

Virginia National Bankshares Corp  
Form 10-Q  
August 11, 2017

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

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2017

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: **000-55117**

**VIRGINIA NATIONAL BANKSHARES CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia** (State or other jurisdiction of incorporation or organization) **46-2331578** (I.R.S. Employer Identification No.)

**404 People Place, Charlottesville, Virginia** (Address of principal executive offices) **22911** (Zip Code) **(434) 817-8621** (Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of August 7, 2017:

Class of Stock	Shares Outstanding
Common Stock, Par Value \$2.50	2,392,011

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**VIRGINIA NATIONAL BANKSHARES CORPORATION**

**FORM 10-Q**

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**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****VIRGINIA NATIONAL BANKSHARES CORPORATION  
CONSOLIDATED BALANCE SHEETS**

(dollars in thousands, except per share data)

	June 30, 2017 (Unaudited)		December 31, 2016 *
<b>ASSETS</b>			
Cash and due from banks	\$ 9,596	\$	10,047
Federal funds sold	-		28,453
Securities:			
Available for sale, at fair value	85,355		56,662
Restricted securities, at cost	1,743		1,709
Total securities	87,098		58,371
Loans	492,802		482,135
Allowance for loan losses	(3,701 )		(3,688 )
Loans, net	489,101		478,447
Premises and equipment, net	7,558		8,046
Bank owned life insurance	14,126		13,917
Goodwill	372		372
Other intangible assets, net	629		680
Accrued interest receivable and other assets	6,045		6,697
Total assets	\$ 614,525	\$	605,030
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Liabilities:			
Demand deposits:			
Noninterest-bearing	\$ 171,875	\$	176,098
Interest-bearing	96,295		96,869
Money market deposit accounts	137,310		136,658
Certificates of deposit and other time deposits	124,929		115,026
Total deposits	530,409		524,651
Federal funds purchased and securities sold under agreements to repurchase	19,942		19,700
Accrued interest payable and other liabilities	1,016		1,625
Total liabilities	551,367		545,976
Shareholders' equity:			
Preferred stock, \$2.50 par value, 2,000,000 shares authorized, no shares outstanding	-		-
Common stock, \$2.50 par value, 10,000,000 shares authorized; 2,392,011 and 2,368,777 issued and outstanding at June 30, 2017 and December 31, 2016, respectively	5,980		5,922
Capital surplus	21,596		21,152
Retained earnings	35,723		32,759
Accumulated other comprehensive loss	(141 )		(779 )
Total shareholders' equity	63,158		59,054
Total liabilities and shareholders' equity	\$ 614,525	\$	605,030

\*Derived from audited Consolidated Financial Statements

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANKSHARES CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(dollars in thousands, except per share data)  
(Unaudited)

	For the three months ended		For the six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
<b>Interest and dividend income:</b>				
Loans, including fees	\$ 5,141	\$ 4,294	\$ 10,106	\$ 8,627
Federal funds sold	105	25	178	56
Investment securities:				
Taxable	304	245	510	525
Tax exempt	65	80	125	164
Dividends	23	23	46	44
Other	3	-	6	4
<b>Total interest and dividend income</b>	<b>5,641</b>	<b>4,667</b>	<b>10,971</b>	<b>9,420</b>
<b>Interest expense:</b>				
Demand and savings deposits	123	68	233	135
Certificates and other time deposits	181	157	337	317
Federal funds purchased and securities sold under agreements to repurchase	10	12	20	24
<b>Total interest expense</b>	<b>314</b>	<b>237</b>	<b>590</b>	<b>476</b>
<b>Net interest income</b>	<b>5,327</b>	<b>4,430</b>	<b>10,381</b>	<b>8,944</b>
Provision for (recovery of) loan losses	115	(275)	45	(395)
<b>Net interest income after provision for (recovery of) loan losses</b>	<b>5,212</b>	<b>4,705</b>	<b>10,336</b>	<b>9,339</b>
<b>Noninterest income:</b>				
Trust income	385	398	777	786
Advisory and brokerage income	128	94	255	181
Royalty income	108	9	176	9
Customer service fees	223	227	453	446
Debit/credit card and ATM fees	232	232	444	430
Earnings/increase in value of bank owned life insurance	104	111	209	220
Fees on mortgage sales	32	67	49	115
Gains on sales of securities	-	-	4	8
Losses on sales of other assets	-	(2)	-	(27)
Other	115	114	209	206
<b>Total noninterest income</b>	<b>1,327</b>	<b>1,250</b>	<b>2,576</b>	<b>2,374</b>
<b>Noninterest expense:</b>				
Salaries and employee benefits	1,871	1,847	3,772	3,765
Net occupancy	458	472	929	948
Equipment	128	132	274	267
Other	1,256	1,308	2,563	2,576
<b>Total noninterest expense</b>	<b>3,713</b>	<b>3,759</b>	<b>7,538</b>	<b>7,556</b>
<b>Income before income taxes</b>	<b>2,826</b>	<b>2,196</b>	<b>5,374</b>	<b>4,157</b>
Provision for income taxes	906	686	1,719	1,292
<b>Net income</b>	<b>\$ 1,920</b>	<b>\$ 1,510</b>	<b>\$ 3,655</b>	<b>\$ 2,865</b>
<b>Net income per common share, basic</b>	<b>\$ 0.80</b>	<b>\$ 0.64</b>	<b>\$ 1.53</b>	<b>\$ 1.21</b>
<b>Net income per common share, diluted</b>	<b>\$ 0.80</b>	<b>\$ 0.63</b>	<b>\$ 1.52</b>	<b>\$ 1.20</b>

See Notes to Consolidated Financial Statements



**VIRGINIA NATIONAL BANKSHARES CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(dollars in thousands)  
(Unaudited)

	For the three months ended		For the six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Net income	\$ 1,920	\$ 1,510	\$ 3,655	\$ 2,865
Other comprehensive income (loss)				
Unrealized gain on securities, net of tax of \$189 and \$328 for the three and six months ended June 30, 2017; and net of tax of \$130 and \$335 for the three and six months ended June 30, 2016	368	252	641	651
Reclassification adjustment net of tax of (\$0) and (\$1) for the three and six months ended June 30, 2017; and net of tax of (\$0) and (\$3) for the three and six months ended June 30, 2016	-	-	(3)	(5)
Total other comprehensive income	368	252	638	646
Total comprehensive income	\$ 2,288	\$ 1,762	\$ 4,293	\$ 3,511

See Notes to Consolidated Financial Statements

**VIRGINIA NATIONAL BANKSHARES CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2017 AND 2016**  
(dollars in thousands, except per share data)  
(Unaudited)

	<b>Common Stock</b>	<b>Capital Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total</b>
<b>Balance, December 31, 2015</b>	\$ 6,031	\$ 22,214	\$ 28,170	\$ (118 )	\$ 56,297
Stock options exercised	6	35	-	-	41
Stock purchased under stock repurchase plan	(137 )	(1,123 )	-	-	(1,260 )
Stock option expense	-	14	-	-	14
Cash dividend declared (\$0.23 per share)	-	-	(542 )	-	(542 )
Net income	-	-	2,865	-	2,865
Other comprehensive income	-	-	-	646	646
<b>Balance, June 30, 2016</b>	<b>\$ 5,900</b>	<b>\$ 21,140</b>	<b>\$ 30,493</b>	<b>\$ 528</b>	<b>\$ 58,061</b>
<b>Balance, December 31, 2016</b>	<b>\$ 5,922</b>	<b>\$ 21,152</b>	<b>\$ 32,759</b>	<b>\$ (779 )</b>	<b>\$ 59,054</b>
Stock options exercised	58	438	-	-	496
Stock option expense	-	6	-	-	6
Cash dividend declared (\$0.29 per share)	-	-	(691 )	-	(691 )
Net income	-	-	3,655	-	3,655
Other comprehensive income	-	-	-	638	638
<b>Balance, June 30, 2017</b>	<b>\$ 5,980</b>	<b>\$ 21,596</b>	<b>\$ 35,723</b>	<b>\$ (141 )</b>	<b>\$ 63,158</b>

See Notes to Consolidated Financial Statements



**VIRGINIA NATIONAL BANKSHARES CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(dollars in thousands)  
(Unaudited)

	For the six months ended	
	June 30, 2017	June 30, 2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 3,655	\$ 2,865
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for (recovery of) loan losses	45	(395)
Net amortization and accretion of securities	214	224
Net gains on sales of securities	(4)	(8)
Net losses on sales of assets	-	27
Earnings on bank owned life insurance	(209)	(220)
Amortization of intangible assets	62	42
Depreciation and other amortization	588	582
Stock option/stock grant expense	6	14
Decrease in accrued interest receivable and other assets	325	98
Decrease in accrued interest payable and other liabilities	(394)	(604)
Net cash provided by operating activities	4,288	2,625
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available for sale securities	(32,836)	(9,481)
Net increase in restricted investments	(34)	(27)
Proceeds from maturities, calls and principal payments of available for sale securities	4,245	13,470
Proceeds from sales of available for sale securities	653	2,030
Net increase in organic loans	(3,930)	(6,029)
Net (increase) decrease in purchased loans	(6,769)	5,114
Cash payment for wealth management book of business	(300)	(700)
Purchase of bank premises and equipment	(100)	(235)
Net cash (used in) provided by investing activities	(39,071)	4,142
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net decrease in demand deposits, NOW accounts, and money market accounts	(4,145)	(19,826)
Net increase in certificates of deposit and other time deposits	9,903	3,779
Net increase in federal funds purchased	2,371	-
Net decrease in securities sold under agreements to repurchase	(2,129)	(7,437)
Common stock repurchased	-	(1,260)
Proceeds from stock options exercised	496	41
Cash dividends paid	(617)	(477)
Net cash provided by (used in) financing activities	5,879	(25,180)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>\$ (28,904)</b>	<b>\$ (18,413)</b>
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	\$ 38,500	\$ 43,527
End of period	\$ 9,596	\$ 25,114
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$ 569	\$ 477
Taxes	\$ 1,950	\$ 1,354
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>		
Unrealized gain on available for sale securities	\$ 965	\$ 978

See Notes to Consolidated Financial Statements



**VIRGINIA NATIONAL BANKSHARES CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**June 30, 2017**

**Note 1. Significant Accounting Policies**

**Basis of Presentation**

The consolidated financial statements include the accounts of Virginia National Bankshares Corporation (the Company), its subsidiary Virginia National Bank (the Bank), and the Bank's subsidiary, VNBTrust, National Association which offers services under the name VNB Wealth Management (VNBTrust or VNB Wealth). All significant intercompany balances and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, the unaudited consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP and the reporting guidelines prescribed by regulatory authorities requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and deferred tax assets. Operating results for the three-month and six-month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.

The statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's Form 10-K for the year ended December 31, 2016. If needed, certain previously reported amounts have been reclassified to conform to current period presentation. No such reclassifications were significant.

**Adoption of New Accounting Standard**

Accounting Standards Update (ASU) 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employer Share-Based Payment Accounting became effective with the quarter ended March 31, 2017. This ASU simplifies several aspects of the accounting for share-based payment award transactions, one of which is the recognition of excess tax benefits and deficiencies related to share-based payments. Prior to the adoption of ASU 2016-09, such tax consequences were recognized as components of additional paid-in capital. With the adoption of this ASU, tax benefits and deficiencies are recognized within income tax expense. In accordance with the adoption provisions of ASU 2016-09, the Company has prospectively applied the requirement to present excess tax benefits as an operating activity on the statement of cash flows. Further, the Company continues to estimate the number of award forfeitures in recording costs for share-based awards. The adoption did not have a material impact on our financial statements for the first two quarters ended June 30, 2017.

**Recent Accounting Pronouncements**

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in ASU 2016-01, among other things: 1) require equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 3) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and 4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the impact that ASU 2016-01 will have on its consolidated financial statements.

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

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During June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements.

During August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business – inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a *set*) that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. The amendments in this ASU provide a screen to determine when a set is not a business. If the screen is not met, the amendments (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output, and (2) remove the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this ASU should be applied prospectively on or after the effective date. No disclosures are required at transition. The Company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

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

During March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

During May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting*. The amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The amendments are effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The Company is currently assessing the impact that ASU 2017-09 will have on its consolidated financial statements.



