts.

The Company continues to focus on diversifying noninterest income through efforts to expand Trust relationships and a continued focus on business checking and other corporate services.

Noninterest Expense

Unless otherwise noted, all comparisons in this section are between the twelve months ended December 31, 2016 and the twelve months ended December 31, 2015.

The Company's noninterest expense decreased $255 thousand or 0.73% due to a number of factors. Since 2014, the Company has maintained a portion of its excess liquidity in a noninterest-bearing account at a correspondent bank. Balances held at the correspondent receive an earnings credit 25 basis points higher than the highest interest rate the Company can earn on its interest-bearing accounts. Beginning in the third quarter of 2016, the Company has made more strategic use of this earnings credit, which can be used to offset the Company's courier and data processing expenses, in addition to normal service charges assessed by the correspondent. The reduction in noninterest expense (and thus the increase in net income) is higher than the reduction in interest income. Due to this strategy, the Company saved $152 thousand in the year ended December 31, 2016.

Although noninterest expense decreased overall, certain categories did increase. The prepayment fee on the Company's $25.0 million FHLB advance was one of the largest increases in noninterest expense. Although this $391 thousand fee had a significant impact on noninterest expense, it was more than offset by reduced interest expense on FHLB advances 2016 as compared to 2015.

Of the remaining categories of noninterest expense, the most significant increases when comparing 2016 to 2015 were in legal and audit expenses, occupancy and equipment, other outside service fees, employee professional development, and capital stock tax.

- Legal and audit expenses ($595 thousand or 82.64%): The Company's 2016 proxy statement included numerous proposals, including changes to the Company's articles of incorporation, the addition of an employee stock purchase plan, and the addition of a new stock incentive plan, all of which required extensive review by outside legal counsel. The implementation of stockholder-approved proposals following the 2016 Annual Meeting of Stockholders also increased legal and audit expense during this period.
- Occupancy and equipment ($245 thousand or 4.60%): The Company implemented a new, more sophisticated disaster recovery plan in the third quarter of 2015. This new plan increased both depreciation and service contract expenses.
- Other outside service fees ($114 thousand or 16.45%): Beginning in the second quarter of 2015, the Company outsourced certain loan review functions. Also in the second quarter of 2015, the Company purchased an additional $14.0 million student loan portfolio, with servicing expenses increased accordingly.
- Employee professional development ($68 thousand or 11.51%): Higher recruitment expense was the main cause of the increase in this category. As part of management's ongoing effort to improve income, during 2016 the Company occasionally relied on the services of employment agencies and recruiters to fill certain positions, particularly those in the lending areas.
- Capital stock tax ($66 thousand or 15.03%): Increases in equity and decreases in other real estate owned both contributed to this increase. Capital stock tax is calculated based on the total equity, with tax credits for real estate taxes paid. As the Company has reduced its holdings of other real estate owned, it has paid less in real estate taxes, thus reducing credits available to offset capital stock tax.

These increased expenses were more than offset by decreases in other areas, primarily salaries and employee benefits, loss on other real estate owned, and FDIC insurance.

- Salaries and employee benefits ($869 thousand or 4.19%): Lower expenses for employee medical insurance accounted for the majority of the decrease in salaries and employee benefits expense. This category was also impacted by the benefits package for an executive officer who retired in the third quarter of 2015. Although the retirement package was paid in 2016, accounting rules required that the entire amount of $353 thousand be expensed in 2015. In 2017, management expects this category of noninterest expense to be higher than in 2016 due to four

factors. As discussed in Item 9B of this Form 10-K, the Company's Chief Financial Officer will be retiring in 2017. As with the benefits package expensed in 2015, the retirement package provided to the CFO will be expensed in 2017. In addition to the retirement package, the Company expects employee benefits expenses to increase in 2017 due to higher medical insurance expense and the termination of the Company's pension plan (discussed in more detail below). The addition of Old Point Mortgage to the Company's consolidated financial statements (discussed in more detail under Loan Portfolio in this Item 7) will also increase salaries and employee benefits expenses.

- Loss on other real estate owned ($803 thousand or 83.91%): The Company has made significant progress on reducing its holdings of other real estate owned, with the balance decreasing from $2.7 million at December 31, 2015 to $1.1 million at December 31, 2016. As these properties are sold, both write-downs and expenses related to these properties will decrease.
- FDIC insurance ($103 thousand or 17.58%): Beginning in the third quarter of 2016, the FDIC made changes to the way that insurance premiums are calculated. Management expects the lower levels of expense to continue into the foreseeable future.

The Company provides pension benefits for eligible participants through a non-contributory defined-benefit pension plan (the Plan). Benefits are based on years of service and average earnings during the highest average 60 month period during the final 120 months of employment. Effective September 30, 2006, the Plan was closed to new entrants and benefit accruals for existing participants were frozen. Under current rules, the Company had no funding obligation as of December 31, 2015 or 2016.

On November 23, 2016, the Company's Board of Directors (the Board) voted to terminate the Plan, effective January 31, 2017. In order to settle its liabilities under the Plan, the Company will offer participants the option to receive either an annuity purchased from an insurance carrier or a lump-sum cash payment. If the total value of the Plan's assets is insufficient to cover the lump-sum payouts and annuity purchases, the Company will contribute the necessary funds to complete the termination of the Plan. The exact amount that will be required is subject to a number of factors, including changes in interest rates and the exact proportion of participants electing a lump-sum distribution versus an annuity. The Company currently estimates that its before-tax expense will be between $3.1 million and $3.3 million, all of which would be recognized in 2017. Other expenses associated with terminating the Plan are currently estimated to be $20 thousand.

The Company anticipates completing the transfer of all liabilities and administrative responsibilities under the Plan by the end of the fourth quarter of 2017. Once this process is complete, the Company will no longer have any remaining pension obligations and thus no periodic pension expense. By comparison, annual pension expense for 2016 was $392 thousand and is currently estimated to be $529 thousand for 2017.

Income tax expense was higher in 2016 than in 2015 due to higher income and a higher effective tax rate. When comparing 2016 to 2015, tax-exempt income was a smaller percent of total income, increasing the effective tax rate from 1.46% to 4.04%. Despite the increase from 2015 to 2016, the Company's effective tax rate remains low, primarily due to its receipt of federal income tax credits for its investment in certain housing projects.

Balance Sheet Review

At December 31, 2016, the Company had total assets of $903.0 million, an increase of $6.2 million or 0.69% compared to assets as of December 31, 2015.

In 2016, the Company built on progress made in 2015 by continuing to move funds from lower-yielding to higher-yielding assets. Cash and cash equivalents decreased $11.1 million or 30.11% from December 31, 2015 to December 31, 2016 as funds were re-invested into loans in 2016. Net loans increased $34.9 million or 6.22%, from $560.7 million at December 31, 2015 to $595.6 million at December 31, 2016. Loan demand began to increase in 2013 and has continued at a moderate pace throughout 2014, 2015, and 2016, but until loan demand recovers significantly, the Company will likely continue to manage the interest margin by focusing deposit-gathering efforts on lower cost funds in the form of noninterest-bearing and savings deposits. These low-cost funds increased $36.6 million or 6.83% between December 31, 2015 and December 31, 2016, while in the same time period, high-cost time deposits increased $1.4 million or 0.67% .

The Company's holdings of Alternative A-paper, or "Alt-A", type mortgage loans such as adjustable rate and nontraditional type loans were inconsequential, amounting to less than 1.00% of the Company's loan portfolio as of December 31, 2016.

The Company does not have a formal program for subprime lending. The Company is, however, required by law to comply with 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 primary service area.

The following table details, as of December 31, 2016, the Company's loans with subprime characteristics that were secured by 1-4 family first mortgages, 1-4 family open-end (i.e., equity lines of credit) and 1-4 family junior lien loans (i.e., 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 December 31, 2016

	Amount (in thousands)	Percent
Subprime	$ 21,675	13.9 %
Non-subprime	134,163	86.1 %
	$ 155,838	100.0 %
Total loans	$ 603,882	
Percentage of Real Estate-Secured Subprime Loans to Total Loans		3.59 %

In addition to the subprime loans secured by real estate discussed above, as of December 31, 2016, the Company had an additional $2.8 million in subprime consumer loans that were either unsecured or secured by collateral other than real estate. Together with the subprime loans secured by real estate, the Company's total subprime loans as of December 31, 2016 were $24.5 million, amounting to 4.05% of the Company's total loans at December 31, 2016.

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

Securities Portfolio
When comparing December 31, 2016 to December 31, 2015, securities available-for-sale decreased $14.8 million, or 6.92%. The Company sold certain securities in the first and second quarters of 2016 to limit the portfolio's susceptibility to interest rate risk, help fund loan growth, and provide liquidity to prepay the $25.0 million FHLB advance in February 2016. With the volatility in market interest rates during 2016, the Company was able to sell for a gain certain under-performing securities. The securities sold were all mortgage-backed securities with rates that have been below market for some time. As management expects that rates will continue to increase, and loan growth necessitated a need for additional funding, the Company sold these securities while the market value was above the Company's book value of the securities. The Company also purchased securities in the third and fourth quarters of 2016 to further management's strategy and absorb temporary excess liquidity.

Restricted securities decreased $1.0 million or 51.88% from December 31, 2015 to December 31, 2016 as a result of lower balances in FHLB stock. The Company is required to hold FHLB stock based on its borrowings; with the repayment of the $25.0 million FHLB advance, the FHLB repurchased a portion of its stock held by the Company.

The Company routinely purchases short-term U.S. Treasury and government agency securities as part of a strategy to reduce its capital stock tax expense. While both of these types of securities have very low yields, the reduction in capital stock tax, a component of noninterest expense, more than offsets the reduction in interest income.

The Company's strategy for the securities portfolio is primarily intended to manage the portfolio's susceptibility to interest rate risk and to provide liquidity to fund loan growth. The securities portfolio is also adjusted to achieve other asset/liability objectives, including pledging requirements, and to manage tax exposure when necessary.

The following table sets forth a summary of the securities portfolio:

TABLE IV
SECURITIES PORTFOLIO

As of December 31,	2016	2015	2014
	(in thousands)		
Available-for-sale securities, at fair value:			
U.S. Treasury securities	$20,000	$0	$20,000
Obligations of U.S. Government agencies	9,195	24,240	4,618
Obligations of state and political subdivisions	77,987	78,433	50,246
Mortgage-backed securities	83,694	107,396	60,888
Money market investments	647	631	719
Corporate bonds	7,678	3,393	2,790
Other marketable equity securities	164	99	85
	$199,365	$214,192	$139,346
Held-to-maturity securities, at cost:			
Obligations of U.S. Government agencies	$0	$0	$100
Obligations of state and political subdivisions	0	0	29,529
Mortgage-backed securities	0	0	60,460
	$0	$0	$90,089
Restricted securities:			
Federal Home Loan Bank stock	$801	$1,847	$2,124
Federal Reserve Bank stock	169	169	169
	$970	$2,016	$2,293
Total	$200,335	$216,208	$231,728

The following table summarizes the contractual maturity of the securities portfolio and their weighted average yields as of December 31, 2016:

	1 year or less	1-5 years	5-10 years	Over 10 years	Total
	(dollars in thousands)				
U.S. Treasury securities	$20,000	$0	$0	$0	$20,000
Weighted average yield	0.35 %	0.00 %	0.00 %	0.00 %	0.35 %
Obligations of U.S. Government Agencies	$0	$297	$0	$8,898	$9,195
Weighted average yield	0.00 %	1.17 %	0.00 %	1.61 %	1.59 %
Obligations of state and political subdivisions	$301	$12,618	$21,850	$43,218	$77,987
Weighted average yield	2.07 %	2.64 %	3.15 %	3.79 %	3.42 %
Mortgage-backed securities	$0	$3,618	$22,090	$57,986	$83,694
Weighted average yield	0.00 %	1.64 %	1.98 %	1.48 %	1.62 %
Money market investments	$647	$0	$0	$0	$647
Weighted average yield	0.25 %	0.00 %	0.00 %	0.00 %	0.25 %
Corporate bonds	$1,499	$1,902	$4,277	$0	$7,678

Weighted average yield	1.23 %	1.53 %	5.26 %	0.00 %	3.55 %
Federal Home Loan Bank stock - restricted	$0	$0	$0	$801	$801
Weighted average yield	0.00 %	0.00 %	0.00 %	4.64 %	4.64 %
Federal Reserve Bank stock - restricted	$0	$0	$0	$169	$169
Weighted average yield	0.00 %	0.00 %	0.00 %	6.00 %	6.00 %
Other marketable equity securities	$0	$0	$0	$164	$164
Weighted average yield	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
Total securities	$22,447	$18,435	$48,217	$111,236	$200,335
Weighted average yield	0.43 %	2.31 %	2.80 %	2.41 %	2.27 %

The table above is based on maturity. Therefore, it does not reflect cash flow from principal payments or prepayments prior to maturity. The weighted average life of the $83.7 million in mortgage-backed securities as of December 31, 2016 was 4.50 years. Yields are calculated on a fully tax-equivalent basis using a 34% rate.