**Note 2. Securities**

The amortized cost and fair values of securities available for sale as of June 30, 2017 and December 31, 2016 were as follows (dollars in thousands):

June 30, 2017	Amortized	Gross	Gross Unrealized	Fair
	Cost	Unrealized Gains	(Losses)	Value
U.S. Government agencies	\$ 24,498	\$ 2	\$ (277)	\$ 24,223
Corporate bonds	2,014	8	-	2,022
Mortgage-backed securities/CMOs	40,539	82	(201)	40,420
Municipal bonds	18,519	196	(25)	18,690
	\$ 85,570	\$ 288	\$ (503)	\$ 85,355

December 31, 2016	Amortized	Gross	Gross Unrealized	Fair
	Cost	Unrealized Gains	(Losses)	Value
U.S. Government agencies	\$ 14,998	\$ -	\$ (497)	\$ 14,501
Corporate bonds	2,017	-	(7)	2,010
Mortgage-backed securities/CMOs	25,470	27	(515)	24,982
Municipal bonds	15,357	30	(218)	15,169
	\$ 57,842	\$ 57	\$ (1,237)	\$ 56,662

As of June 30, 2017, there were \$45.0 million, or 39 issues of individual securities, in a loss position. These securities have an unrealized loss of \$503 thousand and consisted of 23 mortgage-backed/CMOs, 7 agency bonds, and 9 municipal bonds. The following table summarizes all securities with unrealized losses, segregated by length of time in a continuous unrealized loss position, at June 30, 2017 and December 31, 2016 (dollars in thousands):

June 30, 2017	Less than 12 Months		12 Months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. Government agencies	\$ 16,722	\$ (277)	\$ -	\$ -	\$ 16,722	\$ (277)
Mortgage-backed/CMOs	20,941	(153)	2,279	(48)	23,220	(201)
Municipal bonds	5,057	(25)	-	-	5,057	(25)
	\$ 42,720	\$ (455)	\$ 2,279	\$ (48)	\$ 44,999	\$ (503)

December 31, 2016	Less than 12 Months		12 Months or more		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. Government agencies	\$ 14,501	\$ (497)	\$ -	\$ -	\$ 14,501	\$ (497)
Corporate bonds	2,010	(7)	-	-	2,010	(7)
Mortgage-backed/CMOs	18,980	(441)	2,629	(74)	21,609	(515)
Municipal bonds	10,382	(218)	-	-	10,382	(218)
	\$ 45,873	\$ (1,163)	\$ 2,629	\$ (74)	\$ 48,502	\$ (1,237)

The Company's securities portfolio is primarily made up of fixed rate bonds, whose prices move inversely with interest rates. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. At the end of any accounting period, the portfolio may have both unrealized gains and losses. Management does not believe any of the securities in an unrealized loss position are impaired due to credit quality. Accordingly, as of June 30, 2017, management believes the impairments detailed in the table above are temporary, and no impairment loss has been realized in the Company's consolidated income statement.

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An other-than-temporary impairment ( OTTI ) is considered to exist if either of the following conditions are met: it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, or the Company does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). In the event that a security would suffer impairment for a reason that was other than temporary, the Company would be expected to write down the security's value to its new fair value, and the amount of the write down would be included in earnings as a realized loss. As of June 30, 2017, management has concluded that none of its investment securities have an OTTI based upon the information available. Additionally, management has the ability to hold any security with an unrealized loss until maturity or until such time as the value of the security has recovered from its unrealized loss position.

Securities having carrying values of \$34.0 million at June 30, 2017 were pledged as collateral to secure public deposits and securities sold under agreements to repurchase. At December 31, 2016, securities having carrying values of \$34.2 million were similarly pledged.

For the six months ended June 30, 2017, proceeds from the sales of securities amounted to \$653 thousand, with gross realized gains on these securities of \$4 thousand. For the six months ended June 30, 2016, proceeds from the sales of securities amounted to \$2.0 million, and gross realized gains on these securities were \$8 thousand.

Restricted securities are securities with limited marketability and consist of stock in the Federal Reserve Bank of Richmond ( FRB ), the Federal Home Loan Bank of Atlanta ( FHLB ), and CBB Financial Corporation ( CBBFC ), the holding company for Community Bankers Bank. These restricted securities, totaling \$1.7 million as of June 30, 2017 and December 31, 2016, are carried at cost.



**Note 3. Loans**

The composition of the loan portfolio by loan classification at June 30, 2017 and December 31, 2016 appears below (dollars in thousands).

	June 30, 2017	December 31, 2016
<b>Commercial</b>		
Commercial and industrial - organic	\$ 43,511	\$ 41,560
Commercial and industrial - government guaranteed	17,553	5,550
Commercial and industrial - syndicated	17,642	19,107
<b>Total commercial and industrial</b>	<b>78,706</b>	<b>66,217</b>
<b>Real estate construction and land</b>		
Residential construction	1,822	395
Commercial construction	10,235	4,422
Land and land development	10,274	10,865
<b>Total construction and land</b>	<b>22,331</b>	<b>15,682</b>
<b>Real estate mortgages</b>		
1-4 family residential, first lien, investment	38,178	37,538
1-4 family residential, first lien, owner occupied	17,165	16,629
1-4 family residential, junior lien	3,447	2,871
Home equity lines of credit, first lien	8,474	7,912
Home equity lines of credit, junior lien	14,381	14,022
<b>Farm</b>	<b>10,659</b>	<b>11,253</b>
Multifamily	29,202	31,052
Commercial owner occupied	78,574	83,296
Commercial non-owner occupied	108,936	107,062
<b>Total real estate mortgage</b>	<b>309,016</b>	<b>311,635</b>
<b>Consumer</b>		
Consumer revolving credit	19,317	20,373
Consumer all other credit	10,301	11,328
Student loans purchased	53,131	56,900
<b>Total consumer</b>	<b>82,749</b>	<b>88,601</b>
<b>Total loans</b>	<b>492,802</b>	<b>482,135</b>
Less: Allowance for loan losses	(3,701)	(3,688)
<b>Net loans</b>	<b>\$ 489,101</b>	<b>\$ 478,447</b>

The balances in the table above include unamortized premiums and net deferred loan costs and fees. As of June 30, 2017, unamortized premiums on loans purchased were \$1.8 million, with \$700 thousand in unamortized premiums recorded as of December 31, 2016. Net deferred loan costs (fees) totaled \$261 thousand and \$344 thousand as of June 30, 2017 and December 31, 2016, respectively.

Accounting guidance requires certain disclosures about investments in impaired loans, the allowance for loan losses and interest income recognized on impaired loans. A loan is considered impaired when it is probable that the Company will be unable to collect all principal and interest amounts when due according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and current economic conditions.

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Following is a breakdown by class of the loans classified as impaired loans as of June 30, 2017 and December 31, 2016. These loans are reported at their recorded investment, which is the carrying amount of the loan as reflected on the Company's balance sheet, net of charge-offs and other amounts applied to reduce the net book balance. Average recorded investment in impaired loans is computed using an average of month-end balances for these loans for either the six months ended June 30, 2017 or the twelve months ended December 31, 2016. Interest income recognized is for the six months ended June 30, 2017 or the twelve months ended December 31, 2016. (Dollars below reported in thousands.)

**June 30, 2017**

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Land and land development	\$ 46	\$ 97	\$ -	\$ 48	\$ -
1-4 family residential mortgages, first lien, owner occupied	107	142	-	111	-
1-4 family residential mortgages, junior lien	348	348	-	350	8
Commercial non-owner occupied real estate	993	993	-	1,003	22
Student loans purchased	904	904	-	908	25
Impaired loans with a valuation allowance	-	-	-	-	-
Total impaired loans	\$ 2,398	\$ 2,484	\$ -	\$ 2,420	\$ 55

**December 31, 2016**

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Impaired loans without a valuation allowance:					
Land and land development	\$ 51	\$ 100	\$ -	\$ 55	\$ -
1-4 family residential mortgages, first lien, owner occupied	116	147	-	123	-
1-4 family residential mortgages, junior lien	354	354	-	360	16
Commercial non-owner occupied real estate	1,012	1,012	-	1,036	45
Student loans purchased	889	889	-	498	55
Impaired loans with a valuation allowance	-	-	-	-	-
Total impaired loans	\$ 2,422	\$ 2,502	\$ -	\$ 2,072	\$ 116

Included in the impaired loans above are non-accrual loans. Generally, loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other non-accrual loans is recognized only to the extent of interest payments received. The recorded investment in non-accrual loans is shown below by class (dollars in thousands):

	June 30, 2017	December 31, 2016
Land and land development	\$ 46	\$ 51
1-4 family residential mortgage, first lien, owner occupied	107	116
Total nonaccrual loans	\$ 153	\$ 167

Additionally, Troubled Debt Restructurings ( TDRs ) are considered impaired loans. TDRs occur when the Company agrees to modify the original terms of a loan by granting a concession that it would not otherwise consider due to the deterioration in the financial condition of the borrower. These concessions are done in an attempt to improve the paying capacity of the borrower, and in some cases to avoid foreclosure, and are made with the intent to restore the loan to a performing status once sufficient payment history can be demonstrated. These concessions could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions.

Based on regulatory guidance on Student Lending issued in May, 2016, the Company has classified 55 of its student loans purchased as TDRs for a total of \$904 thousand as of June 30, 2017. These borrowers that should have been in repayment have requested and been granted payment extensions or reductions exceeding the maximum lifetime allowable payment forbearance of twelve months (36 months lifetime allowance for military service), as permitted under the regulatory guidance, and are therefore considered restructurings. Student loan borrowers are allowed in-school deferments, plus an automatic six-month grace period post in-school status, before repayment is scheduled to begin, and these deferments do not count toward the maximum allowable forbearance. As all student loans purchased are fully insured, the Company does not expect to experience a loss on these loans and interest continues to accrue on these TDRs during any deferment and forbearance periods.



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The following provides a summary, by class, of TDRs that continue to accrue interest under the terms of the restructuring agreement, which are considered to be performing, and TDRs that have been placed in non-accrual status, which are considered to be nonperforming (dollars in thousands).

**Troubled debt restructuring (TDRs)**

	June 30, 2017		December 31, 2016	
	No. of Loans	Recorded Investment	No. of Loans	Recorded Investment
<b>Performing TDRs</b>				
1-4 family residential mortgages, junior lien	2	\$ 348	2	\$ 354
Commercial non-owner occupied real estate	1	993	1	1,012
Student loans purchased	55	904	50	889
<b>Total performing TDRs</b>	<b>58</b>	<b>\$ 2,245</b>	<b>53</b>	<b>\$ 2,255</b>
<b>Nonperforming TDRs</b>				
Land and land development	1	\$ 27	1	\$ 29
<b>Total TDRs</b>	<b>59</b>	<b>\$ 2,272</b>	<b>54</b>	<b>\$ 2,284</b>

A summary of loans shown above that were modified under the terms of a TDR during the three and six months ended June 30, 2017 and 2016 is shown below by class (dollars in thousands). The Post-Modification Recorded Balance reflects the period end balances, inclusive of any interest capitalized to principal, partial principal paydowns, and principal charge-offs since the modification date. Loans modified as TDRs that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

	For three months ended June 30, 2017			For three months ended June 30, 2016		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Student loans purchased	5	\$ 51	\$ 51	38	\$ 713	\$ 713
Total loans modified during the period	5	\$ 51	\$ 51	38	\$ 713	\$ 713

	For six months ended June 30, 2017			For six months ended June 30, 2016		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Student loans purchased	9	\$ 89	\$ 90	38	\$ 713	\$ 713
Total loans modified during the period	9	\$ 89	\$ 90	38	\$ 713	\$ 713

There were no loans modified as TDRs that subsequently defaulted during the six months ended June 30, 2017 or the twelve months ended December 31, 2016 that were modified as TDRs during the twelve months prior to default.

There were no loans secured by 1-4 family residential property that were in the process of foreclosure at either June 30, 2017 or December 31, 2016.

**Note 4. Allowance for Loan Losses**

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb probable credit losses inherent in the loan portfolio. The amount of the allowance is based on management's quarterly evaluation of the collectability of the loan portfolio, credit concentrations, historical loss experience, specific impaired loans, and economic conditions. To determine the total allowance for loan losses, the Company estimates the reserves needed for each segment of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows.

For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Within these segments, the Company has sub-segmented its portfolio by classes within the segments, based on the associated risks within these classes. As explained below, beginning with the quarter ended June 30, 2016, the classes have been expanded for more granularity in determining risks and losses inherent in the loan portfolio.

**Loan Classes by Segments**

Commercial loan segment:

Commercial and industrial - organic  
Commercial and industrial - government guaranteed  
Commercial and industrial - syndicated

Real estate construction and land loan segment:

Residential construction  
Commercial construction  
Land and land development

Real estate mortgage loan segment:

1-4 family residential, first lien, investment  
1-4 family residential, first lien, owner occupied  
1-4 family residential, junior lien  
Home equity lines of credit, first lien  
Home equity lines of credit, junior lien  
Farm  
Multifamily  
Commercial owner occupied  
Commercial non-owner occupied

Consumer loan segment:

Consumer revolving credit  
Consumer all other credit  
Student loans purchased

Beginning with the quarter ended June 30, 2016, management enhanced its methodology for determining the quantitative risk assigned to unimpaired loans in order to capture historical loss information at the loan level, track loss migration through risk grade deterioration, and increase efficiencies related to performing the calculations. Prior to June 30, 2016, under the Company's allowance model, each loan class was assigned a quantitative loss factor that was primarily based on a rolling twelve-quarter look-back at historical losses for that class. Under the new methodology, the quantitative risk factor for each loan class primarily utilizes a migration analysis loss method based on loss history for the prior twelve quarters.

The migration analysis loss method is used for all loan classes except for the following:

Student loans purchased are fully insured for loss by surety bonds that the Company purchased at the same time that each package of student loans was acquired, and the Company has not experienced any losses in this class to date. In addition to the insurance, the Company holds deposit reserve accounts to offset any losses resulting from the breach of any representations or warranties by the sellers. Qualitative factors are applied, and the calculated reserve is net of any deposit reserve accounts.