Loan Portfolio

The following table shows a breakdown of total loans by segment at December 31 for years 2012 through 2016:

TABLE V
LOAN PORTFOLIO

As of December 31,	2016	2015	2014	2013	2012
	(in thousands)				
Commercial	$54,434	$43,197	$37,698	$30,702	$25,341
Real estate-construction	23,116	19,685	9,082	14,505	12,005
Real estate-mortgage (1)	448,408	437,159	435,914	416,966	398,522
Consumer	58,907	50,427	30,493	19,791	13,146
Other	19,017	18,007	22,807	18,735	22,119
Total	$603,882	$568,475	$535,994	$500,699	$471,133

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

Based on the North American Industry Classification System code, there are no categories of loans that exceed 10% of total loans other than the categories disclosed in the preceding table.

As of December 31, 2016, the total loan portfolio increased by $35.4 million or 6.23% from December 31, 2015. Although competition for quality loans remains fierce, the Company continued to grow its loan portfolio in 2016. As part of management's strategy to grow the loan portfolio, the Company re-opened its dealer lending division in September 2016. Since that time, the consumer auto loan portfolio has grown $9.6 million, which management expects will contribute positively to interest income in 2017. While there are risks inherent in any new loan program, the Company has hired knowledgeable staff and put in place programs and policies to mitigate those risks. Management is monitoring the allowance for loan losses carefully and will make changes as the portfolio ages.

In addition to the loan growth generated by the re-opening of the dealer department, the Company worked with Old Point Mortgage to generate 1-4 family mortgage loans and continued to market the fixed-rate equity line product developed in 2013. Old Point Mortgage is a joint venture between the Bank and Tidewater Mortgage Services, Inc. (TMSI); the Bank owns 49% of Old Point Mortgage, while TMSI owns 51% and is the managing member.

In addition to the 1-4 family mortgage loans purchased from Old Point Mortgage, the Company purchased two other types of loans in 2016. The Company purchased $3.7 million in commercial loans; the entire principal balance of these purchased commercial loans is guaranteed by either the Small Business Administration (SBA) or the United States Department of Agriculture. Also, the Company purchased $3.8 million in consumer installment loans in 2016. The Company maintains a dedicated reserve account funded by the seller of the consumer installment loans. The balance in the reserve account averages 10 - 12% of the outstanding principal balance of these purchased consumer loans. Any loan losses in this portfolio are covered first by the reserve account; loans are charged against the allowance for loan losses only if the funds available in the reserve account are not sufficient.

As part of its strategy to grow the loan portfolio, in 2017, the Company entered into an agreement with TMSI to purchase TMSI's ownership interest in Old Point Mortgage. The purchase is expected to be completed on or before May 1, 2017, at which point the Bank will be the sole member of Old Point Mortgage. Once the purchase is complete, Old Point Mortgage will be included in the Company's consolidated financial statements. The purchase agreement was filed as Exhibit 10.1 to the report on Form 8-K filed by the Company on January 20, 2017.

The maturity distribution and rate sensitivity of certain categories of the Company's loan portfolio at December 31, 2016 is presented below:

TABLE VI
MATURITY SCHEDULE OF SELECTED LOANS

December 31, 2016	Within 1 year	1 to 5 years	After 5 years	Total
	(in thousands)			
Commercial	$15,782	$19,141	$19,511	$54,434
Real estate - construction	3,890	17,111	2,115	23,116
Total	$19,672	$36,252	$21,626	$77,550
Loans due after 1 year with:				
Fixed interest rate		$23,483	$12,290	$35,773
Variable interest rate		12,769	9,336	22,105
Total		$36,252	$21,626	$57,878

Nonperforming Assets

Nonperforming assets consist of nonaccrual loans, loans past due 90 days or more and accruing interest, nonperforming restructured loans, and other real estate owned (OREO). Restructured loans are loans with terms that were modified in a troubled debt restructuring (TDR) for borrowers experiencing financial difficulties. During the year ended December 31, 2016, the Company restructured twelve loans.

Nonperforming assets increased by $431 thousand or 4.04%, from $10.7 million at December 31, 2015 to $11.1 million at December 31, 2016. The 2016 total consisted of $1.1 million of OREO, $2.9 million in loans still accruing interest but past due 90 days or more and $7.2 million in nonaccrual loans. Of the $7.2 million in nonaccrual loans, $6.8 million was secured by real estate. All of the nonaccrual loans are classified as substandard. Substandard loans are a component of the allowance for loan losses. When a loan changes from "90 days past due but still accruing interest" to "nonaccrual" status, the loan is normally reviewed for impairment. If the loan is considered impaired, then the Company records a charge-off based on the value of the collateral or the present value of the loan's expected future cash flows, discounted at the loan's effective interest rate. If the Company is waiting on an appraisal to determine the collateral's value, management allocates funds to cover the deficiency to the allowance for loan losses based on information available to management at the time.

The recorded investment in impaired loans increased to $20.1 million as of December 31, 2016 from $13.1 million as of December 31, 2015 as detailed in Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K. The majority of these loans were collateralized.

The following table presents information concerning the aggregate amount of nonperforming assets, which includes nonaccrual loans, past due loans, TDRs and OREO:

TABLE VII
NONPERFORMING ASSETS

As of December 31,	2016	2015	2014	2013	2012
	(in thousands)				
Nonaccrual loans					
Commercial	$231	$276	$0	$149	$97
Real estate-construction	0	0	499	2,545	3,065
Real estate-mortgage (1)	6,847	4,306	5,071	8,630	7,470
Consumer	81	0	0	0	0
Total nonaccrual loans	$7,159	$4,582	$5,570	$11,324	$10,632
Loans past due 90 days or more and accruing interest					
Commercial	$0	$164	$10	$0	$25
Real estate-construction	0	0	0	0	0
Real estate-mortgage (1)	276	23	107	527	408
Consumer (2)	2,603	3,163	1,019	5	11
Other	5	6	5	14	3
Total loans past due 90 days or more and accruing interest	$2,884	$3,356	$1,141	$546	$447
Restructured loans					
Commercial	$144	$0	$0	$0	$0
Real estate-construction	96	99	102	0	0
Real estate-mortgage (1)	11,616	11,077	12,203	12,076	8,810
Consumer	0	12	13	15	16
Total restructured loans	$11,856	$11,188	$12,318	$12,091	$8,826
Less nonaccrual restructured loans (included above)	2,838	2,497	4,240	3,630	1,908
Less restructured loans in compliance (3)	9,018	8,691	8,078	8,461	6,918
Net nonperforming restructured loans	$0	$0	$0	$0	$0
Other real estate owned					
Construction, land development, and other land	$940	$1,090	$2,138	$2,783	$3,804
1-4 family residential properties	0	724	884	457	676
Multifamily (5 or more) residential properties	0	0	0	0	0
Former branch sites	127	0	886	886	0
Nonfarm nonresidential properties	0	927	1,198	2,289	2,094
	$1,067	$2,741	$5,106	$6,415	$6,574
Total nonperforming assets	$11,110	$10,679	$11,817	$18,285	$17,653
Interest income that would have been recorded under original loan terms on nonaccrual loans included above	$318	$196	$301	$762	$673
Interest income recorded for the period on nonaccrual loans included above	$269	$141	$265	$251	$121

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

(2) Amounts listed include 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 $4.8 million at December 31, 2016 and $5.7 million at December 31, 2015. For additional information, refer to Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.
(3) Amounts listed represent restructured loans that are in compliance with their modified terms as of the date presented.