Prior to the quarter ended September 30, 2016, there was not an established loss history in the commercial and industrial syndicated loans. The S&P credit and recovery ratings on the credit facilities

were utilized to calculate a three-year weighted average historical default rate. During the third quarter of 2016, there was a small loss in the commercial and industrial syndicated loans; therefore, the Company utilized a combination of the migration analysis loss method and the S&P credit and recovery ratings.

Commercial and industrial government guaranteed loans require no reserve as these are 100% guaranteed by either the Small Business Administration ( SBA ) or the United States Department of Agriculture ( USDA ).

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Under the historical loss method, quarterly loss rates are calculated for each class by dividing the cumulative gross charge-offs for the past twelve quarters by the average loan balances for the past twelve quarters. Under the migration analysis method, average loss rates are calculated at the risk grade and class levels by dividing the twelve-quarter average net charge-off amount by the twelve-quarter average loan balances. Qualitative factors are combined with these quantitative factors to arrive at the overall general allowances.

In addition to the movement to the migration analysis method, the following other changes were implemented beginning with the quarter ended June 30, 2016:

The number of classes increased from twelve to seventeen to provide greater loan level detail.

The **Watch** risk rating was separated to account for the higher level of risk associated with this risk rating. Previously the risk rating **Watch** was included in the **Pass** pool.

A minimum qualitative loss factor has been applied to the **Good** risk ratings in an abundance of caution. Previously a loan loss reserve had not been applied to loans risk rated **Good**; however, management deemed a nominal reserve as prudent.

The Company's internal creditworthiness grading system is based on experiences with similarly graded loans. The Company performs regular credit reviews of the loan portfolio to review the credit quality and adherence to its underwriting standards. Additionally, external reviews of credits are conducted on a semi-annual basis.

Loans that trend upward on the risk ratings scale, toward more positive risk ratings, generally exhibit lower risk factor characteristics. Conversely, loans that migrate toward more negative ratings generally will result in a higher risk factor being applied to those related loan balances.

### **Risk Ratings and Historical Loss Factor Assigned**

#### **Excellent**

0% historical loss factor applied, as these loans are secured by cash or fully guaranteed by a U.S. government agency and represent a minimal risk. The Company has never experienced a loss within this category.

#### **Good**

0% historical loss factor applied, as these loans represent a low risk and are secured by marketable collateral within margin. The Company has never experienced a loss within this category.

#### **Pass**

Historical loss factor for loans rated **Pass** is applied to current balances of like-rated loans, pooled by class. Loans with the following risk ratings are pooled by class and considered together as **Pass**:

**Satisfactory** modest risk loans where the borrower has strong and liquid financial statements and more than adequate cash flow

**Average** average risk loans where the borrower has reasonable debt service capacity

**Marginal** acceptable risk loans where the borrower has acceptable financial statements but is leveraged

#### **Watch**

These loans have an acceptable risk but require more attention than normal servicing. A historical loss factor for loans rated **Watch** is applied to current balances of like-rated loans pooled by class.

#### **Special Mention**

These potential problem loans are currently protected but are potentially weak. A historical loss factor for loans rated **Special Mention** is applied to current balances of like-rated loans pooled by class.

#### **Substandard**

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These problem loans are inadequately protected by the sound worth and paying capacity of the borrower and/or the value of any collateral pledged. These loans may be considered impaired and evaluated on an individual basis. Otherwise, a historical loss factor for loans rated Substandard is applied to current balances of all other Substandard loans pooled by class.

### **Doubtful**

Loans with this rating have significant deterioration in the sound worth and paying capacity of the borrower and/or the value of any collateral pledged, making collection or liquidation of the loan in full highly questionable. These loans would be considered impaired and evaluated on an individual basis.



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The following represents the loan portfolio designated by the internal risk ratings assigned to each credit as of June 30, 2017 and December 31, 2016 (dollars in thousands). There were no loans rated Doubtful as of either period.

June 30, 2017	Excellent	Good	Pass	Watch	Special Mention	Sub- standard	TOTAL
Commercial							
Commercial and industrial - organic	\$ 3,139	\$ 19,555	\$ 19,744	\$ 131	\$ 288	\$ 654	\$ 43,511
Commercial and industrial - government guaranteed	17,553	-	-	-	-	-	17,553
Commercial and industrial - syndicated	-	-	14,725	-	-	2,917	17,642
Real estate construction							
Residential construction	-	-	1,822	-	-	-	1,822
Commercial construction	-	-	10,235	-	-	-	10,235
Land and land development	-	-	9,705	4	-	565	10,274
Real estate mortgages							
1-4 family residential, first lien, investment	-	-	35,561	1,703	227	687	38,178
1-4 family residential, first lien, owner occupied	-	-	15,953	133	-	1,079	17,165
1-4 family residential, junior lien	-	-	2,792	273	199	183	3,447
Home equity lines of credit, first lien	-	-	8,236	238	-	-	8,474
Home equity lines of credit, junior lien	-	-	14,270	-	-	111	14,381
Farm	-	-	10,659	-	-	-	10,659
Multifamily	-	-	29,202	-	-	-	29,202
Commercial owner occupied	-	682	77,606	286	-	-	78,574
Commercial non-owner occupied	-	-	106,898	993	-	1,045	108,936
Consumer							
Consumer revolving credit	60	18,581	676	-	-	-	19,317
Consumer all other credit	358	9,118	787	3	-	35	10,301
Student loans purchased	-	-	52,227	904	-	-	53,131
Total Loans	\$ 21,110	\$ 47,936	\$ 411,098	\$ 4,668	\$ 714	\$ 7,276	\$ 492,802

December 31, 2016	Excellent	Good	Pass	Watch	Special Mention	Sub- standard	TOTAL
Commercial							
Commercial and industrial - organic	\$ 816	\$ 24,225	\$ 15,840	\$ 259	\$ 236	\$ 184	\$ 41,560
Commercial and industrial - government guaranteed	5,550	-	-	-	-	-	5,550
Commercial and industrial - syndicated	-	-	16,175	-	-	2,932	19,107
Real estate construction							
Residential construction	-	-	395	-	-	-	395
Commercial construction	-	-	4,422	-	-	-	4,422
Land and land development	-	-	10,271	5	-	589	10,865
Real estate mortgages							
1-4 family residential, first lien, investment	-	-	35,102	1,724	229	483	37,538
1-4 family residential, first lien, owner occupied	-	-	15,207	325	-	1,097	16,629
1-4 family residential, junior lien	-	-	2,214	326	189	142	2,871
Home equity lines of credit, first lien	-	-	7,872	40	-	-	7,912
Home equity lines of credit, junior lien	-	-	13,911	-	-	111	14,022
Farm	-	-	11,253	-	-	-	11,253
Multifamily	-	-	31,052	-	-	-	31,052
Commercial owner occupied	-	695	81,582	1,019	-	-	83,296
Commercial non-owner occupied	-	-	104,963	1,012	-	1,087	107,062
Consumer							
Consumer revolving credit	65	19,766	539	-	-	3	20,373
Consumer all other credit	284	9,977	1,027	4	-	36	11,328
Student loans purchased	-	-	56,011	889	-	-	56,900
Total Loans	\$ 6,715	\$ 54,663	\$ 407,836	\$ 5,603	\$ 654	\$ 6,664	\$ 482,135

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In addition, the adequacy of the Company's allowance for loan losses is evaluated through reference to eight qualitative factors, listed below and ranked in order of importance:

- 1) Changes in national and local economic conditions, including the condition of various market segments
- 2) Changes in the value of underlying collateral
- 3) Changes in volume of classified assets, measured as a percentage of capital
- 4) Changes in volume of delinquent loans
- 5) The existence and effect of any concentrations of credit and changes in the level of such concentrations
- 6) Changes in lending policies and procedures, including underwriting standards
- 7) Changes in the experience, ability and depth of lending management and staff
- 8) Changes in the level of policy exceptions

It has been the Company's experience that the first five factors drive losses to a much greater extent than the last three factors; therefore, the first five factors are weighted more heavily. Qualitative factors are not assessed against loans rated "Excellent" since these are fully collateralized by cash. Beginning in the second quarter of 2016, a nominal qualitative factor has been assigned to loans rated "Good," as discussed above.

For each segment and class of loans, management must exercise significant judgment to determine the estimation method that fits the credit risk characteristics of its various segments. Although this evaluation is inherently subjective, qualified management utilizes its significant knowledge and experience related to both the Company's market and the history of the Company's loan losses.

Impaired loans are individually evaluated and, if deemed appropriate, a specific allocation is made for these loans. In reviewing the loans classified as impaired loans totaling \$2.4 million at June 30, 2017, there was no specific valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the borrower.

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A summary of the transactions in the Allowance for Loan Losses by loan portfolio segment for the six months ended June 30, 2017 and the year ended December 31, 2016 appears below (dollars in thousands):

**Allowance for Loan Losses Rollforward by Portfolio Segment  
As of and for the period ended June 30, 2017**

	Commercial Loans	Real Estate Construction and Land	Real Estate Mortgages	Consumer Loans	Total
<b>Allowance for Loan Losses:</b>					
Balance as of January 1, 2017	\$ 824	\$ 127	\$ 2,506	\$ 231	\$ 3,688
Charge-offs	(58)	-	-	-	(58)
Recoveries	18	-	1	7	26
Provision for (recovery of) loan losses	88	48	(56)	(35)	45
Ending Balance	\$ 872	\$ 175	\$ 2,451	\$ 203	\$ 3,701
<b>Ending Balance:</b>					
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	872	175	2,451	203	3,701
<b>Loans:</b>					
Individually evaluated for impairment	\$ -	\$ 46	\$ 1,448	\$ 904	\$ 2,398
Collectively evaluated for impairment	78,706	22,285	307,568	81,845	490,404
Ending Balance	\$ 78,706	\$ 22,331	\$ 309,016	\$ 82,749	\$ 492,802

**As of and for the year ended December 31, 2016**

	Commercial Loans	Real Estate Construction and Land	Real Estate Mortgages	Consumer Loans	Total
<b>Allowance for Loan Losses:</b>					
Balance as of January 1, 2016	\$ 797	\$ 159	\$ 2,592	\$ 19	\$ 3,567
Charge-offs	(25)	-	(12)	-	(37)
Recoveries	32	-	3	12	47
Provision for (recovery of) loan losses	20	(32)	(77)	200	111
Ending Balance	\$ 824	\$ 127	\$ 2,506	\$ 231	\$ 3,688
<b>Ending Balance:</b>					
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	824	127	2,506	231	3,688
<b>Loans:</b>					
Individually evaluated for impairment	\$ -	\$ 51	\$ 1,482	\$ 889	\$ 2,422
Collectively evaluated for impairment	66,217	15,631	310,153	87,712	479,713
Ending Balance	\$ 66,217	\$ 15,682	\$ 311,635	\$ 88,601	\$ 482,135

As previously mentioned, one of the major factors that the Company uses in evaluating the adequacy of its allowance for loan losses is changes in the volume of delinquent loans. Management monitors payment activity on a regular basis. For all classes of loans, the Company considers the entire balance of the loan to be contractually delinquent if the minimum payment is not received by the due date. Interest and fees continue to accrue on past due loans until they are changed to non-accrual status.

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The following tables show the aging of past due loans as of June 30, 2017 and December 31, 2016. Also included are loans that are 90 or more days past due but still accruing, because they are well secured and in the process of collection. (Dollars below reported in thousands.)

Past Due Aging as of							90
	30-59	60-89	90	Total	Current	Total	Past
June 30, 2017	Days	Days	Days	Past		Loans	Due
	Past	Past	or	Past			and
	Due	Due	More	Due			Still
			Past				Accruing
			Due	Due			
Commercial loans							
Commercial and industrial - organic	\$ 25	\$ -	\$ -	\$ 25	\$ 43,486	\$ 43,511	\$ -
Commercial and industrial - government guaranteed	-	-	-	-	17,553	17,553	-
Commercial and industrial - syndicated	-	-	-	-	17,642	17,642	-
Real estate construction and land							
Residential construction	-	-	-	-	1,822	1,822	-
Commercial construction	-	-	-	-	10,235	10,235	-
Land and land development	-	19	-	19	10,255	10,274	-
Real estate mortgages							
1-4 family residential, first lien, investment	119	-	44	163	38,015	38,178	44
1-4 family residential, first lien, owner occupied	-	-	19	19	17,146	17,165	19
1-4 family residential, junior lien	-	-	-	-	3,447	3,447	-
Home equity lines of credit, first lien	-	-	-	-	8,474	8,474	-
Home equity lines of credit, junior lien	-	-	-	-	14,381	14,381	-
Farm	-	-	-	-	10,659	10,659	-
Multifamily	-	-	-	-	29,202	29,202	-
Commercial owner occupied	-	-	-	-	78,574	78,574	-
Commercial non-owner occupied	-	-	-	-	108,936	108,936	-
Consumer loans							
Consumer revolving credit	-	-	-	-	19,317	19,317	-
Consumer all other credit	-	-	-	-	10,301	10,301	-
Student loans purchased	528	347	214	1,089	52,042	53,131	214
Total Loans	\$ 672	\$ 366	\$ 277	\$ 1,315	\$ 491,487	\$ 492,802	\$ 277

Past Due Aging as of							90
	30-59	60-89	90	Total	Current	Total	Past
December 31, 2016	Days	Days	Days	Past		Loans	Due
	Past	Past	or	Past			and
	Due	Due	More	Due			Still
			Past				Accruing
			Due	Due			
Commercial loans							
Commercial and industrial - organic	\$ 65	\$ 61	\$ -	\$ 126	\$ 41,434	\$ 41,560	\$ -
Commercial and industrial - government guaranteed	-	-	-	-	5,550	5,550	-
Commercial and industrial - syndicated	-	-	-	-	19,107	19,107	-
Real estate construction and land							
Residential construction	-	-	-	-	395	395	-
Commercial construction	-	-	-	-	4,422	4,422	-
Land and land development	-	-	22	22	10,843	10,865	-
Real estate mortgages							
1-4 family residential, first lien, investment	125	-	-	125	37,413	37,538	-
1-4 family residential, first lien, owner occupied	-	-	20	20	16,609	16,629	20
1-4 family residential, junior lien	-	-	-	-	2,871	2,871	-
Home equity lines of credit, first lien	-	-	-	-	7,912	7,912	-
Home equity lines of credit, junior lien	36	-	-	36	13,986	14,022	-
Farm	-	-	-	-	11,253	11,253	-
Multifamily	-	-	-	-	31,052	31,052	-
Commercial owner occupied	-	-	-	-	83,296	83,296	-
Commercial non-owner occupied	-	-	-	-	107,062	107,062	-
Consumer loans							
Consumer revolving credit	-	-	-	-	20,373	20,373	-
Consumer all other credit	1	48	-	49	11,279	11,328	-
Student loans purchased	1,316	139	188	1,643	55,257	56,900	188
Total Loans	\$ 1,543	\$ 248	\$ 230	\$ 2,021	\$ 480,114	\$ 482,135	\$ 208



**Note 5. Intangible Assets**

On February 1, 2016 (the Effective Date), VNB Wealth purchased the book of business, including interest in the client relationships ( Purchased Relationships ), from a current officer (the Seller ) of VNB Wealth pursuant to an employment and asset purchase agreement (the Purchase Agreement ). Prior to becoming an employee of VNB Wealth and until the Effective Date of the sale, the Seller provided services to these Purchased Relationships as a sole proprietor. As of January 15, 2016, the fair value of the assets under management associated with the Purchased Relationships totaled \$31.5 million. Under the terms of the Purchase Agreement, the Company will receive all future revenue for investment management, advisory, brokerage, insurance, consulting, trust and related services performed for the Purchased Relationships.

The purchase price of \$1.2 million is payable over a five year period. During the first quarter of 2016, the Company recognized goodwill and other intangible assets arising from this purchase. As required under ASC Topic 805, Business Combinations, using the acquisition method of accounting, below is a summary of the net asset values, as determined by an independent third party, based on the fair value measurements and the purchase price. The intangible assets identified below will be amortized using a straight line method over the estimated useful life, and the amortized cost will be shown as noninterest expense. In accordance with ASC 350, Intangibles-Goodwill and Other, the Company will review the carrying value of indefinite lived goodwill at least annually or more frequently if certain impairment indicators exist. (Dollars below reported in thousands.)

	Fair Value	% of Total Intangible Assets	Estimated Economic Useful Life
<b>Identified Intangible Assets</b>			
Non-Compete Agreement	\$ 103	9.0%	3 years
Customer Relationships Intangible	670	58.5%	10 years
Total Identified Intangible Assets	\$ 773	67.5%	
<b>Goodwill</b>	<b>\$ 372</b>	<b>32.5%</b>	<b>Indefinite</b>
Total Intangible Assets	\$ 1,145	100.0%	

Through the six months ended June 2017 and 2016, the Company recognized \$62 thousand and \$42 thousand, respectively, in amortization expense from these identified intangible assets with a finite life. The net carrying value of \$629 thousand will be recognized as amortization expense in future reporting periods through 2026. The following shows the gross and net balance of these intangible assets as of June 30, 2017. (Dollars below reported in thousands.)

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
<b>Identified Intangible Assets</b>			
Non-Compete Agreement	\$ 103	\$ 49	\$ 54
Customer Relationships Intangible	670	95	575
Total Identified Intangible Assets	\$ 773	\$ 144	\$ 629

As of June 30, 2017, the Company carried a contingent liability of \$156 thousand, representing the net of the fair value of the purchase price, less the initial two annual payments made to the Seller. The remaining three annual payments as delineated in the Purchase Agreement will be paid from this liability.

**Note 6. Net Income Per Share and Stock Repurchase Program**

On September 22, 2014, the Company announced the approval by its Board of Directors of a stock repurchase program authorizing repurchase of up to 400,000 shares of the Company's common shares through September 18, 2015. The Company announced on September 21, 2015 that its Board of Directors extended the program for another year. A total of 343,559 shares at a weighted average price of \$22.89 per share were repurchased through the program. The program expired on September 18, 2016.

The following shows the weighted average number of shares used in computing net income per common share and the effect on the weighted average number of shares of diluted potential common stock for the three and six months ended June 30, 2017 and 2016. Potential dilutive common stock equivalents have no effect on net income available to common shareholders. (Dollars below reported in thousands except per share data.)

<u>Three Months Ended</u>	June 30, 2017			June 30, 2016		
		Weighted	Per		Weighted	Per
		Average	Share		Average	Share
	Net	Shares	Amount	Net	Shares	Amount
	Income			Income		
Basic net income per share	\$ 1,920	2,386,721	\$ 0.80	\$ 1,510	2,359,101	\$ 0.64
Effect of dilutive stock options	-	22,689	-	-	15,139	-
Diluted net income per share	\$ 1,920	2,409,410	\$ 0.80	\$ 1,510	2,374,240	\$ 0.63

<u>Six Months Ended</u>	June 30, 2017			June 30, 2016		
		Weighted	Per		Weighted	Per
		Average	Share		Average	Share
	Net	Shares	Amount	Net	Shares	Amount
	Income			Income		
Basic net income per share	\$ 3,655	2,381,290	\$ 1.53	\$ 2,865	2,371,026	\$ 1.21
Effect of dilutive stock options	-	21,800	-	-	14,635	-
Diluted net income per share	\$ 3,655	2,403,090	\$ 1.52	\$ 2,865	2,385,661	\$ 1.20

For the periods ended June 30, 2017 and June 30, 2016, option shares totaling 2,000 and 59,110, respectively, were considered anti-dilutive and were excluded from this calculation.

**Note 7. Stock Incentive Plans**

At the Annual Shareholders Meeting on May 21, 2014, shareholders approved the Virginia National Bankshares Corporation 2014 Stock Incentive Plan ( 2014 Plan ). The 2014 Plan makes available up to 250,000 shares of the Company's common stock to be issued to plan participants. Similar to the Company's 2003 Stock Incentive Plan ( 2003 Plan ) and 2005 Stock Incentive Plan ( 2005 Plan ), the 2014 Plan provides for granting of both incentive and nonqualified stock options, as well as restricted stock and other stock based awards. No new grants will be issued under the 2003 Plan or the 2005 Plan as these plans have expired.

For all of the Company's stock incentive plans (the Plans ), the option price of incentive stock options will not be less than the fair value of the stock at the time an option is granted. Nonqualified stock options may be granted at prices established by the Board of Directors, including prices less than the fair value on the date of grant. Outstanding stock options generally expire in ten years from the grant date. Stock options generally vest by the fourth or fifth anniversary of the date of the grant.

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A summary of the shares issued and available under each of the Plans is shown below as of June 30, 2017. Although the 2003 Plan and 2005 Plan have expired and no new grants will be issued under these plans, there were options issued before the plans expired which are still outstanding as shown below.

	2003 Plan	2005 Plan	2014 Plan
Aggregate shares issuable	128,369	230,000	250,000
Options issued, net of forfeited and expired options	(108,054)	(72,107)	(2,000)
Cancelled due to Plan expiration	(20,315)	(157,893)	-
Remaining available for grant	-	-	248,000
<b>Grants issued and outstanding:</b>			
Total vested and unvested shares	17,792	47,402	2,000
Fully vested shares	17,792	46,152	-
Exercise price range	\$18.26 to \$18.26	\$11.74 to \$26.96	\$30.20 to \$30.20

The Company accounts for all of its stock incentive plans under recognition and measurement accounting principles which require that the compensation cost relating to stock-based payment transactions be recognized in the financial statements. Stock-based compensation arrangements include stock options and restricted stock. All stock-based payments to employees are required to be valued at a fair value on the date of grant and expensed based on that fair value over the applicable vesting period. For the six months ended June 30, 2017 and 2016, the Company recognized \$6 thousand and \$14 thousand, respectively, in compensation expense for stock options. As of June 30, 2017, there was \$12 thousand in unamortized compensation expense remaining to be recognized in future reporting periods through 2021.

### Stock Options

Changes in the stock options outstanding related to all of the Plans are summarized as follows (dollars in thousands except per share data):

	Number of Options	June 30, 2017	
		Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at January 1, 2017	98,893	\$ 22.83	\$ 592
Issued	2,000	30.20	
Exercised	(23,234)	20.11	
Forfeited	(4,600)	26.96	
Expired	(5,865)	33.91	
Outstanding at June 30, 2017	67,194	\$ 22.75	\$ 938
Options exercisable at June 30, 2017	63,944	\$ 22.60	\$ 901



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The fair value of any grant is estimated at the grant date using the Black-Scholes pricing model. There were no stock option grants during the twelve months ended December 31, 2016. During the first six months of 2017, a stock option grant of 2,000 shares was issued, and the fair value on the grant issued was estimated based on the assumptions noted in the following table:

	For the six months ended June 30, 2017
Expected volatility <sup>1</sup>	17.90%
Expected dividends <sup>2</sup>	1.72%
Expected term (in years) <sup>3</sup>	6.25
Risk-free rate <sup>4</sup>	2.00%

<sup>1</sup>Based on the monthly historical volatility of the Company's stock price over the expected life of the options.

<sup>2</sup>Calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant.

<sup>3</sup>Based on the average of the contractual life and vesting period for the respective option.

<sup>4</sup>Based upon an interpolated US Treasury yield curve interest rate that corresponds to the contractual life of the option, in effect at the time of the grant.

Summary information pertaining to options outstanding at June 30, 2017 is as follows:

Exercise Price	Options Outstanding			Options Exercisable	
	Number of Options Outstanding	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number of Options Exercisable	Weighted- Average Exercise Price
\$11.74 to 20.00	21,342	2.3 Years	\$ 17.89	20,092	\$ 17.87
\$20.01 to 30.00	43,852	0.7 Years	24.77	43,852	24.77
\$30.01 to 36.74	2,000	9.7 Years	30.20	0	-
<b>Total</b>	<b>67,194</b>	<b>1.5 Years</b>	<b>\$ 22.75</b>	<b>63,944</b>	<b>\$ 22.60</b>

### Restricted Stock

There were no restricted stock grants outstanding throughout 2016 or as of June 30, 2017. No restricted stock grants were awarded during 2016 or the first six months of 2017.

## Note 8. Fair Value Measurements

### Determination of Fair Value

The Company follows ASC 820, Fair Value Measurements and Disclosures, to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. This codification clarifies that the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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

**Fair Value Hierarchy**

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

**Securities available for sale**

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following tables present the balances measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 (dollars in thousands):

Description	Balance	Fair Value Measurements at June 30, 2017 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
U.S. Government agencies	\$ 24,223	\$ -	\$ 24,223	\$ -
Corporate bonds	2,022	-	2,022	-
Mortgage-backed securities/CMOs	40,420	-	40,420	-
Municipal bonds	18,690	-	18,690	-
Total securities available for sale	\$ 85,355	\$ -	\$ 85,355	\$ -

Description	Balance	Fair Value Measurements at December 31, 2016 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
U.S. Government agencies	\$ 14,501	\$ -	\$ 14,501	\$ -
Corporate bonds	2,010	-	2,010	-
Mortgage-backed securities/CMOs	24,982	-	24,982	-
Municipal bonds	15,169	-	15,169	-

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Total securities available for sale	_____	\$	56,662	_____	\$	-	_____	\$	56,662	_____	\$	-
				25								

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Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write downs of individual assets. The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:

### Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral value is significantly adjusted due to differences in the comparable properties, or is discounted by the Company because of marketability, then the fair value is considered Level 3.

The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business financial statements if not considered significant. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3).

Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. The Company had \$2.4 million in impaired loans as of June 30, 2017 and December 31, 2016. None of these impaired loans required a valuation allowance after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

### Other Real Estate Owned

Other real estate owned ( OREO ) is measured at fair value less cost to sell, based on an appraisal conducted by an independent, licensed appraiser outside of the Company. If the collateral value is significantly adjusted due to differences in the comparable properties, or is discounted by the Company because of marketability, then the fair value is considered Level 3. OREO is measured at fair value on a nonrecurring basis. Any initial fair value adjustment is charged against the Allowance for Loan Losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest expense on the Consolidated Statements of Income. As of June 30, 2017 and December 31, 2016, the Company had no OREO property.