As shown in the table above, as of December 31, 2016 compared to December 31, 2015, the nonaccrual loan category increased by $2.6 million or 56.24% and the 90-days past due and still accruing interest category decreased by $472 thousand or 14.06%.

Two loan relationships totaling $4.5 million were placed in nonaccrual status in the third quarter of 2016, based on declines in the borrowers' performance. In the fourth quarter, one relationship was paid down by $528 thousand, while balances on the other relationship remained stable. The addition of these relationships to nonaccrual was partially offset by $1.5 million in payoffs and/or charge-offs on other loans that were on nonaccrual status at December 31, 2015. These relationships are also responsible for the majority of the increase in loans rated substandard between December 31, 2015 and December 31, 2016. Although increases in nonaccrual loans and loans rated substandard would typically warrant an increase in the allowance, management believes that the collateral and/or cash flow on these loans will be sufficient to cover balances for which it has no specific allocation.

Loans past due 90 days or more and still accruing interest decreased primarily due to reductions in past dues in the Company's student loan portfolio. Although this category decreased between December 31, 2015 and December 31, 2016, it may increase in future periods. 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 even significant increases in charged off student loans to have a material effect on the Company.

OREO decreased by $1.7 million or 61.07% when comparing December 31, 2016 to December 31, 2015, as the Company worked to sell these properties in 2016, including the former bank property. Other than the former bank property, as of December 31, 2016, the balance in OREO was for a single property which is currently under contract. The sale is expected to close in the first quarter of 2017.

Management believes the Company has an excellent credit quality review process in place to identify problem loans quickly. For a detailed discussion of the Company's nonperforming assets, refer to Note 4 and Note 5 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Management is cautiously optimistic about the future and is well aware that if the economy begins to decline, nonperforming assets could increase in future periods. As the Company experienced in 2009, 2010 and 2011, the effect of a sustained increase in nonperforming assets would be lower earnings caused by larger contributions to the loan loss provision, which in turn would be driven by larger impairments in the loan portfolio and higher levels of loan charge-offs.

The Allowance for Loan Losses

The allowance for loan losses is based on several components. In evaluating the adequacy of the allowance, each segment of the loan portfolio is divided into several pools of loans:

1. Specific identification (regardless of risk rating)
2. Pool–substandard
3. Pool–other assets especially mentioned (OAEM) (rated just above substandard)
4. Pool–pass loans (all other rated loans)

The first component of the allowance for loan losses is determined based on specifically identified loans that are impaired. These loans are individually analyzed for impairment and include nonperforming loans and both performing and nonperforming TDRs. This component may also include loans considered impaired for other reasons, such as outdated financial information on the borrower or guarantors or financial problems of the borrower, including operating losses, marginal working capital, inadequate cash flow, or business interruptions. Changes in TDRs and nonperforming loans affect the dollar amount of the allowance. Increases in the impairment allowance for TDRs and nonperforming loans are reflected as an increase in the allowance for loan losses except in situations where the TDR or nonperforming loan does not require a specific allocation (i.e., the discounted present value of expected future cash flows or the collateral value is considered sufficient).

The majority of the Company's TDRs and nonperforming loans are collateralized by real estate. When reviewing loans for impairment, the Company obtains current appraisals when applicable. If the Company has not yet received a current appraisal on loans being reviewed for impairment, any loan balance that is in excess of the estimated appraised value is allocated in the allowance. As of December 31, 2016 and December 31, 2015, the impaired loan component of the allowance for loan losses amounted to $800 thousand and $798 thousand, respectively. Improvements in the condition of certain borrowers were offset by additional allocations for loans that moved from the pool to specifically identified during 2016. The impaired loan component of the allowance for loan losses is reflected as a valuation allowance related to impaired loans in Note 4 of the Notes to Consolidated Financial Statements included in Item 8,

"Financial Statements and Supplementary Data" of this report on Form 10-K.

The second component of the allowance consists of qualitative factors and includes items such as economic conditions, growth trends, loan concentrations, changes in certain loans, changes in underwriting, changes in management and legal and regulatory changes. For the December 31, 2016 calculation, the qualitative factors which had the most significant impact on the allowance were those affected by changes in the economy and past due and nonaccrual loans. Continued incremental improvements in the economy allowed for a reduction in the allowance. At the same time, past due and nonaccrual loans increased in several categories when comparing December 31, 2016 to December 31, 2015.

Historical loss is the final component of the allowance for loan losses. The calculation of the historical loss component is conducted on loans evaluated collectively for impairment and uses migration analysis on pooled segments. These segments are based on the loan classifications set by the Federal Financial Institutions Examination Council in the instructions for the Call Report applicable to the Bank.

Consumer loans not secured by real estate and made to individuals for household, family and other personal expenditures are segmented into pools based on whether the loan's payments are current (including loans 1 – 29 days past due), 30 – 59 days past due, 60 – 89 days past due, or 90 days or more past due. All other loans, including loans to consumers that are secured by real estate, are segmented by the Company's internally assigned risk grades: substandard, other assets especially mentioned (rated just above substandard), and pass (all other loans). The Company may also assign loans to the risk grades of doubtful or loss, but as of December 31, 2016 and December 31, 2015, the Company had no loans in these categories.

With the December 31, 2015 calculation, the historical loss was based on a migration period covering the past twelve quarters. The calculation for December 31, 2016 incorporated several changes, which are described in detail below. On a combined basis, the historical loss and qualitative factor components amounted to $7.4 million and $6.9 million as of December 31, 2016 and December 31, 2015, respectively. Growth in the loan portfolio is the major reason for the increase in these combined components when comparing the allowance calculation as of December 31, 2016 to the allowance calculation as of December 31, 2015.

For the December 31, 2016 calculation, management made the following changes to its methodology in order to ensure the allowance accurately reflects probable losses inherent in the loan portfolio.

Change in Migration Periods

Historical loss rates calculated by migration analysis are determined by the performance of a loan over a period of time (the migration period). Multiple migration periods can also be calculated, allowing the Company to assess the migration of loans based on more than one starting point. For example, the Company could run a migration analysis that begins on June 30, 2013 and follows the performance of the loans outstanding on that date through June 30, 2016, assessing changes in risk ratings and the amount of any charge-offs to determine the historical loss rate. The Company could then run a second migration analysis that begins on September 30, 2013 and follows those loans through September 30, 2016 to calculate a second historical loss rate. These two loss rates would then be averaged to determine the overall loss rate applied to the loan portfolio.