ASC 825, Financial Instruments, requires disclosures about fair value of financial instruments for interim periods and excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

### Cash and cash equivalents

For those short-term instruments, including cash, due from banks, federal funds sold and interest-bearing deposits maturing within ninety days, the carrying amount is a reasonable estimate of fair value.

### Securities

Fair values for securities, excluding restricted securities, are based on third party vendor pricing models. The carrying value of restricted securities consists of stock in FRB, FHLB, and CBBFC and is based on the redemption provisions of each entity and therefore excluded from the following table.

### Loans

The fair value of performing loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar remaining maturities. This calculation ignores loan fees and certain factors affecting the interest rates charged on various loans, such as the borrower's creditworthiness and compensating balances and dissimilar types of real estate held as collateral. The fair value of impaired loans is measured as described within the Impaired Loans section of this note.

### Bank owned life insurance

The carrying amounts of bank owned life insurance approximate fair value.

**Accrued interest**

The carrying amounts of accrued interest approximate fair value.

**Deposit liabilities**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

**Federal funds purchased and securities sold under agreements to repurchase**

The carrying amounts of federal funds purchased and securities sold under agreements to repurchase approximate fair value.

**Off-balance sheet financial instruments**

Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. For the reporting period, the fair value of unfunded loan commitments and standby letters of credit were deemed to be immaterial and therefore, they have not been included in the following tables.

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The carrying values and estimated fair values of the Company's financial instruments as of June 30, 2017 and December 31, 2016 are as follows (dollars in thousands):

Fair Value Measurement at June 30, 2017 using:

	Carrying value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Fair Value
		Level 1	Level 2	Level 3	
<b>Assets</b>					
Cash and cash equivalent	\$ 9,596	\$ 9,596	\$ -	\$ -	\$ 9,596
Available for sale securities	85,355	-	85,355	-	85,355
Loans, net	489,101	-	-	485,340	485,340
Bank owned life insurance	14,126	-	14,126	-	14,126
Accrued interest receivable	1,784	-	373	1,411	1,784
<b>Liabilities</b>					
Demand deposits and interest-bearing transaction and money market accounts	\$ 405,480	\$ -	\$ 405,480	\$ -	\$ 405,480
Certificates of deposit	124,929	-	124,892	-	124,892
Federal funds purchased and securities sold under agreements to repurchase	19,942	-	19,942	-	19,942
Accrued interest payable	128	-	128	-	128

Fair Value Measurement at December 31, 2016 using:

	Carrying value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Fair Value
		Level 1	Level 2	Level 3	
<b>Assets</b>					
Cash and cash equivalent	\$ 38,500	\$ 38,500	\$ -	\$ -	\$ 38,500
Available for sale securities	56,662	-	56,662	-	56,662
Loans, net	478,447	-	-	476,438	476,438
Bank owned life insurance	13,917	-	13,917	-	13,917
Accrued interest receivable	1,662	-	272	1,390	1,662
<b>Liabilities</b>					
Demand deposits and interest-bearing transaction and money market accounts	\$ 409,625	\$ -	\$ 409,625	\$ -	\$ 409,625
Certificates of deposit	115,026	-	114,979	-	114,979
Securities sold under agreements to repurchase	19,700	-	19,700	-	19,700
Accrued interest payable	107	-	107	-	107

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The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk; however, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

### Note 9. Other Comprehensive Income

A component of the Company's other comprehensive income, in addition to net income from operations, is the recognition of the unrealized gains and losses on available for sale securities, net of income taxes. Reclassifications of realized gains and losses on available for sale securities are reported in the income statement as Gains on sales of securities with the corresponding income tax effect reflected as a component of income tax expense. Amounts reclassified out of accumulated other comprehensive income are presented below for the three and six months ended June 30, 2017 and 2016 (dollars in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Available for sale securities				
Realized gains on sales of securities	\$ -	\$ -	\$ 4	\$ 8
Tax effect	-	-	(1)	(3)
Realized gains, net of tax	\$ -	\$ -	\$ 3	\$ 5

### Note 10. Segment Reporting

Virginia National Bankshares Corporation has two reportable segments, the Bank and VNB Wealth.

The Company's commercial banking segment involves making loans and generating deposits from individuals, businesses and charitable organizations. Loan fee income, service charges from deposit accounts, and other non-interest-related fees such as fees for debit cards and ATM usage and fees for treasury management services generate additional income for this segment.

The VNB Wealth segment includes (a) trust income from the investment management, wealth advisory and trust and estate services offered by VNBTrust, comprised of both management fees and performance fees, (b) advisory and brokerage income from investment advisory, retail brokerage, annuity and insurance services offered under the name of VNB Investment Services and (c) royalty income from the sale of Swift Run Capital Management, LLC in 2013. More information on royalty income and the related sale can be found under Summary of Significant Accounting Policies in Note 1 of the notes to consolidated financial statements, which is found in Item 8. Financial Statements and Supplementary Data, in the Company's Form 10-K Report for December 31, 2016 (the Company's 2016 Form 10-K).

A management fee for administrative and technology support services provided by the Bank is charged to VNB Wealth. For both the six months ended June 30, 2017 and 2016, management fees of \$50 thousand were charged to VNB Wealth and eliminated in consolidated totals.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies provided earlier in this report. Each reportable segment is a strategic business unit that offers different products and services. They are managed separately, because each segment appeals to different markets and, accordingly, require different technology and marketing strategies.



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Segment information for the three and six months ended June 30, 2017 and 2016 is shown in the following tables (dollars in thousands). The VNB Wealth total assets as shown in the following tables represent the assets of VNB Wealth and should not be confused with client assets under management.

<b>Three months ended June 30, 2017</b>	Bank	VNB Wealth	Consolidated
Net interest income	\$ 5,304	\$ 23	\$ 5,327
Provision for loan losses	115	-	115
Noninterest income	705	622	1,327
Noninterest expense	3,177	536	3,713
Income before income taxes	2,717	109	2,826
Provision for income taxes	869	37	906
Net income	\$ 1,848	\$ 72	\$ 1,920
Total assets	\$ 604,946	\$ 9,579	\$ 614,525

<b>Three months ended June 30, 2016</b>	Bank	VNB Wealth	Consolidated
Net interest income	\$ 4,419	\$ 11	\$ 4,430
Provision for (recovery of) loan losses	(275)	-	(275)
Noninterest income	744	506	1,250
Noninterest expense	3,170	589	3,759
Income (loss) before income taxes	2,268	(72)	2,196
Provision for (benefit of) income taxes	710	(24)	686
Net income (loss)	\$ 1,558	\$ (48)	\$ 1,510
Total assets	\$ 536,061	\$ 9,617	\$ 545,678

<b>Six months ended June 30, 2017</b>	Bank	VNB Wealth	Consolidated
Net interest income	\$ 10,341	\$ 40	\$ 10,381
Provision for loan losses	45	-	45
Noninterest income	1,367	1,209	2,576
Noninterest expense	6,478	1,060	7,538
Income before income taxes	5,185	189	5,374
Provision for income taxes	1,654	65	1,719
Net income	\$ 3,531	\$ 124	\$ 3,655

<b>Six months ended June 30, 2016</b>	Bank	VNB Wealth	Consolidated
Net interest income	\$ 8,921	\$ 23	\$ 8,944
Provision for (recovery of) loan losses	(395)	-	(395)
Noninterest income	1,422	952	2,374
Noninterest expense	6,353	1,203	7,556
Income (loss) before income taxes	4,385	(228)	4,157
Provision for (benefit of) income taxes	1,369	(77)	1,292
Net income (loss)	\$ 3,016	\$ (151)	\$ 2,865

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with Virginia National Bankshares Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2016, included in the Company's 2016 Form 10-K. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results for the year ending December 31, 2017 or any future period.

**FORWARD-LOOKING STATEMENTS AND FACTORS THAT COULD AFFECT FUTURE RESULTS**

Certain statements contained or incorporated by reference in this quarterly report on Form 10-Q, including but not limited to, statements concerning future results of operations or financial position, borrowing capacity and future liquidity, future investment results, future credit exposure, future loan losses and plans and objectives for future operations, change in laws and regulations applicable to the Company and its subsidiaries, adequacy of funding sources, actuarial expected benefit payment, valuation of foreclosed assets, regulatory requirements, economic environment and other statements contained herein regarding matters that are not historical facts, are forward-looking statements as defined in the Securities Exchange Act of 1934. Such statements are often characterized by use of qualified words such as expect, believe, estimate, project, anticipate, intend, will, should, similar meaning or other statements concerning the opinions or judgment of the Company and its management about future events. These statements are not historical facts but instead are subject to numerous assumptions, risks and uncertainties, and represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and outside our control. Any forward-looking statements made by the Company speak only as of the date on which such statements are made. Our actual results and financial position may differ materially from the anticipated results and financial condition indicated in or implied by these forward-looking statements. The Company makes no commitment to update or revise forward-looking statements in order to reflect new information or subsequent events or changes in expectations.

Factors that could cause our actual results to differ materially from those in the forward-looking statements include, but are not limited to, the following: inflation, interest rates, market and monetary fluctuations; geopolitical developments including acts of war and terrorism and their impact on economic conditions; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board; changes, particularly declines, in general economic conditions and in the local economies in which the Company operates; the financial condition of the Company's borrowers; competitive pressures on loan and deposit pricing and demand; changes in technology and their impact on the marketing of new products and services and the acceptance of these products and services by new and existing customers; the willingness of customers to substitute competitors' products and services for the Company's products and services; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); changes in accounting principles, policies and guidelines; other risks and uncertainties described from time to time in press releases and other public filings; and the Company's performance in managing the risks involved in any of the foregoing. The foregoing list of important factors is not exclusive, and the Company will not update any forward-looking statement, whether written or oral, that may be made from time to time.

**APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The accounting and reporting policies followed by the Company conform, in all material respects, to GAAP and to general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Company considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain, and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Company's consolidated financial statements. The Company's accounting policies are fundamental to understanding management's discussion and analysis of financial condition and results of operations.

For additional information regarding critical accounting policies, refer to the Application of Critical Accounting Policies and Critical Accounting Estimates section under Item 7 in the Company's 2016 Form 10-K. There have been no significant changes in the Company's application of critical accounting policies since December 31, 2016.

**FINANCIAL CONDITION**Total assets

The total assets of the Company as of June 30, 2017 were \$614.5 million. This is a \$9.5 million increase from the \$605.0 million total assets reported at December 31, 2016 and a \$68.8 million increase from the \$545.7 million reported at June 30, 2016. The year-over-year net growth in assets was funded largely by a \$60.0 million expansion in deposits, which increased to \$530.4 million at June 30, 2017 compared to \$470.4 million at June 30, 2016.

Federal funds sold

Although the balance in federal funds sold for the first six months of 2017 averaged \$40.2 million, the Company had no balances in federal funds sold at the end of the period. At December 31, 2016 and June 30, 2016, the Company had overnight federal funds sold of \$28.5 million and \$13.4 million, respectively. Any excess funds are sold on a daily basis in the federal funds market. The Company intends to maintain sufficient liquidity at all times to meet its funding commitments.

The Company continues to participate in the Federal Reserve Bank of Richmond's Excess Balance Account (EBA). The EBA is a limited-purpose account at the Federal Reserve Bank for the maintenance of excess cash balances held by financial institutions. The EBA eliminates the potential of concentration risk that comes with depositing excess balances with one or multiple correspondent banks.

Securities

The Company's investment securities portfolio as of June 30, 2017 totaled \$87.1 million, an increase of \$28.7 million from the \$58.4 million reported at December 31, 2016 and an increase of \$15.8 million from the \$71.3 million reported at June 30, 2016. Management continues to strive for an effective mix of earning assets and low cost of funds to maximize the earning capacity of the Company. Since loan funding needs increased significantly in the fourth quarter of 2016, lower earning securities were sold in order to deploy these funds to higher earning loans. However, as deposits increased during the first half of 2017 and loan balances increased only modestly in that same period, \$32.9 million in securities were purchased to increase the yield on earning assets over the rate that was being earned on federal funds sold. At June 30, 2017, the investment securities holdings represented 14.2% of the Company's total assets, compared to 9.7% and 13.1% of total assets at December 31, 2016 and June 30, 2016, respectively.

The Company's investment securities portfolio included restricted securities totaling \$1.7 million as of June 30, 2017 and December 31, 2016. These securities represent stock in the Federal Reserve Bank of Richmond (FRB-R), the Federal Home Loan Bank of Atlanta (FHLB-A), and CBB Financial Corporation (CBBFC), the holding company for Community Bankers Bank. The level of FRB-R and FHLB-A stock that the Company is required to hold is determined in accordance with membership guidelines provided by the Federal Reserve Bank Board of Governors or the Federal Home Loan Bank of Atlanta. Stock ownership in the bank holding company for Community Bankers Bank provides the Bank with several benefits that are not available to non-shareholder correspondent banks. None of these restricted securities are traded on the open market and can only be redeemed by the respective issuer.