The length of a migration period can also be extended. Adding additional quarters to the migration analysis extends the period over which the loan could cease to perform, increasing the number of loans that default and thus also increasing the historical loss rates. While a longer migration period provides a more conservative estimate of expected future losses, extending the migration period too far can provide less accurate estimates if there have been changes in the economy or the Company's loan management processes.

Increasing the number of migration periods, as opposed to lengthening the individual migration periods, provides the Company with an average loss rate that is less affected by unusual balances in the segments of the portfolio. Because migration analysis follows only those loans outstanding at the beginning of the migration period, a significant change in the balance of a loan pool during the migration period can produce results that are not indicative of the performance of the pool.

For example, a particular migration period of twelve quarters (three years) may apply to a pool of loans that had a balance of $300 thousand at the beginning of the migration period. If a new loan of $150 thousand is added to the pool in the following quarter, and this loan is charged off ten quarters later, the migration analysis would show a loss rate of 50%, based on the original outstanding balance of $300 thousand and a charge-off of $150 thousand. In this example, the 50% loss rate calculated for the migration period would result from the unique timing and loan balance factors within the period and would not necessarily provide an appropriate reflection of the performance of the loans in the pool. By using multiple migration periods, such unusual situations have less of an impact on the calculated historical loss rate, providing a more accurate representation of the losses expected to be incurred.

As part of the quarterly calculation, management reviews the length of the migration periods and the number of migration periods used. To better reflect the risks inherent in the loan portfolio, in the third quarter of 2016, the Company increased the number of migration periods from one to four. As with the methodology in prior quarters, one migration period continues to include the twelve most recent quarters. The three new migration periods that are now averaged with the original migration period also include twelve quarters. The migration periods used for the fourth quarter 2016 allowance calculation included the twelve quarters ended December 31, 2016, September 30, 2016, June 30, 2016, and March 31, 2016.

Change in Segments for Pooled Loans
In addition to this change in the number of migration periods, the Company also further sub-segmented its pool of consumer loans not secured by real estate. In quarters prior to September 30, 2016, the Company segmented its consumer loans not secured by real estate into four pools: revolving loans, loans for the purchase of and secured by automobiles, student loans, and all other consumer loans. Beginning in the third quarter of 2016, the Company further divided the last category (all other consumer loans) by separating certain purchased loans into their own pool because this group of loans shares characteristics that are not shared with other consumer loans.

These loans were all purchased from a single source and, in addition to the collateral pledged by the borrower, are covered by an agreement between the Company and the note seller that requires the seller to maintain a reserve account with the Company. The balance in this reserve account, which exists to absorb future losses on these purchased loans, is between ten and fifteen percent of the outstanding balance of the purchased loans, with an average of twelve percent. Given the protection provided by this reserve, management does not anticipate any charge-offs against the allowance on these accounts. Accordingly, beginning with the third quarter of 2016, the historic loss factor does not apply to this group of loans.

Change in Qualitative Factors
Management periodically analyzes the qualitative factors applied to the segments of the loan portfolio. Beginning with the September 30, 2016 calculation, management determined that it was appropriate to modify the number of qualitative factors applied to its student loan portfolio and to the new segment discussed above. Applying the relevant qualitative factors to this new segment resulted in a lower allowance for this new sub-segment.

Overall Change in Allowance
As a result of management's analysis, the Company added, through the provision, $1.9 million to the allowance for loan losses for the year ended December 31, 2016. The allowance for loan losses, as a percentage of year-end loans, was 1.37% in 2016 and 1.36% in 2015. Management believes that the allowance has been appropriately funded for losses on existing loans, based on currently available information. The Company will continue to monitor the loan portfolio and levels of nonperforming assets closely and make changes to the allowance for loan losses when necessary.

See Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K for a discussion of the financial statement impact of these changes.

The following table shows an analysis of the allowance for loan losses:

TABLE VIII
ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

As of December 31,	2016	2015	2014	2013	2012
	(dollars in thousands)				
Balance at the beginning of period	$7,738	$7,075	$6,831	$7,324	$8,498
Charge-offs:					
Commercial	915	293	286	200	138
Real estate-construction	0	0	51	501	831
Real estate-mortgage (1)	504	321	563	1,548	2,554
Consumer	204	92	163	141	259
Other	147	191	175	316	187
Total charge-offs	1,770	897	1,238	2,706	3,969
Recoveries:					
Commercial	79	50	55	76	67
Real estate-construction	3	1	173	6	30
Real estate-mortgage (1)	197	393	524	513	162
Consumer	28	39	64	111	70
Other	40	52	66	207	66
Total recoveries	347	535	882	913	395
Net charge-offs	1,423	362	356	1,793	3,574
Provision for loan losses	1,930	1,025	600	1,300	2,400
Balance at end of period	$8,245	$7,738	$7,075	$6,831	$7,324
Selected loan loss statistics					
Loans (net of unearned income):					
End of period balance	$603,882	$568,475	$535,994	$500,699	$471,133
Average balance	$585,206	$563,534	$517,183	$471,203	$478,220
Net charge-offs to average total loans	0.24 %	0.06 %	0.07 %	0.38 %	0.75 %
Provision for loan losses to average total loans	0.33 %	0.18 %	0.12 %	0.28 %	0.50 %
Provision for loan losses to net charge-offs	135.63 %	283.15 %	168.54 %	72.50 %	67.15 %
Allowance for loan losses to period end loans	1.37 %	1.36 %	1.32 %	1.36 %	1.55 %
Earnings to loan loss coverage (2)	4.14	13.02	13.80	2.68	2.12
Allowance for loan losses to nonperforming loans	82.10 %	97.48 %	105.42 %	57.55 %	66.11 %

(1) The real estate-mortgage segment includes residential 1 – 4 family, commercial real estate, second mortgages and equity lines of credit.
(2) Income before taxes plus provision for loan losses, divided by net charge-offs.

The following table shows the amount of the allowance for loan losses allocated to each category at December 31 of the years presented.

TABLE IX

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

As of December 31,	2016		2015		2014		2013		2012	
	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans	Amount	Percent of Loans to Total Loans
	(dollars in thousands)									
Commercial	$1,493	9.16 %	$633	7.60 %	$595	7.03 %	$350	6.13 %	$677	5.38 %
Real estate-construction	846	3.83 %	985	3.46 %	703	1.69 %	662	2.90 %	187	2.55 %
Real estate-mortgage (1)	5,267	74.25 %	5,628	76.90 %	5,347	81.33 %	5,357	83.28 %	6,179	84.59 %
Consumer	455	9.61 %	279	8.87 %	219	5.69 %	294	3.95 %	204	2.79 %
Other	184	3.15 %	213	3.17 %	211	4.26 %	168	3.74 %	77	4.70 %
Total	$8,245	100.00 %	$7,738	100.00 %	$7,075	100.00 %	$6,831	100.00 %	$7,324	100.00 %

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

For the year ended December 31, 2016 as compared to the year ended December 31, 2015, there was an increase in the allowance for loan losses due to growth in the loan portfolio. The change in the allowance was distributed among the loan segments based on the composition of loans in each segment. See Note 4 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K for further information related to the effect of the change in the calculation method.

Although the allowance for loan losses is allocated into these categories, the entire allowance for loan losses is available to cover loan losses in any category. For example, if real estate-construction loans experienced losses of $1.0 million, the allowance for loan losses could absorb these losses even though only $846 thousand is allocated to that category.

Deposits
The following table shows the average balances and average rates paid on deposits for the periods presented.

TABLE X
DEPOSITS

Years ended December 31,	2016		2015		2014	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)					
Interest-bearing transaction accounts	$20,045	0.04 %	$11,219	0.04 %	$11,537	0.04 %
Money market deposit accounts	221,339	0.08 %	228,627	0.08 %	213,918	0.08 %
Savings accounts	78,305	0.05 %	74,436	0.05 %	73,576	0.06 %
Time deposits, $100,000 or more	110,963	1.05 %	113,945	0.98 %	108,630	0.96 %
Other time deposits	99,376	0.95 %	107,142	0.96 %	128,383	1.03 %
Total interest-bearing deposits	530,028	0.44 %	535,369	0.44 %	536,044	0.48 %
Demand deposits	214,876		194,677		184,555	
Total deposits	$744,904		$730,046		$720,599	

The Company's average total deposits were $744.9 million for the year ended December 31, 2016, an increase of $14.9 million or 2.04% from average total deposits for the year ended December 31, 2015. The demand deposit accounts category had the largest increase, totaling $20.2 million. In addition, average time deposits, which are currently the Company's most expensive deposit categories, decreased by a total of $10.7 million, as seen in the table above. The rates paid on interest-bearing deposits by the Company remained at 0.44% for the year ended December 31, 2016 compared to the year ended December 31, 2015.

To manage its net interest margin, during 2015 and 2016 the Company focused on reducing higher-cost time deposits by lowering deposit rates and allowing time deposits to shrink through attrition. As loan growth continued in 2016, the Company made strategic increases in the rates on time deposits in certain maturities to fund loan growth and manage its interest-rate risk. The Company is also focused on increasing lower-cost deposits by actively targeting new noninterest-bearing deposits and savings deposits.

The following table shows time deposits in amounts of $100 thousand or more by time remaining until maturity at the dates presented.

TABLE XI
TIME DEPOSITS OF $100,000 OR MORE

As of December 31,	2016	2015	2014
	(in thousands)		
Maturing in:			
Within 3 months	$15,074	$23,844	$32,995
3 through 6 months	21,183	11,474	12,212
6 through 12 months	19,276	8,572	12,628

Greater than 12 months	59,501	65,207	47,197
	$115,034	$109,097	$105,032

Return on Equity and Assets

The return on average stockholders' equity and assets, the dividend pay-out ratio, and the average equity to average assets ratio for the past three years are presented below.

As of December 31,	2016	2015	2014
Return on average assets	0.43 %	0.41 %	0.47 %
Return on average equity	3.99 %	4.02 %	4.81 %
Dividend pay-out ratio	52.23%	46.40%	31.32%
Average equity to average assets	10.75%	10.23%	9.83 %

Capital Resources

Total stockholders' equity as of December 31, 2016 was $94.0 million, up 0.87% from $93.2 million on December 31, 2015 as net income exceeded dividends paid and the mark-to-market adjustment on available-for-sale securities.

The Company's capital position remains strong as evidenced by the regulatory capital measurements. Under the banking regulations, Total Capital is composed of core capital (Tier 1) and supplemental capital (Tier 2). Tier 1 capital consists of common stockholders' equity less goodwill. Tier 2 capital consists of certain qualifying debt and a qualifying portion of the allowance for loan losses.

In June 2013, the federal bank regulatory agencies adopted the Basel III Final Rules (i) to implement the Basel III capital framework and (ii) for calculating risk-weighted assets. These rules became effective January 1, 2015, subject to limited phase-in periods. For an overview of the Basel III Final Rules, refer to "Regulation and Supervision" included in Item 1, "Business" of this report on Form 10-K.

The following is a summary of the Company's capital ratios for the past three years. As shown below, these ratios were all well above the regulatory minimum levels.

	2016 Regulatory Minimums	2016	2015	2014
Common Equity Tier 1 Capital	5.125 %	13.39%	13.78%	N/A
Tier 1 Capital	6.625 %	13.39%	13.78%	14.36%
Total Capital	8.625 %	14.51%	14.89%	15.44%
Tier 1 Leverage	4.000 %	10.68%	10.93%	10.75%

Year-end book value per share was $18.94 in 2016, $18.79 in 2015, and $17.85 in 2014. Cash dividends were $2.0 million or $0.40 per share in 2016, $1.7 million or $0.34 per share in 2015, and $1.3 million or $0.26 per share in 2014. The common stock of the Company has not been extensively traded. The table below shows the high and low sales prices and dividends paid for each quarter of 2016 and 2015. The stock is quoted on the NASDAQ Capital Market under the symbol "OPOF" and the prices below are based on trade information as reported by The NASDAQ Stock Market, LLC. There were 1,184 stockholders of record of the Company as of March 10, 2017. This stockholder count does not include stockholders who hold their stock in a nominee registration.

The following is a summary of the quarterly dividends paid and high and low sales prices of Old Point Financial Corporation common stock for the previous two years.

	2016			2015		
		Sales Price			Sales Price	
	Dividend	High	Low	Dividend	High	Low
1st Quarter	$0.10	$20.25	$17.38	$0.08	$15.44	$14.85
2nd Quarter	$0.10	$20.50	$18.50	$0.08	$15.75	$14.83
3rd Quarter	$0.10	$21.45	$18.30	$0.09	$16.00	$14.71
4th Quarter	$0.10	$26.00	$19.34	$0.09	$19.00	$15.40

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.

In addition, secondary sources are available through the use of borrowed funds if the need should arise. The Company's sources of funds include a large stable deposit base and secured advances from the Federal Home Loan Bank of Atlanta (FHLB). As of December 31, 2016, the Company had $270.0 million in FHLB borrowing availability. The increase in availability for FHLB advances is mainly due to the payoff of a $25.0 million advance in

February of 2016, discussed further below. The Company also has available short-term unsecured borrowed funds in the form of federal funds with correspondent banks. As of year-end 2016 and 2015, the Company had $55.0 million and $50.0 million available in federal funds lines of credit to address any short-term borrowing needs.

As a result of the Company's management of liquid assets, the availability of borrowed funds and the 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.