At June 30, 2017, the unrestricted securities portfolio totaled \$85.4 million. The following table summarizes the Company's available for sale securities by type as of June 30, 2017, December 31, 2016, and June 30, 2016 (dollars in thousands):

	June 30, 2017	Percent of Total	December 31, 2016	Percent of Total	June 30, 2016	Percent of Total
U.S. Government agencies	\$ 24,223	28.4%	\$ 14,501	25.7%	\$ 11,391	16.4%
Corporate bonds	2,022	2.3%	2,010	3.5%	6,109	8.8%
Mortgage-backed securities/CMOs	40,420	47.4%	24,782	43.9%	33,503	48.2%
Municipal bonds	18,690	21.9%	15,169	26.9%	18,542	26.6%
Total available for sale securities	\$ 85,355	100.0%	\$ 56,462	100.0%	\$ 69,545	100.0%

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### Loan portfolio

A management objective is to grow loan balances while maintaining the asset quality of the loan portfolio. The Company seeks to achieve this objective by maintaining rigorous underwriting standards coupled with regular evaluation of the creditworthiness of, and the designation of lending limits for, each borrower. The portfolio strategies include seeking industry, loan size, and loan type diversification in order to minimize credit exposure and originating loans in markets with which the Company is familiar. The predominant market area for loans includes Charlottesville, Albemarle County, Orange County, Harrisonburg, Winchester, Frederick County and areas in the Commonwealth of Virginia that are within a 75 mile radius of any Virginia National Bank office.

As of June 30, 2017, total loans were \$492.8 million, compared to the balance of \$482.1 million as of December 31, 2016 and \$424.6 million at June 30, 2016. Loans as a percentage of total assets at June 30, 2017 were 80.2%, compared to 77.8% as of June 30, 2016. Loans as a percentage of deposits at June 30, 2017 were 92.9% compared to 90.3% as of June 30, 2016.

The following table summarizes the Company's loan portfolio by type of loan as of June 30, 2017, December 31, 2016, and June 30, 2016 (dollars in thousands):

	June 30, 2017	Percent of Total	December 31, 2016	Percent of Total	June 30, 2016	Percent of Total
	Balance		Balance		Balance	
Commercial and industrial	\$ 78,706	16.0%	\$ 66,214	13.7%	\$ 63,638	15.0%
Real estate - commercial	216,712	44.0%	221,410	45.9%	188,551	44.4%
Real estate - residential mortgage	92,304	18.7%	90,225	18.7%	90,604	21.3%
Real estate - construction	22,331	4.5%	15,682	3.3%	18,544	4.4%
Consumer loans	82,749	16.8%	88,601	18.4%	63,256	14.9%
Total loans	\$ 492,802	100.0%	\$ 482,132	100.0%	\$ 424,593	100.0%

From the \$424.6 million outstanding at June 30, 2016, gross loans have increased \$68.2 million, or 16.1%. Over the one-year period, the significant loan growth was attributable to approximately \$34.1 million in net organic loan growth, supplemented by purchases of loans. The purchase of loans is considered a secondary strategy, which allows the Company to supplement organic loan growth and enhance earnings. Balances outstanding in purchased loans totaled \$88.3 million as of June 30, 2017 and were comprised of:

Syndicated loans totaling \$17.6 million. Syndicated loans represent shared national credits in leveraged lending transactions and are included in the commercial and industrial portfolio. The Company has developed policies to limit overall credit exposure to the syndicated market, as well as limits by industry and amount per borrower.

Loans guaranteed by a U.S. government agency ( government guaranteed ) totaling \$17.6 million, inclusive of premium. During the fourth quarter of 2016, the Company began augmenting the commercial and industrial portfolio with government guaranteed loans which represent the portion of loans that are 100% guaranteed by either the United States Department of Agriculture ( USDA ) or the Small Business Administration ( SBA ); the originating institution holds the unguaranteed portion of the loan and services it. These government guaranteed portion of loans are typically purchased at a premium. In the event of early prepayment, the Company may need to write off any unamortized premium.

Student loans totaling \$53.1 million. The Company purchased two student loan packages in 2015. In the fourth quarter of 2016, a third tranche was closed for an additional \$24.8 million, inclusive of premium.

Along with the purchase of these three packages of student loans, the Company purchased surety bonds that fully insure this portion of the Company's consumer portfolio.

Management will continue to evaluate loan purchase transactions as needed to supplement organic loan growth, as part of its strategy to strengthen earnings and normalize the loan-to-deposit ratio.

While the increase in loan balances slowed to a modest \$10.7 million during the first two quarters of 2017, compared to December 31, 2016, the Company experienced significant loan growth in the fourth quarter of 2016 and each of the five quarters ending December 31, 2015. The positive impact to earnings from that significant loan growth should continue throughout 2017.

### Loan quality

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Non-accrual loans remained low and totaled \$153 thousand at June 30, 2017, compared to the \$167 thousand and \$179 thousand reported at December 31, 2016 and June 30, 2016, respectively. Additionally, the amount of loans that were past due ninety or more days remains low. At June 30, 2017, the Company had loans in its portfolio that were ninety or more days past due totaling \$277 thousand, which were all still accruing interest as the Company deems them to be collectible.

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At June 30, 2017 and December 31, 2016, the Company had loans in the amount of \$2.4 million classified as impaired loans, of which \$2.2 million were Troubled Debt Restructurings (TDRs) that are still accruing interest. At June 30, 2016, the Company had loans in the amount of \$2.3 million classified as impaired loans, of which \$2.1 million were TDRs that were still accruing interest. Based on regulatory guidance on Student Lending issued in May, 2016, the Company has classified 55 of its purchased student loans as TDRs for a total of \$904 thousand as of June 30, 2017. These borrowers that should have been in repayment have requested and been granted payment extensions or reductions exceeding the maximum lifetime allowable payment forbearance of twelve months (36 months lifetime allowance for military service), as permitted under the regulatory guidance, and are therefore considered restructurings. Student loan borrowers are allowed in-school deferments, plus an automatic six-month grace period post in-school status, before repayment is scheduled to begin, and these deferments do not count toward the maximum allowable forbearance. As all student loans purchased are fully insured, the Company does not expect to experience a loss on these loans and interest continues to accrue on these TDRs during any deferment and forbearance periods.

Management identifies potential problem loans through its periodic loan review process and considers potential problem loans as those loans classified as special mention, substandard, or doubtful.

### Allowance for loan losses

In general, the Company determines the adequacy of its allowance for loan losses by considering the risk classification and delinquency status of loans and other factors. Management may also establish specific allowances for loans which management believes require allowances greater than those allocated according to their risk classification. The purpose of the allowance is to provide for losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate. The Company is committed to determining, on an ongoing basis, the adequacy of its allowance for loan losses. The Company applies historical loss rates to various pools of loans based on risk rating classifications. In addition, the adequacy of the allowance is further evaluated by applying estimates of loss that could be attributable to any one of the following eight qualitative factors:

National and local economic trends;

Underlying collateral values;

Loan delinquency status and trends;

Loan risk classifications;

Industry concentrations;

Lending policies;

Experience, ability and depth of lending staff; and

### Levels of policy exceptions

As discussed earlier, beginning with the second quarter of 2016, the Company moved from a historical loss rate method to a loss migration model. Migration analysis uses loan level attributes to track the movement of loans through various risk classifications in order to estimate the percentage of losses likely in the portfolio. Concurrent with the change in the methodology used, the loan portfolio was further segmented by loan classes and by risk ratings to provide greater loan level detail. Management believes that this new methodology, together with greater data granularity, will more accurately reflect the potential risks and losses inherent in the loan portfolio.

The relationship of the allowance for loan losses to total loans at June 30, 2017, December 31, 2016, and June 30, 2016 appears below (dollars in thousands):

	June 30, 2017	December 31, 2016	June 30, 2016
Loans held for investment at period-end	\$ 492,802	\$ 482,135	\$ 424,593
Allowance for loan losses	\$ 3,701	\$ 3,688	\$ 3,186
Allowance as a percent of period-end loans	0.75%	0.77%	0.75%



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A provision for loan losses totaling \$45 thousand was recorded in the first six months of 2017, while a recovery of \$395 thousand was recognized for the first six months of 2016. The following is a summary of the changes in the allowance for loan losses for the six months ended June 30, 2017 and June 30, 2016 (dollars in thousands):

	2017	2016
Allowance for loan losses, January 1	\$ 3,688	\$ 3,567
Charge-offs	(58)	(12)
Recoveries	26	26
Recovery of provision for loan losses	45	(395)
Allowance for loan losses, June 30	\$ 3,701	\$ 3,186

For additional insight into management's approach and methodology in estimating the allowance for loan losses, please refer to the earlier discussion of Allowance for Loan Losses in Note 4 of the Notes to Consolidated Financial Statements. In addition, Note 4 includes details regarding the rollforward of the allowance by loan portfolio segments. The rollforward tables indicate the activity for loans that are charged-off, amounts received from borrowers as recoveries of previously charged-off loan balances, and the allocation by loan portfolio segment of the provision made during the period. The events that can positively impact the amount of allowance in a given loan segment include any one or all of the following: the recovery of a previously charged-off loan balance; the decline in the amount of classified or delinquent loans in a loan segment from the previous period, which most commonly occurs when these loans are repaid or are foreclosed; or when there are improvements in the ratios used to estimate the probability of loan losses. Improvements to the ratios could include lower historical loss rates, improvements to any of the qualitative factors mentioned above, or reduced loss expectations for individually-classified loans.

Management reviews the adequacy of the Allowance for Loan Losses on a quarterly basis to ensure it is adequate based upon the calculated potential losses inherent in the portfolio. Management believes the allowance for loan losses was adequately provided for as of June 30, 2017.

### Premises and equipment

The Company's premises and equipment, net of depreciation, as of June 30, 2017 totaled \$7.6 million compared to the \$8.0 million and \$8.3 million as of December 31, 2016 and June 30, 2016, respectively. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of assets. Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, assets and related accumulated depreciation are removed from the books, and any resulting gain or loss is charged to income.

As of June 30, 2017, the Company and its subsidiaries occupied six full-service banking facilities in the cities of Charlottesville and Winchester, as well as the counties of Albemarle and Orange in Virginia. The Company's lease for the Loudoun Mall banking office located at 186 North Loudoun Street, Winchester, Virginia expired, and the Company permanently closed that office on October 28, 2016. The Company is continuing to search for at least one new branch office location in Winchester. Any new offices that the Company decides to add are expected to be small commercial spaces.

The multi-story office building at 404 People Place, Charlottesville, Virginia, located in Albemarle County, also serves as the Company's corporate headquarters and operations center, as well as the principal offices of VNB Wealth.

Both the Arlington Boulevard facility in Charlottesville and the People Place facility also contain office space that is currently under lease to tenants.

### Deposits

Depository accounts represent the Company's primary source of funds and are comprised of demand deposits, interest-bearing checking accounts, money market deposit accounts and time deposits. These deposits have been provided predominantly by individuals, businesses and charitable organizations in the Charlottesville/Albemarle area, the Orange County area, and the Winchester area.

Total deposits as of June 30, 2017 were \$530.4 million, up \$5.8 million compared to the balances of \$524.7 million at December 31, 2016 and \$60.0 million higher than the \$470.4 million total as of June 30, 2016. The year-over-year increase was realized in all major deposit categories, but predominately in money market accounts.



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**Deposit accounts**

(dollars in thousands)

	June 30, 2017		December 31, 2016		June 30, 2016	
	Balance	% of Total Deposits	Balance	% of Total Deposits	Balance	% of Total Deposits
No cost and low cost deposits:						
Noninterest demand deposits:						
Interest checking accounts	\$ 171,875	32.4%	\$ 176,098	33.5%	\$ 168,402	35.8%
Money market deposit accounts	96,295	18.1%	96,869	18.5%	87,147	18.5%
Total noninterest and low cost deposit accounts	137,310	25.9%	136,658	26.0%	102,474	21.8%
Total deposit accounts	405,480	76.4%	409,625	78.0%	358,023	76.1%
Time deposit accounts:						
Certificates of deposit	103,965	19.6%	90,084	17.2%	94,636	20.1%
CDARS deposits	20,964	4.0%	24,942	4.8%	17,761	3.8%
Total certificates of deposit and other time deposits	124,929	23.6%	115,026	22.0%	112,397	23.9%
Total deposit account balances	\$ 530,409	100.0%	\$ 524,651	100.0%	\$ 470,420	100.0%

Noninterest-bearing demand deposits on June 30, 2017 were \$171.9 million, representing 32.4% of total deposits. Interest-bearing transaction and money market accounts totaled \$233.6 million, and represented 44.0% of total deposits at June 30, 2017. Collectively, noninterest-bearing and interest-bearing transaction and money market accounts represented 76.4% of total deposit accounts at June 30, 2017. These account types are an excellent source of low-cost funding for the Company.

The remaining 23.6% of total deposits consisted of certificates of deposit and other time deposit accounts totaling \$124.9 million at June 30, 2017. Included in this deposit total are Certificate of Deposit Account Registry Service CDs, known as CDARS™, whereby depositors can obtain FDIC deposit insurance on account balances of up to \$50 million. CDARS deposits totaled \$21.0 million as of June 30, 2017.

Federal funds purchased and securities sold under agreements to repurchase

Short-term borrowings, consisting primarily of federal funds purchased and securities sold under agreements to repurchase, are additional sources of funds for the Company. The level of these borrowings is determined by various factors, including customer demand and the Company's ability to earn a favorable spread on the funds obtained.