The following table sets forth information relating to the Company's sources of liquidity and the outstanding commitments for use of liquidity at December 31, 2016 and December 31, 2015. Dividing the total short-term sources of liquidity by the outstanding commitments for use of liquidity derives the liquidity coverage ratio.

LIQUIDITY SOURCES AND USES

	December 31, 2016			December 31, 2015		
	Total	In Use	Available	Total	In Use	Available
	(dollars in thousands)					
SOURCES						
Federal funds lines of credit	$55,000	$ 0	$55,000	$50,000	$0	$50,000
Federal Home Loan Bank advances	270,048	0	270,048	262,196	25,000	237,196
Federal funds sold & balances at the Federal Reserve			3,718			3,195
Securities, available-for-sale and unpledged at fair value			126,457			94,402
Total short-term funding sources			455,223			384,793
USES						
Unfunded loan commitments and lending lines of credit			69,389			63,039
Letters of credit			1,079			1,042
Commitments to purchase assets			165			165
Total potential short-term funding uses			70,633			64,246
Liquidity coverage ratio			644.5 %			598.9 %

The fair value of unpledged available-for-sale securities increased from December 31, 2015 to December 31, 2016 primarily due to changes in the Bank's pledging requirements for public deposits. Unpledged available-for-sale securities also increased due to a $7.2 million reduction in customer repurchase agreements. The 27.92% decrease in repurchase agreements from December 31, 2015 to December 31, 2016 was primarily a result of balance fluctuations in the account of a single customer.

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 or operations. The Company's internal sources of liquidity are deposits, loan and investment repayments and securities available-for-sale. The Company's primary external source of liquidity is advances from the FHLB.

The Company's operating activities provided $8.7 million of cash during the year ended December 31, 2016, compared to $7.8 million provided during 2015, primarily due to increases in net income before depreciation and amortization. The Company's investing activities used $23.6 million of cash during 2016, compared to $15.4 million used during 2015, principally due to additional loan growth. The Company's financing activities provided $3.8 million of cash during 2016 compared to $11.3 million provided of cash during 2015. This change is principally due to increases in deposits, partially offset by a net decrease in FHLB advances and overnight repurchase agreements.

In February of 2016, the Company elected to prepay a $25.0 million FHLB advance. This $25.0 million advance, which would have matured in June of 2016, bore an interest rate of 4.83%, significantly higher than other borrowing sources in the current rate environment. Although prepayment of the advance subjected the Company to a prepayment penalty equal to the cost to the FHLB to unwind its underlying hedge plus an administrative fee, the Company

determined that the interest expense saved was more than the cost to prepay the advance.

Effects of Inflation

Management believes changes in interest rates affect the financial condition of the Company, and other financial institutions, to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the U.S. government, its agencies and various other governmental regulatory authorities.

Management believes that the key to achieving satisfactory performance in an inflationary environment is the Company's ability to maintain or improve its net interest margin and to generate additional fee income. The Company's policy of investing in and funding with interest-sensitive assets and liabilities is intended to reduce the risks inherent in a volatile inflationary economy.

Off-Balance Sheet Lending Related Commitments

The Company had $145.2 million in consumer and commercial commitments at December 31, 2016. As of the same date, the Company also had $3.6 million in letters of credit that the Company will fund if certain future events occur. It is expected that only a portion of these commitments will ever actually be funded.

Management believes that the Company has the liquidity and capital resources to handle these commitments in the normal course of business. See Note 15 of the Notes to Consolidated Financial Statements included in Item 8, "Financial Statements and Supplementary Data" of this report on Form 10-K.

Contractual Obligations

In the normal course of business, there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows. The following table provides the Company's contractual obligations as of December 31, 2016:

Payments due by period					
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(in thousands)				
Contractual Obligations					
Short-Term Debt Obligations	$18,704	$18,704	$0	$0	$ 0
Long-Term Debt Obligations	0	0	0	0	0
Operating Lease Obligations	632	236	396	0	0
Commitment to purchase assets	165	165	0	0	0
Total contractual cash obligations excluding deposits	19,501	19,105	396	0	0
Deposits	784,502	672,221	52,805	59,476	0
Total	$804,003	$691,326	$53,201	$59,476	$ 0

Short-term debt obligations include federal funds purchased, overnight repurchase agreements and term repurchase agreements.

After December 31, 2016 but prior to the filing of this annual report on Form 10-K, the Company signed additional contracts for fixed asset purchases and professional services. These contracts will require payments of approximately $165 thousand in 2017.

Short-Term Borrowings

Certain short-term borrowings at December 31, 2016, 2015 and 2014 are presented below. Information is presented only on those categories whose average balance at December 31 exceeded 30 percent of total stockholders' equity at the same date.

TABLE XII
SHORT-TERM BORROWINGS

	2016		2015		2014	
	Balance	Rate	Balance	Rate	Balance	Rate
	(dollars in thousands)					
Balance at December 31,						
Repurchase agreements	$18,704	0.10%	$25,950	0.09%	$37,816	0.10%
Average daily balance for the year ended December 31,						
Repurchase agreements	$25,144	0.10%	$30,654	0.10%	$32,780	0.10%
Maximum month-end outstanding balance:						

Repurchase agreements	$34,519	$44,614	$42,429

Quarterly Data

The table below contains a comparison of the Company's quarterly income and expenses for the periods indicated:

	Years Ended December 31,							
	2016				2015			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(in thousands, except per share data)							
Interest and dividend income	$7,590	$7,436	$7,435	$7,365	$7,632	$7,609	$7,550	$7,504
Interest expense	(640)	(633)	(582)	(719)	(906)	(915)	(918)	(893)
Net interest income	6,950	6,803	6,853	6,646	6,726	6,694	6,632	6,611
Provision for loan losses	(630)	100	(1,250)	(150)	(775)	50	(25)	(275)
Net interest income, after provision for loan losses	6,320	6,903	5,603	6,496	5,951	6,744	6,607	6,336
Noninterest income	3,188	3,327	3,286	3,665	3,277	3,223	3,359	3,277
Noninterest expenses	(8,566)	(8,689)	(8,485)	(9,091)	(9,154)	(9,151)	(8,494)	(8,287)
Income before income taxes	942	1,541	404	1,070	74	816	1,472	1,326
Provision for income taxes	(47)	(212)	148	(49)	236	24	(193)	(121)
Net income	$895	$1,329	$552	$1,021	$310	$840	$1,279	$1,205
Earnings per common share:								
Basic	$0.18	$0.27	$0.11	$0.21	$0.06	$0.17	$0.26	$0.24
Diluted	$0.18	$0.27	$0.11	$0.21	$0.06	$0.17	$0.26	$0.24

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

This information is incorporated herein by reference from Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", on pages 20 through 44 of this report on Form 10-K.

Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements and related footnotes of the Company are presented below followed by the financial statements of the Parent.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Old Point Financial Corporation
Hampton, Virginia

We have audited the accompanying consolidated balance sheets of Old Point Financial Corporation and Subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Old Point Financial Corporation and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 15, 2017

Old Point Financial Corporation and Subsidiaries
Consolidated Balance Sheets

	December 31, 2016	December 31, 2015
	(dollars in thousands, except share data)	
Assets		
Cash and due from banks	$21,885	$33,514
Interest-bearing due from banks	1,667	1,064
Federal funds sold	2,302	2,412
Cash and cash equivalents	25,854	36,990
Securities available-for-sale, at fair value	199,365	214,192
Restricted securities	970	2,016
Loans, net of allowance for loan losses of $8,245 and $7,738	595,637	560,737
Premises and equipment, net	39,324	41,282
Bank-owned life insurance	25,206	24,411
Other real estate owned, net of valuation allowance of $1,026 and $2,549	1,067	2,741
Other assets	15,543	14,418
	$902,966	$896,787
Liabilities & Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	$228,641	$215,090
Savings deposits	344,452	321,370
Time deposits	211,409	210,011
Total deposits	784,502	746,471
Overnight repurchase agreements	18,704	25,950
Federal Home Loan Bank advances	0	25,000
Accrued expenses and other liabilities	5,770	6,190
Total liabilities	808,976	803,611
Stockholders' equity:		
Common stock, $5 par value, 10,000,000 shares authorized; 4,961,258 and 4,959,009 shares issued and outstanding	24,806	24,795
Additional paid-in capital	16,427	16,392
Retained earnings	56,965	55,151
Accumulated other comprehensive loss, net	(4,208)	(3,162)
Total stockholders' equity	93,990	93,176
Total liabilities and stockholders' equity	$902,966	$896,787

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Income

	Years Ended December 31,	
	2016	2015
	(dollars in thousands, except per share data)	
Interest and Dividend Income:		
Interest and fees on loans	$26,322	$25,972
Interest on due from banks	48	15
Interest on federal funds sold	6	2
Interest on securities:		
Taxable	1,802	2,510
Tax-exempt	1,535	1,663
Dividends and interest on all other securities	113	133
Total interest and dividend income	29,826	30,295
Interest Expense:		
Interest on savings deposits	227	227
Interest on time deposits	2,116	2,144
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	25	30
Interest on Federal Home Loan Bank advances	206	1,231
Total interest expense	2,574	3,632
Net interest income	27,252	26,663
Provision for loan losses	1,930	1,025
Net interest income, after provision for loan losses	25,322	25,638
Noninterest Income:		
Income from fiduciary activities	3,560	3,617
Service charges on deposit accounts	4,052	4,021
Other service charges, commissions and fees	3,940	4,084
Income from bank-owned life insurance	795	885
Gain on sale of available-for-sale securities, net	522	76
Other operating income	597	453
Total noninterest income	13,466	13,136
Noninterest Expense:		
Salaries and employee benefits	19,878	20,747
Occupancy and equipment	5,575	5,330
Data processing	1,620	1,625
FDIC insurance	483	586
Customer development	612	584
Legal and audit expenses	1,315	720
Other outside service fees	807	693
Employee professional development	659	591
Capital stock tax	505	439
ATM and other losses	477	452
Prepayment fee on Federal Home Loan Bank advance	391	0

Loss on other real estate owned	154	957
Other operating expenses	2,355	2,362
Total noninterest expense	34,831	35,086
Income before income taxes	3,957	3,688
Income tax expense	160	54
Net income	$3,797	$3,634
Basic earnings per share		
Weighted average shares outstanding	4,959,173	4,959,009
Net income per share of common stock	$$0.77	$$0.73
Diluted earnings per share		
Weighted average shares outstanding	4,960,934	4,959,009
Net income per share of common stock	$$0.77	$$0.73

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income

	Years Ended December 31,	
	2016	2015
	(dollars in thousands)	
Net income	$3,797	$3,634
Other comprehensive income (loss), net of tax		
Net unrealized losses on available-for-sale securities	(1,163)	(498)
Net change in unrealized losses on securities transferred from available-for-sale to held-to-maturity	0	3,386
Net change in defined benefit plan assets and benefit obligations	117	(157)
Other comprehensive income (loss)	(1,046)	2,731
Comprehensive income	$2,751	$6,365

See Notes to Consolidated Financial Statements.

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
	(dollars in thousands, except per share data)					
Balance at December 31, 2014	4,959,009	$ 24,795	$ 16,392	$ 53,203	$ (5,893)	$ 88,497
Net income	0	0	0	3,634	0	3,634
Other comprehensive income, net of tax	0	0	0	0	2,731	2,731
Cash dividends ($0.34 per share)	0	0	0	(1,686)	0	(1,686)
Balance at December 31, 2015	4,959,009	$ 24,795	$ 16,392	$ 55,151	$ (3,162)	$ 93,176
Net income	0	0	0	3,797	0	3,797
Other comprehensive loss, net of tax	0	0	0	0	(1,046)	(1,046)
Exercise of stock options	1,250	6	19	0	0	25
Employee Stock Purchase Plan share issuance	999	5	16	0	0	21
Cash dividends ($0.40 per share)	0	0	0	(1,983)	0	(1,983)
Balance at December 31, 2016	4,961,258	$ 24,806	$ 16,427	$ 56,965	$ (4,208)	$ 93,990

See Notes to Consolidated Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows

Years Ended December 31,	2016	2015
	(dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$3,797	$3,634
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,725	2,543
Provision for loan losses	1,930	1,025
Net gain on sale of available-for-sale securities	(522)	(76)
Net amortization of securities	2,196	2,188
Net (gain) loss on disposal of premises and equipment	(3)	6
Net loss on write-down/sale of other real estate owned	154	957
Income from bank owned life insurance	(795)	(885)
Deferred tax benefit	(19)	(227)
Increase in other assets	(567)	(3,969)
Increase (decrease) in other liabilities	(243)	3,637
Pension plan contribution	0	(1,000)
Net cash provided by operating activities	8,653	7,833
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(151,204)	(104,103)
Proceeds from redemption of restricted securities	1,046	277
Proceeds from maturities and calls of available-for-sale securities	43,660	80,790
Proceeds from maturities and calls of held-to-maturity securities	0	300
Proceeds from sales of available-for-sale securities	107,647	23,005
Paydowns on available-for-sale securities	11,288	9,353
Paydowns on held-to-maturity securities	0	8,161
Purchases of government-guaranteed student loans	0	(14,315)
Net increase in all other loans (including repayments on student loans)	(36,830)	(19,081)
Proceeds from sales of other real estate owned	1,699	1,956
Payments for improvements to other real estate owned	(52)	0
Purchases of premises and equipment	(891)	(1,756)
Net cash used in investing activities	(23,637)	(15,413)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in noninterest-bearing deposits	13,551	28,810