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The Company had borrowed overnight federal funds in the amount of \$2.4 million as of June 30, 2017, yet only averaged \$94 thousand for the first six months of the year. The Company had no balances in federal funds purchased as of December 31, 2016 or June 30, 2016.

Securities sold under agreement to repurchase are available to non-individual accountholders on an overnight term through the Company's investment sweep product. Under the agreements to repurchase, invested funds are fully collateralized by security instruments that are pledged on behalf of customers utilizing this product. Total balances in securities sold under agreement to repurchase as of June 30, 2017 were \$17.5 million.

### Shareholders' equity and regulatory capital ratios

The following table displays the changes in shareholders' equity for the Company from December 31, 2016 to June 30, 2017 (dollars in thousands):

Equity, December 31, 2016	\$ 59,054
Net income	3,655
Other comprehensive income	638
Cash dividends declared	(691)
Stock options exercised	496
Equity increase due to expensing of stock options	6
Equity, June 30, 2017	\$ 63,158

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The Basel III regulatory capital rules effective January 1, 2015 required the Company and its subsidiaries to comply with the following new minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.50% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6% of risk-weighted assets (increased from the prior requirement of 4.00%); (iii) a total capital ratio of 8.00% of risk-weighted assets (unchanged from the prior requirement); and (iv) a leverage ratio of 4.00% of total assets (unchanged from the prior requirement). These were the initial capital requirements.

Beginning January 1, 2016 a capital conservation buffer requirement began to be phased in over a four-year period, beginning at 0.625% of risk-weighted assets and increasing annually to 2.50% at January 1, 2019. Therefore, for the calendar year 2017, this 1.25% buffer effectively results in the minimum (i) common equity Tier 1 capital ratio of 5.75% of risk-weighted assets; (ii) Tier 1 capital ratio of 7.25% of risk-weighted assets; and (iii) total capital ratio of 9.25% of risk-weighted assets. The minimum leverage ratio remains at 4.00%. For additional information regarding the new capital requirements, refer to the Supervision and Regulation section, under Item 1. Business, found in the Company's Form 10-K Report for December 31, 2016.

Using the new capital requirements, the Company's capital ratios remain well above the levels designated by bank regulators as "well capitalized" at June 30, 2017. Under the current risk-based capital guidelines of federal regulatory authorities, the Company's common equity Tier 1 capital ratio and Tier 1 capital ratio are both at 12.35% of its risk-weighted assets and are well in excess of the minimum capital requirements of 6.50% and 8.00%, respectively. Additionally, the Company has a total capital ratio of 13.09% of its risk-weighted assets and leverage ratio of 9.65% of total assets, which are both well in excess of the minimum 10.00% and 5.00% level designated by bank regulators under "well capitalized" capital guidelines.

### RESULTS OF OPERATIONS

#### Non-GAAP presentations

The Company, in referring to its net income and net interest income, is referring to income computed in accordance with GAAP, unless otherwise noted. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations also refer to various calculations that are non-GAAP presentations. They include:

**Fully taxable-equivalent ( FTE ) adjustments** Net interest margin and efficiency ratios are presented on an FTE basis, consistent with SEC guidance in Industry Guide 3 which states that tax exempt income may be calculated on a tax equivalent basis. This is a non-GAAP presentation. The FTE basis adjusts for the tax-exempt status of net interest income from certain investments using a federal tax rate of 34%, where applicable, to increase tax-exempt interest income to a taxable-equivalent basis.

**Net interest margin** Net interest margin (FTE) is calculated as net interest income, computed on an FTE basis, expressed as a percentage of average earning assets. The Company believes this measure to be the preferred industry measurement of net interest margin and that it enhances comparability of net interest margin among peers in the industry.

**Efficiency ratio** One of the ratios the Company examines in its evaluation of net income is the efficiency ratio, which measures the cost to produce one dollar of revenue. The Company computes its efficiency ratio (FTE) by dividing noninterest expense by the sum of net interest income (FTE) and noninterest income. A lower ratio is an indicator of increased operational efficiency. This non-GAAP metric is used to assist investors in understanding how management assesses its ability to generate revenues from its non-funding-related expense base, as well as to align presentation of this financial measure with peers in the industry. The Company believes this measure to be the preferred industry measurement of operational efficiency, which is consistent with Federal Deposit Insurance Corporation ( FDIC ) studies.

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Net interest income is discussed in Management's Discussion and Analysis on a GAAP basis, unless noted as FTE; and the reconciliation below shows the fully taxable-equivalent adjustment to net interest income to aid the reader in understanding the computations of net interest margin and the efficiency ratio on a non-GAAP basis (dollars in thousands):

### Reconciliation of

### Non-GAAP

### Measures:

	For the three months ended		For the six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Net interest income	\$ 5,327	\$ 4,430	\$ 10,381	\$ 8,945
Fully taxable-equivalent adjustment	33	43	64	84
Net interest income (FTE)	\$ 5,360	\$ 4,473	\$ 10,445	\$ 9,029
Efficiency ratio	55.8%	66.7%	58.2%	66.8%
Impact of FTE adjustment	-0.3%	-0.5%	-0.3%	-0.5%
Efficiency ratio (FTE)	55.5%	66.2%	57.9%	66.3%
Net interest margin	3.48%	3.47%	3.50%	3.46%
Fully taxable-equivalent adjustment	0.02%	0.03%	0.02%	0.03%
Net interest margin (FTE)	3.50%	3.50%	3.52%	3.49%
<u>Net income</u>				

Net income for the three months ended June 30, 2017 was \$1.9 million, a 27.2% increase compared to the \$1.5 million reported for the three months ended June 30, 2016. Net income per diluted share was \$0.80 for the quarter ended June 30, 2017 compared to \$0.63 per diluted share for the same quarter in the prior year. The \$410 thousand increase in net income for the second quarter of 2017, when compared to the same period of 2016, is attributable to an increase in net interest income of \$897 thousand, an increase in noninterest income of \$77 thousand, and a reduction in noninterest expenses of \$46 thousand. Partially offsetting these increases were an increase of \$220 thousand in the provision for income taxes and an increase of \$390 thousand in the provision for loan losses.

Net income for the first six months of 2017 was \$3.7 million, or 27.6% higher than the reported net income of \$2.9 million during the same period in 2016. Net income per diluted share for the first half of 2017 was \$1.52, or \$0.32 higher than the \$1.20 per diluted share reported in the first half of 2016. The \$790 thousand increase in net income during the first six months of 2017 from the first six months of 2016 is attributable to several positive factors, including an increase of \$1.4 million in net interest income, an increase of \$202 thousand in noninterest income and a decrease of \$18 thousand in noninterest expense. Partially offsetting the net increase was an increase of \$440 thousand in the provision for loan losses and an increase of \$427 thousand in provision for income taxes.

### Net interest income

Net interest income for the three months ended June 30, 2017 was \$5.3 million, an \$897 thousand increase compared to net interest income of \$4.4 million for the three months ended June 30, 2016. Net interest income was positively impacted by an increase in earning assets of \$99.8 million. Most of this additional funding was deployed in higher yielding loans and resulted in average loans for the second quarter of 2017 being \$70.4 million higher than the average loans for the second quarter of 2016. For the six months ended June 30, 2017, the Company recorded \$10.4 million in net interest income, or 16.1% more than the \$8.9 million recorded for the same six months a year ago.

Net interest margin (FTE) is the ratio of net interest income (FTE) to average earning assets for the period. The level of interest rates, together with the volume and mix of earning assets and interest-bearing liabilities, impact net interest income (FTE) and net interest margin (FTE). The net interest margin (FTE) of 3.50% for the three months ended June 30, 2017 remained consistent with the quarter ended June 30, 2016. The net interest margin (FTE) for the first six months of 2017 was 3.52% or 3 basis points higher than the 3.49% reported for the same period in 2016. Refer to the Reconciliation of Non-GAAP Measures table within the

Non-GAAP Presentations section for a reconciliation of GAAP to non-GAAP net interest margin.

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Total interest income (FTE) for the six months ended June 30, 2017 was \$1.5 million higher than the prior year, accounting for the year-to-date increase in net interest income (FTE). The increased loan volume was the major contributor in the increased interest income. This shift resulted in an earning asset yield, as computed on a tax-equivalent basis, of 3.72% on average earning asset balances of \$598.3 million for the six months ended June 30, 2017. The earning asset yield, as computed on a tax-equivalent basis, was 3.67% on average earning asset balances of \$520.4 million for the six months ended June 30, 2016.

The Company's net interest income continues to benefit from having one of the lowest cost of funds among community banks in the country. A table showing the mix of no cost and low cost deposit accounts is shown under "Financial Condition - Deposits" earlier in this report. Interest expense as a percentage of average earning assets was 0.20% for the six months ended June 30, 2017 and 0.18% for the six months ended June 30, 2016.

The following tables detail the average balance sheet, including an analysis of net interest income (FTE) for earning assets and interest bearing liabilities, for the three and six months ended June 30, 2017 and 2016. These tables also include a rate/volume analysis for these same periods (dollars in thousands).

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Consolidated Average Balance Sheet And Analysis of Net Interest Income

	For the three months ended						Change in Interest Income/Expense		Total Increase/ (Decrease)
	June 30, 2017			June 30, 2016			Change Due to: <sup>4</sup>		
(dollars in thousands)	Average Balance	Interest Income/ Expense	Average Yield/ Cost	Average Balance	Interest Income/ Expense	Average Yield/ Cost	Volume	Rate	
<b>ASSETS</b>									
Interest Earning Assets:									
Securities									
Taxable Securities	\$ 69,173	\$ 327	1.89%	\$ 57,850	\$ 268	1.85%	\$ 53	\$ 6	\$ 59
Tax Exempt Securities <sup>1</sup>	11,803	98	3.32%	14,310	121	3.38%	(21)	(2)	(23)
Total Securities <sup>1</sup>	80,976	425	2.10%	72,160	389	2.16%	32	4	36
Total Loans	489,806	5,141	4.21%	419,429	4,294	4.12%	736	111	847
Fed Funds Sold	42,210	105	1.00%	21,425	25	0.47%	37	43	80
Other Interest Bearing Deposits	1,000	3	1.20%	1,148	-	0.00%	-	3	3
Total Earning Assets	613,992	5,674	3.71%	514,162	4,708	3.68%	805	161	966
Less: Allowance for Loan Losses	(3,646)			(3,411)					
Total Non-Earning Assets	36,827			37,523					
Total Assets	\$ 647,173			\$ 548,274					
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest Bearing Liabilities:									
Interest Bearing Deposits:									
Interest Checking	\$ 104,071	\$ 13	0.05%	\$ 86,673	\$ 11	0.05%	\$ 2	\$ -	\$ 2
Money Market Deposits	149,999	110	0.29%	108,917	57	0.21%	26	27	53
Time Deposits	133,057	181	0.55%	112,772	156	0.56%	28	(3)	25
Total Interest-Bearing Deposits	387,127	304	0.31%	308,362	224	0.29%	56	24	80
Securities Sold Under Agreement to Repurchase	15,808	9	0.23%	19,260	11	0.23%	(2)	-	(2)
Federal Funds Purchased	187	1	1.72%	-	-	N/A	-	1	1
Total Interest-Bearing Liabilities	403,122	314	0.31%	327,622	235	0.29%	54	25	79
Non-Interest-Bearing Liabilities:									
Demand deposits	180,286			161,583					
Other liabilities	1,331			1,626					
Total Liabilities	584,739			490,831					
Shareholders' Equity	62,434			57,443					
Total Liabilities & Shareholders' Equity	\$ 647,173			\$ 548,274					
Net Interest Income (FTE)		\$ 5,360			\$ 4,473		\$ 751	\$ 136	\$ 887
Interest Rate Spread <sup>2</sup>			3.40%			3.39%			
Interest Expense as a Percentage of Average Earning Assets			0.20%			0.18%			
Net Interest Margin (FTE) <sup>3</sup>			3.50%			3.50%			

Tax-exempt income for investment securities has been adjusted to a fully tax-equivalent basis (FTE), using a Federal income tax rate of 34%. Refer to the Reconciliation of Non-GAAP Measures table within the Non-GAAP Presentations section for a

(1) reconciliation of GAAP to non-GAAP net interest income and net interest margin.

(2) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.

(3) Net interest margin (FTE) is net interest income (FTE) expressed as a percentage of average earning assets.

The impact on the net interest income (FTE) resulting from changes in average balances and average rates is shown for the period indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in

(4) proportion to the relationship of the absolute dollar amounts of the change in each.



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Consolidated Average Balance Sheet And Analysis of Net Interest Income

	For the six months ended						Change in Interest Income/ Expense		Total Increase/ (Decrease)
	Average Balance	June 30, 2017 Interest Income/ Expense	Average Yield/ Cost	Average Balance	June 30, 2016 Interest Income/ Expense	Average Yield/ Cost	Change Due to: <sup>4</sup> Volume	Rate	
<b>(dollars in thousands)</b>									
<b>ASSETS</b>									
Interest Earning Assets:									
Securities									
Taxable Securities	\$ 60,095	\$ 556	1.85%	\$ 60,146	\$ 569	1.89%	\$ -	\$ (13)	\$ (13)
Tax Exempt Securities (1)	11,460	189	3.30%	14,943	248	3.32%	(58)	(1)	(59)
Total Securities (1)	71,555	745	2.08%	75,089	817	2.18%	(58)	(14)	(72)
Total Loans	485,517	10,106	4.20%	420,446	8,627	4.13%	1,353	126	1,479
Fed Funds Sold	40,245	178	0.89%	23,665	56	0.48%	54	68	122
Other Interest Bearing Deposits	1,000	6	1.21%	1,199	4	0.67%	(1)	3	2
Total Earning Assets	598,317	11,035	3.72%	520,399	9,504	3.67%	1,348	183	1,531
Less: Allowance for Loan Losses	(3,676)			(3,487)					
Total Non-Earning Assets	37,257			37,478					
Total Assets	\$ 631,898			\$ 554,390					
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest Bearing Liabilities:									
Interest Bearing Deposits:									
Interest Checking Money Market Deposits	\$ 100,538	\$ 25	0.05%	\$ 89,241	\$ 22	0.05%	\$ 3	\$ -	\$ 3
Time Deposits	146,593	208	0.29%	107,452	113	0.21%	49	46	95
Total Interest-Bearing Deposits	376,215	570	0.31%	311,309	451	0.29%	90	29	119
Securities Sold Under Agreement to Repurchase	17,061	19	0.22%	20,368	24	0.24%	(4)	(1)	(5)
Federal Funds Purchased	94	1	1.72%	-	-	N/A	-	1	1
Total Interest-Bearing Liabilities	393,370	590	0.30%	331,677	475	0.29%	86	29	115
Non-Interest-Bearing Liabilities:									
Demand deposits	175,706			164,012					
Other liabilities	1,438			1,621					
Total Liabilities	570,514			497,310					
Shareholders' Equity	61,384			57,080					
Total Liabilities & Shareholders' Equity	\$ 631,898			\$ 554,390					
Net Interest Income (FTE)		\$ 10,445			\$ 9,029		\$ 1,262	\$ 154	\$ 1,416
Interest Rate Spread (2)			3.42%			3.38%			
Interest Expense as a Percentage of Average Earning Assets			0.20%			0.18%			
Net Interest Margin (FTE) <sup>3</sup>			3.52%			3.49%			

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- Tax-exempt income for investment securities has been adjusted to a fully tax-equivalent basis (FTE), using a Federal income tax rate of 34%. Refer to the Reconciliation of Non-GAAP Measures table within the Non-GAAP Presentations section for a
- (1) reconciliation of GAAP to non-GAAP net interest income and net interest margin.
  - (2) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.
  - (3) Net interest margin (FTE) is net interest income (FTE) expressed as a percentage of average earning assets.
- The impact on the net interest income (FTE) resulting from changes in average balances and average rates is shown for the period indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in
- (4) proportion to the relationship of the absolute dollar amounts of the change in each.

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Provision for loan losses

A provision for loan losses of \$45 thousand was recorded in the first two quarters of 2017, while a recovery of \$395 thousand was recognized for the first two quarters of 2016. This resulted in a negative impact to income of \$440 thousand when comparing year-over-year. The 2017 provision for loan loss was recorded due to loan growth during the first six months of the year and to replenish the allowance for losses due to a charge-off of \$58 thousand during the period. The allowance for loan losses as a percentage of total loans at June 30, 2017 of 0.75% was level with the allowance for loan losses as of the year prior. As discussed earlier, beginning with the second quarter of 2016, the Company moved from a historical loss rate method to a loss migration model. Further discussion of management's assessment of the allowance for loan losses is provided earlier in the report and in Note 4 Allowance for Loan Losses, found in the Notes to the Consolidated Financial Statements. In management's opinion, the allowance was adequately provided for at June 30, 2017.

Noninterest income

The components of noninterest income for the three months ended June 30, 2017 and 2016 are shown below (dollars in thousands):

	For the three months ended		Variance	
	June 30, 2017	June 30, 2016	\$	%
<b>Noninterest income:</b>				
Trust income	\$ 385	\$ 398	\$ (13)	-3.3%
Advisory and brokerage income	128	94	34	36.2%
Royalty income	108	9	99	N/A
Customer service fees	223	227	(4)	-1.8%
Debit/credit card and ATM fees	232	232	-	0.0%
Earnings/increase in value of bank owned life insurance	104	111	(7)	-6.3%
Fees on mortgage sales	32	67	(35)	-52.2%
Losses on sales of assets	-	(2)	2	100.0%
Other	115	114	1	0.9%
<b>Total noninterest income</b>	<b>\$ 1,327</b>	<b>\$ 1,250</b>	<b>\$ 77</b>	<b>6.2%</b>

Noninterest income for the quarter ended June 30, 2017 of \$1.3 million was \$77 thousand higher compared with the \$1.2 million recorded for the quarter ended June 30, 2016. Royalty income increased \$99 thousand, \$74 thousand of which related to a one-time payment in connection with a revision to our agreement with Swift Run Capital Management, LLC ( SRCM ). Advisory and brokerage income increased \$34 thousand, also contributing to the year-over-year increase. Fees on mortgage sales declined \$35 thousand, negatively impacting noninterest income for the quarter compared to the same quarter in 2016.

The components of noninterest income for the six months ended June 30, 2017 and 2016 are shown below (dollars in thousands):

	For the six months ended		Variance	
	June 30, 2017	June 30, 2016	\$	%
<b>Noninterest income:</b>				
Trust income	\$ 777	\$ 786	\$ (9)	-1.1%
Advisory and brokerage income	255	181	74	40.9%
Royalty income	176	9	167	N/A
Customer service fees	453	446	7	1.6%
Debit/credit card and ATM fees	444	430	14	3.3%
Earnings/increase in value of bank owned life insurance	209	220	(11)	-5.0%
Fees on mortgage sales	49	115	(66)	-57.4%
Gains on sales of securities	4	8	(4)	-50.0%
Losses on sales of assets	-	(27)	27	100.0%
Other	209	206	3	1.5%
<b>Total noninterest income</b>	<b>\$ 2,576</b>	<b>\$ 2,374</b>	<b>\$ 202</b>	<b>8.5%</b>

On a year-to-date basis, noninterest income of \$2.6 million was recognized in the first six months of 2017, an increase of \$208 thousand from the same period in 2016. Royalty income accounted for \$167 thousand of this increase, partially as a result of a one-time payment in connection with a revision to our agreement with SRCM as noted above. Advisory and brokerage income of \$255 thousand for the 2017 period was \$74 thousand higher than the \$181 thousand recognized for the same period in 2016. As a point of reference, for the full year of 2015, Wealth Management recognized \$29 thousand in advisory and brokerage income. The purchase of the wealth management book of business early in 2016, as discussed earlier under Note 5 Intangible Assets, accounts for the increased advisory and brokerage income during both periods.

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Noninterest expense

The components of noninterest expense for the three months ended June 30, 2017 and 2016 are shown below (dollars in thousands):

	For the three months ended		Variance	
	June 30, 2017	June 30, 2016	\$	%
<b>Noninterest expense:</b>				
Salaries and employee benefits	\$ 1,871	\$ 1,847	\$ 24	1.3%
Net occupancy	458	472	(14)	-3.0%
Equipment	128	132	(4)	-3.0%
ATM, debit and credit card	81	79	2	2.5%
Bank franchise tax	119	109	10	9.2%
Computer software	94	94	-	0.0%
Data processing	248	298	(50)	-16.8%
FDIC deposit insurance assessment	67	71	(4)	-5.6%
Marketing, advertising and promotion	116	137	(21)	-15.3%
Professional fees	125	119	6	5.0%
Other	406	401	5	1.2%
<b>Total noninterest expense</b>	<b>\$ 3,713</b>	<b>\$ 3,759</b>	<b>\$ (46)</b>	<b>-1.2%</b>

Noninterest expense for the second quarter of 2017 of \$3.7 million was \$46 thousand lower than the quarter ended June 30, 2016. A reduction in data processing expenses of \$50 thousand accounted for the major decline, mainly due to a renegotiated contract with the Company's core data processing provider.

The components of noninterest expense for the six months ended June 30, 2017 and 2016 are shown below (dollars in thousands):

	For the six months ended		Variance	
	June 30, 2017	June 30, 2016	\$	%
<b>Noninterest expense:</b>				
Salaries and employee benefits	\$ 3,772	\$ 3,765	\$ 7	0.2%
Net occupancy	929	948	(19)	-2.0%
Equipment	274	267	7	2.6%
ATM, debit and credit card	156	149	7	4.7%
Bank franchise tax	239	215	24	11.2%
Computer software	192	181	11	6.1%
Data processing	527	587	(60)	-10.2%
FDIC deposit insurance assessment	119	155	(36)	-23.2%
Marketing, advertising and promotion	232	275	(43)	-15.6%
Professional fees	255	230	25	10.9%
Other	843	784	59	7.5%
<b>Total noninterest expense</b>	<b>\$ 7,538</b>	<b>\$ 7,556</b>	<b>\$ (18)</b>	<b>-0.2%</b>

Noninterest expense for the first six months of 2017 of \$7.5 million was fairly level with the six months ended June 30, 2016. Management continues to evaluate expenses for potential containments and reductions that would have a positive impact on net income on an ongoing basis.

The efficiency ratio (FTE) fell to 55.5% for the second quarter of 2017, an improvement of 10.7 percentage points compared to the efficiency ratio (FTE) of 66.2% for the same quarter of 2016. The efficiency ratio (FTE) of 57.9% for the first six months of 2017 reflected an improvement of 8.4 percentage points compared to 66.3% for the same six months of 2016. The improved asset mix from the loan growth experienced the last three years, together with additional noninterest income prospects, should add to the revenue stream, while cost containment and reduction strategies should control expenses. This combination is expected to continue to support a low efficiency ratio. Refer to the Reconciliation of Non-GAAP Measures table within the Non-GAAP Presentations section for a reconciliation of GAAP to non-GAAP efficiency ratio.

Provision for Income Taxes

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For the three and six months ended June 30, 2017, the Company provided \$906 thousand and \$1.7 million for Federal income taxes, resulting in an effective income tax rate of 32.1% and 32.0%, respectively. For the three and six months ended June 30, 2016, the Company provided \$686 thousand and \$1.3 million, resulting in an effective income tax rate of 31.2% and 31.0%, respectively. The effective income tax rates differed from the U.S. statutory rate of 34% during the comparable periods primarily due to the effect of tax-exempt income from life insurance policies and municipal bonds.

**OTHER SIGNIFICANT EVENTS**

None

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not required

**ITEM 4. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In designing and evaluating its disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this quarterly report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective at the reasonable assurance level. There was no change in the internal control over financial reporting that occurred during the quarter ended June 30, 2017 that has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

None

**ITEM 1A. RISK FACTORS.**

Not required

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable

**ITEM 5. OTHER INFORMATION.**

(a) Required 8-K disclosures.

None

(b) Changes in procedures for director nominations by security holders.

None



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### ITEM 6. EXHIBITS.

Exhibit Number	Description of Exhibit
2.0	Reorganization Agreement and Plan of Share Exchange, dated as of March 6, 2013, between Virginia National Bank and Virginia National Bankshares Corporation <sup>a</sup>
3.1	Articles of Incorporation of Virginia National Bankshares Corporation, as amended and restated <sup>b</sup>
3.2	Bylaws of Virginia National Bankshares Corporation <sup>c</sup>
10.1	Virginia National Bank 2003 Stock Incentive Plan <sup>d</sup>
10.2	Virginia National Bank Amended and Restated 2005 Stock Incentive Plan <sup>e</sup>
10.3	Virginia National Bankshares Corporation 2014 Stock Incentive Plan <sup>f</sup>
31.1	302 Certification of Principal Executive Officer
31.2	302 Certification of Principal Financial Officer
32.1	906 Certification
101.0	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016, (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2017 and June 30, 2016, (iii) the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and June 30, 2016, (iv) the Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2017 and June 30, 2016, (v) the Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and June 30, 2016 and (vi) the Notes to the Consolidated Financial Statements (furnished herewith).

<sup>a, b, c</sup> Incorporated herein by reference to Virginia National Bankshares Corporation's Current Report on Form 8-K, filed with the Securities and Exchange Commission on December 18, 2013.

<sup>d</sup> Incorporated herein by reference to Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 24, 2003. Virginia National Bankshares Corporation assumed this plan from Virginia National Bank on December 16, 2013 upon consummation of the reorganization under the agreement referenced as Exhibit 2.0.

<sup>e</sup> Incorporated herein by reference to Exhibit 99.1 to Virginia National Bankshares Corporation's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on July 25, 2017. Virginia National Bankshares Corporation assumed this plan from Virginia National Bank on December 16, 2013 upon consummation of the reorganization under the agreement referenced as Exhibit 2.0.

<sup>f</sup> Incorporated herein by reference to Exhibit 99.2 to Virginia National Bankshares Corporation's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on July 25, 2017.

SIGNATURES

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

VIRGINIA NATIONAL BANKSHARES CORPORATION  
(Registrant)

By: /s/ Glenn W. Rust  
Glenn W. Rust  
President and Chief Executive Officer

Date: August 11, 2017

By: /s/ Tara Y. Harrison  
Tara Y. Harrison  
Executive Vice President and Chief Financial Officer

Date: August 11, 2017